Glass House Brands Inc.

First Quarter 2023 Investor Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Glass House Brands First Quarter 2023 Investor Call.

I would now like to turn the conference over to Mr. John Brebeck, Glass House Brands' Vice President of Investor Relations. Please go ahead, sir.

John Brebeck — Vice President, Investor Relations, Glass House Brands Inc.

Thank you, Jenny (phon). I'd like to welcome everyone to the Glass House Brands First Quarter 2023 conference call for the three-month period ending March 31, 2023.

Listeners are reminded that certain matters discussed in today's conference call, or answers that may be given to the questions asked, could constitute forward-looking statements that are subject to the risks and uncertainties relating to Glass House Brands' future financial or business performance. Actual results could differ materially from those anticipated in those forward-looking statements. The risk factors that may affect results are detailed in Glass House Brands' periodic filings and registration statement. These documents may be accessed via the SEDAR database.

I'd like to remind everyone that this call is being recorded today, Monday, May 15, 2023.

And I would now like to introduce Mr. Kyle Kazan, Co-founder, Chairman, and Chief Executive Officer of Glass House Brands.

Hey, Kyle, over to you.

Kyle Kazan — Co-founder, Chairman & Chief Executive Officer, Glass House Brands Inc.

Thank you, John. Good afternoon, everyone, and thank you for joining us for today's call.

In the first quarter of this year, we achieved free cash flow-positive operations one quarter ahead of schedule. This has been our goal since we purchased our first farm at Casitas in Santa Barbara, and I can't emphasize enough what an important achievement this is to Graham and me and, of course, to our entire Glass House family.

So much so, in fact, that I'm honoured to be the one to announce this publicly. This achievement would not have been possible without the loyalty, confidence, and support of our shareholders, including those of you who trusted us with your money in the early days of private equity partnerships, all the way up to those who invested in us as a public company and, of course, our debt providers, who took a chance on a fledgling cannabis company with a unicorn asset, our SoCal farm.

This quarter's performance signals that we have crossed a critical threshold in our operations, one that will hopefully lead to increasingly stronger cash flow generation in the months and in the years ahead.

To put this all in context, California is the largest, most well-educated cannabis market in the world with the most discerning consumers and is the recognized home of cannabis. We've long felt that the hard work it would take to succeed in such a competitive and challenging market would be worth the payoff, and now we are closer than ever before. While much hard work lays ahead, we feel like we have just opened the door to even greater opportunities and that the best lies ahead.

To boot, this was accomplished with unique challenges that no other industry has ever faced in the United States: federal prohibition, 280E making many expenses nondeductible, vastly more expensive fundraising in both equity and debt, and the wild swings of an industry in the largest and most competitive market in the United States, a market which has caused many to question whether it is worth competing in. To us, the answer has been a resounding yes.

None of this would have been possible without our amazing team at Glass House Brands. So I'd like to give a special shout-out to my teammates. Thank you for your continued hard work and commitment to excellence.

Our business momentum has remained very strong in 2023, and we hit several major milestones in the first quarter that bolster our confidence in the outlook for 2023 and even more for the longer term.

In the first quarter of 2023, we exceeded our production, revenue, and margin guidance and narrowed our adjusted EBITDA loss to $149,000, versus a $2.6 million loss in the fourth quarter. And we did all this at a time when industry conditions and the overall macroeconomic environment were and remain incredibly challenging.

Collectively, our performance in the first quarter of 2023 continues to demonstrate that our unique business model has significant competitive advantages that we are just beginning to unlock, which will lead to tremendous growth in future revenues and profitability, along with driving sustainable value for shareholders.

Our entire team has been energized by our recent decision to retrofit and begin operations at a second greenhouse on our SoCal farm. It will accelerate our growth trajectory and have a significantly positive impact on long-term profitability, along with further solidifying our strong competitive position.

When you combine our attainment of positive free cash flow with the powerful cash flow generation potential we are now unlocking at our SoCal farm, you can see the power of our financial flywheel starting to take hold.

As I shared with you on the fourth quarter earnings call, we have yet to hit our first anniversary of harvest and sale of SoCal's farm cultivation, and less than 20 percent of capacity is currently growing cannabis, yet we are already generating cash-on-cash rates of return in excess of 20 percent.

The Phase 2 expansion will cost an estimated $10 million and will enable us to increase biomass production by approximately 250,000 pounds annually, or by 80 percent when fully utilized.

This translates into $72.5 million of incremental revenue annually and over $31 million of gross profit, if we simply use our average selling price and margin figures from the first quarter, which we believe are conservative.

Making the SoCal farm the sole focus of our future growth is deeply rooted in our disciplined capital allocation strategy. When you think about the powerful underlying economics of the SoCal farm, there are few other investment opportunities that offer such a high potential risk-adjusted rate of return; certainly not in the cannabis space, and I would contend the same is true relative to opportunities across the broader investment landscape today.

It would be irresponsible of us as managers and owners—remember, our interests are aligned with our shareholders, as we are also significant owners of Glass House Brands' equity, just like you—to not put the Southern Cal farm as a top investment priority for the foreseeable future.

Other factors that support the timing of our Phase 2 expansion include, the current environment of favourable supply-demand dynamics, and our proven operational expertise. The continued uptrend in cannabis pricing is a key indicator that supply-demand conditions are strongly in the favour of cost-competitive producers such as Glass House.

Moreover, given the high probability of additional capacity falling out of the market, there is clearly a tailwind in our favour since we have the lowest cost of production and a long runway of expansion of massive scale ahead of us.

In terms of operational expertise, one only needs to look at our consolidated wholesale biomass gross margins.

Our consolidated gross margin has improved from 17 percent in the first quarter last year, before the booking of any costs from our SoCal farm, to over 40 percent in the first quarter this year.

Our wholesale biomass gross margin went from negative 8 percent in the first quarter of 2022 to positive 43 percent in the first quarter of this year.

