

BCP Research: Tilray Inc (TLRY) - 4Q20 Results, Improved - Maintain 'Positive-Outright' on TLRY '23s

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Summary: Tilray Inc (Tilray), a fully-integrated Canadian cannabis company, released positive 4Q20 results, showing y/y and q/q revenue improvements, reflecting the company's portfolio shift towards premium adult-use product offerings. Inventory days (217) decreased q/q. Adj. EBITDA turned positive (US\$2 mm) for the first time, despite negative performance of hemp operations in the quarter. Cash burn (-US\$41 mm) was higher following heavier interest payments and WK use. Equity issuance of US\$50 mm helped increase cash to US\$190 mm (90% cash to LTM revenue) which, alongside the partial US\$197 mm exchange of TLRY '23s to Class 2 common stock, resulted in significant net debt reduction to US\$170 mm.

We highlight the recent and notable decline in hemp operations, which were impacted by a major customer's shift to store-branded products. Guided decrease of hemp's percentage revenue mix, intended to be driven by cannabis revenue growth, now highlights potential price/supply hurdles for non-domestic and indirect cannabis businesses trying to enter US cannabis markets. Nevertheless, we are impressed with the near-term adj. EBITDA improvements, following cost cutting and product mix adjustments, supported by expansion across all cannabis segments. Meanwhile, ongoing margin improvements and the completion of Tilray's Portugal facility should bring Tilray closer to FCF breakeven, which would further strengthen Tilray's balance sheet.

TLRY 5% 23s have appreciated 6% since our initial upgrade at 86c to 'Positive-Outright' (January 11, 2021). We note bonds will not be restruck for antidilution purposes, as part of the proposed APHA/TLRY merger, leaving them well out-of-the-money. However, TLRY '23s continue to trade below the bond floor, offering 9% YTW and modest 3% upside from current levels (91c) to FV (94c), at an estimated 700 bps spread. Therefore, we maintain our 'Positive-Outright' rating on the TLRY '23s, with implied additional upside backed by an improving credit story.

	Amt Out (US\$ MM)	Mid Price	Mid YTW	IVOL	Cheapness (par)	Delta (par)	Conv. Price	Stock Price
APHACN 5.25% 06/01/2024	259	209.75	(18.10%)	69.19%	(3.72%)	83.65%	\$9.38	\$17.84
TLRY 5% 10/1/2023	278	91.25	8.87%	N/A	2.83%	3.91%	\$167.41	\$24.26

Source: Equity information sourced from Bloomberg. Convertible pricing as of February 26, 2021

4Q20 Operating and Financial Results:

- **Cannabis:**
 - Harvested cannabis decreased 49% y/y and 16% q/q to 7,474 kg, primarily reflecting discontinuation of bulk sales
 - FY19 harvested cannabis totaled 32,690 kg (-35% y/y) on reduced production capacity, related in part to the closure of Tilray's High Park Garden's facility, and discontinuation of bulk sales
 - Average cannabis net cost per gram was US\$3.72 (+143% y/y, -12% q/q). Y/y increases are in line with a shift away from bulk sales to higher margin, and higher cost, dried flower. Sequential decline reflects ongoing cost cutting measure and better absorption rates in Portugal
 - FY19 average cost per gram increased 37% y/y to US\$3.24, in line with Tilray's shift premium product offerings, which utilize higher cost dried-flower
 - We note average cost for the year includes bulk sales, which were related to a one-time settlement of a supply contract in 2Q20, and have since been discontinued

- Cannabis sales totaled 6,901 kg (-54% y/y, +35% q/q), with y/y decline attributable to the elimination of bulk cannabis sales, and q/q increase attributable to higher sales across all cannabis segments
 - FY19 cannabis sales totaled 29,232 kg (-17% y/y) at an average net selling price per gram of US\$4.57 (+52% y/y), reflecting shift in distribution channels, product mix, and sales, with a focus on growth of international medical sales, prioritization of higher potency, and growth of Cannabis 2.0 within its Canadian adult-use markets
 - As with production costs, we note average net selling price includes the impact of one-time bulk sales related to settlement of a supply contract
- *Hemp:*
 - Hemp product sales decreased 16% y/y and 25% q/q to 1,823 units, following major customer, Costco's shift to private label products, as well as changes in consumer shopping patterns
 - FY19 hemp product sales were 26% higher y/y at 9,864 units, reflecting large format retail promotions and acceleration of ecommerce sales resulting from COVID-19
 - FY19 average gross selling price per unit was US\$7.79, a marginal 2% y/y improvement relative to FY19, likely softened by large format retail promotions offered in 3Q20
- Inventory increased 7% y/y and 4% q/q to US\$94 mm, while inventory days, totaling 217, decreased 1% y/y and 8% q/q
 - We note our exclusion of inventory valuation adjustments related to cost of goods sold in our evaluation of inventory days
 - Additionally, we highlight the table below reflects aggregate inventory (cannabis and hemp), providing a relative, but not like-for-like basis, comparison with similar cannabis producers, Aphria Inc. (APHACN) and Aurora Cannabis Inc. (ACBCN)

