Glass House Brands Inc.

Third Quarter 2023 Investor Call

Event Date/Time: November 13, 2023 — 5:00 p.m. E.T.

Length: 51 minutes

CORPORATE PARTICIPANTS

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

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

Mark Vendetti
Glass House Brands Inc. — Chief Financial Officer

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

CONFERENCE CALL PARTICIPANTS

Bobby Burleson
Canaccord — Analyst

Jesse Redmond
Water Tower Research — Analyst

Mike Regan
Excelsior — Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Glass House Brands Third 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 — VP, Investor Relations, Glass House Brands Inc.

Thank you, Operator. Welcome, everyone, to the Glass House Brands Third Quarter 2023 Conference Call for the three-month period ending September 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 filings 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, November 13, 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 very proud to report that our focus, hard work, and resolve have yielded yet another record-breaking quarter. And I'd like to sincerely thank our Glass House team for all of their hard work and dedication.

Prior to discussing our third quarter financial results, I want to refer everyone to the press release, which shares our numbers in detail.

When we entered the cannabis industry back in 2015, we saw an industry that would someday be massive and full of blue skies, and we continue to see it that way. At the same time, it has been very rocky road for companies and investors alike, as this is a new industry and its regulatory structure is unique and fluid.

It feels as though we have run through a trial by fire for years and years to get here, and yet this industry today is still extremely difficult compared to almost any other industry. We relish the opportunity in front of us.

Case in point, as I look at the current state of California cannabis, the total California market is probably about $10 billion to $12 billion, with at least half of that demand supplied by the illicit market. Many legal California retailers are not paying their state excise taxes, nor are they paying their brands. Both brands and retail are under stress, and this period of consolidation is likely to play out for at least the next 12 months.

The demand is huge, and people want a legal, safe, and regulated option. Currently, over 65 percent of the counties in California still do not have even one operating retail dispensary, creating weed deserts where consumers can't access legal products. Moreover, in the areas where dispensaries are allowed, there tend to be too many, resulting in destructive levels of competition.

More than 40 percent of all legal retail stores are located within just seven municipalities, and in these locations, they typically compete against even more illegal stores and delivery services.

For example, the illicit retail market is robust in the city of Los Angeles, and our dispensary, The Pottery, competes with a frequently changing lineup of 10 to 20 illicit operations at any given time. These bodegas, trap shops, and/or delivery operations will often be closed down by authorities, only to reopen in a new location, sometimes just days later.

And yet, as challenging as the industry is, it is getting easier. By managing our expenses with discipline and staying true to our core focus of growing high-quality cannabis at the lowest possible cost, we've built a business that has an ever-widening moat. With every $1 reduction in our cost of cultivation, we bring that much more value to our customers, which makes it much harder for our competitors, while widening our profit margins and strengthening our balance sheet.

While we see the regulatory environment gradually improving, we'd like to see opportunities and even carrots offered to illicit operators to join the legal market as the best way to build a healthy industry. We support less regulation and a suspension of the excise tax as smart next steps. This would be good for the consumer and, ultimately, for the state.

As we continue to bring our costs down while growing our cultivation capacity, we also become more competitive relative to all growers, legal and illicit. For the legal market to win, it needs to deliver the very best value to customers and to patients. This has always been one of our primary goals.

Based on my discussions with policymakers in California and Washington, D.C., I believe there is a high probability that the DEA will provide its recommendation on rescheduling to a Schedule III before the end of this year, with implementation likely by the middle of next year.

To be clear, anything short of decriminalization is bad policy because under Schedule III, people would still face the possibility of going to jail for growing, selling, or using the plant. That said, rescheduling and finally having the acknowledgement that cannabis has medical benefits and a low potential for abuse is still significant progress.

To date, the current administration in Washington, D.C., has not fulfilled their commitment to releasing those jailed due to the harmful policies of the war on drugs. In fact, this administration has done absolutely nothing to support this new industry, which is supported by the vast majority of Americans.

The polls are indicating that the 2024 presidential contest will be very tight, making it more likely that each candidate will need all the votes they can get. This gives us optimism that our national politicians will be motivated to actually move the needle.

Meanwhile, I'm encouraged by the widening breadth of use of cannabis for medicinal purposes amongst friends, family, and our customers. My friends in their 50s, 60s, and 70s are increasingly saying no to prescription drugs like Ambien and yes to sleep gummies, while senior citizens are turning away from opioids and to cannabis for pain management.

We are further encouraged by the increased focus on our super single-state California company by bankers and the media.

