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MJardin Group

Fourth Quarter and Full Year 2018 Financial Results

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CONFERENCE CALL PARTICIPANTS

Nathan Janoff, *Pragma Strategies*

David Vopeau, *Private Investor*

Mike Kelly, *Seaport Global*

PRESENTATION

Operator:

Good morning. My name is Bethany and I will be your conference operator today. I would like to welcome everyone to Mjardin Group's Fourth Quarter and Full Year 2018 Earnings Conference Call. Today's call is being recorded. I will now go ahead and turn the call over to Ali Mahdavi, Investor Relations. Please go ahead.

Ali Mahdavi:

Thank you, Operator. Good morning everyone. Joining us this morning are our MJardin's Chairman and Interim CEO Adrian Montgomery, and Chief Financial Officer Chris Seto. If you have not seen the Fourth Quarter and Full Year 2018 news release, which was issued earlier this week, it is available on the Company's website at mjardin.com as well as on SEDAR, along with our MD&A and audited financial statements. I would also like to remind you that a replay of this call will be accessible until midnight on May 24, 2019. This information as well as Management's remarks will also be posted on our website under the Investor Relations tab.

Following Management's remarks, we will conduct a Q&A session. Instructions will be provided at that time for you to join the queue for questions. Please note that we are limited in time, and will try to answer as many questions as possible. We will be limiting callers to one question at a time to ensure as many investors get a chance to ask questions. Callers can get back in the queue to ask follow-up questions.

Before we begin, we are required to provide the following statements regarding forward-looking information which is made on behalf of Mjardin Group Inc. and all of its representatives on this call. Remarks and answers to your questions today may contain forward-looking information about future events or the Company's future performance. This information is subject to risks and uncertainties that may cause actual events or results to differ materially. Any information regarding forward-looking statements is made as of the date of this call, and the Company does not undertake to update any forward-looking statements. Please read the forward-looking statements and risk factors in the MD&A as these outline the material factors which could cause or would cause actual results to differ. The Company will not provide guidance regarding future earnings during today's call, and Management does not anticipate providing guidance in future quarterly or interim communications with investors.

I will now turn the call over to Chis Seto.

Chris Seto:

Thank you, Ali. I'll begin by reviewing our 2018 earnings. Our 2018 revenue is almost completely attributed to the Company's historical cultivation of management services. Revenue in 2018 increased 38% over the prior year to $27.5 million compared to 2017. The increase is due to the Buddy Boy transaction in early 2018, a net income stream derived from the Buddy Boy operations in the form of interest income, rent, IP licensing, and consulting fees. This was a strategic transaction and the Company is well positioned to benefit from the impending implementation of HB1090 in Colorado whereby publicly traded issuers will be able to invest and own cannabis licenses and operations. The Company believes the implementation of HB1090 should be around the November 2019 timeframe.

In August 2018, the Company also entered in to a transaction to acquire a cultivation facility in Nevada, the Cheyenne transaction. The Company did not recognize any revenue from the facility in 2018 as the transaction had not closed. We expect the transfer of the licenses to be complete by end of June 2019.

With the acquisition of GrowForce in December 2018, the Company acquired cultivation facilities that were in various stages of facility licensing and buildout. On the GrowForce side, the Company recognized approximately 300,000 in sales from its first sale from the Will Cannabis facility. The sale was a wholesale transaction to another licensed producer.

With respect to our operations outlook in 2019, Management expects—demanded services business remained relatively flat year-over-year. Cultivation facilities will experience significant ramp up in both production and revenues in annual results for 2019 and into 2020 as facilities are brought online. The Company is on target to exit annual 2019 at a production run rate of approximately 7,500 kilograms.

Our net loss for the year was $80.4 million or a loss of $2.05 per share compared to net income of $1.5 million in 2017. Excluding non-cash and one-time charges, adjusted net loss was $15.4 million or an adjusted loss per share of $0.37. There were a number of non-cash and one-time items that will not go forward as we run the business into 2019 and 2020. The non-cash and one-time items have been highlighted in our MD&A and include an impairment on promissory notes of approximately $5.2 million; stock-based compensation or shared base compensation of approximately $28.8 million; a settlement on GMI royalty on sales of approximately $21.8 million; RTO listing expenses of approximately $2.8 million; GrowForce acquisition advisory fees of approximately $5.1 million; realized loss in foreign exchange of approximately $1.1 million; and an equity loss booked for AMI of $125,000. All of these are predominantly one-time items.

