



SUNDIAL

Sundial Growers Inc.

Fourth Quarter and Year End 2019 Results

Conference Call Transcript

Date: Tuesday, March 31, 2020

Time: 10:30 AM ET

Speakers: **Zach George**
Chief Executive Officer

Jim Keough
Chief Financial Officer

Andrew Stordeur
President, Canada

Jayson Moss
Investor Relations

OPERATOR:

Welcome to the Sundial Growers Fourth Quarter and Year End 2019 Conference Call and Webcast.

As a reminder, all participants are in listen-only mode and the conference is being recorded. Please be advised that this call will not have a Q&A session. Should you need assistance during the conference call, you may signal an operator by pressing star and zero.

I would now like to turn the conference over to Jayson Moss, Investor Relations, Sundial Growers. Please go ahead, Mr. Moss.

JAYSON MOSS:

Good morning, and welcome to Sundial Growers' Fourth Quarter and Full Year 2019 Financial Results Conference Call.

This morning we issued a press release announcing our financial results for the fourth quarter and full year ended December 31, 2019. This press release is available on our website at sndlgroup.com, and filed on EDGAR and SEDAR.

Presenting on this morning's call we have Zach George, Chief Executive Officer; Andrew Stordeur, President and Chief Operating Officer; and Jim Keough, Chief Financial Officer.

Before we start, I would like to remind investors that certain matters discussed in today's conference call could constitute forward-looking statements. Actual results may differ materially from those anticipated. Risk factors that could affect results are detailed in the Company's financial reports and other public filings that are made available on EDGAR and SEDAR. Additionally, all financial figures mentioned are in Canadian dollars unless otherwise indicated.

I would now like to turn the call over to Zach George.

ZACH GEORGE:

Thank you, Jayson, and thank you everyone for joining us on our fourth quarter and full year 2019 earnings call.

I was appointed as Chief Executive Officer about eight weeks ago on January 30. I accepted the role because of my interest in Sundial's unique assets and its data-driven approach to product development. These factors represent competitive advantages in a challenging, emerging industry, one that is rapidly being rationalized and consolidated.

While Sundial has achieved several important milestones over the past year, the Company has also faced a number of internal and external challenges, including operational difficulties, excess leverage, poor cost controls, regulatory delays and rapidly evolving industry conditions. In order to be successful in delighting our core consumers, the Sundial team is dedicated to improving our focus and discipline at every level of the business.

I am excited to work with a leadership team that has deep experience in consumer packaged goods and industrial agriculture. During these early days of my tenure, I have been inspired by the Sundial team's willingness to embrace change and work together in a decisive manner. During this unprecedented crisis related to COVID-19, our corporate and frontline staff have shown tremendous dedication and courage. Many provinces have deemed cannabis to be an essential service, which, in an extremely challenging environment, motivates us to continue to deliver high quality products to the Canadian market.

We have made some significant changes in Q1 to position Sundial for success as we pursue profitable, self-sustaining operations in 2020. Our primary corporate objectives are as follows: to deliver industry-leading, best-in-class products with a focus on inhalables; to de-risk our balance sheet and improve liquidity; to increase our capacity utilization to unlock the value of our high quality assets; and to conduct a disciplined review of our portfolio of initiatives in Q1.

As I indicated, de-risking our balance sheet and improving liquidity are key priorities. We are currently in active negotiations to secure and finalize a financing transaction. As well, we are in discussions with our lenders to restructure our credit agreements into global credit facilities. The goal is to provide additional working capital to facilitate our operational ramp, while also strengthening our overall capital position. We will update investors as we have material information to release.

In spite of challenging cannabis market conditions, as well as the pressures COVID-19 is placing on the broader economy, reaching profitability in 2020 is a top corporate objective. As

we have disclosed previously, we implemented measures to reduce costs and to align our operating structure with our core value proposition. Our flexible production footprint in Olds, Alberta allows us exploit variable cost reductions during periods of market disruption.

Lastly, we are undertaking an in-depth portfolio review. As part of this review, we are evaluating the economic viability of each asset, opportunity and partnership in an objective and disciplined manner. We are approximately halfway through this review. It is clear that Sundial's success will require significant focus. If we attempt to be all things to all people, we are guaranteed to experience failure. While we expect to update our investors on the material conclusions of our review along with Q1 results in May, we currently expect the Heal, Help and Play strategy to be narrowed materially.

Sundial has numerous competitive advantages. We have best-in-class facilities in Canada that produce high quality product, an already established and growing brand presence, and engaged and talented employees that are also shareholders.

Today we are discussing important steps forward in Sundial's evolution as a premium cannabis company. During my first two months as CEO, our team has successfully mitigated a number of significant business risks and we have acknowledged the need to change, and are excited by the opportunity to continue to grow Sundial's business.

