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FINAL TRANSCRIPT

Glass House Brands Inc.

Second Quarter 2023 Investors Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Glass House Brands, Inc. Second Quarter 2023 Investors Conference Call.

I would now like to turn the conference over to John Brebeck. Please go ahead.

John Brebeck — VP Investor Relations, Glass House Brands Inc.

Thank you, Operator. Welcome, everyone, to the Glass House Brands' second quarter 2023 conference call for the three-month period ending June 30, 2023.

I'd like to remind everyone that matters discussed during today's conference call 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 filing and registration statement. These documents may be accessed via the SEDAR database.

I'd also like to remind everyone that this call is being recorded today, Monday, August 14, 2023.

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

Kyle, over to you.

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

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

We're thrilled to be able to report another successful quarter as we continue to demonstrate our commitment to being the number-one cannabis company in California.

Before we dive into financial highlights, I'd like to thank our Glass House team for their hard work and dedication to our mission and thank our investors for supporting us through the peaks and valleys of the highly volatile cannabis industry as we progress from being cash flow negative to cash flow positive. We also project that we'll be cash flow positive for the rest of the year.

The second quarter of 2023 was the best in our history. We achieved record levels of operating cash flow, exceeded second quarter guidance across several operating metrics, and marked our first quarter of positive adjusted EBITDA.

We have previously stated that our goal is to become a true unicorn in this sector, a cash flow-positive California cannabis company. If our results in the second quarter of the year prove anything, it is that we are capable of being exactly that.

In the first quarter of this year, we showed what our team can do, and in the second quarter, we exceeded our guidance at a time when the overall industry in California is struggling with a challenging regulatory regime, overtaxation, a lack of affordable funding, and the inability to generate positive cash flow.

Growers, e-commerce, delivery companies, distributors, retailers, and brands are all feeling significant pain. For this reason, the excitement we feel at a job well done is tempered with a genuine appreciation for our good fortune and the hope that the regulatory environment will shift to provide a brighter future across the industry.

Prior to discussing our second quarter financial results, I want to refer everyone to the press release, which shares our numbers in detail. During this call, we will highlight some of those numbers and add further context to the information contained in the full press release.

In the second quarter of 2023, we saw our biomass revenues and pounds sold more than quadruple versus the previous year.

Revenues from our retail dispensaries doubled versus the same period last year to $10 million, due to growth from acquisitions.

Consolidated gross margin surpassed 50 percent, and cultivation cost of production per pound fell by 12 percent versus last year.

Finally, adjusted EBITDA flipped to a positive $9.5 million, compared to a negative $9.8 million a year ago.

Areas where second quarter performance significantly exceeded guidance included:

Revenues reached a record $44.7 million versus guidance of $38 million to $40 million.

We produced 103,000 pounds of cannabis biomass versus guidance of 75,000, exceeding guidance by 28,000 pounds. For a sense of perspective, total biomass production in the second quarter last year was only 25,000 pounds.

Gross margin reached 55 percent versus guidance of the mid-40s percent.

Adjusted EBITDA was $9.5 million versus guidance of $5 million and versus a loss of $140,000 in the first quarter.

In the second quarter, we achieved record operating cash flow of $8.3 million, up from 80 percent—more than 80 percent from the first quarter.

We expected to see cash increase to around $19 million in the second quarter, but our actual ending cash balance was nearly $23 million.

This allowed us to begin the Greenhouse 5 retrofit prior to completing our Series D preferred equity raise. We aim to begin planting in Greenhouse 5 in the first quarter of next year with first sales by the second quarter. Once operational, we expect Greenhouse 5 will increase our cultivation capacity by roughly 250,000 pounds, to a total of 600,000 pounds.

Moving on to our retail business. Sales rose sequentially due to the opening of a new Natural Healing Center NHC dispensary in Turlock toward the end of April, as well as an expected seasonal increase around 4/20.

I’m very proud of our team’s successful efforts, led by Chief Revenue Officer, Hilal Tabsh, to increase the sales of in-house brands at our NHC dispensaries. In July of last year, sales of Glass House Brands’ product were below 5 percent of total NHC dispensary sales. They have now climbed to above 25 percent, which is in line with our Farmacy stores.

Not only is this a credit to the managers and budtenders at our NHC stores, it is also an indication of the attractiveness of our brands to consumers when the product is available to them.

We had expected negative sequential growth in our CPG wholesale sales in the second quarter due to the financial difficulties of HERBL, one of the state’s largest distributors, along with the challenges facing all brands in the current California marketplace.

CPG sales for the quarter were $4 million, down 24 percent compared to the first quarter, and down 20 percent versus second quarter last year.

One of the main struggles for CPG in California is the difficulty in collecting receivables, as many retailers themselves are in dire financial straits. We anticipated this difficulty and, over four months ago, we came to an agreement with HERBL which allowed us to take ownership of our inventory and receivables for the product which they were still distributing for us. This agreement helped Glass House avoid material loss when HERBL ceased operations.

We are currently distributing our CPG product via our co-packer, who is providing distribution service to our retail accounts.