I recently made a trip to New York to join the ATB Capital Markets 2023 Life Science (sic) [Sciences Institutional] Investor Conference. While there, I participated in the Thriving in Difficult Markets: Lessons from California and New York panel with ATB analyst Frederico Gomes and was interviewed by Bloomberg's Paul Sweeney and Matt Miller on The Tape podcast.

One week later, I joined Nicholas Vita, CEO of The Cannabist, and Ryan Crandall, the Chief Revenue Officer of MariMed, on a panel hosted by AGP's Aaron Grey called Cannabis Green Shoots Today & To Come.

All three of these were taped and can be accessed through the Events & Webcasts page on our website.

In particular, I could not have made the case for interstate commerce any stronger than Matt Miller or Bloomberg did while interviewing me. While discussing the positive experience a friend of his recently had with our PLUS edibles, he asked rhetorically, Brooklyn Lager is a fine beverage, but if I want Sierra Nevada, I don't want it to be illegal for me to buy it somewhere. Right? Today, though, that is exactly what consumers and patients are faced with, thanks to broken federal policy.

I'll talk about the highlights of Glass House's quarter three performance before turning the call over to Mark for a deep dive on the numbers.

This quarter was a meaningful marker of our progress over the past 12 months, as the third quarter of last year was the first full quarter of operations for Greenhouse 6 at the SoCal farm.

Revenue grew by 71 percent year on year to reach a single-quarter record high of $48.2 million, exceeding the guidance of $45 million to $47 million. The key driver was wholesale biomass revenue, which reached a record high $33.8 million, up 142 percent versus the same period last year.

We produced 102,000 pounds of biomass, at the upper end of guidance of 100,000 to 103,000 pounds and over 36 percent higher than last year. And excitingly, this was done with the same cultivation footprint as last year.

Additionally, we sold a record 101,000 pounds of biomass in the third quarter of 2023, compared to 90,000 pounds in the second quarter of 2023 and 69,000 pounds in the third quarter of last year. Inventory is low, and we continue to be able to sell everything we grow.

Perhaps the most encouraging aspect of this performance is that we are still learning to optimize our yields and have not yet hit the limits of achieving our potential flower production.

I congratulate Graham and his team for once again delivering consistent reductions in cultivation cost.

Cost per pound fell to a record low $118 in the third quarter, 12 percent below the same period last year. This puts us in good shape to reach our stated guidance of $120 a pound for the second half of the year.

Average selling price was 1 percent lower than we expected at $336 per pound from $340 per pound in the second quarter.

Wholesale gross margin fell 1 percentage point to 60 percent. But given the increase in top-line revenue, gross margin dollar value reached a record high $20.2 million, an 8 percent sequential increase and over three times higher than the third quarter of last year.

Sales from our retail dispensaries reached $10.1 million, flat to the second quarter and up 56 percent versus last year.

Retail gross margin reached a record high of 56 percent versus 54 percent in the previous quarter, while revenues from CPG were $4.3 million, up 9 percent versus the previous quarter but down 45 percent year on year.

A bright spot was that our value offering, Allswell, became a top-20 flower brand in the third quarter, which is all the more impressive when you consider that we've done it in less than a year, with our focus on actual cash collection and in a distressed retail and brand market. This is a faster rise in market share than we experienced even with our highly successful Glass House Farms brand.

Gross margin for our CPG business was flat at 6 percent. As I mentioned, the retail and brand segments of the California market continue to be distressed. We are laser-focused on maintaining a disciplined credit management strategy, selling only to stores that pay. This approach has kept our accounts receivables risk low. While this strategy exacts a price in terms of our rankings and third-party point-of-sale surveys, it is a price we are willing to pay.

The brand rankings don't take into consideration if payment is made by the retailer and, thusly, there's no benefit to being the number one brand if we are not getting paid. Our philosophy as an integrated producer, who has the optionality of selling through our CPG channel or via wholesale, is that we are not in business to give our biomass away.

In summary, our outlook continues to be bright as we build upon the success we have already achieved through the first three quarters of 2023. This competitive advantage, as one of the nation's largest and most cost-effective cultivators, will allow us to continue to drive shareholder value, which will be compounded when the gates to interstate trade in cannabis products are allowed.

Before I turn it over to Mark, I'd like to emphasize that the massive success we've had in increasing production and sales of wholesale biomass has come during a year in which we have experienced highly abnormal weather condition.