In terms of description of some of these items, the impairment on the promissory note, this relates to the promissory note acquired on the Buddy Boy transaction. There were a number of operational execution issues from 2018 which impacted the license holder's ability to pay interest on the promissory note. In particular, there was a longer than anticipated closure of Buddy Boy's largest revenue-generating dispensary as it was converted to a dual use recreational and medical store. This dispensary was offline for eight months instead of the planned two months. As the noteholder, the Company is supportive of its customers, and at the Company's discretion allowed for the accrual of interest payments due to support the license holder's growth and ability to strengthen cash flows. That being said, the Company has taken a conservative view and recorded an impairment to the note. Management believes the recovery of principal and accrued interest is highly likely.

In terms of share-based compensation, share-based compensation and fees were approximately $28.8 million for the year. Approximately $19.5 million of the share-based payments relate to share-based compensation awarded throughout 2018. This is predominantly related to the grant of options and RSUs under the long-term incentive plan, as well as historical incentive shares in a warrant issued to long-term employees of the company. To note, the option awards are predominantly in the $6.67 to $12 exercised price. While significantly under water, there is no expectation or intention by Management that these options will be repriced or cancelled as current management strongly believes that the option holders need to be fully aligned with shareholders who invested in both the Mjardin and GrowForce subreceipt financings, respectively. Approximately $9.6 million of the share-based payments relate to fees paid for senior loan facilities. These share-based payments were in the form of common shares and warrants.

Settlement on GMI royalty on sales. The Company and GrowForce finalized the settlement with a third party to buy out the third party's ten-year royalty stream of the GrowForce Warman cultivation facility. The royalty stream was entered into in December 2017 in consideration for the third party to provide a guarantee on the senior loan facility in December 2017. At the time, GrowForce had no capital or asset base to collateralize the loan facility. As such, the Company negotiated the royalty structure to secure a loan facility from its senior lender.

RTO light listing expenses. These relate to Mjardin's RTO transaction with the shell company Sumtra. This includes legal fees, listing fees, and the implied value of the equity issued to the Sumtra shareholders. This fee was transactional in nature and is one-time.

GrowForce acquisition advisory fees. These advisory fees are the combined M&A fees and legal fees for both GrowForce and Mjardin related to the acquisition of GrowForce by Mjardin in December 2018. This fee was transactional in nature and is one-time.

The Adjusted EBITDA loss for the year was $12.2 million compared to $1.7 million based on these one-time items. The increase in Adjusted EBITDA loss is primarily attributed to an increase in general and administrative costs to support the elevated corporate development activity including approximately $9.4 million in professional fees.

I will now hand it over to Adrian Montgomery.

Adrian Montgomery:

Thank you, Chris, and thanks everyone for phoning in today. It's a pleasure to have a chance to speak with you.

I suppose I should start off by saying that I've been in the job for just over two months, and I really want to tell you what I've learned about Mjardin in that time. One, this business has an impressive ten-year history of growing quality cannabis. This business has thrived in perhaps the most competitive cannabis market anywhere, which is Colorado. This business has an enviable collection of premium quality assets in the U.S. and Canada that are already producing and are coming on stream, and that are all poised to deliver meaningful production targets and financial results. I've learned that we also have a talented, passionate, and experienced nucleus of people here that challenge each other every day, that work their collective tails off, and who I'm very proud to be working alongside with to build a successful company.

We have three incredible partnerships with some of the leading First Nations in Canada, Peguis in Manitoba, Rama in Ontario, and the Mi’kmaq in Eastern Canada, who we are going to do great things with. They’re smart, committed, and I learn something every time I’m lucky to spend time with them.

Perhaps most interestingly, and this bears highlight, against the backdrop of some of these external growing pains we’ve experienced, people in this industry really, and I mean really, respect how good we are at what we do. The number of interesting conversations that we’re currently having with many of our peers and “competitors” about many forms of collaboration is highly encouraging, and I believe will yield some interesting outcomes in the future.

In the marketplace, Mjardin has labored under some issues that we need to own and for which we need to take responsibility. The main one is we can’t give ourselves a high grade for being good communicators. Candidly, we haven’t done a good job of this. Part of it is I needed some time to really get in to this business and understand it, the good, the bad, and what we needed to prioritize, so that has contributed to that. A good example could even be this week, lots of things going on this week. As you know, we filed our financials a few days late which really upsets me on a personal level. But up here, if you’re in the cannabis industry you don’t have many options. We have a bandwidth issue that a lot of us are struggling with, and obviously we released some numbers that had some one-time charges that certainly aren’t hall of fame stats, and I think people inferred that there was a relationship between the two when in fact there was no relationship between the two. We definitely have a bandwidth issue here with auditors and cannabis companies, and I just wanted to highlight that.