TLRY (US\$MM)	4Q20	3Q20	2Q20	1Q20	4Q19	y/y	q/q	FY20	FY19	y/y
Kilograms equivalents harvested - cannabis	7,474	8,903	6,781	9,532	14,778	(49%)	(16%)	32,690	50,144	(35%)
Average cost per gram - cannabis	3.72	4.23	2.06	3.97	1.53	143%	(12%)	3.24	2.36	37%
Kilograms equivalents sold - cannabis	6,901	5,107	11,430	5,794	15,039	(54%)	35%	29,232	35,380	(17%)
Average net selling price per gram - cannabis	5.97	6.15	2.64	5.28	1.88	218%	(3%)	4.57	3.01	52%
Thousand units sold - hemp products	1,823	2,431	3,732	1,878	2,182	(16%)	(25%)	9,864	7,826	26%
Average gross selling price per unit - hemp products	n/a	8.22	6.00	11.35	n/a	-	-	7.79	7.65	2%
Raw materials	15	15	11	20	16	(4%)	(1%)	15	16	(4%)
Work-in-process	62	60	70	63	54	15%	3%	62	54	15%
Finished goods	17	15	12	13	18	(8%)	12%	17	18	(8%)
Total Inventory	94	90	93	96	88	7%	4%	94	88	7%
Total COGS (1)	39	34	37	37	36	7%	13%	147	122	21%
Inventory Days	217	236	225	231	219	(1%)	(8%)	229	259	(12%)

(1) Excludes cost of goods sold related to inventory valuation adjustments

- Net revenue increased 21% y/y and 10% q/q to US\$57 mm, with improvements in cannabis revenue outweighing hemp revenue declines
 - Cannabis net revenues increased 46% y/y and 31% q/q to US\$41 mm, reflecting acceleration of international and Canada medical sales, as well as adult-use sales
 - Adult-use (consumer) cannabis revenues increased 51% y/y and 29% q/q to US\$26 mm, following the launch of more premium product offerings (i.e. Cannabis 2.0), increased retail presence, and a change in pricing strategy

- Following, an additional US\$73 mm principal amount was repurchased at a 42% discount to face value (equivalent to a conversion price of US\$6.68/share), in exchange for 6.4 mm shares of Class 2 common stock

TLRY (US\$MM)	4Q20	3Q20	2Q20	1Q20	4Q19	y/y	q/q	FY20	FY19	y/y
Cannabis revenue	41	31	30	31	28	46%	31%	134	107	25%
Hemp revenue	15	20	20	21	19	(18%)	(23%)	77	60	28%
Net Revenue	57	51	50	52	47	21%	10%	210	167	26%
Adjusted EBITDA	2	(2)	(12)	(19)	(36)	(106%)	(245%)	(30)	(90)	(66%)
<i>Adjusted EBITDA margin</i>	4%	(3%)	(24%)	(36%)	(76%)	7,972bps	699bps	(14%)	(54%)	3,941bps
Interest Paid	(17)	(2)	(7)	(1)	(11)	63%	690%	(28)	(28)	(2%)
Taxes Paid	0	(0)	-	-	(0)	-	-	(0)	(0)	31%
Working Capital	(19)	(3)	(13)	(25)	(32)	(40%)	663%	(60)	(121)	(50%)
Accounts receivable	(5)	2	11	(2)	0	(2,503%)	(348%)	6	(15)	(142%)
Inventory	(5)	(5)	(9)	(12)	(29)	(84%)	0%	(30)	(103)	(71%)
Prepayments and other current assets	(10)	(2)	(1)	7	3	(402%)	399%	(5)	(51)	(89%)
Accounts payable	(8)	4	(1)	(15)	(19)	(58%)	(302%)	(20)	20	(202%)
Accrued expenses and other current liabilities	8	(2)	(13)	(3)	12	(35%)	(504%)	(10)	28	(136%)
Capex	(5)	(12)	(9)	(18)	(23)	(77%)	(56%)	(45)	(74)	(39%)
Lease Liability Payments	(1)	(1)	(1)	(1)	(2)	(15%)	20%	(5)	(3)	53%
Free Cash Flow	(41)	(20)	(43)	(64)	(104)	(61%)	109%	(167)	(316)	(47%)
Cash (1)	190	155	137	174	97	96%	22%	190	97	96%
Accounts receivable	29	25	27	38	36	(20%)	17%	29	36	(20%)
Liquidity (2)	219	180	164	212	133	64%	22%	219	133	64%
Accrued lease obligations	34	33	32	32	32	5%	1%	34	32	5%
Senior facility	48	46	45	44	-	-	5%	48	-	-
Convertible notes (3)	278	475	475	475	475	(42%)	(42%)	278	475	(42%)
Total Debt	360	554	552	551	507	(29%)	(35%)	360	507	(29%)
Net Debt	170	399	414	377	410	(59%)	(57%)	170	410	(59%)
LTM Net Revenue	210	201	201	196	167	26%	5%	210	167	26%
LTM Adj. EBITDA	(30)	(68)	(88)	(94)	(90)	(66%)	(56%)	(30)	(90)	(66%)
LTM Gross Leverage	NM	NM	NM	NM	NM	-	-	NM	NM	-
LTM Net Leverage	NM	NM	NM	NM	NM	-	-	NM	NM	-
Cash to LTM Revenue	90%	77%	68%	89%	58%	3,216bps	1,286bps	90%	58%	3,216bps
Liquidity to LTM Revenue	104%	90%	82%	108%	80%	2,427bps	1,430bps	104%	80%	2,427bps

(1) Includes cash and cash equivalents and ST investments

(2) Excludes US\$209 mm remaining available balance from ATM program

(3) Convertible debentures valued at par

Post-4Q20 Events:

- International Segment:** Tilray medical cannabis is now available in seventeen (17) countries
 - United Kingdom: A new agreement has been established with Grow Pharma to import and distribute Tilray medical cannabis products in the UK
 - Portugal/Spain: Tilray has partnered with Worldpharma Biotech, completing its first export of medical cannabis from Portugal to Spain, to be used in medical cannabis trials
 - France: The company was also selected to supply medical cannabis for experimentation in France, which is expected to occur for 18-24 months, beginning 1Q21

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