California saw almost an entire month of rain in January, which wiped out our multiyear drought, months of cloudy weather, a hurricane warning followed by bomb cyclones, and in August, the first tropical storm to hit California in recorded history. And to boot, year to date, the sunlight levels are more than 10 percent below the 10-year average. While Californians adjusted to this peculiar weather, our farmers had to scramble to adapt to every one of these oddities.

As we have chosen to harness Mother Nature to grow amazing cannabis, we benefit from free sunlight and ocean air with the caveat that we must contend with swings in weather conditions. The last few months, which represent a significant portion of the growing season for the fourth quarter, have seen a combination of unseasonably low sunlight, high humidity, and higher temperatures, which is a particularly difficult set of conditions for cannabis cultivation.

While we will far exceed our production compared to the fourth quarter of 2022, we do expect that these conditions will result in lower percentage of flower than is typical for the fourth quarter, effectively reducing our overall selling price. Mark will discuss the impacts in our fourth quarter guidance.

While most cannabis companies have chosen to cultivate inside of warehouses, which typically allows for full environmental control, this comes at a significant cost in dollars and to the environment. Additionally, no other agriculture product is grown in mass inside of industrial warehouses.

I am confident that our skilled and experienced cultivation team faces new challenges, they will learn, and the financial swings will be lessened going forward. For instance, the team learned and made adjustments after battling the extreme heat of last fall, and the same will be true this time.

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. Go, Mark.

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

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 according to US GAAP.

As Kyle mentioned, net revenue for the third quarter was $48.2 million, exceeding guidance of $45 million to $47 million. Revenue increased 71 percent versus the same period last year and was up 8 percent compared to Q2. This was primarily driven by a 10,500-pound increase in sales of wholesale biomass.

Consolidated gross profit was a record $26 million or 54 percent of net revenue, compared to $24.4 million or 55 percent in Q2 2023, and up from 31 percent in the third quarter of 2022.

General and administrative expenses increased to $15.2 million for the third quarter, compared to $13.1 million in Q2 and $11.5 million for the same period last year. The main reason for the increase was $2.5 million more of bonus and stock compensation expense during Q3 than in the previous quarter, based on our year-to-date performance.

Sales and marketing expenses were $0.6 million compared to $1 million in Q2 and $0.8 million in Q3 of 2022.

Professional fees were $1.7 million, down from $2.2 million in Q2 and $2.8 million in Q3 2022. We have made a conscious effort to reduce external consulting and legal fees over the past year, and we are happy to see this result.

Depreciation and amortization in Q3 2023 were $3.7 million, up slightly from $3.6 million in Q2 and up from $3.4 million in the same period last year.

Adjusted EBITDA hit a record $10.7 million in Q3, showing significant improvement from $9.5 million in Q2 and negative $2.7 million a year ago.

The improvement in Adjusted EBITDA in 2023 has been driven by increased production and higher volume sales of wholesale biomass, better pricing, and reduced cultivation cost per pound, which has in turn driven revenue growth and gross margin expansion. Continued improvement in operating expense management has also contributed to the increase.

Through the first three quarters of this year, we have produced a cumulative $20.1 million of Adjusted EBITDA, compared to a negative Adjusted EBITDA of $18.8 million in the same period last year.

Moving on to the balance sheet.

We ended the quarter with $37.9 million in cash versus $22.7 million the previous quarter and $17.5 million in Q3 2022.

The quarter-end cash position includes approximately $5 million in CapEx spending on Phase 2 expansion at Camarillo, including the Greenhouse 5 retrofit, as well as $10.9 million in cash inflows from the first close of Series D preferred equity raise and an additional $1.9 million of cash for the Series D received after the first close.

Since the end of the quarter, we have received $1.6 million more in cash. We expect to receive the final $0.6 million within the next few weeks and plan to close the Series D preferred equity raise soon at US$15 million.

We generated a record $9.1 million in cash from operations in Q3 '23, which is 11 percent more than the $8.3 million generated in Q2 and a significant improvement over the negative $8.2 million in Q3 of last year.

Through the first three quarters of this year, all of which have seen Glass House generate positive operating cash flow, we have produced a cumulative $21.8 million in operating cash flow versus negative operating cash flow of $31.5 million in the same period 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 16 months, though at a slower rate.

During the third quarter of 2023, the number of active, mixed-light, outdoor cultivation licences declined by 455, with another 52 leaving the market in October. In total, the number of active mixed-light and outdoor licences has dropped by 39 percent, from 7,190 in June of last year to 4,364 at the end of October.