While we were always confident that we would prove to be one of the strongest operators in the industry, the pace and trajectory of our margin improvement over the past three to four quarters has surpassed even our initial expectations, and we're just getting started.

To recap, Phase 2 of our SoCal farm expansion is expected to cost approximately $10 million, will increase our current capacity by 80 percent, and should produce over $30 million of gross profit annually.

Phase 1 and Phase 2 together should be able to generate annual revenue of more than $150 million at full capacity, and adjusted EBITDA margins in excess of 30 percent, which we expect to enable us to fund future rounds of investment in the SoCal farm with internally generated cash flow and drive even higher rates of return, accelerating our production and financial flywheel by growing more amazing cannabis, which will drive value for shareholders.

It should be noted that after we complete and turn on the latest expansion, we will only be utilizing approximately 40 percent of our SoCal facility, leaving considerably more room for further expansion of our cash flow generation capability.

I'll now move on to the highlights from our first quarter operating performance.

We had another solid quarter at our SoCal farm, and our total production increased 188 percent year over year to over 48,000 pounds of wholesale biomass, which was ahead of our guidance. As a reminder, first quarter is the seasonal low point, which is why our production was down from the fourth quarter, as we anticipated.

Given the difficult weather conditions during the period, we are very pleased with our performance, and it heightens our level of confidence in achieving our production guidance for the year.

Additionally, the higher-than-expected pricing trends in the first quarter provide us with optimism on the pricing outlook for the rest of the year.

I'm very pleased with our first quarter results, including total revenue of $29 million, which was up 108 percent versus last year and above the top end of our guidance, with all three of our lines of business delivering year-over-year growth.

Wholesale revenues increased by over 180 percent and accounted for the majority of the year-over-year increase, reflecting higher production, as well as improved pricing.

Average selling price for wholesale biomass was $290 in the first quarter, up 54 percent versus last year and up 23 percent compared to the fourth quarter.

Retail revenue nearly doubled, driven by unit growth, including the Farmacy locations we opened in Isla Vista in late December, and Santa Ynez in January.

Gross margin was again a major positive and provides a strong indicator of our future profitability and free cash flow generation potential.

Our consolidated gross margin of 41 percent was up from 17 percent a year ago and 9 percentage points above the fourth quarter.

And similar to revenues, we drove year-over-year improvement in gross margin in each of our business segments.

Wholesale gross margin was in line with the fourth quarter despite the seasonal drop in volume and was aided by improved pricing and year-over-year reduction in production costs as we further optimized performance at our SoCal farm.

Our Retail gross margin benefitted from the shift in excise tax collection, and a strong recovery in CPG gross margin reflected our disciplined approach to managing this business in what continues to be a challenging operating environment.

We are optimistic about future pricing trends, based on the latest results in our business, as well as what we are seeing across the industry in California relative to capacity and licensing renewals.

We estimate that from June 2022 through the end of April, licensed California cultivation capacity has fallen by more than 16 million square feet of canopy, representing about a 21 percent reduction in acreage under cultivation, which is about four times the fully built-out capacity of our SoCal farm.

For additional perspective, 16 million square feet is roughly 17 times the size of our existing cultivation canopy of 959,000 square feet, which partially explains why our Wholesale business and biomass finished goods inventory level has consistently remained about one week since the beginning of the year.

Five hundred and twenty-three cultivation licences are up for renewal in May and another one thousand and seventy-five in June, meaning that one in four active licences in California are up for renewal in the next 60 days.

An underappreciated fact is that, as of January 1, 2023, provisional cultivation licences cannot be renewed for operators that have a total canopy exceeding 22,000 square feet. Almost 50 percent of all outstanding licences are provisional, which we estimate is roughly 30 million square feet of cultivation.

By the end of this year, many of these licences will need to be converted to annual licences, which have higher hurdles than provisional licences, one of these being the need to meet CEQA requirements. For those outside of California who have never heard of CEQA or its formal name, the

California Environmental Quality Act, it is a major hurdle to development, given the expense, reporting, and vulnerability to challenges of the individual projects in court.

It is our understanding that many of these provisional licence holders will have a difficult path to qualify. In Monterey County, for example, only about 10 percent of the farms had converted as of the end of March, and in Mendocino County, only 1.5 percent had converted.

This is not an issue for Glass House. All of our licences have made the challenging transition and are now fully converted to annual.

In summary, we've continued to execute well against our strategic priorities in the first quarter of this year, driving significant growth and hitting several key profitability milestones, including reaching positive free cash flow and nearly achieving break-even adjusted EBITDA a full quarter earlier than expected. We are consistently demonstrating the durable competitive advantage of our vertically integrated model.

Before I hand over to Mark, I'd like to once again extend a warm invitation to all shareholders to join Glass House Brands' Investor Sesh 2023, where investors can tour our unicorn greenhouse facility, ask questions directly to Graham and me, along with the rest of our talented C-suite, and join our annual general shareholder meeting. There will be exclusive merchandise and Glass House Brands products, food, and investor relations booth.

I look forward to personally welcoming our shareholders to the event again this year. It will be held on Friday, June 23rd from 9 a.m. to 4 p.m. Pacific Time.

Transparency is a key part of our name and our culture, which is reflected by our desire to personally meet and provide tours to anyone amongst our loyal investor base. Please join us in Southern California if you can.

With that, I'll turn the call over to Mark Vendetti, our Chief Financial Officer, to discuss our financial results for the quarter in detail, following which, Co-founder and President Graham Farrar, Mark, and I will take your questions. Mark?

Well, I'm not hearing Mark on the call.

Mark Vendetti — Chief Financial Officer, Glass House Brands Inc.

I apologize for that. Thanks, Kyle, and good afternoon, everyone. As a reminder, the results I'm sharing will be filed today. They can be found in our financial statements and MD&A, which are reported in US dollars and prepared in US GAAP.

Total revenue for the first quarter of 2023 was $29 million, at the high end of our Q1 guidance of $27 million to $29 million. This represents 108 percent growth versus last year, driven by strong gains in all three segments.

