

**Aleafia Health, Inc.(Q3 2020 Earnings)
November 11, 2020**

Corporate Speakers:

- Nicholas Bergamini; Aleafia Health, Inc.; VP of IR
- Geoffrey Benic; Aleafia Health, Inc.; CEO
- Benjamin Ferdinand; Aleafia Health Inc.; CFO

Participants:

- Graeme Kreindler; Eight Capital; Analyst
- Greg McLeish; Mackie Research Capital Corporation; Analyst
- Andrew Semple; Echelon Wealth Partners Inc.; Analyst

PRESENTATION

Operator^ Good day, ladies and gentlemen, and welcome to the Aleafia Health 2020 Third Quarter Results Conference Call.

I would now like to turn the call over to Nicholas Bergamini, VP of Investor Relations.

Nicholas Bergamini^ Thank you. Joining me on the call today are Aleafia Health's, CEO, Geoffrey Benic; and CFO, Benjamin Ferdinand. This morning, Aleafia Health filed on SEDAR it's unaudited consolidated financial statements and notes thereto for the 3 and 9 months ended September 30, 2020, and its associated management discussion and analysis.

All comments to be made on this call today should be taken with reference to and are qualified in their entirety by those documents. Please note that this call contains forward-looking statements or information and reflects the company's current expectations, estimates, projections, assumptions, and beliefs about future events and financial trends that they believe may affect the company's financial condition, results of operations, business strategy and financial needs.

By their nature, forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements or other future events to be materially different from any future events, performance or achievements expressed or implied by such forward-looking statements. Given these risks and uncertainties, shareholders and prospective purchasers of the company's securities should not place undue reliance on these forward-looking statements.

Further, any forward-looking statement speaks only as of the date on which such statement is made, and except as required by applicable law, the company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made. This call also contains non-IFRS financial performance measures, which the company believes provides users with

relevant information regarding operations and performance. These measures are not recognized or defined under IFRS and as a result, they may not be comparable to the data presented by other issuers.

Geoffrey, over to you.

Geoffrey Benic^ Thank you, Nick, and thank you, everyone, for joining us today. Today's Remembrance Day in Canada, where we honor the courage and sacrifices of our veterans and active service members of the Canadian Armed Forces. We are proud to have many veterans as patients at Aleafia Health. So to all our veterans and their family members listening today, thank you. I want to first address head on what is appearing in our third quarter results, which is sequential decline in cannabis revenue. I think it's incredibly important to not view this in isolation. We are on track to see significant quarter-over-quarter revenue growth in Q4.

First of all, we have \$16 million in booked near-term sales through the domestic wholesale channel. We expect the majority of this revenue will be recognized in Q4 with our remaining shipments to customers being completed in Q1 2021. But this major sequential increase in revenues not just attributed to the \$16 million sales I've just noted. In the fourth quarter, we expect to see major growth in adult-use cannabis revenue. We are on track for record medical cannabis revenue. And depending on the timing of receiving necessary import and export permits, we may also report record international cannabis revenue.

Looking forward to the fourth quarter, we expect to have our best results to date. I know Ben will spend some time outlining this channel by channel growth shortly. As we've said in our previous 3 quarterly results, we foresaw some seasonality in our revenue due to outdoor cultivation generated sales that's exactly what occurred in Q3. We completed the sales of our final outdoor flower inventory earlier in the year, and at the same time, our series of product launches has only begun generating revenue in Q4. That left us with very limited product availability during the reporting period and it had a noticeable impact on sales.

We see significantly less seasonal revenue lumpiness next year. The path we've taken has been very clear since day 1. 2018 and 2019 saw us building up 3 facilities. In 2020, we received our licenses at these facilities just 6 to 7 months ago. And since then, the entire focus of our business over the last 9 months has been the transition away from wholesale revenue and towards the sale of cannabis sales to patients and consumers. That's meant ramping up and integrating our 3 new facilities that we brought online. We've dedicated resources to building an innovative, differentiated product portfolio.

Finally, beginning in Q4, we are commercializing the business at scale. It's the road map we followed in a disciplined manner since the summer of 2018. I'd like to give a walk-through on a number of key product initiatives. Our portfolio of products is growing exponentially over the next few months as we enter the recreational market in a meaningful way. This expansion will also have a similar impact on our medical cannabis

business. First, we launched Universal 510 Vape cartridges in early October to our medical patients. The reception has been very positive, and we've been pleased to note that the vape cartridges have not cannibalized other products. Rather, they have increased our patient's average order size.