We estimate that this has resulted in a fall in the low-20 percent range in the square footage under cultivation. Given the massive scale of this consolidation, we expect the pace of decline in active licences to moderate in the coming months.

With output across the industry set to fall due to seasonal factors, with lower light levels, cooler weather, and output from outdoor cultivation dropping, we expect prices to improve in the coming months. In fact, we have already begun to hear anecdotal reports of farms who have sold out of their October harvest.

As Kyle mentioned, this is a difficult environment for branded players, especially ones with no proprietary cultivation capacity. We have been tracking the number of brands with sales of at least $30,000 in revenue per quarter, and the pace of consolidation has accelerated in the past two quarters, with the number of brands meeting a 30K hurdle falling by 81 in Q2 and by another 93 in Q3.

Overall, since June 2022, we’ve seen a 29 percent reduction in the number of such brands, with the current number at 662.

Moving on to the demand side, data from Headset shows the retail environment for the California market remained challenging in the third quarter, with total market sales down 11 percent versus Q3 last year.

Flower sales declined 15 percent year on year, while pre-rolls substantially outperformed the market and were down 1 percent. Flower plus pre-rolls combined were down 11 percent year over year in Q3.

The vape market continued to cool significantly, falling 10 percent year on year. This segment of the market saw year-on-year growth decelerate in every quarter last year and has shrunk each quarter so far this year in value terms, though unit demand has continued to show healthy growth.

Edibles were down 6 percent year over year and continue to outperform the overall market.

On a sequential basis, overall, California market sales were down 6 percent, Q3 versus Q2.

Despite the decline in retail sales, total market demand remained steady. Unit volume fell 1 percent versus the same period last year. This is indicative of the extremely competitive CPG market, which has resulted in declining retail prices which benefit consumers.

I'll now provide fourth quarter guidance for key operating metrics.

We expect total revenue to be between $38 million and $40 million, a 21 percent increase from Q4 last year, but a 19 percent decline from the previous quarter at the midpoint of guidance. The expected sequential decline in revenue is caused mainly by the change in mix that we discussed previously.

Typically, we expect flower to account for 40 percent-plus of the production in volume sales this time of year. But this year, in Q4, we expect this figure to fall to the mid-30 percent range.

As a result, we're guiding for ASP to fall to $270 per pound in Q4, versus $336 per pound in Q3, which we expect will result in roughly an $8 million to $9 million reduction in Q4 revenue versus our previous guidance.

Q4 Retail and CPG are expected to be roughly consistent with Q3 sales of $14.3 million.

We expect to produce between 100,000 to 102,000 pounds of biomass in Q4, which is slightly lower than Q3 2023 at the midpoint of guidance. We continue to guide for second half cultivation cost of $120 per pound.

Given the reduced Q4 revenue expectation, and making approximately $5 million in income tax payments in Q4 for tax year 2022, we expect to have negative $2 million to $5 million operating cash flow in Q4 and Adjusted EBITDA in the range of $5 million to $7 million.

Phase 2 expansion into Greenhouse 5 will have no impact on revenue or cost in Q4. We estimate CapEx spending in the quarter associated with the Phase 2 expansion to be approximately $6 million.

Also note, we are reaffirming our guidance on timing related to Greenhouse 5 production and revenue. We expect to have plants in Greenhouse 5 by early 2024, with the first sale projected for Q2 2024. Once operational, we expect Greenhouse 5 will increase our annual cultivation capacity by roughly 250,000 pounds, to a total of 600,000 pounds.

With that, I will turn the call back to Kyle.

Kyle Kazan

Thank you, Mark. A few final notes before we turn it over to question-and-answer.

We recently announced the appointments of our newest board members, John Pérez and Yelena Katchko, and are excited to have their energy and expertise to strengthen our company leadership.

At the same time, we said thank you and farewell to our departing board member, Bob Hoban. We extend our heartfelt gratitude to Bob for his dedicated service as a board member during his two-year tenure.

On the social equity front, we are proud to have assisted Weldon Angelos in launching the REEForm Cannabis line. It has been performing well in stores and is giving us the opportunity to do work which directly benefits those incarcerated for cannabis offenses, assisting their release, and offering scholarships to Oaksterdam University, the world's first cannabis college. REEForm allows our customers to support the cause, along with the team at Glass House.