I’ll tell you that the—just to close the point on communication, I think that better communication starts today, and you have my commitment that we will hold ourselves to a higher standard of more fulsome and transparent communication with all of you.

The Mjardin of today, of right now, is number one, focused. We’re continuing to build out our quality roster of assets in Canada and the U.S. so we can leverage what we do best which is grow quality cannabis to scale, and we want to leverage that in to meaningful production numbers, and by extension profitability.

Number two, we are disciplined. The mentors that I have in my career that taught me how to run businesses, people like the late Ted Rogers, Phil Lind (phon), the Aquilini family, they taught me all about discipline. They taught me to be laser-focused on SG&A, to justify a headcount, to focus on burn rates, construction costs, professional fees, et cetera, and that is what the Mjardin today is laser focused on. I used to run an environmental services company in the past, and I’m sure my staff enjoys when I tell them that great project managers can manage projects with a pen and a piece of paper; we don’t need sophisticated implementation systems, not that we don’t have them, but it’s all about knowing your costs, knowing your inputs and outputs and that’s what we are laser focused on.

Number three, we’re committed to what I would call smart growth. We’re going to take our baseline expertise which people need in this industry, and we’re going to use that to move ourselves in the higher margin, higher growth areas in the U.S., in extraction, in retail, and I’ll explain that in a little bit with our Cannabella acquisition and also with our First Nation partners and with others.

Like some other companies in this space, we’ve had some issues out of the gate, no question about it, but in more than just over two months I can honestly say we have many of the ingredients that you need to build a successful business, and that’s the most encouraging thing to me.

I want to drill down into some of the highlights here. Number one, I want to talk about our refocusing of the business. Step one was to streamline our growth plan with a strict focus on operationalizing our assets across Canada and in Nevada, and through this we will be able to leverage our ten plus years of experience and our training platform to build our team of growers, which I am convinced are second to none in the industry. By doing so, we're confident we'll continue to grow premium high TCH cannabis as we've started to show at our Will and AMI facilities.

As I said, we're laser focused on costs and we've worked to reduce our spend on corporate services, legal, public relations, and advisory, but more than that we've really streamlined the management team and the supporting corporate group. We've reduced corporate staff in the last couple months by close to 20%, by 18%. We've eliminated six senior leadership positions, and we recognize the significance and strength among our core team and refocused them on the development of our cultivation and extraction assets.

These two steps that I've just highlighted have contributed to a large reduction in SG&A. The 2018 SG&A was $18.6 million, and we're forecasted for 2019 at approximately $12.1 million, which is a meaningful 35% reduction. In addition to a reduction in SG&A, we put in place operational processes as I've discussed to monitor spend and monthly burn rates. We've also welcomed back one of Mjardin's founders, James Lowe to our Board of Directors. His ten years of commercial experience in the U.S. across many states will be invaluable to us as we work ourselves in to additional markets and focus our activities on select areas of the value chain.

Number two, shift in capital allocation. Moving forward, we'll increase our focus through a rigorous analysis of return on invested capital investments. As an example of this, our April announcement of the Cannabella acquisition, which is a processing facility with extraction capabilities and a producer of edibles and topicals in Nevada. Married together with our over 40,000 square foot cultivation facility in Nevada, we're able to develop and commercialize the highest margin sections of the value chain. We're looking to improve EBITDA margins for Cheyenne facility by an estimated 40%. This returns Mjardin's invested capital within approximately 18 months. Cannabella will retain established distribution with majority of Nevada dispensaries, and we have a suite of in-house formulations for edible products to provide increased optionality for our own products. We think this is a smart tuck-in acquisition and an example of efficient capital allocation, and we will look to replicate with similar opportunities moving forward.

As I said, this mandate that I've carved for myself really can be summarized by refocusing our priorities. Admittedly when I joined in February, Mjardin was lacking a cohesive story and a clear vision for 2019-2020. As I said off the top, there's a renewed commitment to transparently communicate where we stand with regards to our growth strategy, which can be found in our new and improved investor deck, which is on the website. We're going to complete the buildout of our cultivation facilities; we're going to continue to target value-add bolt on acquisitions such as Cannabella; we're going to develop our license application team and focus them on emerging cannabis markets across the U.S., and those are really the four areas of focus for growth.

I'd like to talk about a bit more of the drill down on to our assets. In terms of Cheyenne, this field is a closed system from cultivation through oil-based branded product generation with the purchase of Cannabella as I've discussed. There's an opportunity for branded dry flower product for potential for a packaging system on site. Our upgrade to full production will be completed by the end of 2019, and our 2019 production forecast in kilograms, for our American friends, is as follows: dried flower 1,106; trim 341 for a total biomass of 1,447.