I would now like to turn the call over to Jim Keough, Sundial's CFO, for a financial update.

JIM KEOUGH:

Thank you, Zach, and good morning everyone.

I would like to remind everyone that all financial figures are in Canadian dollars, unless otherwise stated and the comparative quarter is Q3 2019 unless I state otherwise.

In Q4 2019, we reported consolidated net revenues of \$21.6 million dollars, down from \$33.5 million in Q3 2019. While our cannabis sales to provincial boards increased over the prior quarter, sequential decline in total revenues is attributed to lower unbranded sales to other licensed producers.

Consolidated Adjusted EBITDA for the fourth quarter was a loss of \$19.7 million dollars compared to a loss of \$7.9 million in Q3. Impacting Q4 Adjusted EBITDA were certain costs embedded in cost of sales, as well as general and administrative expenses which I will go into in more detail in a moment.

I want to highlight that we recently announced several efficiency improvements and cost-cutting initiatives that are expected to result in annualized cost savings of approximately \$10 million to \$15 million dollars for 2020. A substantial portion of these initiatives have been implemented, with cost reductions being realized beginning in the first quarter of 2020.

Our net loss for Q4 was \$145.9 million dollars including an impairment charge of \$100 million related to the Bridge Farm acquisition.

Turning to the cannabis segment, in the fourth quarter we harvested approximately 11,000 kilograms of cannabis, and sold nearly 4,300 kilograms of cannabis. In comparison to last quarter, we sold twice as much product to provincial boards. As we mentioned on our Q3 2019 conference call, we expect our sales to other licensed producers to decrease as a percentage of our total sales throughout 2020 as we pivot to increased sales under Sundial brands to provincial boards.

Average selling prices in the quarter were \$6.01 per gram for branded flower and \$3.07 for unbranded flower. Pricing to the boards was consistent on a quarter-over-quarter basis.

Cannabis net revenues for the fourth quarter amounted to \$14.7 million dollars, with sales to provincial boards representing just under 40% of total sales. This compares to last quarter where we reported revenues of \$28 million dollars and sales to the provincial boards of just over 10%.

Gross margin for Q4 2019 was negative \$0.5 million dollars compared to positive \$7.8 million in Q3. Our gross margin for the fourth quarter was impacted by higher cost of sales resulting from product replacement costs and a provision for inventory obsolescence. These costs amounted to just over \$2 million dollars in the quarter.

We incurred higher G&A expenses during the fourth quarter due to increases in employee compensation costs, royalties on Top Leaf products and a provision for credit losses on trade receivables that in total amounted to just over \$2 million and were not incurred in the third quarter. Overall, we reported an EBITDA loss of \$17.9 million for our cannabis operations in the quarter.

Moving to the U.K. business, our Ornamental Flower segment for the fourth quarter of 2019 reported revenues of \$6.8 million dollars and an Adjusted EBITDA loss of \$1.8 million.

The fourth quarter was a period of significant capital investment for Sundial as we completed the fourth and fifth pods in Olds, and the People and Processing building was largely completed. In total, we deployed \$19 million dollars in capital towards completing our Olds facility during the quarter. With that, we have substantially completed construction of our Canadian cannabis operations. Given current market conditions, we have decided to postpone the construction of the Merritt, BC facility which would largely be used to produce BC Weed Co. product, until market demand improves.

In the U.K., capital expenditures amounted to \$28 million dollars in the quarter with the large majority of the expenditures directed towards the construction of the Clay Lake phase 2 expansion, which is substantially complete.

Given the fact that we are in the process of reviewing our entire asset portfolio, capital expenditures will be limited to essential expenditures going forward. With our facilities being newly constructed, maintenance CapEx is limited, estimated at about \$750,000 per quarter to maintain current capacity.

Turning to our balance sheet, as of December 31, we had cash and cash equivalents, including restricted cash, of \$61 million dollars, while total debt stood at \$178 million dollars and net debt was \$117 million at year-end. To provide a more recent snapshot of our liquidity position, as at February 29, 2020, cash and cash equivalents, including restricted cash, stood at \$43 million dollars.

As at year end 2019, we were not in compliance with the interest coverage ratio covenant. However, we have since obtained waivers for the December 31, 2019 covenant breach. Under

the terms of the waivers, we have agreed that on or before April 15, 2020, we will enter into a definitive purchase agreement related to the sale of Bridge Farm and enter into a Term Sheet with our secured lenders that sets out a financing strategy for Sundial. Failure to adhere to these terms will constitute an immediate event of default. The Term Debt Facility lenders have also agreed to defer \$1.2 million of the \$2.8 million interest payment due March 31, 2020 until April 20, 2020.

