Kerrisdale Capital

September 2023

# Tilray Brands, Inc. (TLRY)

## *The Blunt Truth*

We are short shares of Tilray Brands, a $2.4bn failing Canadian cannabis player running a familiar playbook for unsuccessful businesses trading in the public markets: given structurally unprofitable operations, the company has resorted to ongoing, shameless and massive dilution to stay alive, even as management compensates itself generously while operating metrics further deteriorate. Tilray touts itself as being different from other Canadian cannabis companies which lack positive EBITDA and free cash flow. But the truth is that Tilray is just obscuring losses by issuing shares, instead of recording cash expenses, to one of its largest suppliers. Furthermore, the company's "cannabis adjacent" diversification strategy essentially entails incinerating shareholder capital by overpaying for doomed businesses that will ultimately only deepen the company's losses. Valuation made little sense even before retail investors raced to chase recent buzzy headlines on potential marijuana rescheduling, which may be a boon for U.S. weed companies but does next to nothing for Tilray. Now shares are even more poorly positioned ahead of seemingly endless dilution required to fund operations and refinance convertible debt due to mature in a few weeks.

Tilray is caught in a nonstop dilution cycle. It doesn't generate cash internally, and what cash it has on the balance sheet is largely thanks to dilutive equity offerings. To fund operations and maintain a currency for acquisitions, Tilray must keep its share price from joining the penny stock ranks of many of its cannabis peers. Consequently, in late 2021, as Canadian cannabis industry fundamentals continued to implode, rather than pay amounts owed to a key cannabis operating partner in cash Tilray opted to directly issue the supplier increasing amounts of stock. What began as $24m paid in cash in 2021 morphed into *$100m in stock* paid over the last two years, even as Tilray's stock price fell to new lows. We believe these payments are poorly disclosed and allow Tilray to materially inflate reported EBITDA and free cash flow. We believe shareholders are being intentionally misled; **without these convoluted stock payments, last year Tilray's EBITDA would have been zero and its free cash flow would have been deeply negative (again).**

Tilray's recent participation in a broad rally for U.S. cannabis stocks based on hopes that the DEA will quickly reschedule marijuana ignores crucial differences among weed companies and reflects a misunderstanding of the issue. Cannabis is only 30% of Tilray's total revenue and none is generated from US plant-touching operations. Rescheduling would not legalize the sale of marijuana for anything except FDA-approved drugs in specific forms that have been tested and approved. **None of the touted financial benefits of rescheduling marijuana to Schedule III – potential tax savings, major stock exchange uplisting, implied progress toward SAFE Banking Act – help Tilray.** Contrary to the sharp spike in share price, we are convinced that rescheduling Schedule III would actually be terrible for Tilray. Politicians will now focus on various policy changes that would still not allow Tilray to sell recreational cannabis products in the U.S., much less advance Tilray's goal of using craft beer infrastructure to create THC-infused non-alcoholic beverages, all while lifting the prospects of potential competitors.

To distract investors from the stench of its cannabis business, Tilray has pursued craft beer acquisitions, recently agreeing to buy 8 brands from Anheuser-Busch. Investors cheered the move, but they might not have if management had disclosed that retail sales for **key brands have declined over *20% YTD* and the portfolio has only 10-15% EBITDA margins**.

Once the buzz over declining craft beers, inflated earnings, and misunderstood rescheduling benefits wears off, investors will realize Tilray shares are worth only a fraction of the current price. Our sum-of-parts derived price target is $0.89 (-70%).

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# Executive Summary

**Tilray has a dilution problem.** In a move that both grossly distorts key financial metrics and dilutes shareholders, Tilray funds large, recurring cash obligations to a key cannabis operating partner, Double Diamond Holdings, with increasing amounts of stock. What began as a single $24m cash payment in fiscal 2021 has grown into $100m in stock paid over the last two years. The most recent payment was in June, when Tilray issued shares at an implied price of only $1.61. These payments are never discussed on quarterly calls and their significance appears poorly understood by shareholders. Tilray's ongoing reliance on stock issuance to fund operations is evidenced by a proxy filed last Friday after market close which includes a proposal to increase authorized common shares +22% from 980m to 1,208m. This comes less than a year after the company's Charter was amended (using dubious tactics) to better facilitate more common stock issuance.

**Reported Adjusted EBITDA and free cash flow are materially misleading.** Tilray's shift to paying bills in stock rather than in cash leads to serious disclosure issues and distorted non-GAAP financial metrics. As best as we can determine, (based on Tilray's own opaque disclosures) these non-cash payments made to Double Diamond are added back to adjusted EBITDA and missing from Tilray's definition of free cash flow. The arrangement allows Tilray to promote a stronger financial profile than would be possible if it weren't for this contrivance**.** Strip away accounting gimmicks and other one-time benefits and investors are left with the truth: Tilray's underlying financial performance is not inflecting upward, it's deteriorating, badly.

**Potential Schedule III developments are positive for *U.S. Weed companies*, not Tilray.** The recent spike in Tilray's share price over the DEA's possible rescheduling of marijuana to Schedule III reflects a misunderstanding of potential benefits to the company. First, rescheduling would only legalize the sale of marijuana-based FDA-approved drugs in specific forms that have been tested and approved, and prescribed by a doctor. The main potential financial benefit of rescheduling at this time is tax savings to U.S. cannabis companies. Given that Tilray doesn't have any significant U.S. cannabis operations, tax savings for potential competitors doesn't strike us as a positive for a Canadian player like Tilray. Rather, we think Schedule III is a materially negative development, since it would: 1) improve the financial condition of potential Tilray competitors, 2) focus political attention on policies which still wouldn't allow Tilray to sell recreational products in the U.S., and 3) raise the price tag for whatever late-to-the-party investment in the United States that Tilray would hope to make.

**Acquisition of struggling craft beer brands from ABI lacks strategic clarity.** Management announced its acquisition of brands from Anheuser-Busch without providing virtually any financial details – an obvious red flag. Retail sales for the acquired portfolio have declined at a -6% clip through mid-August, according to Nielson data. This follows a decline of -8.5% in 2022 and -13% in 2021. Sales of the 2nd largest and most profitable brand within the portfolio, Shock Top, are in virtual free fall. Tilray has stated part of the strategic rationale for the acquisition is that it positions the company to sell THC-infused non-alcoholic beverages. But buying struggling brands that require considerable investment in marketing and distribution to stabilize performance, *without* the benefit of ABI's support, is a clumsy way to exploit that opportunity.

**Valuation was silly even before rescheduling buzz. Now shares present a dangerous setup ahead of near-term dilutive refinancing risk.** Shares now trade at 36x heavily manipulated EBITDA and over 3x revenue for an assortment of ex-growth/declining and structurally unprofitable businesses. The pattern of payments to Double Diamond suggests over $40m in stock will soon be paid to the supplier ahead of $127m of convertible notes that mature October 1. The last time a convertible note was refinanced in May, shares cratered -30%.

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# Company Overview

## Capitalization and Financial Summary

| $ Millions, Balances as of May 31, 2023 | |
|---|---|
| TLRY share price | $3.00 |
| | |
| Common shares [3] | 723 |
| Market capitalization | **$2,170** |
| | |
| Cash and cash equivalents [4] | 189 |
| Marketable securities | 242 |
| Total cash and equivalents | **431** |
| | |
| Bank indebtedness (LOCs) | 23 |
| Long-term debt [5] | 206 |
| Convertible debentures | 437 |
| Lease liabiltiies | 10 |
| Total debt | **676** |
| | |
| Net debt | 245 |
| Non-controlling interests | 14 |
| | |
| Adj. enterprise value | **$2,429** |

**Financial Summary ($ mm)**

| **Fiscal year end May 31** | **FY '21PF [1]** | **FY '22A** | **FY '23A [2]** | **FY '24E** |
|---|---|---|---|---|
| **Revenue by segment** | | | | |
| Cannabis (net) | $311 | $238 | $220 | $246 |
| Distribution | 277 | 260 | 259 | 262 |
| Beverage alcohol | 29 | 71 | 95 | 233 |
| Wellness (hemp) | 69 | 60 | 53 | 53 |
| Total revenue | $686 | $628 | $627 | $794 |
| | | | | |
| **Adj gross profit by segment** | | | | |
| Cannabis | 109 | 102 | 110 | 99 |
| *Margin* | *35%* | *43%* | *50%* | *40%* |
| Pharma. distribution | 35 | 24 | 27 | 29 |
| *Margin* | *13%* | *9%* | *11%* | *11%* |
| Beverage alcohol | 16 | 42 | 51 | 112 |
| *Margin* | *56%* | *58%* | *53%* | *48%* |
| Wellness (hemp) | 23 | 18 | 16 | 15 |
| *Margin* | *34%* | *30%* | *29%* | *29%* |
| Total gross profit | 183 | 186 | 204 | 255 |
| *Margin* | *27%* | *30%* | *32%* | *32%* |
| | | | | |
| **Reported adj. EBITDA** | **41** | **48** | **61** | **68** |
| Less: stock-based compensation | (17) | (36) | (40) | (45) |
| **Adj. EBITDA (incl. SBC)** | **23** | **12** | **22** | **23** |
| Less: stock issued to non-controlling interest | - | (29) | (60) | (63) |
| Less: non-recuring HEXO advisory service fee | - | - | (40) | |
| **Kerrisdale Adj. EBITDA (incl. SBC)** | **23** | **(17)** | **(78)** | **(40)** |
| | | | | |
| **Adj. Cash flow (CFO-total capex-payments to NCI)** | **(107)** | **(247)** | **(73)** | **(88)** |
| | | | | |
| **Valuation** | | | | |
| EV / Sales | 3.5x | 3.9x | 3.9x | 3.1x |
| EV / Reported Adj. EBITDA | NM | 50.6x | 39.5x | 35.7x |
| EV / EBITDA (incl. SBC) | NM | 201.6x | 111.0x | 105.2x |

