# Aleafia Health Inc. (ALEAF) CEO Geoffrey Benic on Q1 2021 Results - Earnings Call Transcript

Aleafia Health, Inc. (ALEAF) Q1 2021 Earnings Conference Call May 11, 2021 8:30 AM ET

Company Participants

Nicholas Bergamini - VP, IR & Communications

Geoffrey Benic - CEO

Benjamin Ferdinand - CFO & Corporate Secretary

Conference Call Participants

Rahul Sarugaser - Raymond James

Operator

Good day, and thank you for standing by, and welcome to the Aleafia Health First Quarter 2021 Earnings Call.

I would now like to hand the conference over to your speaker, Nicholas Bergamini. Please go ahead.

Nicholas Bergamini

Thank you. Joining me on the call today are Aleafia Health CEO, Geoffrey Benic; and CFO, Benjamin Ferdinand.

This morning, Aleafia Health filed on SEDAR, its financial statements and associated management discussion and analysis for the 3 months ended March 31, 2021. All comments to be made on this call today should be taken with reference to and are qualified in their entirety by those documents. Today's call includes estimates and other forward-looking information from which our actual results could differ. Please review the cautionary language in today's press release regarding various factors, assumptions and risks that could cause our actual results to differ.

Furthermore, during this call, we will refer to certain non-IFRS financial measures, including adjusted EBITDA and adjusted gross margin. These measures do not have any standardized meaning under IFRS, and our approach to calculating these measures may differ from that of other issuers. And so these measures may not be directly comparable. Please see this quarter's MD&A for more information about these measures and reconciliation to IFRS.

I will now pass the call over to our CEO, Geoffrey Benic.

Geoffrey Benic

Thank you, Nick. It's great speaking with my fellow shareholders today. This is now the sixth earnings call that we've conducted in the midst of COVID-19, and under various states of public health lockdowns. But it also feels like it will be our last as we see mass vaccination campaign in Ontario, rapidly picking up steam.

I'd like to thank our employees for their diligence they've shown over the last year in this environment. We've managed to operate 4 production facilities with 0 outbreaks and no significant production delays, while continuing to see thousands of patients virtually through our medical cannabis clinic network. The first quarter of 2021 was an important one for us as we continue with the deployment of our expanded product portfolio in the Canadian medical and adult-use markets. Top line revenue was down sequentially. But this was attributed entirely to a decline in wholesale revenue. In our previous earnings call in MD&A, we said that we expected this decline to occur as we transition our sales mix away from wholesale and towards the adult-use market and the Canadian International Medical Cannabis channels.

Adult-use sales increased 22% sequentially. Looking forward in the first 40 days of Q2 2021, adult-use sales have surpassed the total in Q1 already. Clearly, we are making some significant strides in the adult-use market, which we expect to be a key growth driver for us in the last 9 months of this year. Many of our peers have spoken of some challenges in dealing with certain provincial government wholesalers. This includes SKU rationalization and limiting the number of shipments they accept at their warehouse due to COVID. Certainly, we have felt this as well to a certain degree. But as anyone who has been following our product launches knows, we've had a tremendous amount of success in securing listings from our new products.

We have secured a total of 19 new listings in the adult-use market this year alone across a broad range of formats, including edibles, flowers and wellness. What's most encouraging to me is that our sales growth is being driven by 2 key factors: one, is our Cannabis 2.0 portfolio, with our 510 vape cartridges and Kin Slips sublingual strips, accounting for 50% of the adult-use sales in Q1. Secondly, we began to enter the dried flower and pre-roll space in a meaningful way with the launch of our Divvy brand at the end of this reporting period. In Q2, thus far, we've already more than doubled our previous quarter sales figures for both dried flower and pre-rolls. Our Divvy Sour Kush pre-rolls were the #1 selling value offering on the Ontario cannabis stores e-commerce site for the last 2 weeks.

I'm pleased to report that due to this early success of our dried flower brand, we've secured additional provincial listings for 10-gram milled flower and 14-gram dried flower SKUs. This is an important step for us because these new listings represent our first large-format SKUs. From both a top line and margin contribution perspective, this is certainly our next adult-use revenue catalyst.

A big part of the early success we are having in the value segment is from our outdoor cultivation facility. This has really turned into a 12-month-a-year operation. In the past 2 years, we received 5 separate licenses, either for additional acreages or for key drying buildings in the middle of the growing season. That uncertainty caused many challenges that we will not face this year. Our team has been propagating clones since November on site, and we spent the last month preparing the field for planting, which we expect to start at the end of May.

