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# Cronos Group, Inc. (CRON.CA)

Q3 2024 Earnings Call

## CORPORATE PARTICIPANTS

**Anna Shlimak**

*Senior Vice President-Strategy & Corporate Affairs, Cronos Group, Inc.*

**James Holm**

*Chief Financial Officer, Cronos Group, Inc.*

**Michael Ryan Gorenstein**

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

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## OTHER PARTICIPANTS

**Matt Bottomley**

*Analyst, Canaccord Genuity Corp.*

**Bill Kirk**

*Analyst, ROTH Capital Partners LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Brianna, and I will be your conference operator today. I would like to welcome everyone to Cronos Group's 2024 Third Quarter Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn the call over to Anna Shlimak, Chief Strategy Officer. Please go ahead.

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**Anna Shlimak**

*Senior Vice President-Strategy & Corporate Affairs, Cronos Group, Inc.*

Thank you, Brianna, and thank you for joining us today to review Cronos' 2024 third quarter financial and business performance. Today, I am joined by our Chairman, President and CEO, Mike Gorenstein; and our CFO, James Holm.

Cronos issued a news release announcing our financial results this morning, which is filed on our EDGAR and SEDAR profiles. This information and the prepared remarks will also be posted on our website under Investor Relations.

Before I turn the call over to Mike, let me remind you that we may make forward-looking statements and refer to non-GAAP financial measures during this call. These forward-looking statements are based on management's current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Factors that could cause actual results to differ materially from expectations are detailed in our earnings materials and our SEC filings that are available on our website, by which any forward-looking statements made during this call are qualified in their entirety. Information about non-GAAP financial measures, including reconciliations to US GAAP, can also be found in the earnings materials that are available on our website.

Lastly, we will be making statements regarding market share information throughout this conference call, and unless otherwise stated, all market share data is provided by Hifyre.

We'll now make prepared remarks and then we'll move to a question-and-answer session. With that, I'll pass it over to Cronos' Chairman, President and CEO, Mike Gorenstein.

## Michael Ryan Gorenstein

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

Thank you, Anna, and good morning, everyone. Our results this quarter prove that our long-term approach to this industry is paying off. With record revenue this quarter and our disciplined approach to operating expenses, we're demonstrating our ability to simultaneously grow and increase efficiency across our business. Thanks to our strong balance sheet, we are exceptionally well-positioned to capitalize on future growth opportunities and enhance our position in the current markets we operate in.

Before getting into details on the quarter, I'd like to spend a minute on where we are from a flower supply demand perspective. Over the past year, we've seen a rapid increase in demand for our flower products after taking market share in Canada and Israel. We've also seen additional growth in international markets, particularly Germany and the UK. As a result, we have not been able to fully meet flower demand. We believe the driver of this increased demand is a combination of our genetic breeding program and the cultivation capability to GrowCo. And with European growth picking up and the shortage of high-quality flower in Canada, we only see demand increasing from here.

That is why we announced the expansion of GrowCo. This investment involved an additional approximately \$51 million credit facility to support the expansion of GrowCo's state-of-the-art production facility. With this investment, Cronos obtained majority control of the board and began consolidating GrowCo into our results this quarter. As I've mentioned before, GrowCo's strong performance has been significant yet underappreciated. These consolidated results demonstrate a more complete picture of our whole business.

Turning now to brand updates. In Q3, Spinach became the number one ranked cannabis brand in the Canadian market, with 4.8% market share, supported by number one rankings in edibles and flower, number four in vapes, and number eight in pre-rolls. The brand's market share outperformance represents our relentless commitment to quality, innovation and bringing differentiated products to the competitive Canadian adult-use market.

In the edibles category, SOURZ by Spinach, our industry-leading edibles captured 17.2% of the market share in Q3 and today accounts for 5 of the top 10 bestselling edibles in Canada. Our focus on developing innovative strategies and products in this category has been instrumental in our success. We recently launched our first seasonal offering, Caramel Green Apple SOURZ, which has been a huge hit with consumers. In Q3, we also launched our Fully Blasted SOURZ in Ontario, a single 10-milligram THC gummy. This has been the fastest selling launch in company history.