And I'm also happy to report that we've completed our first shipments of bases to the able use market last week. Second, later this month, we'll commence sales of Kin Slips, our award-winning sublingual strip offering. This format is currently not available in Canada. Ultimately, we have 5 different SKUs featuring different THC and CBD potencies and terpene profiles for various need states. Unlike edibles, which have much stricter limits on quantity and THC content in a package, each Kin Slip unit contains 10 strips with 5 or 10 milligrams of THC or CBD per slip. Kin Slips have a rapid onset time of 10 to 15 minutes with a duration of 2 to 4 hours.

They are discrete and precisely dosed and are made with natural vegan ingredients. It's a really compelling offering, and we think Kin Slips will stand out. Moving to confectionery edibles. We've completed production runs of our own soft candies, which are formulated and produced in packaged in-house at our Paris facility. That's a product category we see as significant underserved and one, we intend to make an impact in. Our soft chews are pectin based and use only natural flavors and colors. We're slated to commence sales of this new category in January 2021.

Lastly, rounding out our products, we're also expanding our dried flower portfolio that leads us to our 2020 outdoor cultivation harvest. In 2019, we seized an outdoor cultivation as a way to differentiate against more established peers. We harvested 13,000 kilograms of dried flower and successfully sold the vast majority of it in the wholesale transactions. Comparable to last year, the cost per gram to harvest, which includes all operating expenses for the year was \$0.10 a gram versus \$0.08 a gram in the previous year. But there are 3 big differences in 2020.

First, we harvested significantly more at approximately 31,000 kilograms, that is limited to dry flower. Second of that amount 7,000 kilograms is THC dominant high-quality flower, much of which can be sold in adult-use market. In contrast, we did not have THC cultivars growing last year. And finally, this year, we have the extraction and packaging capacity with our new Paris facility to convert much of the outdoor harvest into packaged consumer products, whether it be pre rolls, extracts are into distillates for edibles. The Niagara Greenhouse is also contributing to our dried flower portfolio.

With commercial production, lots of core strains already completed. It's scaling up quickly with 40,000 plants currently in the greenhouse. We've talked about a number of formats, but let's put things in perspective. In Q3 2020, we had roughly 10 SKUs in the adult-use market at any given time. Over the course of 2021, that number will increase to over 50. With that diversified flower portfolio in mind, we've also been running a genetics R&D program at the outdoor grow. The Niagara Greenhouse and our indoor grow at the Paris facility, we acquired 40 genetics most of which are not available in the legal markets in Canada.

We've now completed preliminary production runs at all of our facilities to narrow down the top candidates based on cannabinoid content, presentation and other metrics. This is a meticulous process, but it's incredibly important that we take the time to understand which genetics will fare best in each of our unique environments. I'm so excited to be at this stage in the business. Our team has executed well, and we will bring one of the most diverse product portfolios to the market in the near term.

Ben, over to you.

Benjamin Ferdinand^ Thank you, and good morning. Geoff spoke about some of the top line growth in cannabis in Q4, it's worthwhile to unpack that further. Starting with the medical cannabis business, we've continued to see extremely strong growth in active registered patients from 13,300 in Q2 to 17,500 in Q3, an increase of over 30% quarter-over-quarter. This tends to be a leading indicator of growth in medical cannabis sales.

Clearly, we are seeing the strength of our unique medical business model picking up steam. We shifted to seeing patients at our clinics virtually during the COVID-19 pandemic, and it's allowed us to actually be more flexible and effective while containing costs. To put a finer point on the strength of our platform, patients can see their physician be scripted, order products and receive their shipment all in the same day. A very unique value proposition.

September was our best month ever for medical cannabis sales and October, again, beat our all-time highs. We expect to report record medical cannabis sales in Q4 due to this growth in patients, but also from incremental revenue generated from an improved product portfolio. As Geoff mentioned, these new products will include vapes, Kin Slips and others. Likewise, adult-use cannabis revenue is expected to be substantially higher in Q4 compared to Q3. As we entered the adult-use market in a meaningful way with a significantly improved product portfolio, we've invested in a strong sales team. This has already led to an increased pull-through of existing products to retailers. That said, it is the new products that will form the bulk of our sequential gains in Q4 and into 2021.

We're also seeing a ramp-up in international activities, both in Germany and Australia. Our 60% owned joint venture, Aleafia Germany, has also commenced cannabis sales into German pharmacies, and we will begin recognizing revenue from this channel in the fourth quarter. As we announced in September, our German joint venture distribution center is now licensed to purchase, store and shift cannabis into the world's largest global medical market into the EU. We're in the process of fulfilling multiple purchase orders into the Australian market for our medical cannabis brand called Everso.