*Source: Kerrisdale analysis.*

1. *FY 2021 PF reflects LTM Feb 2021 pro forma financials as provided by Tilray following merger with Aphria, adjusted for May fiscal year end.*
2. *FY 2023 cannabis net revenue includes $40m in advisory services revenue related to commercial transaction agreement with HEXO Corp, SEC form 10-K for fiscal year ended May 31, 2023, p. 116. FY 2024 assumes acquisition of beer and beverage brands from Anheuser-Busch InBev (ABI) closes September 30, 2023.*
3. *Pro forma 17.1m shares issued to retire $50m HTI convertible note on August 31, 2023. SEC form 8-K filed September 1, 2023.*
4. *Pro forma announced $85m all-cash acquisition of beverage brands from ABI, $22.5m additional TLRY 27 convertible debentures issued June 9, 2023, and $45m in additional Four Twenty loan principal, SEC form 8-K filed September 1, 2023.*
5. *Pro forma $45m in additional Four Twenty loan principal, SEC form 8-K filed September 1, 2023.*

Headquartered in Leamington, Ontario and New York, Tilray Brands (formerly Tilray) is a Delaware-incorporated global diversified CPG company with operations in the medical and recreational cannabis, beverage alcohol, and hemp-based food industries. Tilray is the product of a 2021 merger between two market share leading Canadian cannabis companies, Tilray and Aphria. Tilray was kept as the new company's name and Irwin Simon, 64, formerly Aphria's CEO and chairman, became new Tilray's CEO.

The company has 4 main reporting segments (as shown below with FY24E pro forma contribution to total revenue, Tilray does not disclose EBITDA by segment):

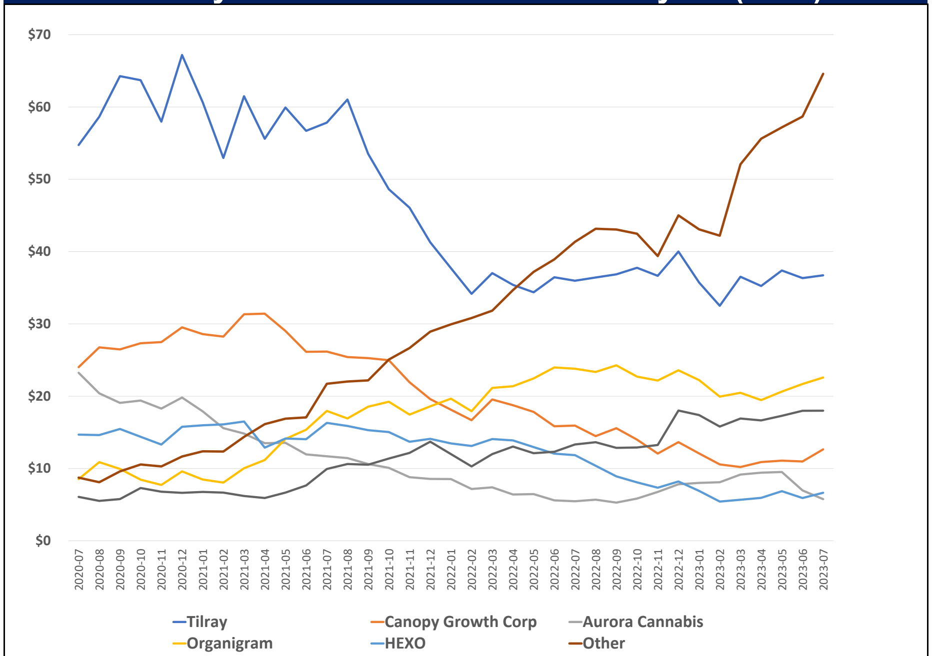
1. *Cannabis (31%): Cultivation, production, distribution, and sale of medical and adult-use cannabis products (flower, vapes, pre-rolls, edibles, etc.)*
2. *Distribution (33%): Purchase and resale of pharmaceutical and wellness products predominantly in Germany through wholly owned CC Pharma GmBH. Gross margins are only ~10% and topline growth is no longer a strategic priority (note: medical cannabis distribution revenue is booked in the cannabis segment).*
3. *Beverage alcohol (30%): Production and sale of craft beer and spirits.*
4. *Wellness (7%): Primarily Manitoba Harvest branded hemp-based foods (acquired in 2019 for $308m for ~4.5x 2020 revenue).Topline performance has been poor since acquisition with sales down -11% in 2023.*

## *Canadian Cannabis Industry*

Despite early promises of a booming industry with endless potential demand, the market for Canadian cannabis Licensed Producers (LPs) has gone bust – if it ever really existed to begin with. MJBizDaily reports that, following Canada's legalization of cannabis for adult-use (*i.e.,* recreational) sales in October 2018, "the largest [cannabis] producers … built out more production capacity than the industry needed. …In fact, cannabis producers in Canada sold less than 20% of their production between legalization in 2018 and the end of 2020."

Tilray has not been immune to the catastrophic miscalculation of anticipated demand. At the time of the merger, Tilray held ~16% retail market share in Canada and a goal of reaching 30% by 2023.

**Monthly Canadian Cannabis Sales by LP (CAD)**




*Source: Hifyre point of sale retail data excluding Quebec. "Other" is all LPs not included in the top 40 by market share.*

As of July, *including* recently consolidated HEXO Corp. (see: Appendix II for details regarding HEXO Corp transaction), Tilray's reported market share was 13%. Intense competition from the growth of new, smaller LPs (approximately 1,000 as of May – the "Other" in the chart above gobbling up share) combined with a still flourishing, price undercutting illicit market (about ~40% of total $11bn market) has resulted in a glut of inventory and severe price compression.

Falling sales combined with high excise taxes and high-cost regulatory burdens have led to steep operating losses, lay-offs and facility closures as many across the industry struggle to stay solvent. Although Tilray reported a decline in cannabis net revenue of -7% in FY 2023, this is skewed by $40m in non-recurring advisory fees (p.46) recorded within Canadian adult-use revenue. On an organic basis, we estimate total cannabis revenue in fiscal 2023 fell *-24%* driven by $33m (-14%) in lost revenue due to price compression (p.44).

## *Beverage Alcohol*

Tilray has a stated ambition to generate $4bn in revenue by fiscal 2024, aided by acquisitions and contingent on U.S. and German federal legalization of cannabis. Of that $4bn, about ~$1 billion has been targeted to come from what management calls "cannabis adjacent" CPG businesses in the U.S., such as beverage alcohol. With the timing of legalization unknown and in need of a pivot, Tilray has expanded aggressively into the beverage alcohol category through acquisitions. Since 2021, Tilray has invested over $545m in craft beers and spirits. Brands include SweetWater Brewing, Montauk Brewing Co., Breckenridge Distillery, and the recently announced acquisition of 8 craft beer and beverage brands from Anheuser-Busch Inbev (ABI) for $85m (anticipated to close by the end of September). According to Nielsen data, retail sales for the portfolio has declined over -6% YTD with some brands (ShockTop, Blue Point) down over -20%. Tilray's reported beverage alcohol business increased by 33% in FY 2023 thanks entirely to acquisitions. On an organic basis, we estimate performance was down low single digits. In addition to providing diversification from a failing cannabis business, management believes acquiring craft beers and spirits have the strategic benefit of branding and infrastructure which can be leveraged for THC-infused non-alcoholic beverages whenever federal legalization finally occurs. Further discussion of trends within the craft beer industry and Tilray's "strategy" for the brands acquired from ABI is provided later in the report.

## *Management History*

Irwin Simon originally joined Aphria in 2018 as Board Chair in the wake of two devastating short-seller reports alleging gross corporate malfeasance, eventually assuming the role of Aphria CEO to help stabilize operations. For shepherding Aphria through the turmoil, Simon was awarded a pay package of $10m in salary and stock options (Aphria management circular, October 15, 2019) and another $10m cash bonus for staying on as CEO of new Tilray through 2022.

Prior to the cannabis industry, Simon founded and ran Hain Celestial Group for 25 years, an organic and natural products company that through 50+ acquisitions/JVs grew to $3 billion in net sales. Simon has stated his "playbook" for building Tilray into a great CPG business is "essentially the same" and many of Tilray's senior executives: COO, CIO, Chief Strategy Officer, and President of Manitoba Health all previously worked at Hain Celestial. We view bragging about re-running Hain Celestial's playbook to be a case of selective memory.