Will, our facility in Brampton, full cultivation, extraction, and sales license was achieved at the end of 2018. There's an area for packaging and dried flower and pre-rolls that's designed in the facility. We're currently undergoing a retrofit of the facility to be completed in Q3 of this year. The 2019 production forecast in kilograms is as follows: Dried flower 1,082; trim 325; total biomass 1,407.

AMI in Halifax, phase one fully populated indoor grow, produced multiple harvests and phase one is in full production. It will contain a GMP certified extraction facility to be built out in 2019. Phase two buildout is forecasted to be 20,000 square feet. The 2019 production forecast in kilograms as follows: Dried flower 246; trim 746; total biomass of 3,232.

Grow, the harvests are starting in the fall of this year. Full sales, cultivation, and processing license achieved by the end of 2019, the potential of additional grow on land is there for us. The 2019 production forecast in kilograms is as follows: Dried flower 385; trim 115; total biomass 500.

Warman, completion of the temporary facility which accelerated licensing timelines was Q2 2019, complete cultivation and processing license in Q3 2019, and basically minimal temporary facility production this year.

Rama, facility construction will begin in Q3 of this year. Dried flower production, extraction, and retail and a visitor's center will be located near the Rama Casino, which I believe gets something like 8,000 visitors a week, so an enviable location, perhaps 8,000 a day I may have that mixed up, but either way it's a lot of people.

That's really what I wanted to bring you up to date with in terms of our facilities.

In summary, I'm excited by what this year has in store for us. We're going to continue to work heads down with a renewed focus on bringing the development of our assets on stream and focusing on our core strength of growing high yield premium cannabis by leveraging the ten plus years of commercial cultivation experience we've built. I believe we've eliminated much of the noise that businesses at this stage of the lifecycle of an industry such as cannabis can experience, and we're preparing ourselves for a robust and focused 2019-2020.

In terms of communication and making it better, I want to say that we'll have our Q1 2019 earnings out by the end of May, and I look forward to sharing our results with you at that time.

All right, Operator. We can open the call to questions.

Operator:

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that's star, one to ask a question, and we will pause for just a moment.

It appears there are no questions at this time. Mr. Mahdavi, I'll turn it back over to you.

Ali Mahdavi:

Thank you, Operator. Once again, on behalf of the entire—actually Operator, I think we do have a couple of questions.

Operator:

Yes, they just came through. Our first one will be from Nathan Janoff of Pragma Strategies.

Nathan Janoff:

Hello. Can you hear me?

Adrian Montgomery:

Yes.

Nathan Janoff:

Hi Adrian, how are you? Nice meeting you by phone. Thank you for taking my question. The main story of Mjardin as, if we're going to dumb it down a little bit, is that you guys were the largest producers of cannabis and more than Tilray and Canopy combined, right, from last year's comments. The main economic story is that instead of receiving royalties from operating other people's assets, we're now going to have ownership economics going forward. As that rolls in then the sales number EBITDA numbers are going to really ramp up, and that's not the main reason we're all invested in this. We all believe that you guys are the best operators out there. Are you producing any forecast, and if you're not, why not?

Adrian Montgomery:

We're not producing forecasts. Again, this is the whole nature of our business as you said, you described it well. It's somewhat of a timing game getting this onstream. Until we have that perfectly nailed down, we're not going to be providing forecasts.

Nathan Janoff:

Are you planning to do so in the future?

Adrian Montgomery:

Yes, I think in terms of forecasts, one of the things we wanted to do today as a step to more transparent communication is I really made a point of trying to go through our production forecasts and commitments. Obviously, there's some fluctuations in terms of the prices for those, but we really drilled down on production numbers I thought. We separated them out in terms of the components of the total biomass, so I think that's significant and that needs to suffice for now.

Chris Seto:

Hi Nathan, it's Chris Seto. I just want to add to that. In terms of production profile, we did provide the production profile. What we did not provide is a forecast around pricing. Certainly, pricing in the wholesale market for some of our facilities is proprietary, and under MD&A we're not prepared to provide pricing for wholesale. What we did give you was I believe a solid production profile for 2019 and where we're exiting 2019. In addition, we did discuss that the legacy business in Colorado, the managed services business, will be flat year-over-year. There are other things that will come online with the passing of HB1090 we believe, but at this point in time, I think we've given a fairly solid production profile for 2019.

