Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Condensed Interim Consolidated Financial Statements and the related Notes thereto for the period ended August 31, 2023 contained in this Quarterly Report on Form 10-Q and the Audited Consolidated Financial Statements and the related Notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended May 31, 2023, as well as in conjunction with the sections entitled "Item 1A. Risk Factors" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended May 31, 2023. Forward looking statements in this Form 10-Q are qualified by the cautionary statement included in this Form 10-Q under the sub-heading "Cautionary Note Regarding Forward-Looking Statements" in the introduction of this Form 10-Q.

Company Overview

We are a leading global cannabis-lifestyle and consumer packaged goods company headquartered in Leamington and New York, with operations in Canada, the United States, Europe, Australia, and Latin America that is changing people's lives for the better – one person at a time – by inspiring and empowering a worldwide community to live their very best life, enhanced by moments of connection and wellbeing. Tilray's mission is to be the most responsible, trusted and market leading cannabis consumer products company in the world with a portfolio of innovative, high-quality and beloved brands that address the needs of the consumers, customers and patients we serve.

Our overall strategy is to leverage our brands, infrastructure, expertise and capabilities to drive market share in the industries in which we compete, achieve industry-leading, profitable growth and build sustainable, long-term shareholder value. In order to ensure the long-term sustainable growth of our Company, we continue to focus on developing strong capabilities in consumer insights, drive category management leadership and assess growth opportunities with the introduction of new products and entries into new geographies. In addition, we are relentlessly focused on managing our cost of goods and expenses in order to maintain our strong financial position.

Trends and Other Factors Affecting Our Business

Canadian cannabis market trends:

The cannabis industry in Canada continues to evolve at a rapid pace during the early periods following the federal legalization of adult-use cannabis. Through analysis of the current market conditions, the following key trends have emerged and are anticipated to influence the near-term future in the industry:

- *Market share*. Tilray continues to maintain its market leadership position in Canada. During the quarter, we experienced a significant increase in market share in Canada, with our share increasing from 8.1% to a 13.4% from the immediately preceding quarter, as reported by Hifyre data for all provinces excluding Quebec where Weedcrawler was deemed more accurate. This increase was driven by the strategic acquisitions of HEXO and Truss during the quarter which contributed favorably to our increase in adult use revenue. We expect that during the next fiscal year, the contribution to our market share from these acquired lines of business will fluctuate until they are fully absorbed into our distribution channels.

- *Price compression.* We have historically seen price compression in the market, when compared to the prior fiscal year, which was driven by intense competition from the approximately 1,000 Licensed Producers in Canada. The price compression year over year has reduced the Company's revenue by approximately $3.1 million for the three months ended August 31, 2023, which affects our cannabis gross margin as well as our bottom line.

- *Excise taxes.* Given the impacts of the above-referenced price compression, excise tax continues to become a larger component of net revenue as it is predominantly computed as a fixed price on grams sold rather than as a percentage of the selling price. The Cannabis Council of Canada has formed an Excise Task Force to present these challenges to the Ministry of Finance in Canada and continues to pursue reform. Additionally, as many as two-thirds of Canadian licensed producers had excise tax deficits owed, which they were unable to pay on time. The Company believes this may result in insolvencies and may be a key element of potential consolidation in the industry and we believe long term there is a possibility of some level of reform but it will likely not occur in the near term.

- *Timing difference in recognizing synergized operating results*. As we continue to acquire businesses such as HEXO and Truss, a large part of our strategy involves removing legacy costs from these businesses as part of our acquisition strategy. Once we have completed our full $27 million synergy plan for HEXO and integrated Truss's operations, we expect our operating results to be more profitable.

- *Change facility utilization as a result of acquisitions*. We continue to assess our facilities for further optimization or cost reduction to ensure utilization is prioritized and our value chain is operating at its peak efficiency. During this period of facility optimization, we expect there to be a temporary short-term negative impact on our operating results until our capacity is optimized.

These identified trends have had impacts on the current period results of operations and are discussed in greater detail in the respective sections.

International cannabis market trends:

The cannabis industry in Europe is in its early stages of development whereby countries within Europe are at different stages of legalization of medical and adult-use cannabis as some countries have expressed a clear political ambition to legalize adult-use cannabis (Germany, Portugal, Luxembourg and Czech Republic), some are engaging in an experiment for adult-use (Netherlands, Switzerland) and some are debating regulations for cannabinoid-based medicine (France, Spain, Italy, and the United Kingdom). In Europe, we believe that, despite continuing recessionary economic conditions and the Russian conflict with Ukraine, cannabis legalization (both medicinal and adult-use) will continue to gain traction albeit more slowly than originally expected. We also continue to believe that Tilray remains uniquely positioned to maintain and gain significant market share in these markets with its infrastructure and its investments, which is comprised of two EU-GMP cultivation facilities within Europe located in Portugal and Germany, our distribution network and our demonstrated commitment to the availability, quality and safety of our cannabinoid-based medical products. Today, Germany remains the largest medical cannabis market in Europe.

The following is a summary of the state of cannabis legalization within Europe:

Germany. In late October 2022, the German government published key details of its plan to legalize and regulate adult-use cannabis, including what Health Minister Karl Lauterbach described as “complete” cultivation within the country.

Recently, Mr. Lauterbach advised that the proposal had been revised and that the new plan is a two-part model, which appears to be designed in order to legalize cannabis as broadly as possibly without running afoul of European Union rules. On July 6, 2023, it was announced that the draft regulations pertaining to decriminalization, home cultivation and non-commercial “cultivation associations” (i.e., social clubs) had been finalized by the health ministry and was ready to be delivered to the German parliament, which is expected to take place in the Fall of 2023.

We continue to believe that Tilray is well-positioned in Germany to provide consistent and sustainable cannabis products for the adult-use market whether only in-country cultivation is permitted or whether imports are also allowed given our Aphria RX facility located in Germany and our EU-GMP-certified production facility in Portugal, as well as our distribution platform, which provides us with access to 13,000 pharmacies in Germany.