While for a time Hain Celestial was celebrated for its rapid growth as it hoovered up trendy natural and organic products – a year after being named to Fortune's 100 Fastest-Growing Companies, it became clear Hain Celestial had amassed an unwieldy, complex collection of underperforming brands with declining organic sales in an intensely competitive industry. Simon's final two years were characterized by execution misses, filing delays, an SEC investigation into accounting errors, earnings releases with over a dozen adjustments to EBITDA, executive departures, shareholder gripes about bloated executive compensation, and a share price at multi-year lows. Some of these should sound strikingly familiar to Tilray shareholders.

### *Aphria Diamond Joint Venture*

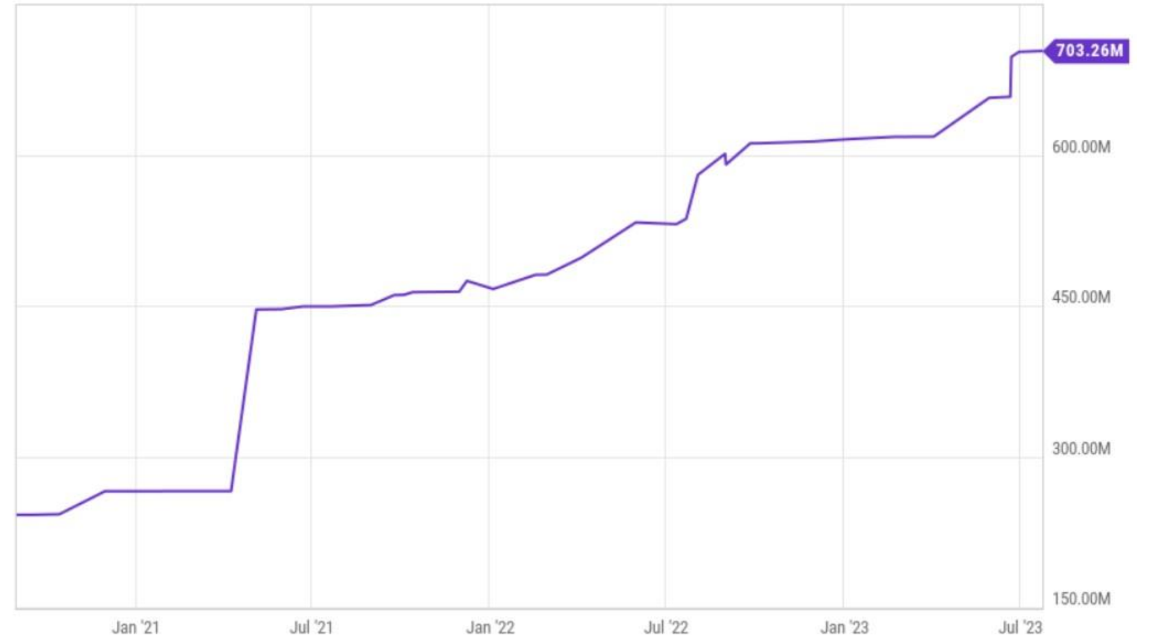
Aphria Diamond is of critical importance to understanding Tilray's consolidated financials. Aphria Diamond is a joint venture between 51% majority owner Aphria Inc. (now wholly owned by Tilray) and greenhouse operator Double Diamond Holdings. Double Diamond is engaged in the cultivation of cannabis in Leamington, Ontario. Double Diamond is run by twin brothers Chris and Benji Mastronardi, part of a sprawling network of Mastronardis (some with colorful backgrounds) that have grown produce in Leamington for generations. Aphria Diamond reported $161m in revenue in 2023 making it a crucial component of Tilray's cannabis operations and consolidated financials despite it not being wholly owned.

As far as responsibilities within the JV, Double Diamond supplies the land, state-of-the art 1.5m square foot greenhouse, and employees while Aphria supplies "Standard Operating Procedures and quality oversight." Aphria Diamond's sole customer is Tilray. According to Aphria, the cannabis coming from Aphria Diamond moves on a wholesale basis to Tilray, which takes that product, does all of the packaging, branding, product format conversion and then sells them into the market. Based on these descriptions, we believe Double Diamond (with Chris Mastronardi as CEO) runs daily operations and incurs the cash expenses necessary to grow cannabis on an industrial scale.

## Caught in Endless Dilution

Along with executive compensation, seemingly endless dilution is a particularly sensitive subject among Tilray's retail shareholders. Rightly so. Since the close of the Aphria-Tilray merger in April 2021, shares outstanding have increased by over 250m, or by more than 50%. Despite nearly an estimated ~$800m worth of stock dilution and multiple acquisitions, reported EBITDA (after deducting for an egregious ~$40m in stock-based compensation) has seen little improvement. Given upcoming maturities and recurring cash obligations to Double Diamond (more on this shortly), dilution is about to ratchet up again very shortly. Unsurprisingly, after market close last Friday (September 15), Tilray filed a proxy statement ahead of its November annual stockholder's meeting which includes a proposal to increase the authorized number of common shares 22% from 980m to 1,208m (p.57).

**Shares Outstanding**




*Source: ycharts.com. Shares outstanding are 723m as of September 15, 2023, p.57.*

The problem Tilray has been unable to solve is how to sustain and grow core operations without issuing stock. Long gone are the days when a company like Tilray could access the credit markets at cheap rates to cover its cash burn while pursuing a roll-up story. The company's desperate attempts to pivot from a failed cannabis business through acquisitions are certainly hampered by its meagre access to credit. Acquiring quality growth businesses which don't require significant investment is expensive, and absent a federal legalization miracle (which Schedule III falls far short of), acquisition targets are unlikely to accept Tilray's overvalued stock as currency. Even for a challenged, declining set of businesses like the ABI craft beer portfolio, ABI was apparently unwilling to accept Tilray stock as payment. HEXO was acquired using Tilray stock – but HEXO had few alternatives as it hurtled toward insolvency.

So that leaves cash to acquire businesses. But Tilray doesn't have *that* much cash (~$400m post ABI deal) and Tilray doesn't generate cash internally. What cash it does have is largely thanks to a $400m at-the-market equity offering. Simon's only option, therefore, is to find creative ways to conserve cash without drawing the ire of shareholders wary of dilution, while also trying to acquire challenged businesses it can promote as being attractive, for cheap (cue: the ABI craft beer portfolio).

This is not a recipe for long-term shareholder value creation. It's a recipe for constant dilution, tall tales about making craft beer cool again and, as we will now explain, materially misleading and aggressive accounting tricks.

# High Finance: Misrepresenting Profitability by Directly Issuing Stock to Key Cannabis Supplier

**2022 Annual General Meeting of Stockholders of Tilray Brands, November 11, 2022**

> **Berrin Noorata, Tilray Brands – Chief Corporate Affairs Officer**
>
> *Thank you. Our third and last question.* ***Are you ever going to stop diluting shares?***
>
> **Irwin D. Simon, Tilray Brands – President, CEO & Chairman**
>
> *So again, I know the sensitivity on this here. I, again, as a large shareholder myself, dilution of shares is something that I am absolutely against. And* ***increasing your shares or using your shares for accretive acquisitions*** *to do the right things for shareholders that enhances shareholder value is what our plan is.*
>
> *I understand in the industry there's been* ***a lot of cannabis companies that have come out there and used their shares and diluted their shares to fund operations and growth. And being cash flow positive, having the balance sheet that we have, [that] is not our intention to do. If we are to issue shares, it will be for growth opportunities that are accretive to the Tilray shareholders.*** *[emphasis added]*

Tilray management frequently attempts to differentiate itself from cannabis industry peers that have diluted shareholders to fund operations by referencing positive EBITDA, positive free cash flow, and having an "industry-leading" balance sheet.

We believe management has made misleading statements in all respects. Tilray has avoided reporting negative cash flow because it directly funds its cash obligations to a critical cannabis supplier, Double Diamond, using material amounts of stock – an unusual arrangement that circumvents the company's definition of free cash flow while also flattering reported adjusted EBITDA.

Just weeks after stating no intention to dilute shares to fund operations at the 2022 annual stockholders meeting (quoted above), Tilray issued $9m worth of stock to fund cash amounts owed to Double Diamond (p.62). This marked the third time it issued stock to Double Diamond that year, part of $60m paid 100% in stock to the minority operating partner in fiscal 2023 and $100m since late 2021.

## *Issuing More and More Stock as Canadian Cannabis Market and Share Price Collapses*

**Summary of Recurring Payments to Double Diamond**

| Date | Amt. Paid to Double Diamond ($) | Shares Issued | Implied Price per share |
|---|---|---|---|
| 6/30/3023 | $8,057,622 | 5,004,735 | $1.61 |
| 2/21/2023 (1) | $6,648,304 | 2,328,739 | $2.85 |
| 12/5/2022 | $9,264,250 | 1,979,541 | $4.68 |
| 9/1/2022 | $39,049,959 | 10,276,305 | $3.80 |
| 6/30/2022 | $5,063,709 | 1,529,821 | $3.31 |
| 10/14/2021 | $28,560,000 | 2,677,596 | $10.67 |
| | $7,484,000 | Cash | |
| Fiscal 2021 | $23,895,000 | Cash | |
| | | | |
| Total payments (cash+stock) | $128,022,844 | | |
| **Total stock issued** | **$96,643,844** | **23,796,737** | |
| | | | |
| **Shares issued in:** | | | |
| YTD FY 2024 | **$8,057,622** | **5,004,735** | |
| FY 2023 | **$60,026,222** | **16,114,406** | |
| FY 2022 | **$28,560,000** | **2,677,596** | |
| FY 2021 | **0** | **0** | |

*Source: Kerrisdale analysis. TLRY SEC Form 10-K for FY 2023 and FY 2022. For further information on the accounting for these stock payments, please see Appendix III.*

1. *At this time, Tilray also issued Double Diamond 120,000 shares of super-voting Series A preferred stock. This was done to help obtain enough shareholder votes to collapse Tilray's dual class share structure, improving the ability to issue more common stock (see: Appendix IV – Rigging the Vote).*

Over the last three years, as Tilray has moved production from other facilities in Canada to Double Diamond amid collapsing cannabis profitability, the company has made increasingly large, recurring payments *in stock* to the greenhouse operator. Crucially, what began as $24m all in cash in fiscal 2021, grew to $36m in a mixture of cash and stock in fiscal 2022, to last year ballooning to over $60m *all* in stock (FY 2023 10-K, p. 42 and FY 2022 10-K, p. 99). The payments have continued into the current fiscal year, with $8m in stock issued at an implied price per share of only $1.61 in June.