Wholesale biomass revenues of $14.5 million were up 182 percent year on year, and down 7 percent quarter on quarter, reflecting the normal seasonality of our business.

We produced 48,000 pounds and sold nearly 50,000 pounds in the first quarter, up 188 percent and 179 percent respectively from the same period last year.

Price per pound, blended across flower, smalls, and trim, reached $290 per pound, which was above our guidance of $275, and was up 54 percent versus a year ago and up 23 percent compared to the fourth quarter.

As a reminder, the cultivation tax was eliminated effective July 1, 2022. For ease of comparison and to ensure consistency, we have removed the impact of cultivation tax on both revenue and cost of sales from prior periods.

Moving on to the California market, data from Headset shows the retail environment for the California market remained challenging in the first quarter, with total market sales down 8 percent versus Q1 last year.

Flower sales declined 17 percent year on year, while pre-rolls substantially outperformed the market, rising 4 percent. Flower plus pre-rolls, combined, were down 11 percent year over year in Q1. Vape and edibles were both flat, year over year, continuing to outperform the overall market. And on a sequential basis, overall California market sales fell 4 percent in Q1.

In addition to challenging industry dynamics, we feel the first quarter continued to be negatively impacted by macro factors, particularly, inflation pressure and consumer behaviour.

Despite the decline in retail sales, total market demand remained steady. Unit volume declined 1 percent versus Q4, but was up 3 percent from last year. This is indicative of the extremely competitive CPG market, which has resulted in declining retail prices.

Moving on to Retail for the first quarter, where our total footprint encompassed nine locations under three different banners.

We have five Farmacy dispensaries, including three that have been open all of 2022, one in Isla Vista that opened in mid-December, and one in Santa Ynez that opened in the first half of January.

Our four other locations include The Pottery dispensary and three Natural Healing Center locations, all of which were acquired during Q3 of last year.

For Q2 earnings, our retail footprint will include 10 dispensaries. The NHC Turlock store opened in late April.

First quarter retail sales were $9.4 million, up 93 percent year over year, primarily reflecting the addition of new retail locations since the first quarter of 2022.

Looking forward, 2023 retail sales should continue to show strong year-over-year growth, with the contribution of the seven dispensaries we've added since Q3 '22.

Turning to our CPG business, first quarter sales were $5.2 million, up 30 percent year on year, and down 13 percent sequentially, ahead of our guidance of down 20 percent sequentially.

The retail credit environment continues to be very challenging, but we're able to navigate this better than anticipated. We expect retail will remain credit-challenged for the remainder of the year.

Discounting is still higher than we'd like to see, but has remained relatively stable over the past six months and has significantly improved from a year ago. During Q1, discounts as a percent of gross sales was 21 percent, up slightly from 19 percent in Q4, but well below the 42 percent we experienced in Q1 2022.

Moving to gross margins, we continue to be very pleased with our progress. Consolidated gross margin in the first quarter of 2023 was $12 million or 41 percent of revenue versus $2.3 million or 17 percent of revenue in the first quarter of 2022. This is 9 percentage points above Q4 and the highest gross margin percent since Q2 2021, the last quarter before wholesale prices began their large decline.

Importantly, gross margin in each of our three business lines showed improvement on a year-over-year basis. The Wholesale biomass gross margin was 43 percent, matching the Q4 level, and the highest since Q2 of 2021, when the average selling price was $341 per pound or 18 percent above first quarter 2023.

The increase in average selling price helped offset the seasonal increase in cost of production, which increased from $127 per pound in Q4 to $196 per pound in Q1. However, this was better than our guidance of $200, and 18 percent better than Q1 last year.

Retail gross margin in the first quarter was 52 percent, up 10 percentage points sequentially, and 9 percentage points year over year. The increase was in line with expectations and driven by the change in collection of excise tax discussed on our last call.

Please note the first excise tax payment from retailers was due to the state May 1st. We made our payment, and we'll monitor this closely to see how this impacts retailers.

This also provided a one-time benefit to our first quarter cash of approximately $1 million because we collected excise tax but did not have to make the payment within the quarter.

And CPG gross margin was 18 percent, up 33 percentage points sequentially, and up 2 percentage points year over year.

Recall our fourth quarter was negatively impacted by several one-time items related to the PLUS relaunch and heavy discounting related to the Allswell launch.

In addition, we fully implemented a disciplined sales and operating process that tightly links the sales and production forecast at the item level to ensure we have the right inventory levels and tightly control our aged inventory.

General and admin expenses were $11.4 million for the first quarter compared to $13.9 million in Q4. The $2.5 million reduction was primarily attributable to a $2 million reduction in stock-based compensation.

No new grants were given in the first quarter compared to the fourth quarter, which contained several year-end adjustments. We expect this number to increase in subsequent quarters.

The remainder is due to a reduction in bad debt expense. In Q4 '22, we incurred bad debt expense of $0.6 million related to PLUS receivables from the acquisition.

Sales and marketing expense were $700,000, down 25 percent year over year and 24 percent sequentially, as we continue to be choiceful about where we invest in marketing.

Professional fees were $1.5 million, down 42 percent year on year, and down 20 percent from Q4 2022.

We have significantly reduced our reliance on outside legal and consulting resources over the last six months, and we will continue to look for areas where we can further reduce our expenses, both in professional fees and general and admin expenses. Our plan all along has been to limit growth in SG&A as we increase revenue, to improve cash flow and profitability.

Depreciation and amortization in Q1 2023 was $3.8 million, up $0.4 million from Q4 due to the effects of CapEx spending in the fourth quarter of 2022 for both our SoCal Farm and the Isla Vista and Santa Ynez dispensaries.

During the quarter, the Company recognized a non-cash impairment expense of $23 million for goodwill and intangible assets related to the CPG unit and PLUS edibles. The impairment was triggered by the decline in the outlook for revenue and profit for the CPG unit, which resulted in the fair value of the unit being less than the carrying amount of the business unit. The difference created the impairment charge in the quarter.