Switzerland. In October 2021, Switzerland announced its intention to legalize cannabis by allowing production, cultivation, trade, and consumption. In the meantime, a three-year pilot project commenced on January 30, 2023, which permits selected participants to purchase cannabis for adult-use in various pharmacies in Basel, and more recently in Zurich, to conduct studies on the cannabis market and its impact on Swiss society. It is the first trial for the legal distribution of adult-use cannabis containing THC in Europe.

Spain. The Spanish Congress' Health Committee has recently approved a Medical Cannabis Report that paves the way for a government-sponsored bill on medical cannabis. The Report explicitly opens the door to standardized preparations other than the drugs already approved, highlighting their advantages in relation to safety, security and stability; as well as the possibility to prescribe medical cannabis in community pharmacies and not only in hospitals, favoring the access to the patients that may need it.

France. France launched a two-year pilot experiment to supply approximately 3,000 patients with medical cannabis. To date, 2,300 patients are enrolled in the experiment, which has been extended for another year and is now ending March 2024 in order to collect more data and to adopt a legal framework. The first results of the experimentation are positive. Several independent agencies have produced reports that show the effectiveness of medical cannabis, especially in situations of chronic pain.

Czech Republic. The Czech Republic has discussed plans to launch a fully regulated adult-use cannabis market and is reviewing in the context of the European regulations.

Malta. In 2021, became the first country in the European Union to legalize personal possession of the drug and permit private “cannabis clubs,” where members can grow and share the drug.

Beverage alcohol market trends:

The beverage alcohol category, while more established, continues to shift with changes in consumer trends for the craft industry. Specifically, based on IRI data, for the last 13 weeks ended August 27, 2023, the US beer industry grew 3.14%, with craft beer growing 0.71%, a slight improvement from the immediately preceding quarter. Nationally SweetWater trends softened during the three months ended August 31, 2023, due to the timing of key marketing programming being pushed into our second quarter, while SweetWater’s home market remained in a growth trend, finishing an increased 5.9% in the quarter. SweetWater is expected to return to growth nationally at the start of the second quarter through programming and innovation. Early results from the launch of SweetWater’s latest innovation, Gummies, are encouraging, with the brand quickly becoming a top 3 offering in activated markets. Additionally, Montauk finished the period with an increased 9.2% growth based on IRI data for the aforementioned period, through sustained success in home markets and new market expansion. The Company anticipates continued growth through focused innovation, targeted marketing efforts, and gains in distribution across the portfolio of brands.

Breckenridge Distillery is a leader in the bourbon industry and continues to gain market share in both the vodka and gin markets. A primary growth objective is to continue expansion of market share across the United States, including expanding the national chain's footprint, to maintain a double-digit annual top-line growth. To ensure continued growth in the future, the company is focused on expanding the marketing strategy, highlighting its quality products. Recent media coverage includes coverage of newly released products, the expanded Denver Broncos Sponsorship, and recognition of the world class restaurant located at the distillery. The overall whiskey market continues to grow through premiumization and expanding into new target demographics. The Company expects its spirits business to continue to grow with the integration of the national distributer agreement with RNDC as well as new product offerings.

Wellness market trends:

Manitoba Harvest's branded hemp business continued to expand its U.S. and Canadian leading market share position this year. During the quarter, the Company successfully continued expansion of its Hemp Food portfolio into more accessible consumer formats with the continued launch of a breakthrough CBD wellness beverage, Happy Flower™. The Company will look to expand the Happy Flower™ brand with retail distribution into key markets, focusing on U.S. states with established CBD permissibility and sales momentum in future periods.

Acquisitions, Strategic Transactions and Synergies

We strive to continue to expand our business on a consolidated basis, through a combination of organic growth and acquisition. While we continue to execute against our strategic initiatives that we believe will result in the long-term, sustainable growth and value to our stockholders, we continue to evaluate potential acquisitions and other strategic transactions of businesses that we believe complement our existing portfolio, infrastructure and capabilities or provide us with the opportunity to enter attractive new geographic markets and product categories as well as expand our existing capabilities. In addition, we have exited certain businesses and continue to evaluate certain businesses within our portfolio that are dilutive to profitability and cash flow. As a result, we incur transaction costs in connection with identifying and completing acquisitions and strategic transactions, as well as ongoing integration costs as we combine acquired companies and continue to achieve synergies, which is offset by income generated in connection with the execution of these transactions. For the three months ended August 31, 2023, we incurred $8.5 million of transaction expenses, discussed further below.

Our acquisition strategy has had a material impact on the Company's results in the current quarter and we expect will continue into future periods generating accretive impacts for our stockholders. There are currently three primary cost saving initiatives as follows:

- ***HEXO acquisition:***

On June 22, 2023, Tilray acquired HEXO Corp. ("HEXO") as discussed in Note 6 (Business acquisitions). With the HEXO Acquisition, Tilray expects to achieve additional cost savings in excess of $27M on an annualized pre-tax basis, driven by synergies across production, sales, marketing, distribution, and corporate savings, with potential incremental upside resulting from consolidating packaging, procurement, freight, and logistics. This builds on Tilray's substantial progress optimizing its Canadian cannabis operations discussed below. During the three months ended August 31, 2023, we have achieved $17.1 million of our synergy plan on an annualized run-rate basis of which $2.9 million represented actual cost savings during the period. As discussed in our trends section, these saving initiatives take time to implement, resulting in related benefits being realized over time.

- ***Cannabis business cost reduction plan:***

During the fourth quarter of our fiscal year ended May 31, 2022, the Company launched a $30 million cost optimization plan of our existing cannabis business to solidify our position as an industry leading low-cost producer. The Company took decisive action to manage cash flow amid an evolving retail environment by identifying opportunities to leverage technology, supply chain, procurement, and packaging efficiencies while driving labor savings. In the current period ended August 31, 2023, we have achieved $22 million of our cost optimization plan on an annualized run-rate basis of which $21 million represented actual cost savings during the period. The amount achieved is comprised of the following items:

  - *Optimizing cultivation*. We made impactful strides to right-size our cultivation footprint by maximizing our yield per plant and by honing the ability to flex production during optimal growing seasons to manage our cost to grow.