For our own stores, we now sell direct and treat this as an intercompany transaction instead of booking the sale through the distributor. And this reduced the second quarter CPG revenue by $1.1 million, accounting for almost the entire sequential decline in CPG sales. Without the change, CPG sales would likely have been flat.

We are focused on selling to retailers who are paying their bills in a timely fashion. It should be noted that HERBL was our distributor only for the CPG segment of our business and not for biomass. We sell directly to our wholesale biomass customers and do not use a third-party distributor.

As an indication of what we are now seeing in the CPG landscape, the total number of brands with sales of more than $30,000 per quarter peaked at 960 in the second quarter of last year and since, has fallen by 22 percent to 748.

We expect to see continued consolidation amongst brands due to the combined effects of rising wholesale cannabis prices, which are causing increased costs for brands and the difficulty of collecting for retailers who are delinquent or not paying their invoices.

The landscape for retailers in California is extremely difficult, as many areas have far too many stores, leading to heightened competition for foot traffic, and consumers have become increasingly price sensitive. The result is a margin and cash flow squeeze for retailers.

I believe that our position as a vertically integrated California cannabis company, with a competitive core competency in the cost-efficient cultivation of premium flower, is the reason why we've been able to persevere in this difficult market environment. We value our retail and brand businesses for the revenues and market awareness they provide, and we see potential for our brands to create significant shareholder value over the long term.

As we have stated over the previous two quarters, our SoCal farm is the main focus of our growth. And we have the flexibility to pivot between wholesale and CPG as market and regulatory opportunities arise.

We expect to announce the first close of our Series D preferred equity later this week and currently have $15 million of total commitment and $8 million of cash in hand.

Holders of the Glass House Brands preferred shares will be entitled to a 15 percent annual cash dividend, paid on a quarterly basis, with the dividend increasing to 20 percent, if we haven't paid it back by the end of year five. Investors will receive one warrant for each $5 invested, and each warrant will have a strike price of $6 and be valid for five years.

A final close is targeted for 60 days from the initial close. We expect to close at the fully committed amount of $15 million, which is the cap for this round.

It is worthy of note that approximately one year after completing the initial close for our Series B preferred equity round, we were able to raise new money in our Series D at a 5 percent lower dividend rate and a $1 higher strike price for the warrants, all while interest rates in the United States are higher in 2023 than in 2022.

We expect that the funds from the Series D preferred equity raise will allow us to move quickly to retrofit Greenhouse 5. At current pricing, Greenhouse 5 is capable of producing over $80 million of incremental revenue annually and over $30 million in incremental EBITDA. Adding this to our current cultivation portfolio, long as pricing doesn't drop significantly, which we don't anticipate, we are in a position where we can self-fund the retrofit of our remaining greenhouses.

As you are aware, the potential upside to revenues and earnings from all five greenhouses is immense. When they are complete, our cultivation output can reach 1.5 million pounds. So our overall long-term outlook has changed significantly for the better. This momentum started late last year, and we anticipate it will continue through remainder of 2023.

Before I hand the call over to Mark, I'd like to share some thoughts on our recent Investor Sesh 2023. Held on June 23rd at our SoCal farm, concurrent with our annual shareholder meeting, the second annual Investor Sesh was attended by over 300 investors who enthusiastically joined the six farm tours we hosted during the day.

The C-suite took investor questions for almost one hour immediately after the shareholders meeting concluded, and we thoroughly enjoyed having the chance to spend time in casual conversation with our longtime equity partners, as well as those who have come aboard more recently.

If you have not had a chance to join us at an Investor Sesh, I encourage you to mark your calendars for late June of 2024. It is, without a doubt, our most important investor event of the year.

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?

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

Thanks, Kyle, and good afternoon, everyone. As a reminder, the results I am sharing will be filed today. They can be found in our financial statements and MD&A, and in our press release, which are reported in US dollars and prepared according to US GAAP.

As Kyle mentioned, net revenue for the second quarter was $44.7 million, up 171 percent versus the same period last year, and up 54 percent compared to the first quarter. This was primarily driven by a 112 percent sequential increase in wholesale biomass revenues to $30.6 million.

Consolidated gross profit was $24.4 million or 55 percent of net revenues, compared to $12 million or 41 percent in Q1 2023. This is the highest gross margin percent since the Company listed in Q2 2021.

The two key drivers were wholesale biomass average selling price reaching $340 per pound, well above $290 per pound in the first quarter; and cost of production falling to $139 per pound in Q2 from $196 per pound in Q1 2023. The result was a record-high wholesale biomass gross margin of 61 percent, up from 43 percent in Q1, which itself was a record high since listing.

General and administrative expenses increased by $1.7 million in the second quarter, reaching $13.1 million. This compares to $11.4 million in Q1 and $10.9 million for the same period last year. The majority of the increase was due to an increase in bad debt expenses associated with the HERBL transition, which was a one-time event, and increased sales tax related to an increase in wholesale revenue.

Sales and marketing expenses were $997,000, compared to $652,000 in Q1 and $898,000 for Q2 2022.