At a loss of $149,000, our Q1 adjusted EBITDA was sharply improved from both Q4 and Q1 a year ago, driven by top-line growth (phon), higher gross margins, and improved management of operating expenses.

We define adjusted EBITDA as earnings before interest, taxes, depreciation, and amortization, adjusted for transaction costs, restructuring costs, share-based compensation, and other non-cash operating costs.

Please note the adjusted Q4 EBITDA results include the incremental costs associated with the PLUS relaunch and the bad debt expense associated with the PLUS acquisition.

We ended the quarter with $16.4 million in cash, including $3 million of restricted cash, which compares to $14.1 million of cash at the end of Q4 2022.

We generated $4.5 million of cash from operations in Q1 ’23, versus cash usage from operations of $9.3 million in Q4 and $15.5 million in Q1 last year.

In Q1, our cash impact from net income improved to a loss of minus $4.1 million from minus $6.6 million in Q4.

In addition, working capital benefitted by $5.6 million because there was no income tax paid in the quarter. Recall, in Q4 ’22, we paid our state and federal taxes for fiscal year 2021.

In addition, we had favourable working cap broadly within the quarter. Capital spending was $1.1 million in Q1 compared to $4.1 million in Q4, because the CapEx associated with Isla Vista and San Ynez stores were complete in Q4, and the CapEx associated with the SoCal Farm dropped to $1 million versus $2.5 million in Q4.

Delivering positive free cash flow one quarter ahead of our guidance was another major achievement in the first quarter, further reflecting the significant improvements we have made to drive scale and enhance profitability.

Now on to our outlook for Q2 and the balance of 2023. Based on the strength of the first quarter results and current trends, we remain confident in the direction of our business. We are providing the following guidance for the second quarter.

We expect total revenue to be between $38 million and $40 million, which is a 34 percent sequential growth from the midpoint and a 137 percent change from Q2 last year.

Wholesale revenue will increase in Q2 versus Q1, due to the seasonal increase in production and higher average selling price.

With regards to biomass production, we expect to produce a minimum of 75,000 pounds in Q2 compared to 48,099 pounds in Q1, as a result of normal seasonality. This compares to 25,173 pounds in Q2 last year.

Also note, Q2 of this year will be the last quarter in which the prior-year quarter includes only our Casitas and Padaro farms.

Recall we include all flower, smalls, and trim in our calculations for pounds produced and pounds sold.

In addition, given current wholesale pricing through mid-May, we are projecting the average selling price in Q2 to be approximately $325 per pound compared to $290 per pound in Q1.

Regarding our consumer-touching businesses of Retail and CPG, we expect Q2 to be similar to Q1 in revenue. We’re assuming the retail environment remains impacted by heavy discounting for brands and that retailers remain credit challenged.

We expect to make continued gross margin improvement in Q2 versus Q1, with total company gross margin percent improving to the mid-40s percent, up from 41 percent in Q1. We expect improvement in margin to be driven by the higher average selling price in wholesale, as well as a decreasing cost of sales. Retail and CPG profit margins are forecast to be consistent with Q1 in percentage terms.

Cost of production for wholesale biomass is projected at $150 per pound, down from $196 in Q1 and $159 in Q2 last year.

For the quarter, we expect adjusted EBITDA to exceed $5 million and operating cash flow to be similar to Q1.

Please note, Q1 had the benefit of collecting excise taxes but not having to pay them until Q2. That provided about a $1 million benefit in Q1.

In addition, the Company paid $1 million in semiannual property tax in Q2, which further reduces Q2 cash flow compared to Q1.

We will continue to manage CapEx expenditures conservatively and expect Q2 CapEx to be similar to Q1 at $1 million.

With the close of the Preferred Equity B Series in late Q4 and the closing of the C Series in Q1, our quarterly cash dividend will be $1,375,000 until the end of 2026 or until we pay back the Preferred Equity.

Looking forward into the second half of 2023 and the full year, I want to first talk about biomass production. We are increasing our production estimate from 310,000 pounds to 315,000 pounds.

Recall that when we first provided biomass production guidance for 2023, we started at 275,000 pounds. At current selling price, the incremental 40,000 pounds equates to over $13 million in incremental revenue and almost 6 million gross margin dollars at our current gross margin percent.

Our guidance implies almost 192,000 pounds of biomass production in the second half, an increase of 28 percent versus the second half of last year. However, we are increasing our cost of production for the year and second half by $10 per pound.

We have raised our guidance for cost per pound in the second half of the year to $120 per pound from $110. This still represents an 8 percent decrease from last year. We are also raising our full year estimates to $140 per pound from under $130.

With the improved wholesale pricing, we have increased our emphasis on maximizing production, which is reflected in our increased production estimates. In parallel, we are working on a number of operational improvements in processing, which we will believe have long-term net benefits, but which will have a short-term efficiency cost.

Until we see those improvements translate into cost savings, we are being slightly more conservative on our full year production costs, but we remain confident in our long-term cost target of $100 per pound.

In addition to our Q2 guidance on operating cash flow and adjusted EBITDA, we expect Q3 and Q4 to have positive operating cash flow and adjusted EBITDA. We are leaving our total revenue guidance of $160 million unchanged. This is a 76 percent increase from fiscal '22 with revenue of $91 million.

However, we are shifting revenue between our three segments.

We are raising guidance for 2023 Wholesale biomass revenue to $100 million from $85 million. This is primarily a result of the rapid increase we're enjoying in biomass wholesale pricing. We are projecting that our average selling price in Q3 and Q4, compared to our projection of $325 per pound for the second quarter. During the second half of the year, we expect the increase will be driven entirely by product mix, as we expect to sell a higher volume of flower relative to smalls and trim, and we are not assuming any increase in product pricing.