In addition to dried flower, we have some further product portfolio developments during the quarter, which are important both in the medical and consumer segments. Our product development team has really begun to establish a track record of finding and exploiting gaps in the product landscape where we see some unmet demand. Likewise, we've shown strong execution in the research and development, formulation and production of these products, which don't exist elsewhere in Canada.

We see a major gap in the marketplace for CBD dominant wellness products in familiar formats that aren't yet available within cannabis. We've recently launched Omega CBD Soft Gels with omega fish oil products, a top 3 nutritional supplement in Canada. Complementing this are CBD bath bombs and our high potency CBD 50 oil offering. As we begun to establish a presence and have success in the allo use market, we're also improving the scale and service of our highly differentiated medical cannabis ecosystem. The patient ecosystem provides the full suite of care to medical cannabis patients, all as a part of our seamless experience. At its core, that means medical cannabis physicians, consultations, educations, products and delivery. Not only are we the only company that offers all 4 elements of these services. We are also an industry leader in each.

The importance of our medical cannabis ecosystem has only increased due to COVID-19, which will leave lasting changes in how we live and work. The rapid rise of e-commerce will continue. That's why we invested in our Toronto area distribution center, which allows patients to order at 2:00 p.m. and have their medicine hand delivered by our careers that same evening. This is the best service available in the cannabis industry, and a unique differentiator for Aleafia Health. Likewise, we intend to continue offering virtual only cannabis consultations to our patients who value its convenience and accessibility.

Scheduled same-day delivery, virtual consultations and our growing suite of medical cannabis products provide a unique ecosystem for patients. It is completely differentiated value proposition for patients that does not exist elsewhere in the Canadian cannabis industry. But the missing piece, which unlocks the most value is insurance coverage. That's because for most people, their medicine is not a pocket experience. We are beginning to change that through our exclusive partnership with Unifor, Canada's largest private sector union with over 315,000 members. Through collective parting with some of Canada's largest employers, Unifor is advocating for medical cannabis coverage an insurance plan. This program has just launched to unionize employees of the Ford Motor Company of Canada. I'm very happy to report that we have just begun processing the first patients as part of the Unifor program. They are able to purchase medical cannabis from us, and be reimbursed through their insurance plan.

We are working diligently to expand this program, and are well underway in discussions with other major employers in Canada.

Benjamin, over to you.

Benjamin Ferdinand

Thanks, Geoff. With respect to the clinic transaction with Myconic Capital that we announced yesterday, we view this as a financial transaction with limited effect on our operations. As Geoff said, we moved to a virtual-only model for our clinic business, which is something that is more cost effective and better for our patients. Because of this shift, our physical clinic locations are not fully utilized. As a result, we have sold certain physical clinic assets, including leases.

We did not sell patient data nor the Canabo legal entity or brand, and we will continue to operate the clinics and provide care for patients virtually. We believe this provides substantial upside to Aleafia with the consideration paid to Aleafia currently valued at approximately $12 million.

Getting back to Q1, starting with our financial position. We repaid $25 million in convertible debt during the quarter. This cuts our total debt load by approximately 40%. With regards to cannabis sales, it's helpful to drill down a little bit. To provide better insight on both revenue and gross margin, we've segmented it in our MD&A. Our medical cannabis adjusted gross margins improved for the third consecutive quarter to 53%. Likewise, our revenue per gram equivalent sold improved for the fourth straight quarter to $8.46. This improvement in adjusted gross margins in medical was driven by 2 factors. One, we're benefiting from economies of scale and greater operational efficiencies from our state-of-the-art manufacturing and innovation facility in Paris. Secondly, we're able to capture greater margin and some key new product launches, including Kin Slips and high potency CBD oil.

It's much the same story in adult-use, where we've reported 56% adjusted gross margin, our best to date in this segment. In addition to some of the high margin cannabis-derivative formats I just mentioned, we're also benefiting from our low-cost outdoor cultivation advantage.

Now the flowers segment is incredibly important in adult-use, but it's also highly competitive. The very best greenhouse producers clock in at around $0.50 per gram to produce flower. So our low cost outdoor grow makes a substantial difference in margins. As Geoff said, the decline in total revenue compared to Q4 was solely due to a decline in domestic wholesale revenue. As we align our sales mix to more valuable segments, this has left us with a transitory period from a top line sales perspective.