Professional fees were $2.2 million, up from $1.5 million in the first quarter and down from $2.7 million in the same period last year. The sequential increase in professional fees was due to increased legal fees related to litigation, the Turlock acquisition, and expenses related to our annual shareholder meeting.

Depreciation and amortization in Q2 2023 was $3.6 million, down from $3.8 million in Q2, and up from $2.8 million in the same period last year.

Adjusted EBITDA hit a record $9.5 million for Q2, showing significant improvement from negative $149,000 in Q1 and negative $9.8 million a year ago. This was driven by top line growth, higher gross margins, and disciplined management of operating expenses.

Moving on to the balance sheet.

We ended with $22.7 million in cash, which compares to $16.4 million in cash at the end of the first quarter.

We generated $8.3 million in cash from operations in Q2 ‘23 versus $4.5 million in Q1 and negative $7.8 million in the second quarter of last year.

We’ll now take a look at the supply side developments in the California market.

We continue to see active cultivation licence count decline as it has for the last 13 months, though at a slower rate. During the second quarter of 2023, the number of active, mixed light, outdoor cultivation licences declined by 470, with another 174 leaving the market in July.

In total, the number of active, mixed light, and outdoor licences has dropped by 35 percent, from 7,190 in June of last year to 4,697 at the end of July. We estimate that this has resulted in a fall in the low-20 percent range in the square footage under cultivation.

In total, there are almost 1,900 active cultivation licences that expire by the end of this year, and we believe that the number of active licences is likely to continue falling, particularly with the lower seasonal pricing we are seeing in Q3.

Moving on to the demand side.

Data from Headset shows the retail environment for California market remained challenging in the second quarter, with total market sales down 9 percent versus Q2 last year.

Flower sales declined 15 percent, year on year, while pre-rolls substantially outperformed the market and were flat. Flower plus pre-rolls, combined, were down 11 percent year over year in Q2.

Vape was down 5 percent, and edibles were down 4 percent year over year, continuing to outperform the overall market.

And on a sequential basis, overall California market sales were flat, Q2 versus Q1.

Despite the decline in retail sales, total market demand remained steady. Unit volume increased 3 percent versus Q1 and was up 2 percent from last year. This is indicative of the extremely competitive CPG market, which has resulted in declining retail prices which benefit consumers.

Now on to our outlook for Q3 and the balance of 2023.

We expect Q3 consolidated revenue to be between $45 million and $47 million, anticipating 3 percent sequential growth at the midpoint of guidance and a 63 percent change from Q3 last year.

The increase versus Q2 ‘23 is driven by projected low- to mid-single digit percent growth in wholesale biomass revenue, with pricing projected to increase slightly above Q2’s average selling price of $340 per pound as a seasonally favourable increase, and the percentage of flowers and smalls relative to trim offset a seasonal dip in prices due to increased summer output from outdoor and mixed light farms.

Production is expected at 100,000 to 103,000 pounds, roughly in line with Q2 levels. While the second half of the year is usually our highest in terms of production, we do not expect the typical seasonal uptick in Q3 compared to Q2 this year, due to efficiency improvements in post-harvesting processing that boosted Q2 production by approximately 10,000 pounds; and because unusually low sunlight levels in May, June, and the first half of July reduced the normal seasonal lift in biomass bulk harvest that we typically see in Q3.

As a reminder, plants harvested today are the cumulative result of sunlight in the preceding 60 to 90 days.

Retail and CPG revenues in Q3 are expected to be similar compared to Q2.

We expect consolidated gross margin percent to be flat to up slightly versus Q2's 55 percent, driven by a 14 percent sequential reduction in cost per pound to $120.

Our full year production cost estimate remains $140 per pound.

In addition, we expect adjusted EBITDA to be similar to Q2 and expect operating cash flow to be about $4 million to $6 million, which is lower than the Q2 level of $8 million. The main contributing factors are as follows.

Cash benefitted in Q2 from an approximate $2 million in invoices that came late in the quarter and will be paid in Q3.

Also in Q3, we will have to make a $1 million payment to WhiteHawk for their Q4 2022 and Q1 2023 waivers on the debt service coverage ratio covenant.

In addition, we will pay $1.3 million more in retail excise and cultivation sales taxes in Q3 versus Q2 because of the sequential increase in taxable revenues from these businesses in Q2 versus Q1, as these taxes are paid in the quarter after they occur.

We are raising our full year 2023 consolidated revenue guidance to $165 million to $170 million, which represents 85 percent growth over fiscal 2022 at the midpoint and is an increase of $5 million to $10 million from our previous guidance of $160 million.

The increase in revenue guidance is driven entirely by upward revisions to projections for our wholesale biomass business. We are raising our biomass production estimate for the year to 350,000 to

355,000 pounds, an increase of 35,000 to 40,000 pounds over our previous guidance, while projected 2023 average selling price per pound remains at $330 per pound.

None of the above guidance includes any impact from the ongoing retrofit of Greenhouse 5 at our SoCal farm, which began in early July.

Revenue projections for our retail and CPG businesses remain unchanged at $40 million and $20 million respectively.