Nathan Janoff:

Sorry, but may I ask another question on this point. The stock we all know where it's trading, right, and from a markets perspective we know that that's a "liability" because you can't really issue stock to raise money. You're relying on the debt facility by bridging. That makes your balance sheet look kind of iffy to some people and the market obviously doesn't like it. The option of raising capital from the capital markets is really bad. We see as shareholders, you see a (inaudible) going for $3.5 billion purchase and I believe they have less assets than we do. The market is not really giving us the kind of valuation that we all think we should be trading at based on the future potential of a company. With the price of the stock where it is, releasing some kind of a forecast for people to more or less understand what multiples are buying right now, seems like a low-risk proposition. I'm just leaving you with that comment, and you guys know how to do this better than I do, but that's just a thought.

Adrian Montgomery:

Okay. I encourage you to look at the investor deck, which is on the website, and then I'm happy to continue this with you offline.

Operator:

Our next question will come from David Vopell (phon), a private investor.

David Vopeau:

Good morning. Yes, my name's Dave Vopell, I'm a small time investor but I'm very interested. I live down in Florida. I'm very familiar with the True Leaf chain down here. I really like what they're doing. They have such a low share float, so their stock trades kind of funny. You guys I believe are fully issued. How do you intend to raise money here in the future, and how much cash is on hand?

Adrian Montgomery:

Yes. As of December 31, 2018, we have just over $30 million cash on hand.

Operator:

We will take our next question from Mike Kelly, Seaport Global.

Mike Kelly:

Hi guys.

Adrian Montgomery:

Good morning.

Mike Kelly:

Adrian, thank you for doing this call. I think your comments certainly are well received by me. It seems that you guys have a game plan now and are on much stronger footing. The question for you is on—kind of follows the first guy's question on the debt front. Just maybe a little bit more color you could give us in terms of your comfort with the balance sheet and that's a bridging loan. In your opinion is it really this looming ominous thing that could potentially be a big risk for investors? Thanks.

Adrian Montgomery:

Sure. Thanks, Mike. Before answering that question to specifically, I just want to remind people that the intension of this business, which I don't think was ever disguised, was always to be a levered business with minimal shareholder dilution. The issue that we currently have is this is bringing facilities onstream and getting them to full production at the type of quality you need to generate prices, whether it be wholesale or otherwise, that are attractive is a timing issue. Candidly, the current issue which I've taken it through all the steps we're dealing to address is that the revenue hasn't caught up to the balance sheet.

The strategy of being a levered business was always the case, but again, that lag between revenue generation from a timing perspective is the very reason we've made all those decisions to refocus the business, streamline the headcount, get laser focused on cost, et cetera, et cetera.

In terms of our relationship with the lender, we speak to the lender regularly. They are supportive. They are aligned with our renewed focus and our commitment. They are instrumental in some of these great First Nations relationships we've established. They're also smart business people and they want to see rigorous analysis and internal debate about things like return on invested capital and making wise decisions. So long as we tow the line on holding ourselves accountable to being diligent, disciplined, and smart, I'm confident in the strength of that relationship, and quite frankly, given what we've said off the top in terms of how we got here, I'm also grateful for that relationship.

Mike Kelly:

Okay, great. The other thing that kind of caught my attention in your prepared remarks were your comments on collaboration with other some of your peers and some really competitors too. I'm hoping you can give a little more color on kind of how those conversations have trended. What types of ideas you may be considering, especially with consolidation in mind in the industry has obviously been a big trend in gaining steam, how does Mjardin potentially kind of fit in in that kind of M&A landscape here, in your opinion?

Adrian Montgomery:

Yes. I think, Mike, that out of respect for the nature of those conversations, I'm certainly not going to betray too many of the specifics. The point of my raising this was to illustrate the fact that this industry has a high regard for this company's ability to grow cannabis. This industry and our peer set has a high regard for our geographic footprint. This industry has a high regard for our experience and our success in one of most competitive jurisdictions in the world in cannabis. What that, to use a phrase that my teenage nephew would use, what that street cred has given us is access to a lot of inbound conversations about all sorts of things that would be exciting and accretive for this company. That's all I will say about that, but I'm grateful for that "street cred" because it's putting us in an advantageous position vis-à-vis some interesting opportunities.

Operator:

Ladies and gentlemen, there are no further questions at this time. I will hand the call back over to Mr. Mahdavi for any closing or additional remarks.

Ali Mahdavi:

Thanks again, Operator. This concludes today's call. Once again, on behalf of the Mjardin management team, I'd like to thank you for joining us today, and we look forward to providing you an update on our Q1 2019 conference call when the earnings released. Have a great day.

Operator:

Once again, ladies and gentlemen, this does conclude today's conference. We thank you for your participation. Have a great day.