This quarter, we also launched new SOURZ flavors with rare cannabinoids. Our Strawberry Watermelon 4:1 gummy with CBG and THC, and our Peach Passionfruit gummy with CBN, CBD and THC are now in market. Edibles from our Lord Jones brand are also doing well in the chocolate category, quickly growing to become the third bestselling chocolate brand in Canada. We look forward to seeing Chocolate Fusions perform during the holiday season and heading into the winter months, which tends to have a lift in the chocolate category.

Spinach continued its exceptional performance in the flower category at the number one spot in the Canadian market, with 6% market share led by popular genetics such as GMO Cookies, Wedding Cake and Space Cake in a variety of sizes. This segment has also been bolstered by our milled flower offering, Spinach Grindz. The

continued success of our breeding program and GrowCo has further strengthened our position in this category, ensuring premium quality and consistency.

The vape category continues to perform steadily. Spinach maintains the number four position with 6.4% market share. This quarter, we launched a new Spinach hits all-in-one vapes in Pink Lemonade and Rocket Icicle as well as new flavors, Mango and Grape for our 1.2-gram vapes. Our Pink Lemonade vape is now the number one 1.2-gram vape. This is a competitive category and we are committed to continuing to innovate and bring differentiated products, flavors and cannabinoid combinations to market.

This quarter, we saw an improvement in market share in the pre-roll category. In infused pre-rolls, Spinach saw a 25% retail dollar sales growth, boosting our brand rank to sixth among all infused pre-roll brands. Lord Jones is shaping up to be a clear leader in hash infused pre-rolls in the Canadian market. The recently launched Sour Blueberry infused pre-roll ended Q3 as a top selling hash-infused pre-roll. The infused pre-roll category is growing, so we're particularly pleased to be winning here. We are laser-focused on improving and innovating our pre-roll offerings and we are seeing signs of that success roll through the numbers. But we still have plenty of room to grow in the space. We remain focused and optimistic about our plans for expansion.

Our strategy has always been to develop a portfolio of best-selling and disruptive branded products we can launch in new markets as cannabis regulations open globally. The Spinach brand becoming the best-selling brand in Canada is validation of our strong capabilities, and we're just getting started in expanding our winning portfolio of borderless products and bringing to markets globally.

Now moving to Israel. Our team there has shown remarkable performance throughout Q3 with record volumes sold and our best revenue quarter in two years. Cronos Israel built significant momentum throughout the year despite a very competitive market with declining patient growth, which is a testament to the strength and the quality of the PEACE NATURALS branded products. We are excited about the growth in Israel despite geopolitical factors affecting the region this past year, which gives us confidence in our position in this market.

Internationally, we've made great strides in the markets we have entered. In Germany, our PEACE NATURALS brand continues to penetrate the market and grow at a strong clip. We are confident in the momentum we are seeing in the German market, given we are selling the same products that led us to our number one flower position in Canada. We believe we have a right to win and are well-positioned to continue to take share in the German market. Similarly, while it's early days in the UK, we are starting to grow our PEACE NATURALS brand and are excited about our growth potential. This quarter's success, driven by our growing portfolio of borderless products, strong infrastructure and industry-leading balance sheet, enables us to not only expand in our existing markets, but also to seize opportunities in any new market we choose to enter.

Now I'll turn it over to James to walk you through the financials.

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## James Holm

*Chief Financial Officer, Cronos Group, Inc.*

Thanks, Mike, and good morning, everyone. I will now review our third quarter 2024 results, which now include the consolidation of GrowCo's financials. The company reported consolidated net revenue of \$34.3 million, a 38% increase from the prior year period. Net revenue from Cronos, excluding GrowCo, was \$30 million, representing a 21% growth year-over-year on a standalone basis, while GrowCo net revenue was \$4.3 million. The net revenue increase was primarily driven by higher cannabis flower extract sales in Canada, higher flower sales in Israel, and sales in other international countries, which include Australia, Germany and the UK.