  - *Refining selling fees.* We assessed our current product-to-market strategy to optimize our direct and controllable selling fees as a percentage of revenue without compromising our sales strategy on a go-forward basis.

  - *Reducing general and administrative costs*. We remain focused on reducing operating expenses by leveraging innovative solutions to maintain a lean organization. We plan to further automate processes, reducing outside spend where efficient, and ensuring we are obtaining competitive pricing on our administrative services.

- ***International Cannabis business cost reduction plan:***

During our fiscal year ended May 31 2023, the Company launched an $8.0 million cost optimization plan for our international cannabis business to adapt to changing market dynamics and slower than anticipated legalization in Europe. In the current period ended August 31, 2023, the Company achieved an annualized run-rate basis of $6.8 million of cost savings. This was driven by the integration of our Distribution and European cannabis business for redundant costs including headcount consolidation in addition to optimization of our facility utilization.

In addition to our cost saving strategies, the Company has also executed the following strategic transactions during the quarter:

- ***Beverage Alcohol Acquisitions:***

On August 7, 2023, the Company entered into a securities and asset purchase agreement (the “Purchase Agreement”) by and among Anheuser-Busch Companies, LLC, Craft USA Holdings, LLC, Craft Brew Alliance, Inc. (collectively, “AB”), the Company and Tilray Beverages, LLC. Pursuant to the Purchase Agreement, Tilray will acquire a portfolio of craft beer brands, assets and businesses from AB that includes Breckenridge Brewery, Blue Point, 10 Barrel, Redhook, Widmer Brothers, Square Mile, Shock Top and HiBall. The purchase price to be paid to AB at closing is expected to be equal to $85.0 million in cash, subject to working capital and other applicable closing adjustments. The acquisition closed on September 29, 2023 as described in Note 25 (Subsequent events), and is expected to be transformational to our growing beverage alcohol strategy.

Political and Economic Environment

Our results of operations can also be affected by economic, political, legislative, regulatory, legal actions, the global volatility and general market disruption resulting from geopolitical tensions, such as Russia's incursion into Ukraine. Economic conditions, such as recessionary trends, inflation, supply chain disruptions, interest and monetary exchange rates, and government fiscal policies, and the recent banking credit crises, can have a significant effect on operations. Accordingly, we could be affected by civil, criminal, environmental, regulatory or administrative actions, claims or proceedings.

Results of Operations

Our consolidated results, in thousands except for per share data, are as follows:

	For the three months ended August 31,		Change	% Change
(in thousands of U.S. dollars)	**2023**	**2022**	**2023 vs. 2022**	
Net revenue	$ 176,949	$ 153,211	$ 23,738	15%
Cost of goods sold	132,753	104,597	28,156	27%
Gross profit	44,196	48,614	(4,418)	(9)%
Operating expenses:				
General and administrative	40,516	40,508	8	0%
Selling	6,859	9,671	(2,812)	(29)%
Amortization	22,225	24,359	(2,134)	(9)%
Marketing and promotion	8,535	7,248	1,287	18%
Research and development	79	166	(87)	(52)%
Change in fair value of contingent consideration	(11,107)	211	(11,318)	(5,364)%
Litigation costs	2,034	445	1,589	357%
Restructuring costs	915	—	915	0%
Transaction (income) costs	8,502	(12,816)	21,318	(166)%
Total operating expenses	78,558	69,792	8,766	13%
Operating loss	(34,362)	(21,178)	(13,184)	62%
Interest expense, net	(9,835)	(4,413)	(5,422)	123%
Non-operating (expense) income, net	(4,402)	(32,992)	28,590	(87)%
Loss before income taxes	(48,599)	(58,583)	9,984	(17)%
Income tax expense	7,264	7,211	53	1%
Net loss	$ (55,863)	$ (65,794)	$ 9,931	(15)%

Use of Non-GAAP Measures

Throughout this Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report on Form 10-Q, we discuss non-GAAP financial measures, including reference to:

- adjusted gross profit (excluding purchase price allocation (“PPA”) fair value step up) for each reporting segment (Cannabis, Beverage alcohol, Distribution and Wellness) as applicable,

- adjusted gross margin (excluding purchase price allocation (“PPA”) fair value step up) for each reporting segment (Cannabis, Beverage alcohol, Distribution and Wellness) as applicable,

- adjusted EBITDA,

- cash and marketable securities, and

- constant currency presentation of net revenue.

All these non-GAAP financial measures should be considered in addition to, and not in lieu of, the financial measures calculated and presented in accordance with accounting principles generally accepted in the United States of America, ("GAAP"). These measures, which may be different than similarly titled measures used by other companies, are presented to help investors' overall understanding of our financial performance and should not be considered a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. Please see "Reconciliation of Non-GAAP Financial Measures to GAAP Measures" below for reconciliation of such non-GAAP Measures to the most directly comparable GAAP financial measures, as well as a discussion of our adjusted gross margin, adjusted gross profit and adjusted EBITDA measures and the calculation of such measures.

Constant Currency Presentation

We believe that this measure provides useful information to investors because it provides transparency to underlying performance in our consolidated net sales by excluding the effect that foreign currency exchange rate fluctuations have on period-to-period comparability given the volatility in foreign currency exchange markets. To present this information for historical periods, current period net sales for entities reporting in currencies other than the U.S. Dollar are translated into U.S. Dollars at the average monthly exchange rates in effect during the corresponding period of the prior fiscal year rather than at the actual average monthly exchange rate in effect during the current period of the current fiscal year. As a result, the foreign currency impact is equal to the current year results in local currencies multiplied by the change in average foreign currency exchange rate between the current fiscal period and the corresponding period of the prior fiscal year.

Cash and Marketable Securities

The Company combines the Cash and cash equivalent financial statement line item and the Marketable securities financial statement line item as an aggregate total as reconciled in the liquidity and capital resource section below. The Company’s management believes that this presentation provides useful information to management, analysts and investors regarding certain additional financial and business trends relating to its short-term liquidity position by combining these three GAAP metrics.