In addition to changes in size and payment mix, the past two years have seen a change in timing. In 2022, Tilray issued 2.7m shares in a single transaction (October 2021). For fiscal 2023 this apparently changed to regular quarterly payments beginning in June 2022, with an additional supersized annual payment in calendar 3Q. Last September that annual payment was *$39m*, triggering the issuance of 10.2m shares.

The pattern suggests that, any day now, over $40m in stock will be paid to Double Diamond (~13m shares issued at the prevailing stock price). Combined with 17m issued two weeks ago to retire $50m in HTI convertible notes, this Fall has already been a busy season of dilution ahead of $127m of TLRY 23 convertible notes that mature October 1. The last time a convertible note was refinanced in May, shares cratered 30% because investors reacted negatively to 38m shares issued to convertible bond investors for hedging purposes.

We found some sell side commentary which described the May stock price decline as an overreaction given the technically modest level of dilution (~6%) to be missing the point because: 1) The cost of capital for Tilray to raise just $150m of convertible notes, done in theory to avoid outright dilution…still required the issuance of $91m in stock because institutions will only lend money to Tilray if there is virtually zero risk, 2) the dilution was “modest” only because of *non-stop* dilution leading up to that point. It’s like saying it shouldn’t matter too much that 6 more banks were robbed because 100 have already been hit. The point is whether to address maturities (after the TLRY 23s, $137m of TLRY 24s come due in 9 months) or come up with ways to flatter reported financials (more on that soon), Tilray can’t seem to stop diluting shareholders.

## *Payment Mechanics Obscure the Nature and Intent of Stock Issuance*

Simon can pitch dilution to already frustrated shareholders for the sake of growth, but endless dilution to sustain profitless cannabis operations is problematic. Consequently, while Tilray cannot (legally) avoid disclosure of the payments, there is an incentive to not be as fully transparent about them either. We believe the full nature and intent of the transactions are not well disclosed, and, based on comments from Tilray’s investor base, not well understood. We have found zero mention of these stock issuances to Double Diamond in any earnings call transcript. These payments are ongoing (the most recent was in June) and not made to retire long-term debt (even though the presence of a promissory note lends it that appearance). These payments are also not going toward consolidation of the entity as ownership percentages in quarterly and annual SEC filings have never changed.

Here Is a step-by-step guide of the roundabout way Tilray pays Double Diamond, using last September as an example:

| | |
|---|---|
| **Step One:** | 1974568 Ontario Limited (the legal name for the Aphria Diamond JV) issues two promissory notes (one for the quarterly amount owed and a separate one for the annual amount) acknowledging that Double Diamond is owed *a lot* of money ($39m combined) for "value received"<br><br>**PROMISSORY NOTE**<br>**NON INTEREST-BEARING DEMAND**<br>Amount: USD $30,585,819.60 Due: On Demand<br><br>**FOR VALUE RECEIVED** the undersigned, 1974568 Ontario Limited (the "**Corporation**"), acknowledges itself indebted to and unconditionally promises to pay to the order of Double Diamond Holdings Ltd. (the "**Shareholder**"), the principal amount of USD $30,585,819.60 without interest, ON DEMAND.<br><br>**PROMISSORY NOTE**<br>**NON INTEREST-BEARING DEMAND**<br>Amount: USD $8,464,139.70 Due: On Demand<br><br>**FOR VALUE RECEIVED** the undersigned, 1974568 Ontario Limited (the "**Corporation**"), acknowledges itself indebted to and unconditionally promises to pay to the order of Double Diamond Holdings Ltd. (the "**Shareholder**"), the principal amount of USD $8,464,139.70 without interest, ON DEMAND. |
| **Step Two:** | Tilray then assumes / is assigned the notes issued by Aphria Diamond (Tilray the ParentCo with a liquid stock will take care of paying the bill, not the JV). Even though the amount owed is clearly denominated in cash, Tilray and Double Diamond agree to settle payment with 10,276,305 shares of common stock. Why would a cannabis grower accept being paid in risky stock…?<br><br>EXHIBIT 10.1<br>**ASSIGNMENT AND ASSUMPTION AGREEMENT**<br><br>THIS ASSIGNMENT AND ASSUMPTION AGREEMENT (this "**Agreement**") is entered into as of September 1, 2022, by and between Tilray Brands, Inc., a Delaware corporation ("**Assignee**"), and Double Diamond Holdings Ltd., an Ontario corporation ("**Assignor**").<br><br>**WHEREAS**, Assignor owns: (i) a promissory note issued by 1974568 Ontario Limited ("**Aphria Diamond**") in favour of the Assignor in the amount of USD $8,464,139.73 (the "**Quarterly Note**") and (ii) a promissory note issued by Aphria Diamond in favour of the Assignor in the amount of USD $30,585,819.60 (the "**Annual Note**", and together with the Quarterly Note, the "**Promissory Notes**"); and<br><br>**WHEREAS**, Assignor desires to assign and transfer to Assignee the Promissory Notes in exchange for 10,276,305 shares of class 2 common stock of the Assignee (the "**Tilray Shares**"); |
| **Step Three:** | Because Tilray immediately files a registration statement ensuring Double Diamond can ~~dump~~ sell all its freshly received shares on the open market.<br><br>**10,276,305 Shares**<br>**Tilray Brands, Inc.**<br>**Class 2 Common Stock**<br><br>This prospectus supplement supplements our prospectus dated September 10, 2019, and registers the resale of an aggregate of 10,276,305 shares of our Class 2 common stock, par value $0.0001 per share ("Common Stock"), held by the selling stockholder identified herein. The selling stockholder acquired these shares of Common Stock from us on September 1, 2022 in connection with the assignment from the selling stockholder to us of certain promissory notes payable by 1974568 Ontario Limited, an Ontario corporation. The selling stockholder (which term as used herein includes its donees and pledgees, transferees or other successors in interest) may sell these shares through public or private transactions at market prices prevailing at the time of sale, at prices related to such market prices, at varying prices determined at the time of sale, at fixed prices or at negotiated<br><br>**This prospectus supplement is dated September 1, 2022** |

Note: all three steps, from issuing the IOUs to registering Double Diamond's shares for resale, take place on the *exact same day* – September 1, 2022. Tilray has taken these steps each time it has paid Double Diamond in stock, issuing $100m worth of stock over the past two years.

We (and multiple auditors and forensic accountants we have consulted with) believe the payment arrangement is unnecessarily complicated by design and shareholders concerned over dilution should be troubled by the potential for (further) abuse and conflicts of interest. For example, despite Tilray having adequate cash on its balance sheet, this past June the company still paid Double Diamond $8m in stock, when shares traded at only $1.60. The implication is that Tilray cares so little about diluting shareholders that settlement of rising Double Diamond related cash obligations will continue to be met with further dilution, no matter how low the stock goes. Keep in mind, Double Diamond does not assume market risk when its bills are paid in stock, Tilray immediately registers the stock for resale – it is only *every other* Tilray shareholder who is left holding the bag.

Tilray and Double Diamond should be engaged in an arm's length business relationship but it's hard to see how they aren't in cahoots. Last February, in addition to being issued $6m in common stock, Double Diamond was issued 120,000 preferred shares with *1,000 to 1* super-voting rights (seriously) for the sole purpose of securing enough votes to amend the company's charter in a way that would facilitate the issuance of yet more common stock. In other words, by concocting a way to give a non-wholly owned cannabis farm *120m votes,* Tilray gained greater flexibility to pay the farmers yet more stock (see: Appendix IV – Rigging the Vote for more detail).

## Puffed-Up Profits

When Tilray last reported earnings, it proudly stated it had grown adjusted EBITDA +28% y/y to $61m, narrowly exceeding the low end of its (previously lowered) guidance range, and posting a surprising inflection to (barely) positive adjusted free cash flow. These results helped launch shares *50%* in the week that followed.