Gross profit in the third quarter was \$3.6 million, equating to an 11% gross margin. Adjusting for the impact of the inventory step up from Cronos' GrowCo transaction that was recorded into cost of sales, our adjusted gross profit was \$10.7 million, equating to a 31% adjusted gross margin. We will continue providing this adjustment until the inventory that was stepped up fair market value to the purchase accounting adjustment has been sold through as we believe it is useful in reviewing and evaluating our ongoing performance.

Year-over-year adjusted gross profit improved by \$6.8 million and adjusted gross margin improved by 15 percentage points. The increase is primarily driven by higher sales in cannabis flower and extracts in Canada, higher cannabis flower sales in Israel, and sales in other international markets. Consolidated adjusted EBITDA in the third quarter was negative \$6 million, representing a \$9.2 million improvement from the prior year period. The improvement was driven by an increase in net revenue and a decrease in general and administrative expenses. The disciplined approach to OpEx controls employed to date have put us well on our way to achieving our 2024 goal of saving an incremental \$5 million to \$10 million for Cronos on a standalone basis. And we are tracking toward the high end of that range. However, the addition of GrowCo's OpEx into our consolidated financials are expected to offset these savings next year.

Turning to the balance sheet and cash flow, the company ended the quarter with \$862 million in cash and cash equivalent. Cash and cash equivalents were up \$14 million from Q2, driven primarily by improved cash flow from operations and some FX fluctuations. Cash flow from operations was positive \$11.6 million compared to a negative \$0.2 million in the prior year period. And free cash flow was positive \$5 million compared to a negative \$0.5 million in the prior year period, driven by an increase in adjusted gross profit and an income tax refund, a significant improvement. Looking back on the progress we have made, I share in Mike's confidence in the trajectory of our business and our preparedness for entry into new markets as they become available.

With that, I would like to hand it back to Mike for a brief comment before going into Q&A.

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## Michael Ryan Gorenstein

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

In closing, we're proud of the record-breaking progress we've made this quarter. Our strategies are delivering results, and we remain committed to building on this momentum as we close out the year. We'll continue to drive top line growth, improve margins, and expand our international presence, positioning Cronos for long-term success.

With that, I'll open the line for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. At this time, we will conduct the question answer session. [Operator Instructions] Please stand by while we compile the Q&A roster. Our first question comes from Matt Bottomley of Canaccord Genuity. Your line is now open.

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### Matt Bottomley

*Analyst, Canaccord Genuity Corp.*

Q

Yeah. Good morning, everyone. Thanks for the questions. Mike, just wanted to start off. I know it's not really fundamental to the business, but I know you have a longstanding -- some longstanding experience and knowledge in sort of the US sector. And I'm just curious your thoughts coming out of the election, you guys have obviously a very potent balance sheet potentially one day if there are opportunities down south. And just curious, based on how these equities have reacted and flip in administration any sort of takeaways on your end of where you see the US going in the next year or so?

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### Michael Ryan Gorenstein

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

A

Thanks, Matt. It's a great question. I think there's still some uncertainty over the next couple of weeks as we see the transition team come together and what that might mean. But generally, I think it's a matter of policy in incoming administration. It's often pulled back and restarts all the pending regulatory rules. Our understanding is that the Trump administration supports the States Act. And I think that's still something that's positive. But at a minimum, I would expect for the rescheduling efforts, sort of restart the clock.

So if at all, Schedule 3, I think is about 18 months away, if there is going to be rescheduling. But we believe that building on the States Act and on some of the existing hemp frameworks are the way forward. The big picture, what I'll say is that I think we're now actually in a very good position where we don't need to rely on that regulatory change, given the growth we're seeing in Canada, Israel and the regulatory tailwinds in Europe and growth there.

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### Matt Bottomley

*Analyst, Canaccord Genuity Corp.*

Q

Okay, interesting. Got it. And then just more on the Cronos side of things. So, yeah, just interesting some of the commentary you made on the dynamic you're seeing for your own branded flower and some of the genetics. I know you guys have a differentiation in that space of the market. But we have not heard in a very, very long time of LPs expanding capacity. So just kind of the risk rewards of that and sort of how it's specific to the Cronos model relative to what we've seen over the last couple of years, which is some pretty ugly supply demand dynamics for maybe lower, lower grade flower.