Furthermore, I would like to congratulate Weldon, our Chief Revenue Officer, Hilal Tabsh, and our Vice President Of Marketing, Josh Karchmer, as well as our marketing team and our agency partners, for the multiple Clio Award wins. This is a significant achievement and is an honour to have our release, rebuild, reform campaign recognized in the advocacy's Social Good and Illustration categories of the Clio Awards.

And besides the wonderful social aspects of reform, consumers get to enjoy some of the finest cannabis strains curated by Weldon Angelos, who has demonstrated an exquisite taste for a top-shelf flower experience.

Advocating for those in prison for nonviolent cannabis offenses isn't just a Glass House commitment; it's a moral imperative. Parker Coleman Jr. recently celebrated his 38th birthday while behind bars, as he is serving 60—six, zero—years in a federal prison for a nonviolent cannabis offense. Parker was convicted of conspiracy to distribute cannabis and money laundering. However, during the trial, no witness testified they'd ever purchased cannabis from Parker.

These injustices need to stop, and we are working tirelessly to ensure Parker is out of prison so he can celebrate his thirty-ninth birthday at home with his family. It should not be forgotten that approximately 3,000 people remain in federal prison for cannabis-related offenses, and we will continue to adopt and support initiatives for those still behind bars as we go forward.

As the CEO of Glass House, I believe in using our influence to shine a bright light on the dichotomy which currently exists. With a massive cannabis industry which is legal in almost every state, on one hand, thousands of Americans are suffering in prisons for the nonviolent sale and distribution of that same plant. This inequity imbrues the very fabric of our justice system, which lives under the illusion of fairness and impartiality. Sadly, the system remains blind to this continuing injustice.

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 *, 1. If you want to withdraw your question, please press *, 2. Your questions will be polled in the order they are received. If you are using a speakerphone, please lift the handset before pressing any keys.

One moment, please, for your first question.

Your first question comes from Bobby Burleson from Canaccord. Please go ahead.

Bobby Burleson — Canaccord

Hi. Thanks for taking my questions. So just curious, in terms of the lower flower mix in your production, how early were you able to kind of assess what was happening?

And then, how lingering could the impact be? Is this something that could linger, in terms of your average selling price, beyond this quarter?

Kyle Kazan

Thanks for the question, Bobby. Let me ask Graham to respond to that.

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

Sure. Hey, Bobby. How you doing? Thanks for the question.

So a couple—I think, just to start with a couple of notes. Someone asked the other day, isn't—with (phon) the weather earlier, how does that impact quarter four? And so it's worth a reminder that the plants that we're harvesting and finishing and selling in quarter four actually started their life as mother plants in March. So some of this that stretches back, as Kyle mentioned in the call, where we were having the first tropical storm to ever hit California and things like that, is where some of this started.

The good news is, even with us being more conservative here, we're still talking about guidance that would be a 30 percent increase from what we did in Q4 last year. And so really, it's fairly dynamic, especially with these conditions. I mean, if we were amazing weather forecasters, we'd probably all be retired, and that's challenging for everyone.

So it really does—you kind of get what you get each day with the weather. So as things develop—and we just—we've had a couple runs where we've had that combination of cloudy, low light, warm temps and, in particular, high humidity. So it really is dynamic in terms of when—you can have an event over a weekend, and it can change your forecast.

The good news is, don't expect it to linger. This is not—as the weather kind of goes back to normal seasonality, and as we look into five- and ten-year averages, what we've seen over the last few months were far off what you would expect. So expectations would be that you get back to kind of the normal cycles, and this stuff passes through in a couple months.

It's basically the plants that are growing, you harvest them, you process them, you sell them, and then you're on reloading the funnel with like the weather that we've had in the last few weeks has been great and very much in line with what we'd expect to see for the season. So it should pass through fairly quickly.

Bobby Burleson

Okay. Great. And then on the topic of a crystal ball, Kyle, in your comments, you had some timetables that sound pretty reasonable in terms of a rescheduling to Schedule III and implementation. And I'm wondering, what kind of things can you do preemptively to be best ready to adapt to that new environment? Would there be a fundamental change in some aspects of your business?

And maybe we can just touch on implications for the model or just anything else that you think could get drawn into this if that does in fact happen?

Kyle Kazan

So, Bobby, I appreciate that question. I will tell you, trying to prepare for what the federal government may or should do is like standing in the middle of a minefield because they've literally done nothing to help this industry at the federal level since—I don't know, since Richard Nixon started the war on drugs. So—

Bobby Burleson

Ever?

Kyle Kazan

Now that said, with Schedule III, we're being asked, will we be able to up-list to NASDAQ or NYC, to New York? We don't have it, and a lot of this is going to be—the devil's going to be in the details. Will that open up interstate commerce? Again, that's probably not likely.