As detailed earlier, in FY 2023, Tilray paid $60m to Double Diamond entirely in stock. The 2023 10-K states amounts to settle outstanding notes with non-controlling interest shareholders is included in "Other non-operating (losses) gains, net" within Non-operating (expense) income. It looks ridiculous but after multiple consultations with a forensic accountant and a senior auditor, taken as presented, this strongly implies $60m in stock settlements is buried in a poorly disclosed $(7.9m) line item. Tilray's definition of adjusted EBITDA adds back the entirety of $(66m) in non-operating expense meaning Tilray's heavily adjusted EBITDA of $61m is bogus**.** **If it weren't for Tilray's clever way of having shareholders *directly* foot the bill, adjusted EBITDA would have been zero.**

## Double Diamond payments are buried in Other non-operating (losses)… and added back to Adj. EBITDA

**19. Stockholders' equity**

c) 16,114,406 shares to settle amounts owed to the non-controlling shareholders of Aphria Diamond in the amount of $60,062.

**26. Non-operating (expense) income**

Non-operating (expense) income is comprised of:

| | For the year ended May 31, 2023 | 2022 | 2021 |
|---|---|---|---|
| Change in fair value of convertible debenture payable | $ (43,651) | $ 163,670 | $ (170,453) |
| Change in fair value of warrant liability | 12,438 | 63,913 | 1,234 |
| Foreign exchange loss | (25,535) | (28,383) | (22,347) |
| Loss on long-term investments | (2,190) | (6,737) | (2,352) |
| Other non-operating (losses) gains, net | (7,971) | 5,208 | 9,080 |
| | $ (66,909) | $ 197,671 | $ (184,838) |

Other non-operating (losses) gains, net for the year ended May 31, 2023, includes amounts to settle outstanding notes with non-controlling interest shareholders.

| Adjusted EBITDA reconciliation: | 2023 |
|---|---|
| Net (loss) income | $(1,443,000) |
| Income tax benefits, net | (7,181) |
| Interest expense, net | 13,587 |
| Non-operating income (expense), net | 66,909 |
| Amortization | 130,149 |
| Stock-based compensation | 39,595 |
| Change in fair value of contingent consideration | 855 |
| Impairments | 934,000 |
| Other than temporary change in fair value of convertible notes receivable | 246,330 |
| Inventory valuation adjustments | 55,000 |
| Purchase price accounting step-up | 4,482 |
| Facility start-up and closure costs | 7,600 |
| Lease expense | 2,800 |
| Litigation (recovery) costs | (505) |
| Restructuring costs | 9,245 |
| Transaction costs | 1,613 |
| Adjusted EBITDA | $ 61,479 |

"Amounts to settle outstanding notes with non-controlling interest shareholders" is a term in the FY '23 10-K found only in reference to the non-controlling shareholders of Aphria Diamond (i.e., Double Diamond) which totaled $60m in stock in FY 2023 (p.101 of 10-K). This description above misleadingly omits the large dollar amount buried in "Other non-operating (losses) gains, net."

*Source: SEC form 10-K for fiscal year end May 31, 2023, p.62 and p.108.*

Tilray's already puny achievement of $1.3m in adjusted free cash flow is also not at all what it seems. First, the result is heavily distorted by a large $42m working capital benefit in fiscal 4Q as Tilray ran down prepaid expenses while extending payables and liabilities (classic unsustainable financial distress behavior). Defined as essentially cash flow from operations less net maintenance capex, Tilray's adjusted free cash flow does not capture these material recurring stock payments to Double Diamond. Tilray's "positive" adjusted free cash flow does not represent an inflection to sustainable cash generation, nor capture the true underlying cash resources needed to run its business – it's financial gimmickry.

Strip away what Tilray management pays itself in stock (now *equal* to total FY 2021 EBITDA), $40m in non-recurring HEXO advisory fees in 2023, and what it pays Double Diamond in stock to fund would-be cash outflow, and only now does a more fulsome picture of Tilray's reported "growing" EBITDA and "positive" cash become clear.

**Adj. EBITDA and FCF Without Accounting Tricks and One-time Benefits**

| Fiscal year end May 31 | FY '21A | FY '22A | FY '23A |
|---|---|---|---|
| **Reported EBITDA** | **41** | **48** | **61** |
| Less: stock-based compensation | (17) | (36) | (40) |
| **Adj. EBITDA (incl. SBC)** | **23** | **12** | **22** |
| Less: stock issued to Double Diamond | - | (29) | (60) |
| Less: non-recuring HEXO advisory service fee | - | - | (40) |
| **Kerrisdale Adjusted EBITDA** | **23** | **(17)** | **(78)** |
| **Reported FCF** | **(77)** | **(188)** | **1** |
| Less: cash and stock issued to Double Diamond | (25) | (36) | (60) |
| Less: non-recuring HEXO advisory service fee | - | - | (40) |
| **Kerrisdale Adjusted FCF** | **(102)** | **(224)** | **(99)** |

*Source: Kerrisdale analysis, TLRY SEC Form 10-K for fiscal year ended May 31, 2023 and earnings press release, July 26, 2023.*
*Note: Accounting proficient observers would also be correct to point out that company reported EBITDA should deduct 49% of Aphria Diamond net income ($48m in FY23) to show proportionate EBITDA available to TLRY shareholders.*

## Slow Your Roll: Schedule III Might be Great for *U.S.* Weed Companies, but it's a Setback for Tilray

Despite already being grossly overvalued, Tilray's stock price has risen 40% in just the last two weeks. The move reflects premature optimism that HHS's non-binding recommendation to re-schedule cannabis as a Schedule III controlled substance may soon lead the federal government to nationally legalize cannabis for recreational purposes. Consequently (so the thinking goes), Tilray may soon be allowed to manufacture, import, distribute and sell its Canadian-produced pre-rolls, its THC-infused gummy bears, and even – at long last – realize its dream of cornering the market for THC-infused non-alcoholic bourbon. The current mini-bubble in cannabis stocks with U.S. operations reflects market enthusiasm for these recent regulatory developments. But *Tilray's* participation in this rally makes absolutely no sense. Investors who mindlessly lump Tilray in with U.S. cannabis MSO (multi-state operator) stocks ignore numerous critical differences. Most significantly, none of Tilray's plant-touching cannabis operations are located in the United States and thus none of the potential financial ripple effects of rescheduling benefit Tilray at all. In their haste to chase buzzy headlines, we think traders and investors in Tilray stock have made a serious mistake.

A quick review: Although many U.S. states have recently legalized the sale of domestically grown cannabis for medical and/or recreational use, the federal government has not. Pursuant to the Controlled Substance Act and Controlled Substances Import and Export Act (CSA), growing, selling, possessing and/or using cannabis (classified as Schedule I substance, along with LSD and heroin) remains illegal under federal law. Federal legalization of cannabis in the U.S. (and in Europe) has evolved more slowly than cannabis industry participants had initially hoped, with many now believing U.S. federal legalization is so hopelessly stalled it will be another 10 years before meaningful progress is made, if it is ever made at all.

Since his election, President Biden has been under considerable pressure from more progressive, liberal voters to legalize cannabis at the federal level. Accordingly, in October 2022, President Biden instructed the Department of Health and Human Services (HHS) and the Attorney General "to review expeditiously how marijuana is scheduled under federal law" and make recommendations to the DEA, which has final authority. HHS diligently obeyed Biden's order and "expeditiously" provided its recommendation eleven months later. For the first time in memory, HHS's recommendation to the DEA was leaked. On August 30, 2023, news outlets reported that HHS had recommended that the DEA reschedule cannabis from Schedule I to Schedule III. HHS's rescheduling recommendation attracted enormous attention because, historically, HHS and the FDA had not recommended moving cannabis from Schedule I. Experts, would-be experts, and average pot users were universally excited. The news was hailed as "one of the biggest and long-awaited changes to hit the industry," "a game-changer for the industry," and cannabis users.

The DEA has had plenty of practice reviewing the scheduling of cannabis under the CSA; it did so in 2011, 2015, 2016, and 2018. Each time, the DEA categorically rejected proposals to reschedule cannabis or de-schedule it entirely (which would take cannabis out of the DEA's purview). DEA will now conduct its own review based on its own criteria, with timing on a decision still uncertain. We've encountered references to a 90-day deadline within which the DEA must act on HHS's recommendation, but this is based on a misreading of the CSA, nothing in substantive or procedural federal statutes obligates an executive agency to propose or finalize rulemaking on any rigid schedule.

Schedule III drugs are still considered "controlled substances" with some potential for abuse and addiction. Examples of Schedule III substances include testosterone, anabolic steroids and ketamine. Schedule III drugs require a prescription from a medially licensed doctor and are not sold OTC. As explained by law firm McGlinchey Stafford, "rescheduling marijuana under the CSA **would not legalize the sale of marijuana for recreational use**, nor would it legalize marijuana products – such as flower, edibles, vapor products, topicals, **or anything besides FDA-approved drugs in specific forms that have been tested and approved."** [emphasis added].

Rather than building momentum toward more positive regulatory change for Tilray, we believe the consequence of rescheduling will be to distract lawmakers from the question of legalization, perhaps indefinitely. Reclassifying cannabis from Schedule I to Schedule III – but leaving it a "controlled substance" that is not legal for recreational use – may be a strikingly savvy political move, as it placates progressive voters without antagonizing conservatives. However, it does *nothing* to advance Tilray's goal of seeing its cannabis-lifestyle CPG products on U.S. store shelves.