These are the largest international orders we've seen to date by a wide margin, and they will ship in either Q4 or Q1 2021, depending on regulatory approvals. The next catalyst for international sales will be securing EU-GMP certification for our Paris facility. We do have an inspection scheduled for December, but it is possible that the inspection could be delayed into Q1 due to COVID-19 travel concerns. However, EU-GMP certification is

now with insight. With that certification, we will be 1 of only a handful of cannabis producers globally with EU-GMP certification, allowing the production and export of extract products. We believe that the importance of this certification, the highest global standard for pharmaceutical production in the world will only increase.

In addition to the growth in medical, adult-use and international sales channels, the company has contracted sales that will, upon completion of shipments, generate net revenue of \$16 million. It is expected that the majority of the domestic wholesale shipments will be completed in Q4 with the remainder shipping to customers early in the first quarter of 2021. Now we'll move to margins. Sequentially, Q3 gross margins declined due to a ramp-up at our Paris facility, opportunistic sales of wholesale extract and a concerted price reduction in the adult-use market.

Looking forward, we expect to see significant improvement in cannabis gross margins in the fourth quarter. Now we will discuss our strong balance sheet. At quarter's end, we had \$34.5 million in cash and \$8.5 million in marketable securities for a total of approximately \$43 million in total cash and marketable securities. Over Q3 and Q4, we sold approximately 1.6 million shares of Aphria for approximately \$11.5 million. This further strengthened our cash position. The Q3 net loss was \$19.8 million, which was primarily due to a \$14 million noncash write-down of inventory to net realizable value.

Like most other LPs, we saw a market-wide decline in prices. Now our focus on disciplined growth remains a core priority. An example of that is that our SG&A expenses declined significantly on a sequential basis. We've also observed a decline in capital expenditures during the reporting period. We expect capital expenditures to decline even further in Q4 compared to Q3. With the licensing of the Paris facility, Niagara Greenhouse and Port Perry 60 Acre expansion, all arriving in the first half of this year, we have no further ongoing significant capital projects.

Operator, over to you.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions)

And the first question comes from the line of Graeme Kreindler with Eight Capital.

Graeme Kreindler^ I wanted to ask a question regarding the expected sales of \$16 million spread across majority of Q4 and looking like some of it into Q1 '21. You talked about how the sequential decline in Q3 driven by most of that 2019 outdoor harvest product being sold throughout the year. So as we look into 2021 and towards the middle of the year, can you discuss a bit in terms of the supply picture and what that looks like? And what's the availability of product there especially product used for all the SKUs that you're going to launch in order to continue to propel sales growth going into the new year?

Benjamin Ferdinand^ Thanks, Graeme. Great question. And it's Ben. So as we think about our production and supply going into 2021, I'll unpack it separately between our outdoor growth as well as our greenhouse. So on the outdoor growth side, as we talked about, is a supply issue in Q3 as we sold through a lot of the product that we had grown last year in Q1 and Q2 and didn't have a lot remaining for Q3.

That picture changes significantly going into Q4 with our outdoor harvest, which sets us up for having products for flower sales, pre-roll and input products for extract going into 2021. The other side of it is our greenhouse, which we're really excited about with a significant number of new genetics that are going to be high potency on THC side, which will be a game changer in the adult-use market. And that will give us a consistent year-long supply of that product to really allow us to drive into the adult-use market in a very meaningful way.

Graeme Kreindler^ Okay. Understood. And then just to follow-up on that. You gave some color about into the next quarter, you're going to see record medical revenue and a significant ramp-up on the adult use. So in terms of, again, thinking into 2021, the medical channel being very resilient for (inaudible), and in fact, an area of growth. How do you go from 10 to 50 SKUs in the adult-use market, what should we expect in terms of the overall revenue mix? Do you think that's going to tilt to one favor of adult-use as we get through the heart of next year?

Benjamin Ferdinand^ Look, we don't give kind of specific splits, but we would -- we definitely expect to see a majority of our revenue generated in 2021, coming from combination of adult-use in medical. And this has really been the intention of management since day 1 to increase our proportion of revenue into medical consumers and adult-use consumers.