We are reducing our CPG Wholesale revenue to $20 million from $25 million, reflecting credit-challenged retail landscape, as well as the change in our distribution strategy. We are now shipping to our own stores directly and not through a distributor that took ownership of the product. As a result, we are no longer booking a sale to the distributor. This should result in a slightly improved margin for our retail stores as they get to buy it at cost and exclude the distributor markup.

Also, total gross margin dollars within CPG and Retail will not be impacted. This change also gives us greater control over our supply chain, as we shorten the distribution channel and time to market for products delivered to our stores.

We are reducing our guidance for Retail revenues to $40 million from $50 million, reflecting the intensely competitive retail landscape, heavy discounting of products, and the fact that sales at our new stores are not meeting our initial expectations.

Although this is not guidance, we expect the wholesale and retail environment will begin to disrupt the brand landscape in a more meaningful way as the year progresses, and we will see more brands leaving the market. Non-vertically integrated brands are having to deal with rising biomass input costs, and all brands are dealing with retailers who are not paying. They are getting squeezed on both cost and incoming cash collection.

Using Headset data, we calculate there were 171 less brands with revenue of at least $10,000 per quarter (phon) in Q1 '23 than in Q3 '22, a reduction of 15 percent. With this potential upheaval lying ahead in the CPG landscape, we remain committed to maintaining a meaningful brand presence both in and out of our stores, especially given the advantages of cost consistency and quality that our vertically integrated model provides.

Finally, none of this guidance includes any impact on revenue, cost, or CapEx for the expansion of the cultivation capacity we are planning at our SoCal farm.

And with that, I will turn the call back to Kyle.

Kyle Kazan

Thank you, Mark. Appreciate that. And for all you listeners that have hung in from Mark's and my initial comments, just a couple more small comments, and then we'll open up to questions.

I would like to take this opportunity to update you on our latest efforts to push for the release of those serving prison time for nonviolent cannabis consumption in both state and federal prisons.

Last month, we made the exciting announcement that Luke Scarmazzo had formally joined our Glass House family as lead brand ambassador for Northern California.

Recall that Luke was released from federal prison in March after serving 15—one, five—years of an unjust 22-year sentence for operating a medical cannabis dispensary under California's Proposition 215, which was passed by voters in 1996.

His release was made possible by years of work by attorneys and passionate advocates, including The Weldon Project and MISSION [GREEN], both of which were founded and are led by Weldon Angelos.

Luke is now a partner at MISSION [GREEN] and plans to dedicate his energy to advocate on behalf of those serving prison time for nonviolent cannabis convictions in both state and federal prisons and to promote the responsible use of cannabis.

Luke's personal experience of being incarcerated for his involvement in the cannabis industry has given him a unique perspective on the importance of advocacy and social responsibility. His story is an inspiration to the entire industry, and we are thrilled to provide him with the opportunity to quickly rejoin the California cannabis industry.

Additionally, I look forward to working together with Weldon and Luke as The Weldon Project and MISSION [GREEN] strive to gain mass pardons and more enlightened regulatory policies.

The fact that I'm finishing an earnings call for a publicly traded company which derives all of its revenues from the sale of cannabis, while over 2,700 people sit in prison for selling far less than Glass House does, demands action if we truly believe in a fair and just legal system.

I continue to call on President Biden to do the right thing and fully pardon all of those people with the same vigor he used in securing the release of Brittney Griner from Russian jail. It is always the right time to do the right thing.

With that, let me turn it back to the Operator for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the *, followed by the 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request. Questions will be taken in the order received. Should you wish to cancel your request, please press the *, followed by the 2. If you are using a speakerphone, please lift the handset before pressing any keys.

Your first question is from Bobby Burleson from Canaccord. Please ask your question.

Bobby Burleson — Canaccord

Hi. Yeah. Thanks for taking my questions. Congratulations on the strong results. It's nice to see a cannabis company going in the right direction.

I think, probably just to start, can you maybe help us understand what form factors in the brand arena—and if we're going into kind of an extinction event for brands—where you see the most pressure in terms of form factor? Is it edibles? Is it some other form factor?

Kyle Kazan

You know, the—so thank you for the call—the question, Bobby. The difficulty right now is that retailers are under such stress that they're having difficulty just paying their bills. So I might say it's less

about form factor and more about the wherewithal of these companies. All the distributors in the state are distressed, and many of the retailers are, so there's been a bit of a juggle.

And let's also remember that, as Mark mentioned, retailers now carry the burden of the excise tax. And so that has also made it so they have to juggle. So imagine retailers that have, perhaps, higher-than-normal rents, perhaps some debt that's out of the ordinarily—it's high also. And now you've got to pay excise tax, and the industry is tough. We're highly taxed.

So I don't think it's like gummies are going out and flower's coming in or something like that. I just think it's all brands are under significant stress from getting paid.

Bobby Burleson

Fair enough. And then just—yeah?

Mark Vendetti

Bobby, I can add—I can note that—add on to that just sort of just quickly. I think it's probably flower, your vapes that are going—and vapes that are going to see the most pressure—

Bobby Burleson

Yeah.

Mark Vendetti

—edibles probably will see the least. And the reason for that is basically just you're seeing a recovery in biomass prices. So the inputs to those products are getting more expensive.

They were destructively and artificially low for a while there, and so we saw when you could buy flower for $350 a pound, a lot of people—and I'll put "brands" in quotes here—came in and bought inexpensive, I would say sub-cost of production for most farmers, flower, put it in the package and put a sticker on it and called it a brand. But you had a bunch of those guys who saw a lot of competitive pressure

there. Now that flower is recovering, and you're seeing pricing much higher, that margin goes away. So they can't keep doing that.

The other place you'll see it is vapes, where distillate was as low as $700 a litre. Now that pricing has—even just in the last four or five months, has come up to $2,300 a litre. So the input cost there has literally tripled in the last few months.

And so again, I think if you don't have—if you don't control your supply chain, if you don't have very low and efficient COGS, that you're going to find yourself priced out of the market because these—if your business was based on packaging up sub-cost-of-production flower, that's going to go away, and you're going to have to have a real business that can run in sustainable fashion.