And it's worth commenting here on how much more production we have been able to achieve at our SoCal farm than we originally expected. When we turned on our first greenhouse at the SoCal farm in early 2022, we projected that the combined annual output from our Casitas-Padaro farm, plus Greenhouse 6 at our SoCal farm would reach 275,000 pounds annually.

Our current 2023 guidance for these same farms represents an almost 30 percent increase over that figure, and we are still in the early learning phases of harnessing the full growth potential of Greenhouse 6.

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

Kyle Kazan

Thank you, Mark. I have a few final comments before we begin the question-and-answer session.

First, we recently announced the resignation of Hector De La Torre, who stepped down from our board to accept an appointment as Executive Director of the Gateway Cities Council of Governments. I am excited for Hector and wish him the best in his new endeavours, yet we will be sad to see him go. Hector was an initial board member, participating and assisting in our public birth, evolution, and success. I'd like to express my extreme gratitude to him.

In tandem with our financial progress, Glass House continues to follow, support, and demand progress for justice initiatives related to cannabis. Those of you who were able to join us at Investor Sesh heard our Justice Ambassador, Luke Scarmazzo, give a heartfelt talk about how grateful he is to have gained his release after serving 15 years of a 22-year sentence in a federal prison in Mississippi for lawfully operating what was a state-compliant medical cannabis dispensary in California from 2004 to 2006. Luke had been out of prison for only 141 days.

We are grateful to have him as part of our Glass House family, which leads me to our recent announcement regarding our partnership with Weldon Angelos and the August 1st launch of his first exclusive premium indoor flower brand, REEFORM.

Weldon was a rising music producer and recording artist who had worked with industry heavyweights such as Snoop Dogg and Nas when he was arrested in 2003 for selling less than $1,000 of cannabis. Federal prosecutors turned this into 20 counts that, if convicted, mandated 105 years in prison.

Weldon was ultimately convicted of 16 counts of the charges and sentenced to 55 years in federal prison without the possibility of parole. Through the crime bill of 1994, the federal judge was forced to impose the prescribed punishment yet took the extremely unusual action of describing the sentence as cruel, unjust, and even irrational.

2016, after serving 13 years in prison for this minor first-time cannabis-related offense, Weldon was released from prison due to a sentence commutation from President Obama, while ultimately earning a full presidential pardon in December of 2020 from President Trump.

Our partnership with Weldon, MISSION [GREEN], and REEFORM is dedicated to helping those currently serving cannabis-related prison sentences, providing resources and education to help rebuild their lives, and to advancing policy reform to end the war on drugs.

Liberation of those who are incarcerated for nonviolent cannabis offences is a must, given there are more than 2,700 people still in prison for a plant, which the vast majority of the United States population agrees should be federally legal.

As the CEO of Glass House Brands, it is my moral responsibility to advocate for these individuals, and we stand committed to securing their immediate release. Let's all hold President Biden accountable for his campaign promise to release and pardon all cannabis prisoners, to give them their life back. It has been several years, and he has yet to release even one of them. The time is now.

With that, let me turn it back to the Operator for your 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 *, followed by the 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request. Should you wish to remove yourself from the queue, please press *, 2. If you are using a speakerphone, please lift the handset before pressing any keys.

One moment, please, for your first question.

The first question comes from Bobby Burleson of Canaccord. Please go ahead.

Bobby Burleson — Canaccord

Great. Thanks for taking my questions. Congratulations on—it's a fantastic performance.

So yeah, maybe just starting with some of the potential optionality you have from exceeding your guidance, your timetables, et cetera. Are there areas, considering the stress out there or elsewhere in California, where you might get more aggressive versus just what you've talked about so far with being focused on cultivation?

Kyle Kazan

So thanks for the question, Bobby. Are you asking us what plays we're about to run? Like we are definitely seeing some interesting opportunities. But I don't think we want to give out our playbook.

I guess what I would tell you is, as you can imagine, our team, being solely focused on California, knows everybody in this business, and we're in communication. And so I would tell you that while we're very, very focused, laser focused on increasing our cash cow, which is our SoCal farm, we are also always talking and always considering different options. Sorry to be so vague.

Graham, you want to offer some other vagueness?

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

Yeah. No. I think it's a good question, Bobby. And of course, we're always looking for the opportunities out there. I think one of the really nice things that we have is our cornerstone, which is our deep roots in cultivation. And now, with the experience of the team and the SoCal asset and just how well that, that is working, it gives us a really strong ability to play off the front foot. That said, 1,000 nos for every yes. Focus, focus, focus to steal some lines from Mr. Steve Jobs.

So while we do expect there to be lots of opportunities and keep coming back to the fact that with all the challenges we see in California, we're still selling $5 billion a year of legal cannabis, which is as big as the next few markets combined.

So that's where we sit now, which leaves tremendous opportunity out there. And we will certainly have our eyes open for the diamonds in the rough that plug into our platform in accretive ways.

Bobby Burleson

Understood. Yes. I think I got the philosophical kind of response, which sounds like there's some flexibility if something's attractive. So just also curious on the wholesale pricing dynamic. Maybe just walk us through how that's unfolding versus expectations that you've had?