So I think our focus is, behind the scenes, we're looking at those different options to see what we might be able to do to optimize in less than any amount of time. But we don't—while I believe Schedule III is absolutely coming, we have to see what the details—what's in the details before we can really react.

But I will say, it's something we're talking about behind the scenes and trying to find ways to quietly be in preparation for any potential outcome because we'll take any positive we can get.

Bobby Burleson

Okay. Great. And then just one last quick one in terms of the weather impact and what that's done in terms of your output, the mix of your output. Curious how broad of an issue this has been for outdoor grows in California, as far as you can tell.

And then, just in terms of guys that are on the edge of financial ruin or what have you, like does this accelerate some of that if, in fact, there's been tough harvests for other folks out there, as far as you can see?

Kyle Kazan

So again, appreciate the question. And I'm sitting here with our marketing team, our IR team. And they're saying, hey, somebody on Twitter said this, somebody on Twitter said that, which is always a bad rabbit hole to go down. But somebody was questioning the weather, like somehow we're making that up. I'm like, look, the internet, just go to the interweb and play with your Google machine, and it will help with that.

All of that said, the one thing that a lot of us seem to forget—because there are some very large companies that grow inside warehouses, and they have optimal climates where they are not susceptible to anything other than a power outage from outside. But we know, long term, that this is an agriculture product. That's what this entire industry is based on, whether you're in apples, grapes, wine, anything. And there is no other industry that grows indoors.

So we, compared to all the other large companies, are more susceptible to that because we act like an agriculture business. And we did suffer some very interesting weather out here, and that did affect us. Will it affect others as well? A hundred percent.

But I just want to make sure I level set the expectations of the Street out there to go, why is Glass House a little different? Well, we're also trying not to beat $800 a pound; we're trying to beat $100 a pound. And that's sort of the difference.

But let me ask Graham to kind of finish the question about what we might expect from the rest of the industry because of the weather issues we dealt with. Graham?

Graham Farrar

Yeah. Yeah. It absolutely is a statewide issue, Bobby. It's not limited to us or even our region. I think you might remember Casey Houweling, who was the individual that we bought and purchased the farm from. He built it, so he's been there for about 25 years. And in his historical context, he says he's never seen a year quite like this.

Another grower who's been there said, oh, yeah, I remember this year, it was like this in 2002. Right? So you're talking about, A, he remembers it and, B, he's going back 20 years for that memory.

And you can look—I mean, this isn't even a cannabis-specific thing. Right? If you want to go and Google California weather and harvest, you'll see that wine growers are talking about late harvests. There's folks that we know that grow cucumbers and tomatoes, and they're coming up short on their production targets and wanting to run lights and things like that to make good on their contracts.

So it's A, absolutely. I mean, it's a tangible thing if you—we track light on a weekly level. And we can tell you, empirically, that the light so far this year is 10 percent less than the 10-year average. Like that's a pretty—it's a pretty significant deviation. And even that varies, parts of the story, when there was runs of 50 percent half the light that you would normally have for weeks and weeks at a time. Right? So it's absolutely widespread, and it's not even specific to cannabis.

It is, as Kyle mentioned, we believe, long term, over the long haul, that growing with the sun in a greenhouse is absolutely the winner. But that means in the short haul, you also—Mother Nature is your dance partner. And sometimes, you play the hand you're dealt.

And even in this case, again, just a reminder that we're still tracking towards a 30 percent year-over-year improvement. It's the anomalies that teach you lessons. And we've always said it takes a couple years to get a greenhouse humming. So these are the times when we learn and improve. And we've made a number of changes that we feel will serve us better in the future as well.

Kyle Kazan

And remember, Bobby, the word terroir—

Bobby Burleson

Yeah?

Kyle Kazan

—the word terroir means the location, the weather, all the things that make this year's harvest, whether it's like an '05 wine or a 2015 wine. And so that's just common in agriculture. So any company that's not dealing with this, I would question whether they're really an ag company. If they're not an ag company, should they really be in cannabis?

Bobby Burleson

Yeah. So maybe we get more purple crystals or purple hairs or whatever this time around and a nice vintage year.

Kyle Kazan

Wow. I can't believe that—

Bobby Burleson

I like it.

Kyle Kazan

—a good analyst like you made us all like sort of go—we all sat up in our chairs ready to get that purplicious. Thank you.