Bobby Burleson

Okay. Great. Makes a lot of sense. And then just—yeah. Thank you for that. And then just quickly on the weather impact, you guys managed to exceed your expectations and guidance on a number of lines in the P&L. I'm curious what might have happened, had the weather cooperated.

Kyle Kazan

Yeah. It's a good question. And I think it really highlights the power of our SoCal farm. So we had one of the darkest, rainiest Decembers and January on record, and then that fuels the production for Q1 for us. So I think, if anything, it really shows the power of that farm to manage the climate that Mother Nature gives us. We like Mother Nature being our dance partner because it's free, and it doesn't have any environmental impact.

The downside is, sometimes, she throws curveballs at you, and the upside of our facility is the ability to manage and kind of polish and supplement those curveballs to keep giving the plants what they want. I mean, I think if you'd seen the normal seasonal weather, you'd see these numbers even higher.

And I think that's part of what gives us confidence in what we're doing and where we're going, and why we're excited to turn on that next million square feet.

Bobby Burleson

And is there a piece of your guidance for the year that you guys are standing by, where you think you're being particularly conservative? Is it the cost of production, for example?

Kyle Kazan

Bobby, I would just say the one place that I hope we can do better is continue, after Q2, potentially take the production number up for the back half of the year. But I mean, we're already lapping 150,000 pounds from last year. So we are still being—we're guiding to basically up 28 percent in the back half of the year.

But I think that, to me, that would be one place I hope we can do better because it has such a positive economic impact on the Company's number.

Bobby Burleson

Fantastic. Congratulations.

Kyle Kazan

Thanks.

Operator

Thank you. The next one is from Scott Fortune from ROTH MKM. Please ask your question.

Scott Fortune — ROTH MKM

Yeah. Good afternoon and thanks for the questions. Obviously, we've seen the shakeout of cultivators. We've seen those licences come up. Just kind of give us—so the environment on the retail side and shaking out. I know your strategy's kind of been for kind of limiting your retail growth beyond

your 11 stores, but kind of how you're looking at the retail side of things in California coming forward for you.

And obviously, in a sense, what's the timing or what needs to happen for a healthier retail environment in California and potential timing on that occurring? That'd be helpful.

Kyle Kazan

Sure. I can take that. So I mean, I think the most fundamental thing, and it's actually fundamental to the market on a macro sense, is the regulations, there's too many regulations, the taxes are too high, and there's not enough retail. Right?

We currently have about 11,000 liquor stores in California. There's probably something like 900 dispensaries. There's 77,000 places in California that you can buy a cocktail. There's 900 places you can buy a joint. Right? So that's fundamentally not the right number.

You can look at all the other states, and you can see much closer to one dispensary for every 5,000 people. California's got a dispensary for every 40,000 people. Right?

You look at Montana, which has a million people and sold $300 million worth of cannabis. And if you apply that same metric to California, California's legal market should be $13 billion instead of $5 billion. Right?

So there's a fundamental broken piece here, which there's not enough ways for companies like us, who only sell licensed product, to reach consumers.

The secondary piece of that is, where there are dispensaries, they're concentrated and leave these wide weed deserts. Something like 60 percent of the municipalities in California still don't have licensed legal retail. And then you have other places like a Palm Springs, where you've got 20 dispensaries, and it should be 5.

So, I think our view is that retail and where we are in the market is strategic. It allows us to access—have shelf space, connect with the consumer. It's a great data platform. It's an amazing source of data and analytics towards our goal of making better products.

It also gives us a place that, if we need to hunker down as the retail kind of goes through the shakeout similar to what cultivation went through, we know that we can reach consumers with our products. It's also a strategic tool because in a tight competitive market, having a shelf to trade is valuable.

So I think, from here, we're 10 stores open. Our eyes are not closed to retail, as long as the retail is in places that make sense—limited-license markets, places where you can run a business that does 20 percent, EBITDA margins are better so you can deal with, again, the onerous 280E taxes that particularly hit retail.

So I think our eyes are open. We've got a nice footprint. Where opportunities come along, either it be de novo licences or acquisitions that make sense for our strategy, connecting with consumers, volume, and moving our brands, we will, of course, consider it. But it's not something that we're in a rush to do, except for where it makes good business and financial sense.

Scott Fortune

Yeah. I appreciate that. And then kind of follow-up for me, as far as demand from the wholesale side, can you provide a little more colour of who's coming in? Obviously, a lot of reliable suppliers are leaving the market, and you guys are left with a good quality opportunity for that. There's less brands in the market. But what colour on the wholesale side—are these new brands that you're now supplying? Or expanding the existing brands using Glass House brands? Just a little more colour on the available (phon) market for, for the wholesale side that you're selling.

Kyle Kazan

Sure. Yeah. So in our—and I think, fundamentally, just as a reminder on our strategy, which is about the best possible cannabis for the best possible price so, so far on the left-hand side of the cost curve and so high up on the quality curve, that it—and kind of no matter what's going on in the market, it's an undeniable value in what we grow and produce. We'll clear the market, kind of prices up or prices down.

Now you take that focus, which we've been working on for seven, going on eight years now, and then the facility that we're lucky enough to work in. And then you add to that the licence attrition that Mark was talking about, right, where we see it's coming up on 20 percent, in 10, 11 months, of the cultivation licences that should have renewed, didn't. Right? And I think that's reflective of the pain of the last two years.

So there's many people who are saying, basically, I can't grow a good enough product for a low enough cost to continue to operate, given where the market's at. So that production is driving people towards us.

Obviously, we get (phon) a lot of product into our brands. We do work with a lot of brands directly. We work with distributors or then distribute to other brands. So you see our flower filling up in a lot of different brands all around the state. It's becoming, I think, one of the foundations of the market because, again, that high-quality, low-cost combination is a tough one to beat.

Scott Fortune

Got it. And then real quick, the distribution strategy, you're not moving away completely from using distributors? Or is this something, from a higher cost standpoint, that you are, kind of from a strategic standpoint, kind of do your own distribution? Just kind of some real quick colour on that?