And maybe, in the back half of the year—no one has a crystal ball—but outside of the seasonal kind of things that happen, how does pricing look versus your internal model?

Kyle Kazan

Graham, you want to take it?

Graham Farrar

Sure. Maybe I can start with a high level, and I don't know if, Mark, you have any specifics you want to share.

I think, generally, things—not to say that we knew the depth, the timing, et cetera. Our crystal balls are made out of salt as well. But I think, generally, things are progressing kind of in the order that we expected them to, with coming through a period of what we viewed as deeply destructive pricing. We're certainly seeing that reflected in the licence counts out there. But we've seen—continue to see and seen significant attrition, both the number of licences as well as the square footage.

You've seen the kind of commensurate rise that you would expect over the last 12 months, price appreciation up to 100 percent. We're currently into the kind of post-June/July, which is typically when the first light deprivation harvests in California start to come down. So we are seeing, a little bit of a plateauing to softening of the market, which is not unexpected seasonally.

It continues to be in a very good range for us and continues to, frankly, be at levels which are higher than we kind of initially forecasted and built the business to operate on.

So I think we're going to continue to see attrition, albeit at maybe a slightly slower pace. There's still a decent number of provisional licences out there. Many of those need to—or will go away by statute. Every single one of them has to be gone, I believe it's January 1st of 2025. So the clock is definitely ticking down on those.

Continues to be a very high bar with having to get over the CEQA hurdle in California, which is the California Environmental Quality Act, and then is a very high, rigorous standard and one that can be weaponized by opposition groups which, unfortunately, we still have in cannabis.

So I do think we're going to continue to see licence attrition, and that should give us relatively stable pricing going forward. And it's at a level that's very workable and good for us right now.

Kyle Kazan

And, Bobby, I think you've heard us—I don't want to sound like a broken record, but what we can control are our COGS, and that is our focus. And prices are cyclical. They're going to go up; they're going to go down. But as we think our moat that we can deepen is just to continue to focus in on our COGS and our efficiencies.

Bobby Burleson

Great. Thanks for that. And just to close—

Kyle Kazan

(unintelligible)

Bobby Burleson

—I'm wondering, is there some lag effect potentially, also, in terms of the timing of some of those folks kind of shutting their doors or their operations and the impact on market pricing where, maybe, there's some lingering positive effect going forward?

Kyle Kazan

Mark?

Mark Vendetti

Yeah. The licences are definitely a trailing indicator. The way it works in California is they're annual licences. So we don't see the nonrenewal until it actually hits its annual date, so people could stop operations—and theoretically, it could be almost 12 months, that you could stop operations—

Bobby Burleson

Sure.

Mark Vendetti

—before you see the licence not renew. So I do think that we're seeing a decrease in supply, and we're seeing that kind of objectively documented in the licences after the fact.

I actually just had a call with the CEO of Santa Barbara County where, previously, there was a waitlist for people waiting to get into the cap in Santa Barbara County. A number of operators have closed down. They've offered up the resulting spots to the waitlist. They've now cleared the waitlist, and there's not enough people who to even fill the cap anymore. So what went from a mad rush is now very much honing in and consolidating on the operators who are efficient enough to survive in this environment.

Like to Kyle's point, COGS is what we can control, and we continue to focus our energy on that and bringing that down. I think we had a record low COGS for Q2, and then we expect to significantly knock that down in the second half of the year.

Bobby Burleson

Great. Thank you.

Kyle Kazan

Thanks, Bobby.

Operator

Thank you. The next question comes from Scott Fortune of Roth MKM. Please go ahead.

Scott Fortune — ROTH MKM

Good afternoon and thanks for the questions. Yeah. Want to say impressive production level. Obviously, in the second quarter, where the period of kind of a tough weather for Southern Cal, low light from that standpoint, but just want to provide a little more colour on your being able to bring down the cost down to $139 per pound. Kind of step us through the seasonal production. And obviously, 3Q is usually one of the higher production levels, but you're keeping that, maintaining that. But just other measures that—you haven't been doing this very long in this large facility, but other measures that are continuing to bring that cost of production down?

And then as you look to get to that $120 level, just kind of step us through additional measures on the cost side from that standpoint? That'd be great.

Kyle Kazan

Sure. Yeah. So you nailed the light at the nuance there in your question. We did have very uncharacteristic low light in the front half this year. I've joked that we basically had six months of Februarys. And if you look, as we do, and track light levels on a weekly basis, you can actually go and see that in June, we were getting less light than we were getting in February, and it was actually taking 14 hours to do it instead of the 10 hours that it takes in February, which means the plants actually see less.

So it was a real testament to the team to produce the results that they did, given what they had to work with. The weather's turned around, and so we're optimistic about that. But as Mark mentioned, the growing cycle is really the preceding kind of 60 to 90 days. So a lot of what we will harvest and process and sell in Q3 is actually—a significant amount of that is growing in Q2, which is when we did have, in some cases, 50 percent less light than the 5 and 10-year averages, so not just a few points out but significant amounts.