Operating Metrics and Non-GAAP Measures

We use the following operating metrics and non-GAAP measures to evaluate our business and operations, measure our performance, identify trends affecting our business, project our future performance, and make strategic decisions. Other companies, including companies in our industry, may calculate operating metrics and non-GAAP measures with similar names differently which may reduce their usefulness as comparative measures. Certain variances are labeled as not meaningful ("NM") throughout management's discussion and analysis.

	For the three months ended August 31,	
(in thousands of U.S. dollars)	**2023**	**2022**
Net cannabis revenue	$ 70,333	$ 58,570
Distribution revenue	69,157	60,585
Net beverage alcohol revenue	24,162	20,654
Wellness revenue	13,297	13,402
Cannabis costs	50,517	28,861
Beverage alcohol costs	11,266	10,849
Distribution costs	61,468	54,984
Wellness costs	9,502	9,903
Adjusted gross profit (excluding PPA step-up) (1)	49,302	49,721
Cannabis adjusted gross margin (excluding PPA step-up) (1)	35%	51%
Beverage alcohol adjusted gross margin (excluding PPA step-up) (1)	56%	53%
Distribution gross margin	11%	9%
Wellness gross margin	29%	26%
Adjusted EBITDA (1)	$ 11,434	$ 13,531
Cash and marketable securities (1) as at the period ended:	464,852	490,643
Working capital as at the period ended:	$ 291,981	$ 637,623

(1) Adjusted EBITDA, adjusted gross profit (excluding PPA step-up) and adjusted gross margin (excluding PPA step-up) for each of our segments, and cash and marketable securities are non-GAAP financial measures. See "Use of Non-GAAP Measures" below for a reconciliation of these Non-GAAP Measures to our most comparable GAAP measure.

Segment Reporting

Our reporting segments revenue is comprised of revenues from our cannabis, distribution, beverage alcohol, and wellness operations, as follows:

	For the three months ended August 31,		Change	% Change
(in thousands of U.S. dollars)	**2023**	**2022**	**2023 vs. 2022**	
Cannabis business	$ 70,333	$ 58,570	$ 11,763	20%
Distribution business	69,157	60,585	8,572	14%
Beverage alcohol business	24,162	20,654	3,508	17%
Wellness business	13,297	13,402	(105)	(1)%
Total net revenue	$ 176,949	$ 153,211	$ 23,738	15%

Our reporting segments revenue using a constant currency(1) are as follows:

(in thousands of U.S. dollars)	For the three months ended August 31, as reported in constant currency 2023	2022	Change 2023 vs. 2022	% Change 2023 vs. 2022
Cannabis business	$ 71,389	$ 58,570	$ 12,819	22%
Distribution business	66,952	60,585	6,367	11%
Beverage alcohol business	24,162	20,654	3,508	17%
Wellness business	13,459	13,402	57	0%
Total net revenue	$ 175,962	$ 153,211	$ 22,751	15%

Our geographic revenue is as follows:

(in thousands of U.S. dollars)	For the three months ended August 31, 2023	2022	Change 2023 vs. 2022	% Change 2023 vs. 2022
North America	$ 93,521	$ 82,192	$ 11,329	14%
EMEA	79,704	66,041	13,663	21%
Rest of World	3,724	4,978	(1,254)	(25)%
Total net revenue	$ 176,949	$ 153,211	$ 23,738	15%

Our geographic revenue using a constant currency(1) is as follows:

(in thousands of U.S. dollars)	For the three months ended August 31, as reported in constant currency 2023	2022	Change 2023 vs. 2022	% Change 2023 vs. 2022
North America	$ 95,214	$ 82,192	$ 13,022	16%
EMEA	75,116	66,041	9,075	14%
Rest of World	5,632	4,978	654	13%
Total net revenue	$ 175,962	$ 153,211	$ 22,751	15%

Our geographic capital assets are as follows:

(in thousands of U.S. dollars)	August 31, 2023	May 31, 2023	Change 2023 vs. 2022	% Change 2023 vs. 2022
North America	$ 384,091	$ 319,173	$ 64,918	20%
EMEA	106,761	107,131	(370)	(0)%
Rest of World	3,767	3,363	404	12%
Total capital assets	$ 494,619	$ 429,667	$ 64,952	15%

Cannabis revenue

Cannabis revenue based on market channel is as follows:

	For the three months ended August 31,		Change	% Change
(in thousands of US dollars)	2023	2022	2023 vs. 2022	
Revenue from Canadian medical cannabis	$ 6,142	$ 6,520	$ (378)	(6)%
Revenue from Canadian adult-use cannabis	71,195	58,355	12,840	22%
Revenue from wholesale cannabis	5,295	392	4,903	1,251%
Revenue from international cannabis	14,252	10,422	3,830	37%
Total cannabis revenue	96,884	75,689	21,195	28%
Excise taxes	(26,551)	(17,119)	(9,432)	55%
Total cannabis net revenue	$ 70,333	$ 58,570	$ 11,763	20%

Cannabis revenue based on market channel using a constant currency(1) is as follows:

	For the three months ended August 31, as reported in constant currency		Change	% Change
(in thousands of US dollars)	2023	2022	2023 vs. 2022	
Revenue from Canadian medical cannabis	$ 6,310	$ 6,520	$ (210)	(3)%
Revenue from Canadian adult-use cannabis	73,111	58,355	14,756	25%
Revenue from wholesale cannabis	5,458	392	5,066	1,292%
Revenue from international cannabis	13,777	10,422	3,355	32%
Total cannabis revenue	98,656	75,689	22,967	30%
Excise taxes	(27,267)	(17,119)	(10,148)	59%
Total cannabis net revenue	$ 71,389	$ 58,570	$ 12,819	22%

(1) The constant currency presentation of our Cannabis revenue based on market channel is a non-GAAP financial measure. See "Use of Non-GAAP Measures –Constant Currency Presentation" above for a discussion of these Non-GAAP Measures.

Revenue from Canadian medical cannabis: Revenue from Canadian medical cannabis decreased to $6.1 million for the three months ended August 31, 2023, compared to revenue of $6.5 million for the prior year same period. On a constant currency basis revenue from Canadian medical cannabis decreased to $6.3 million for the three months ended August 31, 2023, compared to revenue of $6.5 million for the prior year same periods. While revenue was relatively consistent period over period and on a constant currency basis, the decrease in revenue from medical cannabis continues to be driven by increased competition from the adult-use recreational market and its related price compression impacting the medical cannabis market.