Mark Vendetti

You know, that's a great question, Scott.

Kyle Kazan

Yeah. That's a great question, Scott. I mean, right now, we have not started our own distribution, nor do we have plans in the works to do so. We're working within the model of people that have done a great job.

We're still clients of Herbal, and as we have for a long time, but we're watching the landscape carefully to see how things go, but. So as of right now, we are still using outside distro, and I think that's sort of our plan for the—certainly, for the immediate future.

Scott Fortune

Got it. Congrats again on the execution, and I will jump back in the queue. Thanks.

Kyle Kazan

Hope to see you soon, Scott.

Operator

Thank you. Your next question is from Jesse Redmond from Water Tower Research. Please ask your question.

Jesse Redmond — Water Tower Research

Hey, guys. Congratulations on the quarter. Just to elaborate a bit on Scott's question, I feel like I'm in touch with the wider issues in California on the retail side—limited access, high taxes, 280E tax burden. But specific to your network of stores, you pursue more limited-licence environments, exemplified by the newer stores in Santa Ynez and Isla Vista. And I was wondering if you're seeing the same pressure others are seeing on the retail side?

Or if you're finding you're a bit more insulated from that with your locations?

Kyle Kazan

You know, that's a great question. We do have some locations that have a lot of competition, like Santa Ana certainly has a lot, and then we have one of five licences in Berkeley, which is—which abuts Oakland, which has a lot of licences. So we sort of have a mix. Our Santa Barbara stores, for sure, don't have that same competition.

And you'd absolutely notice the difference in those markets, where you just have—Santa Ana, I think, has 20 licences, and now Costa Mesa's coming online. So any new industry faces these kinds of bumps as it grows.

I will say this. The future, when we consider new potential stores, the ones that have limited licences, at least at the beginning, are the ones that are most interesting.

Jesse Redmond

And have the IV in Santa Ynez—IV standing for Isla Vista—have the Isla Vista and Santa Ynez stores been in line with your expectations? Or what are your thoughts on those so far?

Mark Vendetti

I think it's a little slower to go out the gates than we had expected, but we know they're both very, very good markets. We have a good base in Santa Barbara. I know in Isla Vista, people smoking cannabis, that's not an issue. It's making sure that they know about us, and that they choose us over the illicit market. So it's a work in progress, but we're still optimistic.

Jesse Redmond

Thanks. And on the wholesale side, it seems like, logically, we should see prices improve or be consistent, at least through the summer. We typically have that light-depth harvest, maybe in June, that's ready in late July, and then we have Croptober in October.

But with the reduced canopy, I'm curious, what do you think the effects will be of that light-depth harvest? And more specifically, even looking out through this fall, where we typically see the drop in prices? We didn't see that as much last year, and this year, with even fewer licences, I'm curious how you're thinking about that Croptober effect in this new reduced canopy environment.

Kyle Kazan

Graham, you want to take that?

Graham Farrar — Co-founder and President, Glass House Brands Inc.

I think it'll—yeah. I'll do that. I think it'll be muted. I mean, we will see more supply than we have sitting here today, for example, but the licences that have been expiring over the last year, like that's not—you don't quickly recover from that. Right? It's not as if the licence expired, and you change your mind 60 days later and decide you want to reactivate it. Typical time to turn on and get licensed with an annual licence is something like 180 to 200 days. So once a licence expires, you've got to go back through the process to do that.

So I think we'll see a pretty muted effect. I'd be ready for—the prices are recovering, people who are still cultivating are going to be more likely to not scale back their production as they might have if prices were lower, but I do think it's going to be pretty stable.

And I think we're returning to a point where the market, you can't have sales price below your marginal cost of production for an extended period of time because what happens is what we're seeing happen, which is, supply falls out because it doesn't make sense to them until prices rise until there's enough oxygen for enough people to supply the demand to continue to exist.

So might we see a plateau? Sure. Do I think we're going to ride the roller coaster again? That's not my prediction.

Mark Vendetti

So one— again, one other—

Jesse Redmond

, Well, great. Thanks.

Mark Vendetti

—I just will add one thing to that, and Kyle mentioned it. During the month of May and June, basically, one out of four active licences in the state are up for renewal. So If we move through May and June and we see what happens, then I think that's going to go a long way to determining what happens in the second half of the year. If a lot of those leave the market, I think prices will definitely remain stable in the second half of the year.

Jesse Redmond

Well, great. Thanks, guys. Congratulations again, I look forward to seeing you next month at the Investor Sesh.

Kyle Kazan

That's awesome. We look forward to seeing you too.

Jesse Redmond

All right. Thanks, guys.

Operator

Thank you. Once again, ladies and gentlemen, please press *, 1 should you wish to ask a question.

The next one is from Howard Penney from Hedgeye. Please ask your question.

Howard Penney — Hedgeye

Thanks very much for the question. I was asking a question about the retail network and your desire to grow that network while, at the same time, maintaining your free cash flow stance, given the high capital-intensive nature of the retail network. Thanks.

Kyle Kazan

Graham, you want to take that?

Graham Farrar

Sure. Yeah. And I'm—Howard, if you can maybe just clarify a little bit? I'm not sure I totally—

Howard Penney

Yes.

Graham Farrar

—understood the question, but. Yeah. Go ahead.

Howard Penney

So it was an important milestone that you got to a free cash flow position this quarter. If I'm hearing you right, and you're wanting to grow the retail network, your retail store base, that will require a lot of capital. This would not—you're not going to be in a free cash flow position. So I'm curious as how do you maintain your free cash flow position while also growing the retail network?

Graham Farrar

Got it. Yeah. So a few a few things there.

One, free cash flow positive and staying there is sacrosanct and important to us. A reminder that Q1 is actually seasonally our lowest quarter because of less light, less yield, less revenue on the cultivation side And so as we move through the year, we expect that to accelerate—more light, more yield, more revenue. So we do believe that we will be into a position where we can grow from operations.