So that's why we're keeping the Q3 flat to Q2, which is a little less than you would typically see, except more of a seasonal bump. But the reality is Q2 was a really strong quarter, so matching that kind of best-ever number, given the conditions the team is working with, I think is good. And what we're really focused on and grinding on and making great progress on is producing what we do at a high quality, even more efficiently.

So the $139 for Q2, we think we're going to be able to knock that down to $120 through the back half of the year, and that represents pretty significant reduction in costs that would be a best ever COG for us. And it's really just—I kind of use the rule of thumb that it takes two years to get a greenhouse really running smoothly, and we're just past, basically, the one-year mark, having sold our first pounds right at the end of June last year. And the team just keeps getting better and better and finding better ways and more efficient ways to do it.

So as we get more familiar in the greenhouse, we get better at what we do, and we're able to generate more from less. And that's the focus on keeping the quality up and the cost down, so we can bring quality California cannabis to California and eventually to, hopefully, the rest of the country.

Scott Fortune

Yeah. A quick follow-up on that—I appreciate that.

As you bring on Greenhouse 5, obviously, all these efficiencies you're able to put into Greenhouse 5. Are there more efficiencies that you can bring in as you bring on that new greenhouse?

And remind us, believe you said in the past, it's $10 million to $13 million to bring that on for that $80 million in revenue, $30 million in EBITDA, kind of. Are we still that same ballpark of bringing on that next greenhouse here?

Mark Vendetti

Yeah. So it is, and I think this next greenhouse is really where you'll see a number of our kind of efficiencies start to leverage themselves, all the way from the retrofit which, if you look back on the investment we needed to make to turn on the first million square feet of canopy, building nurseries, building pack houses, putting fences around a 165-acre property, odour control systems, all kinds of things, which we now, with the next million square feet, don't have to do again. Right?

You don't need to build another $0.25 million fence. You don't need to put another odour control system in there. We've already got our security in much of our cameras. So on a per-square foot basis, we'll be able to do that retrofit and stand up that next million square feet a whole lot more efficiently than the first phase.

And again, we're going into this one—the last time we did it, it was our best guess. Right? We hadn't operated in this facility. We hadn't used these greenhouses. Now with Greenhouse 5, it's literally 100 feet away from the current greenhouse where we've now got just over a year of experience. So we know the things that we want to tweak. We know the improvements we want to make. We've got the experience. We have the team. We're operating the facility.

Also, of course, the challenge of running what we're running and now layering this on top, but I do think we'll be able to continue to grind down the cost and even build—set it up more efficiently and operate it more efficiently as well, so very optimistic on what we should be able to do there.

Kyle Kazan

And, Scott, real quick—

Scott Fortune

Just one last—

Mark Vendetti

Yes.

Kyle Kazan

—just one—the answer to your third question is, I think Stanford wins the Mountain West in 2025. Congratulations.

Scott Fortune

(unintelligible) Well, I feel sorry for all the Olympic sports (unintelligible).

Real quick, one last follow-up is on the distribution side. Obviously, your lead distributor, HERBL, has gone out of business. Are you seeing pressure from the other distributors?

And you're working with co-manufacturing. How are you looking at it strategically? Will you look to kind of maybe do your own distribution? Just kind of update us on the distribution side of things?

Kyle Kazan

So, Scott, I would tell you this. We were close with HERBL for many years. We knew that the sad outcome that happened was one of the potentials. And so, as you can imagine, being in cannabis and this very volatile industry, we were prepared for the shutdown of HERBL.

Right now, we are still fully distributing our products through our co-packer. And we are certainly considering our options. We know all the other distributors in the state. As you can imagine, we have had many conversations with them and continue to do so. And I would tell you everything is on the table.

Scott Fortune

Got it. Thanks for the colour and congrats again.

Kyle Kazan

Hey. Thanks, Scott. Hope to see you soon.

Operator

Thank you. Once again, ladies and gentlemen, if you do have a question, please press *, 1 at this time.

The next question comes from Aaron Edelheit of Mindset Capital. Please go ahead.

Aaron Edelheit — Mindset Capital

Hey. I just want to make a comment that in a very, very difficult environment, especially in California, as a shareholder, I just want to thank you and the entire team for navigating such a difficult environment. Before I ask my question, I just wanted to say that, so thank you.

My question really is on unit-level economics. What was the average flower price? I know you provide the biomass. But roughly, what was the flower price that you were selling your flower in Q2?

Kyle Kazan

Why don't we let Mark handle? And thank you, Aaron, for your kind comments.

Mark Vendetti

So Aaron, in Q2, flower was selling in a $750 per-pound range.

Aaron Edelheit

Okay. So basically, what I just want to appreciate and just make sure I'm thinking about this the right way is, just for your wholesale business, at $750 flower, at 20 percent capacity utilization, you're producing a 61 percent gross margin, and that—

Mark Vendetti

Yes.

Aaron Edelheit

—you expect that to go up if—now I know you can't control pricing. But if pricing stays generally where it's at, by Q4, when you don't have the six weeks of crazy fog that we had, am I right thinking that this is going to approach or exceed 70 percent in Q4?