Revenue from Canadian adult-use cannabis: During the three months ended August 31, 2023, our revenue from Canadian adult-use cannabis increased to $71.2 million compared to revenue of $58.4 million and for the prior year same period. The increase in adult-use revenue was driven by organic growth from launching new product innovations from our existing brand portfolios as well as the increased revenue from the acquisition of HEXO on June 22, 2023, and Truss on August 3, 2023. Additionally, due to the decline in the Canadian dollar, on a constant currency basis, our revenue from Canadian adult-use cannabis increased to $73.1 million for the three months ended August 31, 2023. Offsetting the increase in the current period, was the reduction of advisory services revenue to $1.5 million from $7.8 million in the prior year comparative period as a result of the HEXO acquisition being completed during the quarter which terminated the previous strategic arrangement that was in place.

Wholesale cannabis revenue: Revenue from wholesale cannabis increased to $5.3 million for the three months ended August 31, 2023, compared to revenue of $0.4 million for the prior year same period. On a constant currency basis, revenue from wholesale cannabis increased to $5.5 million. The Company continues to believe that wholesale cannabis revenue will remain subject to quarter-to-quarter variability and is based on opportunistic sales. The wholesale transactions that occurred in the period aided with our liquidity initiatives to increase our cash flow from operations despite having unfavorable impacts on our gross margin and EBITDA of $(2.7) million.

International cannabis revenue: Revenue from international cannabis increased to $14.3 million for the three months ended August 31, 2023, compared to revenue of $10.4 million for the prior year same period. Given the increase of the Euro against the U.S. Dollar when compared to the prior year quarter, on a constant currency basis, revenue from international cannabis was $13.8 million compared to $10.4 million in the prior year same period for the three months ended August 31, 2023. The increase in the period is largely driven by expansion into emerging international medical markets.

Distribution revenue

Revenue from Distribution operations increased to $69.2 million for the three months ended August 31, 2023 compared to revenue of $60.6 million for the prior year same period. Revenue was positively impacted during the three month period from the increase of the Euro against the U.S. Dollar in the quarter, which when the impacts are eliminated on a constant currency basis, revenue was $67.0 million for the three months ended August 31, 2023. The increase in the period was driven by increased production capacity achieved through out-sourcing to third party production facilities as well as leveraging our own internal production and improved procurement processes, which has allowed CC Pharma to improve its product mix.

Beverage alcohol revenue

Revenue from our Beverage alcohol operations increased to $24.2 million for the three months ended August 31, 2023, compared to revenue of $20.7 million for the prior year same period. The increase in the three month period relates primarily to our acquisition of Montauk which occurred on November 7, 2022, and is not reflected in the prior year comparative period.

Wellness revenue

Our Wellness revenue from Manitoba Harvest was relatively consistent at $13.3 million for the three months ended August 31, 2023 compared to $13.4 million from the prior year same period. On a constant currency basis for the three months ended August 31, 2023, Wellness revenue increased to $13.5 million from $13.4 million. Overall, sales remained relatively consistent period over period despite increasing pricing when compared to prior year to combat the inflation of ingredient costs.

Gross profit, gross margin and adjusted gross margin(1) for our reporting segments

Our gross profit and gross margin for the three months ended August 31, 2023 and 2022, is as follows:

(in thousands of U.S. dollars)	For the three months ended August 31,		Change	% Change
Cannabis	**2023**	**2022**	**2023 vs. 2022**	
Net revenue	70,333	58,570	11,763	20%
Cost of goods sold	50,517	28,861	21,656	75%
Gross profit	19,816	29,709	(9,893)	(33)%
Gross margin	28%	51%	(23)%	(45)%
Purchase price accounting step-up	4,516	—	4,516	NM
Adjusted gross profit (1)	24,332	29,709	(5,377)	(18)%
Adjusted gross margin (1)	35%	51%	(16)%	(31)%
Distribution				
Net revenue	69,157	60,585	8,572	14%
Cost of goods sold	61,468	54,984	6,484	12%
Gross profit	7,689	5,601	2,088	37%
Gross margin	11%	9%	2%	22%
Beverage alcohol				
Net revenue	24,162	20,654	3,508	17%
Cost of goods sold	11,266	10,849	417	4%
Gross profit	12,896	9,805	3,091	32%
Gross margin	53%	47%	6%	13%
Purchase price accounting step-up	590	1,107	(517)	(47)%
Adjusted gross profit (1)	13,486	10,912	2,574	24%
Adjusted gross margin (1)	56%	53%	3%	6%
Wellness				
Net revenue	13,297	13,402	(105)	(1)%
Cost of goods sold	9,502	9,903	(401)	(4)%
Gross profit	3,795	3,499	296	8%
Gross margin	29%	26%	3%	12%
Total				
Net revenue	176,949	153,211	23,738	15%
Cost of goods sold	132,753	104,597	28,156	27%
Gross profit	44,196	48,614	(4,418)	(9)%
Gross margin	25%	32%	(7)%	(22)%
Purchase price accounting step-up	5,106	1,107	3,999	361%
Adjusted gross profit (1)	49,302	49,721	(419)	(1)%
Adjusted gross margin (1)	28%	32%	(4)%	(13)%

(1) Adjusted gross profit is our Gross profit (adjusted to exclude purchase price accounting valuation step-up) and adjusted gross margin is our Gross margin (adjusted to exclude purchase price accounting valuation step-up) and are non-GAAP financial measures. See "Use of Non-GAAP Measures" below for additional discussion regarding these non-GAAP measures. The Company's management believes that adjusted gross profit and adjusted gross margin are useful to our management to evaluate our business and operations, measure our performance, identify trends affecting our business, project our future performance, and make strategic decisions. We do not consider adjusted gross profit and adjusted gross margin in isolation or as an alternative to financial measures determined in accordance with GAAP.