Geoffrey Benic^ We think we're going to have a very, very compelling offering in the recreational market. Ontario is just getting going. Ontario is in our backyard. So I just want to put things in perspective here. I think we're up to 220 stores right now, licensed stores in Ontario. I think this market probably hold about 1,000 stores in Ontario. So the pull-through is just going to be very incredible, and I can tell you with our sales organization in the field right now, establishing those really key relationships with a lot of the retail stores. We think that we're going to bode really well.

That, coupled with some -- if you take our 7,000 kilos of outdoor THC into a pre-roll format, low-cost and differences our pre-roll is going to be made out of flower with great price points and kind of our mantra as best product, best price here. We think we're going to do really well in this burgeoning Ontario marketplace. So we're really going hard here in Ontario. Our patient counts continue to grow tremendously quarter-over-quarter, and we're really excited about that part of our business, especially as we're starting to add all these new SKUs and new formats.

As I mentioned earlier, we're not seeing cannibalization. We're actually seeing growth in our business, in that channel as we bring on some of these new SKUs. So we're excited.

We also think Kin Slips are going to be a great, great offering, unique. That, coupled with our pre-rolls, I think it's going to be disruptive. And I think that we're based on the POs that we have coming in right now from a lot of these wholesalers, we think the future is looking really bright for us.

Graeme Kreindler^ All right. Understood. Appreciate the color. Then my last question here is with respect to the international medical shipments, you talked about potential timing falling on either side of next quarter. Just wondering, can you explain a little bit more in detail what sort of steps are involved or what step gives the most uncertainty in terms of when that timing will be and whether there's any impact to getting a approvals or shipments taken because of the pandemic?

Benjamin Ferdinand^ Yes. Yes, that's a good question. It's a fairly standard import export permits. And for example, to Australia, we've already shipped product there last year. So it's a fairly straightforward process for us.

Operator^ And our next question comes from Greg McLeish with MRCC.

Greg McLeish^ Just wanted to drill down on Graeme's question just regarding the contracted cannabis sales for the \$16 million. I think I don't want to use you of dodging the question, but what percentage of revenue or what percentage of the \$16 million do you think you will record in Q4 this year?

Benjamin Ferdinand^ Yes. I think we've said in our release that a majority of it, we expect to happen in Q4. So I think that guidance is fairly clear there. So we give you the percentages, but a majority of it. And again, some of it's dependent on shipping time and whatnot, but a majority of it.

Greg McLeish^ Okay. Great. And just going over to your CapEx, you sort of highlighted that the majority of your CapEx has been spent. So what type of -- how should we be sort of looking at maybe Q4 CapEx? I know it's going down and even into '21 what are you sort of forecasting on a yearly basis for 2021?

Benjamin Ferdinand^ Yes. We haven't disclosed kind of the specific numbers. But as we said, the CapEx builds for Paris, Grimsby and the port -- infrastructure for the Port Perry Outdoor are already built. So you can imagine that kind of coming down significantly into Q4 into just more maintenance mode and will be much the same on the maintenance side into 2021.

Geoffrey Benic^ Greg, it's just down the break/fix now. So the only things where work that we'll be spending money on will be break/fix because everything at this point is completely built out. And outside of our distribution center, weighing on the license. We're -- everything is just ready to execute and executing very well right now.

Greg McLeish^ Great. And just on the Kin Slips. I think you highlighted that you'll be able to put 10 in a pack to either 5 milligrams or 10 milligrams per strip. How are you

going to -- are these going to be available in the recreational market as well? And if so, you can't sell them in multiples, I guess, but is that only for the medical side? Or how should we be thinking of Kin Slips going forward?

Geoffrey Benic^ So we're excited about that because that's a differentiator. We actually can sell them packs a 10. So they're 100 mils or 50 mils. So you could look at Q4, they'll be in the adult-use or rec channel. And in November, I think, if I'm not mistaken, next week, they launch in the medical channel. So no later than 2 weeks. They'll be in the medical channel, and I encourage everyone to try them. I think they're going to be exciting, and I think they're going to be disruptive, just like our pre rolls. Our pre-rolls are going to be disruptive. And some of these innovative products that we are going to be announcing and bringing on are going to be very, very disruptive. And Kin Slips, I think, are going to be well received in the medical channel as well as the adult-use or rec channel. I think the discrete, the onset is is very quick and 2 to 4 hours is what you'll get out of them. And the fact that we can sell in market at 100 mils or 50 mils is, I think, very disruptive, Greg.

Greg McLeish^ That's great. And just on the Kin Slips, what's the bioavailability comparatively to some of the other adult Cannabis 2.0 products?

Geoffrey Benic^ So because it's sublingual, that's why we get the 2 hour on -- sorry, the 10-minute onset. So just like it would compare with any sublingual tincture comparative, Greg.