Bobby Burleson

All right. Thanks, guys.

Operator

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

Jesse Redmond — Water Tower Research

Hey, guys. Congratulations on the quarter.

I was wondering if you could give me a little bit more guidance on what you're seeing in terms of pricing as we get into Q4. Seems like the headline data I'm seeing is maybe not as much impact from Croptober this year and some price stability and, maybe, even some weeks where prices are moving up. But just curious what you're seeing on your side in terms of pricing so far for this quarter.

Kyle Kazan

So thanks, Jesse.

Graham Farrar

Hey, Jesse.

Kyle Kazan

Great to hear your voice. Let me turn that one to Graham, who is—I think we checked. Everything Croptober falls under Graham's order.

Graham Farrar

Yeah. Hey, Jesse. How you doing? Thanks for the question.

So I think, as Mark mentioned, since last June, 40 percent less licences out there. I think we're seeing the impact of that, if you keep in mind that what's harvested in October then needs a couple weeks to be dried and then a couple weeks to be processed before it's sold. We're really just kind of coming into the mid-season of what you'd see there.

But the early indications, anecdotal though they are is—and again, this is stuff you can also find in the news in some case as well—is farms up in NorCal that have already sold through their Croptober harvests, people talking about not being able to find enough supply. We've noticed the phone ringing more frequently.

So for the fact that we're this early into it and already seeing some of those signs, I think it's—or I'd be cautiously optimistic that stable pricing through here is a good sign, and that's what we're seeing. And as the rest of the harvest passes through and is consumed, there's not another big chunk on the other side of it. So we generally expect to see some, at least mild, upward price pressure, which would be great.

Jesse Redmond

And, Graham, I thought I recalled when I was out there in June doing a tour that you were testing some supplemental lighting with the idea of being in low-light conditions, you could throw on these LEDs, and that might give you more consistent results. I was curious if you had gotten any data back from that and drawn any conclusions if that was a path.

Graham Farrar

Yeah. So we've actually been doing light testing, supplemental light testing for quite a while now. We've got almost 20 months of data going back into that, so we've been testing and really put it in three different categories.

One is supplemental grow lights. And as a reminder, one of our greenhouses down at SoCal has 11,000 thousand-watt HPF lights in it, and we're capable of generating all that power on site very cost-efficiently and very environmentally friendly way.

So we're really well set up as—and part of the reason we want to make sure we get it right with the right R&D is because it is such a strategic advantage that we have, the ability to make that power, just use the heat and the CO2, and do it less than you can purchase it for, is a potential for a big win there.

So we've been testing supplemental grow lights. We've been—and we're about to start testing supplemental veg lights for our nursery, and we're actually in process installing low as low output, but important LED lights into our clone domes. And we've done the testing there and have seen some very positive results, which I actually think would help in a situation like this. If we had another Q4 that looked like this one, it would have made a big difference, and those lights should all be installed by the end of the month.

So I do think supplemental lights are a place where you can find benefit. Not only does it help with the actual yield, but it also gives you the ability to control the climate a bit better and a little bit more freedom to operate in terms of the temperatures that you run the plants at—are connected to how much light they have available, so the more light and the higher the heat and the lower humidities that you can manage.

Jesse Redmond

Great. And finally, any updates on Greenhouse 5? Everything on track there? Any changes to the timeline? Or anything worth discussing there?

Kyle Kazan

I think we're right on pace, as Mark kind of reaffirmed that guidance. As you can imagine, Graham and his team are always trying to think of ways to go faster, but nothing to report other than, status quo, the plane should land on time.

Jesse Redmond

Awesome. Great., guys. Appreciate it.

Kyle Kazan

Thanks, Jesse.

Operator

Thank you. Ladies and gentlemen, as a reminder, should you have a question, please press *, 1.

Your next question comes from Mike Regan from Excelsior. Please go ahead.

Mike Regan — Excelsior

Hey, everyone. Thanks for taking the question. Kyle, when you were talking about the expectation of rescheduling and no one knows what the government will do, hopefully, the one definite thing is that rescheduling should remove 280E tax treatment of your income statement.

Sort of, in preparation of that, can you help us understand how you all think about the prioritization of how you'd reallocate those dollars that you're no longer sending to the IRS between the various stakeholders and potential uses in the business?

Kyle Kazan

Yeah, Mike. Yeah. That's the one thing that—great point you brought up—is we are expecting that if it does go to Schedule III, that 280E would go away. So that was one thing I didn't say earlier, as we look at some of the other potentials.