Cannabis gross margin: Gross margin decreased during the three months ended August 31, 2023 to 28% from 51% for the prior year same period. Excluding the impact of the non-cash fair value purchase price accounting step-up, adjusted gross margin during the three months ended August 31, 2023 decreased to 35% from 51% when comparing the same prior year period. The remaining decrease is a result of the termination of the HEXO advisory services agreement which contributed $1.5 million of gross profit in the current year compared to $7.8 million in the prior year and a significant wholesale transaction with a negative gross profit of $(2.7) million, which was entered into to optimize our inventory levels and prioritize the generation of positive operating cash flow. Combining these factors, adjusted gross cannabis margin would have been 39% compared 43% in the prior period and the remaining decrease in gross margin is due to price compression.

Distribution gross margin: Gross margin of 11% for the three months ended August 31, 2023 increased from 9% for the same periods in the prior year. The increase in the three month period is attributed to a change in product mix as the Company continues to focus on higher margin sales and a decrease in its cost of goods driven by the outsourcing of production.

Beverage alcohol gross margin: Gross margin of 53% for the three months ended August 31, 2023 increased from 47% from the same period in the prior year. Adjusted gross margin of 56% for the three months ended August 31, 2023 increased from 53% from the same periods in the prior year. The increase in beverage alcohol gross margin for the current three month period is a result of a change in sales mix between beer and spirits as well as the impacts of the Montauk acquisition that was not completed in the prior period comparison.

Wellness gross margin: Gross margin of 29% for the three months ended August 31, 2023 increased from 26% from the same period in the prior year. The increase in gross margin is a result of increased pricing from the prior period, which was used to combat the impacts of higher input costs of seed ingredients as a result of inflation.

Operating expenses

(in thousands of US dollars)	For the three months ended August 31, 2023	2022	Change 2023 vs. 2022	% Change
General and administrative	$ 40,516	$ 40,508	$ 8	0%
Selling	6,859	9,671	(2,812)	(29)%
Amortization	22,225	24,359	(2,134)	(9)%
Marketing and promotion	8,535	7,248	1,287	18%
Research and development	79	166	(87)	(52)%
Change in fair value of contingent consideration	(11,107)	211	(11,318)	(5,364)%
Litigation costs	2,034	445	1,589	357%
Restructuring costs	915	—	915	NM
Transaction (income) costs	8,502	(12,816)	21,318	(166)%
Total operating expenses	$ 78,558	$ 69,792	$ 8,766	13%

Operating expenses are comprised of general and administrative, share-based compensation, selling, amortization, marketing and promotion, research and development, change in fair value of contingent consideration, impairments, litigation costs, restructuring costs and transaction (income) costs. These costs increased by $8.8 million to $78.6 million for the three months ended August 31, 2023 as compared to $69.8 million for the same period of the prior year. These changes period over period are described below.

General and administrative costs

During the three months ended August 31, 2023, general and administrative costs were relatively unchanged as compared to the prior year same periods.

(in thousands of US dollars)	For the three months ended August 31, 2023	2022	Change 2023 vs. 2022	% Change 2023 vs. 2022
Executive compensation	$ 3,661	$ 3,555	$ 106	3%
Office and general	8,168	5,829	2,339	40%
Salaries and wages	13,114	14,635	(1,521)	(10)%
Stock-based compensation	8,257	9,193	(936)	(10)%
Insurance	3,849	2,703	1,146	42%
Professional fees	1,499	2,490	(991)	(40)%
Gain on sale of capital assets	3	77	(74)	(96)%
Travel and accommodation	1,107	1,161	(54)	(5)%
Rent	858	865	(7)	(1)%
Total general and administrative costs	$ 40,516	$ 40,508	$ 8	0%

Executive compensation increased by 3% in the three months ended August 31, 2023. Executive compensation has remained generally consistent period over period.

Office and general increased by 40% during the three months ended August 31, 2023. The increase for the three months is a result of the acquisition of Montauk and HEXO, which did not occur in the prior period.

Salaries and wages decreased by 10% during the three months ended August 31, 2023. The decrease is primarily due to our focus on optimizing our cost structure and is offset by the inclusion of Montauk and HEXO employees, which were not in the prior period.

The Company recognized stock-based compensation expense of $8.3 million for the three months ended August 31, 2023 compared to $9.2 million for the same period in the prior year. The balance has remained relatively consistent period over period as this is based on the time-based vesting schedules.

Insurance expenses increased by 42% for the three months ended August 31, 2023 to $3.8 million from $2.7 million for the same period in the prior year. This increase was driven by the expanded polices required for our recently acquired HEXO and Montauk entities.

Selling costs

For the three months ended August 31, 2023, the Company incurred selling costs of $6.9 million or 3.9% of net revenue as compared to $9.7 million and 6.3% of net revenue in the prior year period. These costs relate to third-party distributor commissions, shipping costs, Health Canada cannabis fees, and patient acquisition and maintenance costs. Patient acquisition and ongoing patient maintenance costs include funding to individual clinics to assist with additional costs incurred by clinics resulting from the education of patients using the Company's products. The decrease in the three month period was related to the renegotiation of terms in one of our distributor relationships resulting in reduced variable fees. This impact was also emphasized in the three month period as a portion of our selling fees related to our Canadian adult-use cannabis with fixed components did not increase with the increase in our revenue during the quarter.

Amortization

The Company incurred non-production related amortization charges of $22.2 million for the three months ended August 31, 2023 compared to $24.4 million in the prior year period. The decreased amortization in the period, is a result of the reduced intangible asset levels.

Marketing and promotion costs

For the three months ended August 31, 2023, the Company incurred marketing and promotion costs of $8.5 million as compared to $7.2 million for the prior year period. The increase is due to the acquisition of HEXO and Montauk in the period.

Research and development

Research and development costs were $0.1 million during the three months ended August 31, 2023 compared to $0.2 million in the prior year period. These relate to external costs associated with the development of new products.

Change in fair value of contingent consideration

The Company measures contingent consideration at fair value classified as Level 3, as discussed in Note 23 (Fair value measurements). The Company currently has three contingent consideration liabilities of $3.0 million, $13.0 million and $4.2 million for the Sweetwater, Montauk, and Truss acquisitions, respectively, as of August 31, 2023 compared to $16.2 million, $10.9 million and $nil respectively as of May 31, 2023. The decrease in fair value of $11.1 million was driven by the lowered probability of achieving the incentive targets, primarily relating to Sweetwater.