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### Michael Ryan Gorenstein

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

A

Yeah. So, I think we're in a fortunate position where early on a lot of our focus was more on genetic breeding, on consumer insights and generally R&D on cultivation methods. And we've seen flower demand steadily increase. So we've got SKUs that are in the top in Canada and in Israel. We're seeing really strong momentum in Europe. And I think we're in a position where we have to pick which markets we're filling. And that's just Cronos on its own. I think there's also a lot of demand from other LPs, from GrowCo, but we feel like we would be performing much better in flower if we had more supply, and that's really across markets. So, I think as long as we continue to be

focused on quality the model having GrowCo produce the genetics that we have in market and the pipeline of genetics we have, which we're really excited about, should continue to drive that success.

**Matt Bottomley**

*Analyst, Canaccord Genuity Corp.*

Q

Awesome. Thanks. I'll leave it there.

**Operator:** Thank you. Our next question comes from Bill Kirk of Roth. Your line is now open.

**Bill Kirk**

*Analyst, ROTH Capital Partners LLC*

Q

Hey, thanks. Thanks for taking the question. Mine's related to kind of your last answer there, Mike. For GrowCo, how should we think about the seasonality of the business, whether its top line contribution or profitability contribution? Now that you're consolidating that, like how should we think about the seasonality going forward? And then how is the resource allocation determined between your needs and third-party needs? How is that determined to make sure you get what you want, but also sell into the customers that need it as well. Thank you.

**Michael Ryan Gorenstein**

*Chairman, President & Chief Executive Officer, Cronos Group, Inc.*

A

Sure. Thanks. It's a great question. I think there's really not a lot of seasonality on the top line, especially given the shortage and where we are today. You do have some slight deviations in terms of which seasons are the most efficient for production, how much power you need to pull for supplemental lighting versus heating and cooling. Sometimes you see the summer is not the best season to cultivate in, but just given the high-tech nature of the greenhouse that's still a relatively smooth over and pretty hard to notice a difference.

And then overall, the way that we've structured the deal, we have a option but not an obligation. Until the second phase is online, we can purchase up to 80% of the supply at a preset price. And then once the second phase is online, that would expand current capacity today by 70%. We have a option, but not obligation to purchase up to 70% at a preset price. So, we feel like it's a really good balance where we're able to make sure that we're only filling demand that we think is there and is right for the brand, but still significant upside to where we are today.

**Bill Kirk**

*Analyst, ROTH Capital Partners LLC*

Q

Okay. And then maybe I missed it in the prepared remarks, but there was like a step-up in CapEx spending in the quarter relative to the levels that had been. What's behind that may be, maybe I should already know this, but what's behind that? And does that signify any sort of change in kind of capital use intentions?

**James Holm**

*Chief Financial Officer, Cronos Group, Inc.*

A

Hey, Matt (sic) [Bill]. So the CapEx really was driven by that GrowCo Phase 2 expansion. So we spent roughly \$6.5 million in CapEx in Q3. We would expect increased CapEx levels along with that expansion until completion. So that's really the main driver there.

**Bill Kirk**

*Analyst, ROTH Capital Partners LLC*

Q

And like, if we're thinking about a quarterly around at the same level as 3Q, and what's the total kind of CapEx expectation for that second phase?

**James Holm**

*Chief Financial Officer, Cronos Group, Inc.*

A

Yeah. So Mike had kind of highlighted that earlier, but at least we have granted them approximately \$51 million in, right? It could be something a little bit south of that. But I would anticipate maybe some of it evenly it could be a little bit lumpy right over the next few quarters. We do expect kind of that additional biomass to be online second half. So kind of mid-year, hopefully when the CapEx spend would complete for Phase 2. Hope that helps.

**Bill Kirk**

*Analyst, ROTH Capital Partners LLC*

Q

Okay. Thank you. It does.

**Operator:** Thank you. I am showing no further questions at this time. Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

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