Greg McLeish^ Perfect.

Geoffrey Benic^ Yes, Greg, make sure you pick up those Kin Slips.

Greg McLeish^ I sure will.

Operator^ And our next question comes from Andrew Semple with Echelon Capital Markets.

Andrew Semple^ Just my first question here. I also wanted to touch upon the \$16 million of contracted sales. Just curious whether you'd be able to disclose any additional details on that. Some of the stuff that might be interesting is whether there's a fixed or floating price for that product that you expect to deliver is that a fixed pricing level or based on prevailing market rates? And whether you could comment on what the products -- what the product mix would be between flower, trim and other possible formats?

Benjamin Ferdinand^ Yes. It's Ben. Good question. So this is a -- these are -- it's a fixed price contract. So it's not floating. So the dollar amounts are fixed and contracted and the mix is focused on flower.

Andrew Semple^ Understood. And in terms of the fixed pricing level, would that be somewhat comparable to, I guess, historical levels for your bulk pricing?

Benjamin Ferdinand^ With the trend in the market, it will be lower compared to some of the previous pricing. But when we think about our very low-cost structure, and \$0.10 a gram, we expect it to be very, very profitable for us.

Andrew Semple^ Okay. Understood. It doesn't look like you experienced some modest pricing increases to your adult-use and medical channels in the quarter compared to sequentially, which appears to be somewhat contra trend. As your availability of supply increases, would it be reasonable to expect some modest pricing compression in the adult-use and medical channels as well? Or -- with the new product formats you plan to launch could potentially offset some of that pricing pressure?

Benjamin Ferdinand^ Yes. It's Ben. So there's going to be a couple of things that are going to be happening to the coming quarters. So as Geoff has highlighted, new product formats coming into the market at a relatively premium price compared to the 1.0 products. So that will help the pricing, but also what we're seeing in this market, as Geoff has said, is we're very focused on providing the best product for the best price. So we're seeing this as a growing area in the market that we're going to be able to take advantage of. And so we're going to be adjusting our prices to get to the right level, but with extremely high-quality product. And very low-cost structure. We see we have a lot of flexibility and are going to be able to really disrupt the market.

Geoffrey Benic^ Andrew, I just want to be clear, that pricing pressure is going to come from us. We're going to be disruptive. And I really think that in some of these categories, that represent the majority of the -- sorry, recreational channel, we will be disruptive. We will be the ones in market with the best product, best price because we can. So we think stay tuned, you'll see it. You'll see it real soon.

Andrew Semple^ That's good color. Just my last question here. I just wanted to get your high-level sense and your high-level comments on the medical market in Canada. I just want to touch on your guidance that you expect record medical cannabis revenues in Q4. Are you seeing any lessening of the competitive pressure for medical patients as some of your industry peers have increasingly turned to the adult-use market? And what's the potential market opportunity to continue to build into the medical cannabis?

Geoffrey Benic^ So the medical market is just getting going. I know everyone's talked about declining memberships or enrollments or patient counts. And people think that as the OCS in Ontario starts to roll out more stores, it just becomes more convenient. But we haven't even seen the beginning of the medical channel. You're going to see unions that are going to actually have fully funded programs for their members that will get in the game, and that will be a game changer. And we think that, that will be the pivoting point of the resurgence of the medical channel.

And let's face it. If you really want to get off an opioid, if you really want to change your behavior away from opioids and getting something that's more healthy, is the only way to really get that benefit is to go through the medical channel. We have a lot of folks that

haven't even tried cannabis yet in Canada. We're just skimming the iceberg here. And I truly, truly believe that there'll be unions that will come in with fully funded benefit programs that will game change and really start the process going with more folks have never even considered cannabis as an opioid alternative as therapy. And I think those folks that are new to cannabis will come through the cannibal GrowWise clinics and our virtual clinics get seen, get heard and get scripted and I think that they'll make the pivot, especially with a funded program to support that.

Benjamin Ferdinand^ And it's Ben. And what just highlighted is kind of the size of the pie for medical growing over time. But we also are well positioned to take market share-based on our ecosystem. So we're able to continue to sell into patients. We're able to continue to have unique offerings such as our same-day delivery and the GTA, which is being expanded. And lots of different offerings that our competitors don't have tied to our great quality products that allow us to take market share. So it's a combination of medical. We're bullish on it, but then also be able to take market share from our competitors.

Operator^ And I'm not showing any further questions at this time. Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect. Everyone, have a good day.