Additionally, we are in advanced discussions with our lenders to restructure our Syndicated Credit Agreement and our Term Debt Facility into Global Credit Facilities. We remain committed to working with our lenders to improve our overall liquidity and capital positions.

To further improve our liquidity, we have engaged financial advisors and are in advanced negotiations with potential public and private capital providers, which could provide further sources of equity and/or debt. We will provide an update in due course should we complete a financing transaction.

We are also pursuing other avenues to improve our liquidity position, which could include liquidating inventory, entering into long-term supply agreements with other licenced producers, as well as monetizing additional assets. As Zach indicated, we are conducting an entire portfolio review and will look to optimize our asset base. I would highlight that as part of this review we recently sold a non-core property in Kamloops, B.C. for \$2.1 million dollars in Q1 2020.

Overall, we believe the culmination of our efforts will improve our liquidity and capital positions to ensure we have a solid foundation to withstand the current challenging environment and position us for future profitable growth.

Now, Andrew Stordeur, Sundial's President and Chief Operating Officer, will review some of the key milestones that Sundial has achieved to date.

ANDREW STORDEUR:

Thanks, Jim.

First, I would like to reiterate that Sundial's strategic focus will be consumer and customer centric within the Canadian recreational industry. Our portfolio of high quality cannabis products

has been developed with a focus on the inhalables segment consisting of flower, vape and concentrates. We have invested and developed best-in-class, differentiated facilities in Canada, leveraging our award-winning genetics and an experienced team of Sundialers to deliver on our value proposition.

We are currently selling under four brands—Grasslands, Palmetto, Sundial and Top Leaf—that span the entire value chain. To illustrate how we are building our brands and capturing market share in Canada, I want to share some commercial highlights.

We successfully launched our vape products on the first day of legalization in December with strong initial sales and customer demand. In fact, 100% of the vape inventory from our first production run in December sold out in a few weeks. Following the recent Alberta Gaming, Liquor and Cannabis approval permitting cannabis vape sales in Alberta, our entire vape cartridge inventory of 19,200 cartridges sold on the first day of sales. As the vape market develops, we expect to see further growth.

We have also achieved strong sales statistics in the last few months with Top Leaf ranking amongst the highest pricing tiers across Canadian retail. In Ontario, Sundial Cannabis' Lemon Riot is a top 10 selling vape SKU and the fourth highest selling 510 cartridge while Top Leaf's Strawberry Cream is the second best-selling vape SKU within the best pricing category

Consumer and customer demand remain strong for our portfolio of products. Sundial launched a total of 105 SKUs in the adult-use market in the first quarter of 2020 to date, representing a 72% increase versus the fourth quarter of 2019. New launches represent 74 flower SKU's and 31 vape SKU's under the Top Leaf, Sundial Cannabis, Palmetto and Grasslands brands. Sundial also plans to launch additional products in 2020 in Canada under its existing brand portfolio, based on market conditions, customer feedback and data analytics. Our sales per point of distribution remains healthy and we will continue to invest intelligently in our brands nationally.

Although our focus is on branded sales, we recently executed a significant wholesale agreement with a Top 5 licensed producer representing estimated net revenue of \$9.3 million to be realized in the first half of 2020.

We continued to ramp up operations in the fourth quarter and now have all 114 grow rooms at our Olds, Alberta facility completed and licensed. We are using our purpose-built, modular grow rooms to cultivate over 20 strains which are being sold under all of our brands to provincial boards. The majority of our harvests are now testing above 18% THC with several harvests now testing well above 20%. Each strain has its own optimal growing environment and while we continue to tweak each specific environment, we believe the high quality product we are harvesting validates the cultivation success of our Olds facility and our production techniques.

We have listed and shipped adult-use cannabis products to nine Canadian provinces from coast to coast. In February 2020, Sundial received approval from Quebec, expanding our distribution network to cover 98% of the national recreational industry.

While we still have some heavy lifting to do to get to where we need to be, I believe we have made significant progress in a very short period of time, given we only started selling our Sundial-branded product in January 2019.

With that, I would like to turn the call back to Zach for closing remarks.

ZACH GEORGE:

Thanks, Andrew.

To conclude, I look forward to engaging with you and many of Sundial's stakeholders over the coming weeks and months. We are working hard to ensure that Sundial navigates the current challenging and uncertain environment, has adequate liquidity, and becomes sustainably profitable. In the next 12 to 24 months, we believe that our industry will see many business failures, as well as some consolidation. Against this backdrop, Sundial will leverage the strength of our team, assets, and brands as we seek a strong leadership position within the industry.

Thank you everyone for joining the call and we look forward to updating you on our progress when we report our Q1 2020 financial results. Take care of yourselves and stay safe. I will now turn it back over to the operator.

OPERATOR:



Thank you, sirs. This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.