Mark Vendetti

So, Aaron, I just—again, the simplest way to think about the unit economics is just to look at the average selling price that we've communicated. We did $340 in Q2, and we've said it's going to be similar or up slightly in Q3. And then you always have some timing differences with what goes in and out of inventory.

But just on kind of going trend, if you literally just do $340 minus $120, and that's going to be kind of the gross margin on a dollar basis, so you're going to have a gross margin per pound in excess of $200 per pound. And $200 divided—

Aaron Edelheit

Gotcha.

Mark Vendetti

—by $340 is going to be kind of your margin. Again, it's going to vary a little bit quarter to quarter, depending on inventory levels. But that's a good way to think about the number on a kind of a long-term basis, where we could end up.

Aaron Edelheit

And I know—and maybe this is a question for Graham. I know I've taken a number of tours, and you showed me all the little things and big things that you're doing at the farm. And I know that your farm—and I believe it's a special unicorn of a farm. But it's pretty amazing to just watch competitors announce negative gross margins at these flower prices, but you're putting up 61 percent.

And I guess, is there anything in particular—especially, the production number was much higher than I expected this quarter—what is causing such a large differential? Like what—is it that the production is just much greater than expected? Is that all your improvements are all coming together? Is there anything you could give me tangibly that can explain such a wide gap?

Graham Farrar

Yeah. Sure. So I mean, obviously, I can't speak too much to the other operators and how they operate. But for us, I think it's really a combination of things. We definitely agree with you that this farm is special. It is in an ideal location. It is built in a way that is built for efficiency, both on the production side as well as the operations side. I mean the tools that we have there are kind of a—are a cultivator's dream.

And we went into this thinking it was special. And one of the things that we're finding is that we were conservative in our—in just what it's capable of. And again, I would stress we're still one year into this. The amount of trials that we have going on are significant, many of them focused on COGS, many of them focused on quality, many of them focused on improved operations, which translates to lower cost.

We also had some improvements in our post-harvest processing, which had the impact of getting things done quicker. So things that would have typically taken us four to six weeks, we got done instead in two weeks. And that brought in some of the production as well into Q2.

Part of the reason that our Q2 to Q3 forecast is flatter than you might typically expect from seasonalities, we just got work done that, typically, wouldn't have been completed until Q3 or into Q2. So I mean, really, it's been—everywhere, there's been kind of Japanese Kaizen model of continuous incremental improvement, lots of places where—there's 20 places where we're finding ways to be 1 percent and 2 percent better.

And the team is really—they are never satisfied. So a lot of credit to them and the fact that they just—they stay up at night and lay in bed and think about how they can grow higher quality cannabis for less cost. And then they come into work, and they make it happen. So it is a—like I said, I can't speak to other folks, but we're happy with the progress that we're making and still feel like we're just getting started.

Aaron Edelheit

And so just the last question about that improved post-production and the increase in production is if you assume that—if I just assume, and who knows with the crazy weather these days—but that we just have normal California sunlight in Q3, does this mean that you're just going to have a monster production quarter in Q4, when you don't have six weeks of 50 percent less sunshine?

Graham Farrar

You know, I can't forecast the weather, but if I could, I'd be in a different business. But I do think that we had tough lighting in the first half of the year. As I'm sure you've heard me say, 1 percent more light is 1 percent more yield, and we had a lot less light. And we're hoping and expecting things to—it doesn't need to be special, just if we can get back to normal, it should allow us to take the work that we've done and get even more from it.

And the beautiful thing about light is, since Mother Nature is our dance partner, and we've got the one lighter in the sky, more light doesn't cost us anything. So we get more output from, essentially, a very similar amount of input and cost, which both yields more as well as drives down our prices as well.

So I think feeling good about going into the back half of this year, and what we're seeing when we wake up each morning and look at the sky should help us get that done.

Aaron Edelheit

Thank you so much.

Operator

Thank you. The next question comes from Jesse Redmond, Water Tower Research. Please go ahead.

Jesse Redmond — Water Tower Research,

Hey, guys. Congratulations on the strong quarter. I had a question about the genetic side of things. I think in cannabis and particularly in California, people always want the new, new thing and trends and strains tend to turn over more quickly than ever. And I've noticed some people finding a challenge in finding the strains where there's going to be demand and the trendy ones people want, and then overlaying that with strains that'll also yield well to keep your costs down.

So I'm curious—and probably a question for Graham. How are you going about assessing the demand for strains and making that forecast of what genetics to grow? And two, how are you successfully overlaying that with things that will yield well to keep your production costs down?

Graham Farrar

Yeah. Great question, Jesse. And so it's challenging. It's one of those kind of treadmill challenges. This is the place where you never get to a destination. You're just trying to, again, kind of get a little bit better each time. So we've got a great team on kind of, I guess, all three sides.

One is our genetics team and the feedback we have, and this is the place where being vertically integrated is helpful because we've got our hands in the retail market and with our brands, which go to not only our stores, but all the other stores across the state. So we've got a pretty good pulse on things.