That said, I think our stance with retail is kind of watch and wait for the real winners. Right? And I think we believe that retail is going to go through a bit of a shakeout. The excise tax that we mentioned that moved from the distributor to the retailer, it's a personal tax liability. So it's not discharged by dissolving the business or bankruptcy or things like that. So I think there is going to be a handful of operators out there that are going to be looking for ways to deal with that, and that may create opportunities for us. And otherwise, it's really just going to be a decision of what's the ROI; how do you make the investment.

Are there places where you can get de novo lines and open up capital efficient ways that provide good ROIs moving forward through the year? We expect that we're going to be able to do that, basically from operations, to make those things happen.

Kyle Kazan

And, Howard, one—and as a follow-up, I would tell you that I know in the cannabis industry, there's always this land grab, especially in new states, for retail. We question that quite a bit inside our company, where we say what's the value when 7-Eleven and Circle K also have stores? So long term, I would tell you that we're not involved. We don't think the land grab is the way to go.

But we will be particular on some opportunities because we think we're a value add to stores that might want to have us help them manage it, things like that. But capital allocation to go buy existing successful stores is not likely in our future, but we could open up some that we think—where we have some opportunities very cheaply. So we're mindful of cash.

Howard Penney

So a Marriott model might make more sense if you think about it that way?

Kyle Kazan

Maybe. I may have stepped over Mark. Mark, you want to say something?

Mark Vendetti

All I was—Kyle, all I was just going to say is all of the outlooks we've provided for this year just continue to assume the 10 stores we now have open in our baseline, and there are no plans currently that have any stores coming in soon. And again, I think Kyle phrased it very nicely in terms of thinking about how we would consider additional retail stores, but we're at 10, and our plans are built off 10.

Howard Penney

Perfect. I guess what I wanted to hear was you're not intending to do a land grab strategy, which has proven disastrous in this industry. Thank you.

Kyle Kazan

Welcome.

Operator

Thank you. Your next question is from Mike Regan from Excelsior Equities. Please ask your question.

Mike Regan — Excelsior Equities

Hi, everyone. Thanks for taking the question. [Audio gap] is pretty great to see, and also, the [audio gap] expectations on that average pricing. So sort of two questions on it.

One, is there any impact in that from quality mix upwards, sort of just larger flowers or a larger percentage of the biomass being higher end flower?

And a second, sort of, I guess. Where do you think that can sort of ultimately go as all the capacity keeps coming offline?

Graham Farrar

Yeah. So I can—

Kyle Kazan

Graham?

Graham Farrar

—answer that. I think the first—so the half of your question, I think it's worth a reminder that we're still about six weeks away, almost, from our one-year anniversary of the first pound that we sold out of our SoCal facility. So big picture, we're still quite early down there and still very much learning but very happy with where we are today and expect that the additional experience will continue to improve our quality as well as our efficiency and costs.

So we are seeing that, that greenhouse does allow us to help increase the ratio or the mix, as we call it, of flower relative to smalls and trim. Flower trades at a significant premium to both smalls and trim. So the more flower that we can produce as a percentage, the more that helps the average selling price. So I do think we'll be able to push on that.

Also, as the days go by, our quality continues to improve, and I think we're getting very close to mixed light and even indoor quality down there in many cases. And that's something that the team strives to make. The exception becomes the norm, and we keep pushing that upward.

I do think that, as Mark mentioned and Kyle mentioned, just kind of structurally in the market, there's a whole lot of licences that are not going to be able to make it across the provisional-to-annual threshold. And you can no longer renew those licences if they're over 22,000 square feet. You have to be SEQA-compliant now. Those are kind of back-end loaded because of when those provisional licences could no longer be issued, there was a push to get the licences in.

And in the next few months, we see a significant portion of that market that is going to have to either have made it over the hurdle or maybe no longer be there. So I think we'll continue to see a significant attrition in the market. Hard to say exactly where pricing goes. We're pretty happy with it right here, so. And if it stayed in this zone, we'd be happy campers.

Mike Regan

No. Yeah. That's basically what I'm asking, is that the guidance implies it's continuing to increase even beyond the 325 to get to 330 for the year. So sorry, just trying to wonder, like what's that—if you exit December and call it 350, is that sort of the upper limit?

Or is that—then you have the—as you point out, you're still trying to figure out how to get even better product out of the greenhouse, and you have opportunity beyond that.

Kyle Kazan

Yeah. I mean, I think I would say there's more cannabis consumers today than there ever have been, and there'll be more tomorrow than today. So as we move forward, I think demand is going to continue to go up and to the right, particularly in terms of units and volume. And I think that you're going to continue to—it's kind of embedded in the system, almost, that you're going to continue to see supply attrition and the pivoting back in is a lengthy process. So it won't happen particularly quickly.

Obviously, as we move forward, and as you look around California, California still has the lowest-price cannabis, I believe, in the country right now. Right? So as happy as we are to see the market recovery, every other state is looking and probably can't quite imagine how they would even function with the prices that we have today. Right?

That's one of the things that we like about where we sit is we're happy right here. And for most other states and in many other places, this would be something that they wouldn't even know what to do

with. So long-term big picture, we like where we're at, structurally, and think the winds will continue to be at our back.

Mark's throwing some real-time information here right now. So far, in the first two weeks of May, we've seen 107 licences that have left already. So those are typically 10,000 square-foot licences. So basically, in the last two weeks, we've seen another million square feet of supply that is not renewed and falling out of the market. So the trend continues.

Operator

Thank you. Once again, please press *, 1, should you wish to ask a question.

There are no questions at this time. Please continue.

John Brebeck

I think we can wrap it up, Operator. Thank you.

Operator

Thank you. Ladies and gentlemen, the conference has now ended. Thank you all for joining. You may all disconnect.

John Brebeck

Thank you.

Graham Farrar

Thank you, everyone.

Kyle Kazan

Thank you.