The main potential financial benefit at this time is if reclassified as a Schedule III substance, U.S. cannabis businesses would no longer be subject to IRC § 280E of the Internal Revenue Code, providing meaningful tax savings to an industry that desperately could use help turning a profit. The problem for Tilray stockholders is: Tilray doesn't have any exposure to U.S. cannabis operations that benefit from this change (other than its investment in crippled MedMen Enterprises – see Appendix II for more detail). For Tilray, Schedule III and time spent anchored on it is therefore a terrible outcome – it will: 1) expend political capital on policy that falls well short of legalization, 2) leaves Tilray still unable to sell recreational products in the U.S., 3) potentially improves the profitability of U.S. cannabis producers and MSOs, i.e., Tilray's *potential competitors*, and 4) raises the price tag for any effort to buy into the industry.

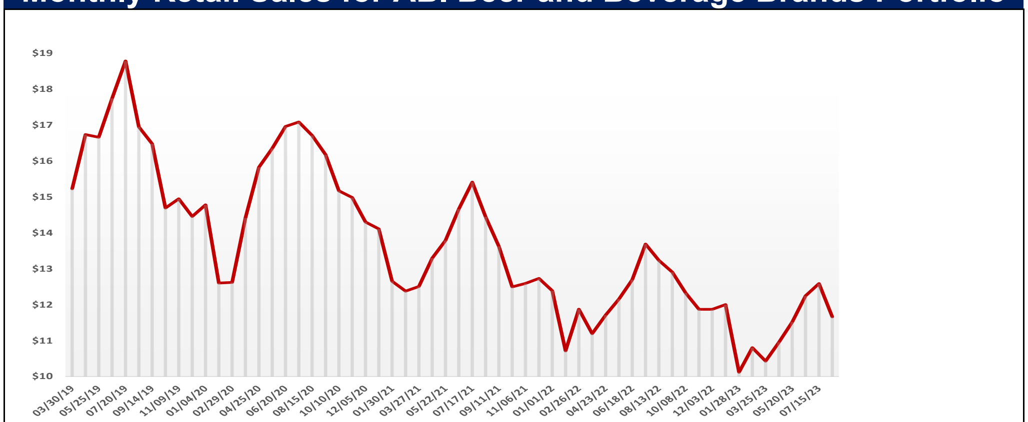
## Brewing Trouble

> *"Tilray still hasn't gotten their core business right…they've ballooned to this massive, obese piece of [business] that needs to really move quickly because they have way too much capacity for what they will sell, so they need to fix that…In the meantime they're out buying craft beer… I think the one thing they really lack is this really tight focus on 'what is our actual strategy?' I think they have way too much going on…* ***I don't think you'll get anybody in the industry outside of Tilray who thinks what they're doing is right****…it just feels that they don't settle enough and they're in this perpetual integration and that's dangerous." [emphasis added]*
>
> — Veteran industry consultant, former manager at two large Canadian LPs

> *"He's a deal junkie. He just buys things to buy things. I don't know if he is strategically doing anything… HEXO was going to go under. If he hadn't bought it, he would have had to write down the debt and lose the consulting fee and had no way to mask it. Now he will move the goal post when the fees don't come in anymore, flip it and talk about craft beer."*
>
> — Cannabis industry senior executive

Craft beer is ironically rather similar to cannabis: a heavily regulated, low moat, market saturated, distribution challenged, declining revenue, low margin business that will add complexity and distraction to Tilray's already bloated operations. Perhaps that's why when Tilray announced its acquisition of 8 beer brands from ABI, it neglected to provide financial details that would allow investors to fully assess the transaction. The main financial disclosures provided in the press release state that the company's pro forma revenue contribution from craft beer is projected to be $250m and the transaction will be "accretive to EBITDA." One then has to check the footnotes to see that pro forma revenue is based on *last year's* revenue for the acquired brands and it's unclear whether "accretive" means EBITDA positive or higher margins than Tilray's current business (or whether the accretion is pre- or post- synergies). The biggest red flag, however, is Simon neglected to provide any substantive answers to questions on revenue trends within the portfolio, gross or EBITDA margins, and what level of investment would be required to improve profitability.

**Monthly Retail Sales for ABI Beer and Beverage Brands Portfolio**




*Source: NielsenIQ retail data through August 12, 2023.*

According to multiple former ABI executives we interviewed who had direct insight into the performance of the brands acquired, the recently acquired portfolio is far from set up "extremely well", as Simon claimed on the August 7 conference call discussing the transaction.

**Retail Sales for Acquired ABI Beer and Beverage Brands**

| | 2019 | 2020 | 2021 | 2022 | YTD 2023 |
|---|---|---|---|---|---|
| $ Sales in MM | | | | | |
| BLUE POINT BREWING COMPANY | 12.2 | 12.8 | 12.1 | 11.0 | 5.1 |
| BRECKENRIDGE | 14.1 | 17.5 | 18.1 | 17.4 | 8.5 |
| 10 BARREL BREWING CO. | 31.3 | 39.8 | 38.0 | 36.6 | 23.7 |
| REDHOOK | 24.0 | 23.5 | 23.0 | 24.0 | 15.9 |
| SHOCK TOP | 67.5 | 52.6 | 35.6 | 28.5 | 14.2 |
| SQUARE MILE CIDER CO. | 2.7 | 3.3 | 2.5 | 3.2 | 3.7 |
| WIDMER BROTHERS | 30.6 | 30.6 | 28.1 | 24.4 | 13.7 |
| HI BALL | 23.1 | 16.8 | 14.7 | 11.6 | 5.1 |
| **Total ABI portfolio** | **205.6** | **196.8** | **172.2** | **156.6** | **90.1** |

| | | | | |
|---|---|---|---|---|
| YoY Growth | | | | |
| BLUE POINT BREWING COMPANY | *4.8%* | *-4.9%* | *-9.5%* | *-28.5%* |
| BRECKENRIDGE | *23.7%* | *3.5%* | *-4.1%* | *-11.3%* |
| 10 BARREL BREWING CO. | *27.0%* | *-4.4%* | *-3.8%* | *7.2%* |
| REDHOOK | *-2.2%* | *-2.0%* | *4.1%* | *11.3%* |
| SHOCK TOP | *-22.0%* | *-32.4%* | *-19.8%* | *-22.2%* |
| SQUARE MILE CIDER CO. | *23.0%* | *-23.2%* | *26.7%* | *133.8%* |
| WIDMER BROTHERS | *0.0%* | *-8.2%* | *-13.1%* | *-11.6%* |
| HIBALL | *-27.6%* | *-12.1%* | *-21.4%* | *-30.6%* |
| **Total ABI Portfolio** | ***-4.3%*** | ***-12.5%*** | ***-9.1%*** | ***-6.2%*** |

*Source: NielsenIQ retail data through August 12, 2023.*

According to data from Nielsen (which doesn't capture on-premise taproom sales but we believe are still analytically relevant), retail sales for the acquired portfolio declined at a worrisome -6% clip through mid-August of this year. This follows a decline of -9% in 2022 and -13% in 2021. Sales of the 2nd largest brand within the portfolio, Shock Top, are in virtual free fall. Shock Top is a light Belgian wheat beer with citrus notes that like most beer sales is seasonally strongest during summer months. This past summer (3 months ended August 12), Shock Top retail sales fell -22% y/y. Monthly sales are now down a whopping -70% from pre-pandemic levels. This performance is particularly alarming because according to former ABI executives interviewed, Shock Top is *by far* the most profitable brand within the group since it isn't a true craft beer in the first place – it's brewed in ABI industrial breweries with a similar base recipe as Budweiser and therefore enjoys better gross margins than the rest of the portfolio.

On the transaction conference call, Simon waxed on about Blue Point winning numerous brewing awards and Breckenridge Brewery being one of the leading craft brands in Colorado, but what he failed to mention is *Blue Point's and Breckenridge's retail sales are down -28% and -11% YTD*, respectively. 5 out of the 8 brands being acquired have posted double digit YTD declines against already weak comps.

The portfolio's poor performance is driven by secular shifts in consumer preference and the category's declining strategic importance within ABI. As a percentage of alcohol consumption, beer has lost consistent share to spirits and wine for decades. Craft beers had previously been a much-needed bright spot within the broader beer industry (which is why ABI went on a buying spree in 2011 beginning with Goose Island) but after years of attractive growth, the craft beer industry has become mature and saturated with competitive offerings. Craft beer dollars and case sales fell in 2022 and recent data from the Brewers Association showed the market falling

-2% in 1H23. Popular craft beer festivals in Breckenridge, Colorado and Portland, Oregon – states where Tilray just expanded its craft beer presence – were cancelled this past year in part due to declining interest.

## *Anheuser-Busch Failed with Craft Beer. So Will Tilray.*

Tilray management has talked about "expanding distribution significantly" to boost sales but this strategy is problematic for several reasons. For one, ABI, which hardly lacks distribution or marketing muscle, already tried this strategy with many of the very brands Tilray just acquired, and failed. ABI found that trying to expand 10 Barrel from Portland into California and Colorado, or trying to sell Blue Point away from the tri-state area, simply didn't work – the brands did not resonate with consumers outside of local/regional markets. The value of a craft beer brand lies within its special connection to its local roots. Why would brands that suffered backlash after being sold to a large corporation such as Anheuser-Busch suddenly find going national easier because they are now owned by a multi-billion dollar Canadian weed company? Outside a few early success stories, a "national" craft beer is almost a contradiction in terms. According to a recent Slate article on the challenges confronting the craft beer industry, increasing competition from these "beyond beer" alternatives, in addition to a crowded field of smaller, more agile micro-breweries, is precisely why the worst place to be within the craft beer landscape is in the middle ground of regional/national breweries, i.e., where Tilray apparently thinks it's prudent to expand.