Lastly, I'll touch on the international opportunity. Q1 2021 was the first time we've reported international sales in 2 consecutive quarters. The most important immediate opportunity on the international front is through the export of our greenhouse grown flower to the European market. This has been over a year-long regulatory process with our European partners with both sides navigating through a tremendous amount of regulatory hurdles. We are now making strides. Following certified lab testing in Germany, our signature THC cultivar has been approved by German regulators, and a key customer has also received their import permit. That leaves us with the final step of a Health Canada export permit for which we have applied. Certainly, the international opportunity does test our patients, but we are making strides.

With significant barriers to entry, we believe strongly that it will be well worth it.

Operator, over to you.

Question-and-Answer Session

Operator

[Operator Instructions]. Your first question comes from Rahul Sarugaser with Raymond James.

Rahul Sarugaser

So we clearly see that the wholesale has been down across the sector. So not a surprise to see wholesale attenuated. I guess maybe my question is, how should we be thinking about wholesale in the medium term? But also, as we look at medical revenue, we tend to correlate that with the number of active patients in the clinics. And please forgive me if I -- correct me if I'm wrong. It looks like the number of patients has declined a bit. So maybe you can give us a little color in terms of how we're looking at revenue trajectory, both in wholesale, but also in the medical clinic channels.

Benjamin Ferdinand

Thanks, Rahul. It's Ben. So I'll address them in turn. I'll start with wholesale. So we're not in a position to give guidance, but at a high level, we do expect to see continued growth in adult-use, international and medical cannabis sales through the year. And it's -- as we've discussed in previous conversations on these calls, it's part of a concerted realignment of our sales mix to a more sustainable and profitable sales channel mix.

Having said that, we'll continue to be opportunistic in domestic wholesale when opportunities present themselves. And so that's the way we think about the wholesale side. On the medical side, to your point about the active patients. So earlier in the year, due to -- last year due to COVID, there was -- the government had an extension, an automatic extension of scripts. And so this led to a large increase. But as those expiries have come off, you're getting back to more normalized levels.

Rahul Sarugaser

Terrific. And then given yesterday's announcements of the sales of brick-and-mortar clinics, I guess I want to understand the strategy there, given that Aleafia really is an ecosystem company with all of these different elements that feed into each other. So how is the strategy evolving from essentially divesting these brick-and-mortar and moving towards a more virtual format?

Geoffrey Benic

Yes. So the strategy hasn't changed, Rahul. In fact, we think that it's improved. And that's not the case also. So we've retained ownership of cannibal patient data and contact information. The cannibal brand, the IP that we built over the 5-year track record, is ours. We've just entered into an agreement to continue operating the clinics. So essentially, we operate the clinics. We still have access to them. They're still a big part of our business. We've just been able to take a lot of that cost. In operating it and move it over to another entity that is also going to focus in on other parts of mental health, and opportunities in mental health. So for from our perspective, we think that it's been -- it was a great move in terms of our strategy, in terms of reducing costs in terms of creating another revenue stream for us without changing our strategy on how we're going to bring new patients onto our platform.

Rahul Sarugaser

Terrific. That's very helpful. And do one -- just one last question then. Last -- on the last call, we talked a little bit about the Unifor deal and your sort of estimates of when that will start to yield revenue as patients onboard. And I think we had talked about sort of Q3, back half of the year. Is there any update that you can share about how that's going? And then when we should be looking at onboarding of patients, and then that's in resulting revenues that we can expect from that channel?

Geoffrey Benic

Yes. So first of all, it's really, really exciting to see just in the last few days, the first patient signing up through this program. So we expect Unifor program to provide incremental revenue in Q2, and gradually pick up steam in the back half of the year. So we are very -- sorry, and we are also in very, very deep discussions with other large employers, particularly in the automotive sector. And hopefully, they expand our offering to them this year. As we said in our earnings call today, I alluded to it, is that we have

Ford Canada now. And so not only the qualifying Ford Canada employees, but their qualifying household members as well. So we're excited about that. And we're going to be working hard to continue to throughput them, get them on our platform, get them the medicine that they need through the coverage that they deserve. And through the insured coverage, we're really excited about this role.

Operator

And there are no further questions at this time. Ladies and gentlemen, thank you for participating in today's conference. You may now disconnect.