Litigation

For the three months ended August 31, 2023, the Company recorded $2.0 million of litigation cost compared to an expense of $0.4 million for the prior period comparative. The increase is related to period to period variability as litigation is non-recurring in nature.

Restructuring costs

In connection with executing our acquisition strategy and strategic transactions, the Company has incurred non-recurring restructuring and exit costs associated with the integration efforts of these transactions. For the three months ended August 31, 2023, the Company incurred $0.9 million of restructuring costs compared to $nil for the prior period comparative. The restructuring charges for the three months ended August 31, 2023 are related to the HEXO cost optimizations occurring subsequent to acquisition and the operating costs of the Truss facility, which is classified as assets held for sale.

Transaction (income) costs

Items classified as transaction (income) costs are non-recurring or extraordinary in nature and correspond largely to our acquisition and synergy strategy. The three months decrease of 166% from the prior year period is related to the following items:

- the current period included costs associated with exit and closing costs on completing the HEXO Acquisition on June 22, 2023, including, but not limited to, discretionary incentive compensation payments of $5.8 million, transaction income from the loan amendment agreement of $(6.0) million, and HEXO director and office runoff insurance of $5.1 million;

- in the prior year period comparative, we recognized transaction income for a change in fair value of $18.3 million on the HTI Share Consideration's purchase price derivative as a result of an increase in our share price on the shares paid for the HEXO convertible note receivable in the previous year. This did not recur in the current period results.

Non-operating (expense) income, net

Non-operating (expense) income is comprised of:

(in thousands of US dollars)	**For the three months ended August 31, 2023**	**2022**	**Change 2023 vs. 2022**	**% Change**
Change in fair value of convertible debenture payable	$ (2,147)	$ (7,884)	$ 5,737	(73)%
Change in fair value of warrant liability	(8,198)	1,548	(9,746)	(630)%
Foreign exchange loss (gain)	6,267	(25,573)	31,840	(125)%
Loss on long-term investments	(109)	(1,008)	899	(89)%
Other non-operating (losses) gains, net	(215)	(75)	(140)	187%
Total non-operating income (expense)	$ (4,402)	$ (32,992)	$ 28,590	(87)%

For the three months ended August 31, 2023, the Company recognized a change in fair value of its convertible debentures payable of ($2.1) million compared to ($7.9) million in the prior year same periods. The change is driven primarily by the changes in the Company's share price and the change in the trading price of the convertible debentures payable. Additionally, for the three months ended August 31, 2023, the Company recognized a change in fair value of its warrants, resulting in a loss of ($8.2) million compared to $1.5 million also as a result of the change in our share price and the exercise price of the instrument. For the three months ended August 31, 2023, the Company recognized a gain of $6.3 million, resulting from the changes in foreign exchange rates during the period, compared to losses of ($25.6) million for the prior year same periods, largely associated with the recovery of the Euro. Lastly, included in other non-operating (losses) gains, net for the three months ended August 31, 2023 was the disposal of an operating entity during the period.

Reconciliation of Non-GAAP Financial Measures to GAAP Measures

Adjusted EBITDA

Adjusted EBITDA is a non-GAAP financial measure that does not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. The Company calculates adjusted EBITDA as net loss/net income before income taxes, net interest expense, depreciation and amortization, equity in net loss of equity-method investees, non-cash inventory valuation adjustments, purchase price accounting step-up on inventory, stock-based compensation, integration activities, transaction (income) costs, litigation costs, change in fair value of contingent consideration, unrealized currency gains and losses and other adjustments.

We believe that this presentation provides useful information to management, analysts and investors regarding certain additional financial and business trends relating to its results of operations and financial condition. In addition, management uses this measure for reviewing the financial results of the Company and as a component of performance-based executive compensation.

We do not consider Adjusted EBITDA in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of Adjusted EBITDA is that it excludes certain expenses and income that are required by U.S. GAAP to be recorded in our consolidated financial statements. In addition, Adjusted EBITDA is subject to inherent limitations as this metric reflects the exercise of judgment by management about which expenses and income are excluded or included in determining Adjusted EBITDA. In order to compensate for these limitations, management presents Adjusted EBITDA in connection with GAAP results.

For three months ended August 31, 2023, adjusted EBITDA decreased to $11.4 million compared to $13.5 million from the prior year same period. The decrease was primarily driven by the aforementioned negative impacts to our cannabis gross margin.

Adjusted EBITDA reconciliation:	For the three months ended August 31, 2023	2022	Change 2023 vs. 2022	% Change
Net loss	$ (55,863)	$ (65,794)	$ 9,931	(15)%
Income tax expense	7,264	7,211	53	1%
Interest expense, net	9,835	4,413	5,422	123%
Non-operating income (expense), net	4,402	32,992	(28,590)	(87)%
Amortization	30,789	34,069	(3,280)	(10)%
Stock-based compensation	8,257	9,193	(936)	(10)%
Change in fair value of contingent consideration	(11,107)	211	(11,318)	(5,364)%
Purchase price accounting step-up	5,106	1,107	3,999	361%
Facility start-up and closure costs	600	1,800	(1,200)	(67)%
Lease expense	700	700	—	0%
Litigation costs	2,034	445	1,589	357%
Restructuring costs	915	—	915	NM
Transaction (income) costs	8,502	(12,816)	21,318	(166)%
Adjusted EBITDA	$ 11,434	$ 13,531	$ (2,097)	(15)%

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, net loss. There are a number of limitations related to the use of Adjusted EBITDA as compared to net loss, the closest comparable GAAP measure. Adjusted EBITDA adjusts for the following:

- Non-cash inventory valuation adjustments;
- Non-cash amortization and amortization expenses and, although these are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future;
- Stock-based compensation expenses, a non-cash expense and are an important part of our compensation strategy;
- Non-cash impairment charges, as the charges are not expected to be a recurring business activity;
- Non-cash foreign exchange gains or losses, which accounts for the effect of both realized and unrealized foreign exchange transactions. Unrealized gains or losses represent foreign exchange revaluation of foreign denominated monetary assets and liabilities;
- Non-cash change in fair value of warrant liability;
- Interest expense, net;
- Costs incurred to start up new facilities, and to fund emerging market operations for our German cultivation facilities and Columbian operations. The prior period also included start up costs for SweetWater Colorado and Malta facilities;
- Lease expense, to conform with competitors who report under IFRS;
- Transaction (income) costs, which includes acquisition related income and expenses, related legal, financial advisor and due diligence cost and expenses and transaction related compensation, which vary significantly by transaction and are excluded to evaluate ongoing operating results;
- Restructuring charges;
- Litigation costs includes costs related to legacy and non-operational litigation matters, legal settlements and recoveries;
- Amortization of purchase accounting fair value step-up in inventory value included in costs of goods sold; and
- Current and deferred income tax expenses and recoveries, which could be a significant recurring expense or recovery in our business in the future and reduce or increase cash available to us.

Adjusted Gross Profit and Adjusted Gross Margin

Adjusted gross profit and adjusted gross margin are non-GAAP financial measures and may not be comparable to similar measures presented by other companies. Adjusted gross profit is our Gross profit (adjusted to exclude purchase price accounting valuation step-up) and adjusted gross margin is our Gross margin (adjusted to exclude purchase price accounting valuation step-up) and are non-GAAP financial measures. The Company's management believes that adjusted gross profit and adjusted gross margin are useful to our management to evaluate our business and operations, measure our performance, identify trends affecting our business, project our future performance, and make strategic decisions. We do not consider adjusted gross profit and adjusted gross margin percentage in isolation or as an alternative to financial measures determined in accordance with GAAP.

Liquidity and Capital Resources

We actively manage our cash and investments in order to internally fund operating needs, make scheduled interest and principal payments on our borrowings, and complete acquisitions. We believe that existing cash, cash equivalents, marketable securities and cash generated by operations, together with access to external sources of funds, will be sufficient to meet our domestic and foreign capital needs for a short and long term outlook.

For the Company's short-term liquidity requirements, we are focused on generating positive cash flows from operations and being free cash flow positive. As a result of delays in legalization across multiple markets, management continues to optimize our operating structure, headcount, as well as the elimination of other discretionary operational costs. Some of these actions may be less accretive to our adjusted EBITDA in the short term, however we believe that they will be required for our liquidity aspirations in the near term future. Additionally, the Company continues to invest our excess cash in the short-term in marketable securities which are comprised of U.S. treasury bills and term deposits with major Canadian banks.

For the Company's long-term liquidity requirements, we will be focused on funding operations through profitable organic and inorganic growth through acquisitions. We may need to take on additional debt or equity financing arrangements in order to achieve these ambitions on a long-term basis.

The following table sets forth the major components of our statements of cash flows for the periods presented:

	For the three months ended August 31,	
	2023	**2022**
Net cash provided by (used in) operating activities	$ (15,842)	$ (46,269)
Net cash (used in) investing activities	(26,290)	(1,537)
Net cash (used in) provided by financing activities	14,018	123,620
Effect on cash of foreign currency translation	614	(1,080)
Cash and cash equivalents, beginning of period	206,632	415,909
Cash and cash equivalents, end of period	$ 179,132	$ 490,643
Marketable securities	287,333	-
Less: restricted cash	(1,613)	-
Cash and marketable securities(1)	$ 464,852	$ 490,643

(1) Cash and marketable securities are non-GAAP financial measures. See "Use of Non-GAAP Measures" below for additional discussion regarding these non-GAAP measures. The Company combines the Cash and cash equivalent financial statement line item, and the Marketable securities financial statement line item as an aggregate total as reconciled in the liquidity and capital resource section below. The Company's management believes that this presentation provides useful information to management, analysts and investors regarding certain additional financial and business trends relating to its short-term liquidity position by combing these three GAAP metrics.

Cash flows from operating activities

The change in net cash used in operating activities was ($15.8) million for three months ended August 31, 2023 compared to ($46.3) million for the prior year same period. This decrease in cash used in the three month period was primarily related to improved operating efficiencies and increased management of our working capital requirements.

Cash flows from investing activities

The change in net cash used in investing activities was ($26.3) million for three months ended August 31, 2023 compared to ($1.5) million for the prior year same period, and is a result of investing in marketable securities partially offset by cash acquired from the HEXO Acquisition, Note 6 (Business acquisitions).

Cash flows from financing activities

The change in cash provided by financing activities was $14.0 million for three months ended August 31, 2023 compared to $123.6 million for the prior year same period. In the current period, cash was provided by funds from the overallotment of TLRY 27 Notes and other long term debt, while in the comparative period a larger amount of cash was provided by the ATM capital raise.

Subsequent Events

Refer to Part I, Financial Information, Note 25 *Subsequent Events.*

Contingencies

In addition to the litigation described in the Part II, Item 1 - Legal Proceedings, the Company is and may be a defendant in lawsuits from time to time in the normal course of business. While the results of litigation and claims cannot be predicted with certainty, the Company believes the reasonably possible losses of such matters, individually and in the aggregate, are not material. Additionally, the Company believes the probable final outcome of such matters will not have a material adverse effect on the Company's consolidated results of operations, financial position, cash flows or liquidity.

Critical Accounting Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. The accounting principles we use require us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and amounts of income and expenses during the reporting periods presented. We believe in the quality and reasonableness of our critical accounting policies; however, materially different amounts may be reported under different conditions or using assumptions different from those that we have applied. The accounting estimates that have been identified as critical to our business operations and to understanding the results of our operations pertain to revenue recognition, valuation of inventory, valuation of long-lived assets, goodwill and intangible assets, stock-based compensation and valuation allowances for deferred tax assets. The application of each of these critical accounting policies and estimates is discussed in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of our Annual Report on Form 10-K for the fiscal year ended May 31, 2023.

Recently Issued Accounting Pronouncements

A description of recently issued accounting pronouncements that may potentially impact our financial position and results of operations is disclosed in "Part I, Item 1. Note 1 – Basis of presentation and summary of significant accounting policies" to our financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.