According to multiple former ABI executives we spoke with, topline challenges combined with a persistent inability to improve margins burdened by limited scale, raw material inflation, and competitive pricing resulted in the pulling of managerial and marketing support for the acquired brands. According to the ABI formers, EBITDA margins for the portfolio are only ~10-15%, well below broader beer industry averages of 30%-40%, with some brands (Square Mile, Blue Point) having little to no EBITDA margin at all. This means the ABI brands will likely begin life within Tilray as a significant drag on current beverage alcohol segment profitability.

While renewed focus under Tilray ownership may help, driving sustained improvement in financial performance will be, as one former ABI executive put it, "a long shot" requiring considerable time and investment. One major challenge will be negotiating with distributors. The acquired brands all presently benefit from ABI's near unrivaled reach and leverage with local/regional distributors. We were advised that whenever Tilray now approaches major distributors, without ABI support or any sales data that indicates booming interest in these beers, it will have a hard time negotiating favorable economics. Tilray will have to give on margin, supply its own salesforce, and spend its own marketing dollars to ensure successful distribution. These actions will only further reduce profitability, which is why we suspect Tilray declined to explain why the acquisition did not result in an automatic raise to FY 2024 EBITDA guidance on the M&A call.

## *Buying Craft Beer Breweries for Distribution of Non-Alcoholic THC Infused Beverages Makes Little Sense*

Tilray has stated part of the strategic rationale for acquiring craft beer brands and distribution scale is that it better positions the company to "hit the ground running" and sell THC-infused beverages, whenever U.S. federal legalization of cannabis finally occurs. It sounds reasonable but the thesis doesn't hold up for several reasons. The so-called "free option" of leveraging the attributes of cannabis adjacent brands and infrastructure for THC businesses is: 1) not free because the businesses are declining and will require additional investment, 2) the timing and nature of legalization is entirely unknown, 3) while Tilray is prohibited from utilizing its acquired assets to what it believes is their fullest use, the rest of the market will not be standing still and will only grow more competitive, 4) Simon is not always precise in promoting "beer and bourbons and that would be infused with THC" but to dispel any confusion, for numerous regulatory reasons THC cannot be infused into what the vast majority of craft beer and spirit drinkers enjoy in their drink of choice: alcohol, and 5) creating flanker brand versions of non-alcoholic THC products which attempt to parlay off the so-called iconic status of the brand risks diluting the value of the brand itself.

## Valuation

We view price targets that apply an EV / sales multiple on consolidated sales as lazy and fail to capture the disparate margin characteristics of Tilray's individual businesses. Applying the same multiple to both a severely challenged cannabis segment at 40% gross margins and a low growth (non-medical marijuana) pharmaceutical distribution segment with 10% gross margins is nonsensical. It is equally silly to assign revenue multiples for Tilray's craft beer focused beverage alcohol segment consistent with the best run global diversified beer and spirit companies. Tilray has acquired its way into a grab bag of businesses that should be valued on a sum-of-parts basis. Rather than rewarding Tilray's complexity and uncertain outlook with a single multiple or assumption-riddled DCF that doesn't capture ongoing dilution, we use a sum-of-parts to value Tilray using the following assumptions (see: Appendix I – Trading Comparables):

1. *Given impediments to generating cash flow (without resorting to accounting tricks) and U.S. federal legalization potentially a decade away, we value the cannabis operations at 1x revenue, in-line with the median of comps. Note, Canopy Growth's multiple is distorted by significant leverage and unlike Tilray has exposure to U.S. operations through various investments.*
2. *We mark the beverage alcohol business segment at Tilray's acquisition cost, which we believe is generous given the decline in market valuations since the acquisitions, the broad decline in the craft beer sector, and lack of significant change in financial performance since being acquired.*
3. *We mark the CC Pharma pharmaceutical business at cost as topline growth is not a strategic priority of this extremely low margin business.*
4. *We value Manitoba Health at 1.5x sales, in-line with other plant-based food companies.*
5. *Shares outstanding pro forma for recent/near-term dilution as described earlier in the report.*

Our resulting price target is $0.89 (-70%).

| Sum-of-Parts Valuation | |
|---|---|
| Cannabis | $246 |
| Beverage alcohol: | 545 |
| ABI portfolio | 85 |
| SweetWater | 300 |
| Montauk Brewery | 45 |
| Breckenridge Distillery | 109 |
| Green Flash and Alpine | 5 |
| Wellness (Manitoba Harvest) | 84 |
| Distribution (CC Pharma) | 52 |
| Total enterprise value | **$927** |
| | |
| Adjusted enterprise value | $927 |
| Less: net debt | (245) |
| Equity value | $682 |
| Shares outstanding | 764 |
| Implied share price | $0.89 |
| Discount to current | -70% |

*Source: Kerrisdale analysis.*

## Conclusion

The common refrain we heard during our research was exemplified by a quote from one industry veteran: "Tilray doesn't have a real strategy." Whether it were individuals familiar with Simon from his Hain Celestial days, veteran Canadian cannabis consultants, beer distribution professionals, et. al., no one we spoke with seemed to think the path Tilray is on makes much sense in terms of diversification targets or allocation of capital resources. Only if the objective is to be bigger (and more complicated), not better, does the strategy even loosely hang together. When we reviewed what we have laid out in the report as evidence of misrepresented financial performance with a cannabis industry peer, we didn't encounter surprise that there have been shenanigans… we encountered confirmation of pre-existing suspicions. Tilray shares may trade on any given day on retail sentiment and news flow about rescheduling or legalization but nothing within the investable horizon will change an overvalued stock being ground down by lack of organic growth and dilution.

# Appendix I: Trading Comparables

**Tilray Business Segment Trading Comparables**

| Cannabis LPs | | | EV / Sales | | EV / EBITDA | |
|---|---|---|---|---|---|---|
| | Mkt. Cap. | TEV | 2023E | 2024E | 2023E | 2024E |
| Aurora Cannabis | $379 | $544 | 2.0x | 1.8x | 46.0x | 18.8x |
| Canopy Growth | $989 | $1,813 | 4.3x | 4.1x | NM | NM |
| Cronos Group | $911 | $70 | 0.9x | 0.7x | NM | NM |
| Decibel Cannibis (CAD) | $70 | $115 | 0.9x | 0.8x | 3.8x | 3.0x |
| OrganiGram | $147 | $146 | 0.9x | 0.9x | 15.0x | 10.6x |
| Village Farms Intl. | $111 | $170 | 0.6x | 0.6x | 22.3x | 18.2x |
| | | **Mean** | 1.8x | 1.7x | 21.6x | 10.8x |
| | | **Median** | 0.9x | 0.9x | 15.0x | 10.6x |

| Beverage Alcohol | | | EV / Sales | | EV / EBITDA | |
|---|---|---|---|---|---|---|
| | Mkt. Cap. | TEV | 2023E | 2024E | 2023E | 2024E |
| Boston Beer Co. | $4,546 | $4,388 | 2.2x | 2.1x | 21.2x | 17.0x |
| Constellation Brands | $47,727 | $60,214 | 6.0x | 5.6x | 16.3x | 14.8x |
| Molson Coors | $13,748 | $19,874 | 1.7x | 1.7x | 8.6x | 8.6x |
| Anheuser-Busch Co. | $114,835 | $199,976 | 3.3x | 3.1x | 9.7x | 9.0x |
| Heineken | $52,186 | $69,320 | 2.3x | 2.1x | 10.6x | 9.5x |
| | | **Mean** | 3.1x | 2.9x | 13.3x | 11.8x |
| | | **Median** | 2.3x | 2.1x | 10.6x | 9.5x |

| Specialty Foods | | | EV / Sales | | EV / EBITDA | |
|---|---|---|---|---|---|---|
| | Mkt. Cap. | TEV | 2023E | 2024E | 2023E | 2024E |
| Oatly Group | $617 | $904 | 1.1x | 1.0x | NM | NM |
| Beyond Meat | $666 | $1,672 | 4.6x | 4.3x | NM | NM |
| Benson Hill | $106 | $207 | 0.5x | 0.5x | NM | NM |
| Nomad Foods | $2,698 | $4,347 | 1.4x | 1.4x | 8.2x | 7.7x |
| SunOpta | $461 | $909 | 1.0x | 0.9x | 10.3x | 8.4x |
| Hain Celestial | $894 | $1,770 | 1.0x | 0.9x | 11.0x | 10.3x |
| | | **Mean** | 1.6x | 1.5x | 9.8x | 8.8x |
| | | **Median** | 1.1x | 1.0x | 10.3x | 8.4x |

*Source: Kerrisdale analysis, Bloomberg consensus estimates.*

# Appendix II: HEXO and MedMen – Burning Shareholder Capital

### *HEXO Corp.*

In October 2021, failing Canadian cannabis licensed producer HEXO Corp. issued a "going concern" warning as excessive leverage and liquidity risks mounted. In July 2022, Tilray acquired all outstanding senior secured convertible notes issued by HEXO Corp to HTI Investments MA LLC (an affiliate of Hudson Bay Capital Management). The purchase price of $157m was satisfied with 33m Tilray common stock and a new $50m 4.00% convertible promissory note due September 1, 2023 (repaid last Friday through the issuance of 17.1m shares). In addition to various commercial agreements, Tilray structured a deal with HEXO which resulted in $40m in advisory fees in FY 2023 (p.46).