This year, it would have saved us 10 million bucks. And remembering that we raised 15 million this year to build out Greenhouse 5, if we didn't have 280E, we wouldn't have had to raise that money. I mean, so just in that alone would have been huge for us.

At this point, I would tell you that we have more greenhouses to build out, so having more cash on the balance sheet would be a positive. I don't have like a Santa Claus wish list of what I would do with that, if it goes away.

And remember, we turn on Greenhouse 5. That would mean that our 280E goes up from 10 million to close to probably 15 million. So I guess what I'm saying is it would certainly make us much more of a healthy company to be able to behave like every other industry in the United States.

Mark Vendetti

So, Mike, Mark Vendetti here. Just a couple other points to build on with Kyle is 280E does change a lot of the thinking around how you would access capital markets as well because, all of a sudden, you'd look at interest and go, that's deductible. We're not deducting it today. So all of a sudden, debt markets, even at elevated rates, are more attractive.

So there are just a lot of moving pieces, but I echo Kyle's point. I think our first thought is as we generate cash, we want to plow it back into the business and continue to look for ways to try to grow the cash flow of the Company from an organic perspective.

Mike Regan

No. That definitely makes sense. And then on—yeah. You also mentioned about how there's still opportunities to improve and optimize the yields. And Graham mentioned, I guess, using some of the lights on, I guess, the veg in the mother rooms, I guess. Are there sort of thoughts on how much more you could improve the yields?

And sort of what—I guess, is there like a baseline or sort of what gives you the confidence you can get to those? Like we're doing it in this little area, let's just say multiply it by 1,000? Or help us understand sort of the yield management that it could still do.

Graham Farrar

Good question, Mike. I think the biggest impact of supplemental lights, that's an area where you can—it basically depends on how much power you want to put in, and it can affect yields significantly; 50 percent to 100 percent are not impossible with that, with the right lighting setup. But that also does come at a cost to both CapEx and OpEx.

In terms of like, as an upper bound, that's a tough one. I mean, what I would expect is I would expect to see us to continue to improve as we're new in the greenhouse. And just a reminder, we sold our first pound right at the end of June a year ago. So from an actual product sale, coming out all the way at the end of the process, we're just—whatever, so—15, 16 months into this thing. So I would expect us to improve at a pretty good rate.

And then, over time, that's going to plateau to some degree. You're not going to improve 10 percent year over year forever, of course. So I think we continue to make optimizations with a number of things that we've done and some improvements that we've made that are going in Greenhouse 5, that I think are going to help us as well.

The way that we're operating the nursery is working, but I think at a place where we can improve significantly. And then that benefits not only Greenhouse 6, but all Greenhouse 5 and benefits our two farms up in Carpinteria as well. So I think there's—we've got—we're doing well. We've got room to get better which is, in some ways, the best possible position we could be in.

Mike Regan

Great.

Mark Vendetti

Mike, one thing—one other point—

Mike Regan

Thanks a lot.

Mark Vendetti

—one other point on that is I think we've talked about the next greenhouse, Greenhouse 2, having supplemental light and, in addition to potentially getting more yield year-round, it would help us even production out.

So if you look at our results historically, Q1 has been half of what Q2, Q3, or Q4 is. So there's a huge economic benefit of just getting Q1 closer to where Q2 was and having a more—and one of the greenhouses—a more consistent supply year-round. And then we don't have to manage the swings that happen moving from Q4 into Q1 and then back out into Q2, where they become smaller.

Graham Farrar

And I want to make sure that, Mike, just as a last point, where I'm basically railing against anybody that's just growing in a warehouse as their main source of this product, we were very fortunate that this property has a very clean electrical power plant, a green power plant that's capable of generating 14 megawatts of electricity annually.

So we're just being thoughtful and prudent with our cash in how we go ahead and move forward, but we could grow cannabis that has 125 percent of the light that you would get from any indoor. So we can grow ultra top shelf if that's one of the directions we want to go.

Mike Regan

All right. That's great. Thanks a lot.

Graham Farrar

Thank you.

Operator

Thank you. Ladies and gentlemen, there are no further questions at this time. I'll turn the call over to Mr. Kazan for closing remarks. Please proceed.

Kyle Kazan

Thank you, Operator, and thank you, everybody, for your interest and for tuning in today.

As a reminder, every June, we have an investor sesh, our annual meeting, in Camarillo, so please start making your plans now, as airplane tickets are a lot cheaper today than they will be in May.

Thanks, Operator.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Thank you.