We've also got a great team in terms of the cultivation side. They learn new strains quickly.

And then one of the things that we've really added is on Mark's team, our financial planning and analysis. We have a director of finance who works very closely with our operations team and the amount of data and the analytics that we're getting back, strain by strain, yields, cost of process, what seasons they work best in, average potencies. That data is really helpful for us as we look to refine our menu.

Or I should also mention we just hired a new VP of Operations and Supply Chain, comes to us with lots of experience from large agricultural operations as well as some time in cannabis and is a lean manufacturing type of guy. And he's now embedding himself into the process so that we can really hone that down.

And you called it. It's like fast fashion, is that you never finish. You just keep trying to keep up and stay ahead of the trends and grow what the market likes and the cultivators are happy to grow and find out how to mesh those together.

So we do have the ability to have our farm up in Carp, where we've got a whole new nursery that is just doing R&D in a section now, so we're female hunting, we're trialing new genetics, we're working with other nurseries and breeders. So we really have our fingers—and we're lucky to know the people in California we do. So we have lots of incoming stuff, and I'm excited for how our menu's going to be improving over the next six to nine months.

Jesse Redmond

And just, this isn't so much financially relevant but I'm still curious anyway. It feels like we've been in this, what I call the dessert phase for a while, where it's all candies, cookies, and sherbets out there, runts and lemon cherry gelatos too. I'm just curious, are you still seeing the demand—a lot of that candy dessert phase? Or maybe just trends in terms of what consumers are looking for on the flower side?

Graham Farrar

Yeah. So purple candy is still the vast majority of the demand out there. I personally kind of look forward to the green gas coming back, and I think it will. Again, like fashion, the trends tend to be somewhat cyclical, but that's definitely—the more purple and the more sweet is the way the market's leaning right now.

But again, we're trying to lead that so we've got some good OGs and some good kushes and some good sour diesels and things like that, so we're not going to abandon that side of the market. But of course, our job is to provide what people want, so we're growing what they seem to be looking for.

Operator

Thank you. We have time for one more question from Mike Regan of Excelsior Equities. Please go ahead.

Mike Regan — Excelsior Equities

Hey, guys, Thanks for taking the question and, as everyone said, sort of impressive quarter on the production and increases. So looking forward on Greenhouse 5, I guess, two questions on it.

First, the 250,000 pounds of production guidance—you just mentioned it takes a couple years to sort of dial in the greenhouse. So is that 250,000 the dialled-in number? Or is that sort of the first year-out-the-gate number on that greenhouse?

Graham Farrar

No. That's what we expect to start with. Obviously, as we start the greenhouse up, we will plant it gradually. We're not going to plant the entire thing in one day, so you will see that ramp up, but call it our first full year of operation, 250,000 is the number that we expect to kind of come out of the gate with there.

The beautiful thing about Greenhouse 5 is it's almost a carbon copy of Greenhouse 6, which we now have experience in. So whereas the first time going in, it was a lot of best guesses and forecasting, but now we've got over a year of actuals. So for a lot of what we're doing there, it's not quite a copy-and-paste, but it's not so far away. We now have some experience, and we kind of know what to expect from that design and that location, and that helps a lot in our planning.

Mike Regan

Got it. Okay. And then second, I think, Graham, it was actually you that said this to me a couple years ago about one thing to grow the weed, but you actually have to sell it. So I guess, can you help us understand sort of what steps you're taking in preparation to actually sell 600,000 pounds once that greenhouse actually opens versus what you're doing today?

Graham Farrar

Yeah. Sure. So I think the quote is crops aren't grown, they're sold. If you grow something no one wants, you wish you hadn't grown it at all. So it definitely is the key, and I think that's one of the things that as you—can look at our numbers, you can see the demand stays strong. Our inventory levels are low.

We've got a great sales team, who's busting their ass every day. And thankfully, we also have customers who, if anything, are wishing that they could get more from us. And we have—and also are operating in a market where we're seeing decline in supply, as evidenced by the licence attrition out of the market.

So if you think of—if you think about it from the scale, or think about the background context in the state, we see something like 20 million square feet of cultivation have left the market over the last, call it, 14 months.

The new greenhouse that we bring on, it's 1 million square foot of footprint, but from an actual canopy point of view, you're somewhere around the 700,000-square-foot range. So on the one hand, 20 million square feet have left. On the other hand, we're talking about bringing on 700,000. So when you look at those two things, it's—continues to be somewhat of a drop in the bucket of the overall California market.

As we sit here today, we're probably less than 2 percent of the cultivation licences in the state. This will add another chunk but, again, very low digit—very low single-digit percentage of the overall market. So we're confident that we can continue to improve our quality, and high-quality weed at great prices is something that the market seems to have a strong appetite for.

Operator

Thank you. That is all the time we have for questions. I will turn the call back over to Kyle Kazan for closing remarks.

Kyle Kazan

Thank you, Operator. Thank you to everybody who listened in. Really appreciate you and look forward to doing this again at the end of the third quarter.

Operator

Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.