In June, Tilray exercised its HEXO convertible note and issued an additional 40m shares to complete the acquisition of all outstanding HEXO shares. Including $7.7m in interest income from the convertible note, Tilray earned $48m from the transaction ($40m in advisory services it essentially paid itself plus the interest) which exceeded an internally set target of $40m to be earned 1 year following the HEXO note deal. As reward for achieving this performance target, Simon received 1.4m in stock options with additional smaller amounts awarded to other members of the executive team. With HEXO now consolidated, $40m in high margin advisory services fees are non-recurring, which Tilray has stated will be offset in part by $25m in cost synergies on an annualized basis. All told, Tilray will have issued ~90m+ shares to purchase a company headed for bankruptcy with negative cash flow saw and sales plummeting -50% in the 3-month period ended April.

### *MedMen Enterprises*

In August 2021, Tilray issued $118m worth of stock to purchase $166m of senior secured convertible notes and related warrants issued by MedMen Enterprises Inc, a nationwide cannabis retailer in the U.S. (p.90). A key equity conversion "triggering event" in the convertible notes is federal legalization (notably, *not* just a rescheduling of marijuana to Schedule III which does nothing for Tilray's recreational use products). Once regarded as a "cannabis darling," financial performance has been a debacle. In May 2023, MedMen disclosed it had made numerous accounting errors and previous audited financials should not be relied upon. In June, MedMen's CFO resigned and a month later MedMen's interim CEO was replaced with Ellen Harrison, 62, who worked with Simon in various executive C-suite roles at Hain Celestial from 1996 to 2019. In May (less than 2 years after acquiring the interest), Tilray booked an $118m impairment charge on MedMen, essentially writing off the entire value of the stock issued to purchase the stake.

# Appendix III: Accounting for Double Diamond

In fiscal 2021, when payments were made in all cash, the amounts paid to Double Diamond were captured on the cash flow statement as "Amounts paid to non-controlling interest" (p.78). Over the last three years, as the price of Canadian cannabis fell and profitability across the industry collapsed, Tilray turned to issuing large amounts of stock to pay Double Diamond and the accounting line item changed to "dividends" paid to non-controlling interest (p.15). The effect of this change meant that if one were to examine the cash flow statement, it appears that payments to non-controlling interests have been eliminated… when in fact, the opposite is true, they've increased significantly but just not in cash. According to a forensic accountant we consulted with, Tilray's disclosures on these payments are lacking. A supplemental statement disclosing all non-cash investing and financing transactions should be provided at the bottom of the statement of cash flows.

**Payments to Double Diamond Have Increased Significantly… Just Not in Cash**

| | For the year ended May 31, 2023 | 2022 | 2021 |
|---|---|---|---|
| **Cash provided by (used in) financing activities:** | | | |
| Share capital issued, net of cash issuance costs | 129,593 | 262,509 | 102,550 |
| Proceeds from warrants and options exercised | — | 5,403 | 144 |
| Shares effectively repurchased for employee withholding tax | (1,189) | (8,686) | — |
| Proceeds from convertible debentures issuance | 145,052 | — | — |
| Repayment of convertible debentures | (187,394) | (88,026) | — |
| Proceeds from long-term debt | 1,288 | — | 102,798 |
| Repayment of long-term debt | (21,336) | (40,254) | (64,559) |
| Repayment of lease liabilities | (1,114) | (4,672) | (1,058) |
| Net increase in bank indebtedness | 5,258 | 9,406 | 8,328 |
| Dividend paid to NCI | — | (7,484) | (23,895) |
| Net cash provided by financing activities | 70,158 | 128,196 | 124,308 |
| Effect of foreign exchange on cash and cash equivalents | (2,230) | (1,958) | 2,124 |
| Net (decrease) increase in cash and cash equivalents | (209,277) | (72,557) | 127,820 |
| Cash and cash equivalents, beginning of period | 415,909 | 488,466 | 360,646 |
| **Cash and cash equivalents, end of period** | $ 206,632 | $ 415,909 | $ 488,466 |

*Source: TLRY SEC form 10-K for fiscal year end May 31, 2023.*
*Note: for the avoidance of doubt, the $129m listed as share capital issued is related to Tilray's ATM equity program, not payments to the non-controlling shareholders of Aphria Diamond (p.101).*

## Appendix IV: Rigging the Vote

Getting Tilray's heavily retail shareholder base to vote for proposals isn't easy. In 2021, when an increase in the share authorization was needed to close the combination with Tilray, Simon stated, "It's hard to get those shareholders to show up and vote. You know, nobody has home phones anymore. No one answers their cellphone to an unknown number. When you mail a proxy to someone's house or apartment, it goes in the garbage."

Indeed, the next time Tilray needed shareholder votes to eliminate super-voting stock and create more (regular) common stock to issue if it needs to, it took three tries and the help of another unusual arrangement with Double Diamond. Tilray issued 120,000 preferred shares to Double Diamond which gave the entity 1,000-to-1 voting rights (i.e., an extra 120 million votes), that could only be used when voting on the proposed changes to the company's share structure. After voting, the preferred shares converted back to ordinary shares. Simon justified this issuance to Double Diamond by stating, "[It] would ultimately help execute our strategic plan by facilitating accretive acquisitions." The maneuver worked and 233m Class 1 stock with super voting rights and 747m Class 2 common stock became a single (easier to dilute) pool of 980m authorized common shares. In short, a key beneficiary of the new share structure, Double Diamond, was gifted an enormous number of votes for the express purpose of approving a Charter amendment providing Tilray greater flexibility to continue issuing the operating partner more stock.

# Appendix V: Lack of Alignment with Shareholder Interests

> *"When you see overcompensation, it's usually indicative of failure in other areas. Compensation is oversight. It's a picture window into the boardroom because it's such an important issue."*
>
> — Charles Elson, director of the John L. Weinberg Center for Corporate Governance

In a reddit AMA from May, CFO Merton tried to assuage shareholder annoyance over whether executives have enough "skin in the game" by referencing 9.3m shares held by "section 16 executives" but this included ~6.5m from *former* CEO Brendan Kennedy who retired from the Board in 2022 and sat on no board committees. Simon owns *a third* of what the *ex*-CEO of legacy Tilray owned as of November 2022. Senior executives Simon, CFO Merton, Chief Strategy Officer Faltischek and COO Meiers now collectively own just under ~3m shares (see table below), equal to .4% of 720m shares outstanding. To date, management has admirably not sold what shares they own, but they haven't bought any either. Simon, who is a *very* wealthy individual, received a 7% base salary increase to $1.8m for fiscal 2023 (p.42) despite *abysmal* stock price performance in 2022. In 2021, Simon was paid a one-time $10m *cash* "Transformation Bonus" in August 2021 for his role in the Tilray-Aphria merger and agreeing to stay on as CEO.

Tilray's executive pay practices and shareholder anger over them bear striking resemblance to the conditions which surrounded/presaged the accounting failures during Simon's previous tenure at Hain.

**Board and Executive Officer Stock Ownership**

| Holder Name | Position | Filing Date | % Out | Source |
|---|---|---|---|---|
| Simon Irwin David | 1,979,358 | 7/31/2023 | 0.27% | Form 4 |
| Merton Carl A | 430,325 | 7/31/2023 | 0.06% | Form 4 |
| Faltischek Denise M | 283,269 | 7/31/2023 | 0.04% | Form 4 |
| Meiers James R | 137,954 | 9/19/2022 | 0.02% | Proxy |
| Gendel Mitchell S | 183,196 | 7/31/2023 | 0.03% | Form 4 |
| Looney Thomas | 81,332 | 7/26/2023 | 0.01% | Form 4 |
| Persofsky Renah | 61,467 | 7/26/2023 | 0.01% | Form 4 |
| Hopkinson David | 77,793 | 7/26/2023 | 0.01% | Form 4 |
| Herhalt John M | 49,057 | 7/26/2023 | 0.01% | Form 4 |
| Clanachan David F | 46,007 | 7/26/2023 | 0.01% | Form 4 |
| Butts Jodi | 46,007 | 7/26/2023 | 0.01% | Form 4 |
| Robb Walter | 15,314 | 9/26/2022 | 0.00% | Proxy |
| **Total** | **3,391,079** | | **0.47%** | |
| Kennedy Brendan (ex-CEO) | 6,459,136 | 11/7/2022 | 0.90% | Form 4 |

*Source: CapitalIQ.*

All of the preceding may lead investors to ponder just how much management cares whether the equity performs well. They should also examine the nature of the performance-based stock awards. The most recent proxy statement only describes the granting of awards upon meeting undisclosed net revenue, adjusted EBITDA, and realization of synergies targets. Importantly, there is no mention of awards based on per share metrics, organic growth, or return on invested capital. In our experience, this type of compensation structure leads to short-termism, as initiatives that contribute to sustaining growth are neglected (*a la* Hain Celestial), in favor of risky, suboptimal use of shareholder capital (MadMen, HEXO, never-ending stock payments to Double Diamond).

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