FINAL TRANSCRIPT

Glass House Brands Inc.

First Quarter 2024 Investor Call

Event Date/Time: May 14, 2024 — 5:00 p.m. E.T.

Length: 62 minutes

CORPORATE PARTICIPANTS

John Brebeck
Glass House Brands Inc. — Vice President, 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 Genuity — Analyst

Mike Regan
Excelsior — Analyst

Scott Fortune
ROTH MKM — Analyst

Colin George
Haywood Securities — Analyst

Aaron Grey
Alliance Global Partners — Analyst

Andrew Semple
Echelon — Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Glass House Brands First Quarter 2024 Investor Call.

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

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

Thank you, Operator. Welcome, everyone, to the Glass House Brands First Quarter 2024 Conference Call for the period ending March 31, 2024.

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, Tuesday, May 14, 2024.

And now, I would 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.

Before discussing our results, I'll refer everyone to our first quarter 2024 press release, where you can review our numbers in more detail.

I'll start by addressing the recent news surrounding the US Drug Enforcement Administration's recommendation to reclassify cannabis from a Schedule I drug to a Schedule III. While the recent step is still subject to OMB review, a public comment period, and then a final ruling from the DEA, this is very promising news.

I expect that the most notable effects will be the potential uplifting of cannabis companies to the New York Stock Exchange or to NASDAQ; better access to commercial banking and lending services, resulting in reduced financial costs; and of course, the removal of the 280E tax burden, which will allow companies to retain more cash and, for some, to finally break even financially.

Additionally, rescheduling is long overdue federal government validation of the therapeutic value of cannabis products and an important step towards, inevitably, ending prohibition.

Those of you who have been following our Plants Over Pills video series will remember our recent video interview of two-time MMA featherweight champion, Javier El Mariachi Garcia. If you haven't seen the video, I recommend you view it on our Glass House Brands Instagram channel.

In Javier's words, I'm a cannabis athlete. I believe cannabis has a lot of therapeutic effects, CBD and THC both. I can't remember the last time I popped a pill or took any medicine like Advil. I believe in natural remedies, and I believe that plants heal. I want to break the stigma that stoners are just lazy because I'm the hardest worker in the gym, and I try to outdo myself every single day.

I strongly urge the federal government to leverage the rescheduling to finally begin releasing those incarcerated and to change the laws regarding nonviolent cannabis-related crimes currently on the books. It is the federal administration, state legislators, and the broader community's responsibility to view this not only as a legal issue but a moral one as well.

As I have stated many times in the past, no one should be in prison for a plant. We at Glass House are hopeful that the reclassification will trigger the massive legal reform we believe is imperative toward addressing systemic issues and rebuilding communities. We'll continue monitoring any developments closely and won't stop advocating until the necessary pardons and changes are made.

The first quarter of 2024 was another very successful quarter for Glass House, where we exceeded quarter one guidance across all operating metrics, including cash, sales, production, and adjusted EBITDA. We did this even with a challenging industry-wide environment and typical quarter one seasonality, and the results demonstrate our continued ability to bring down our costs without sacrificing quality.

Also included in the quarter was the all-hands-on-deck management focus related to turning on production at Greenhouse 5 while, at the same time, not missing a beat in cultivating in Greenhouse 6 and our Padaro and Casitas farms.

First quarter 2024 revenue was $30.1 million, ahead of our guidance of $28 million to $29 million.

Average selling price was $282 per pound, which beat guidance of $280 per pound, but was down from $290 per pound in the first quarter of last year.

During the first quarter, we produced over 61,300 pounds of biomass, above our guidance of 60,000 pounds, and also 28 percent higher than the same quarter last year.

Cost per pound was $182, 7 percent below the same period last year and below guidance of $185.

It is worth noting that the increase in production is from the same footprint as quarter one 2023 and is not the result of our expansion to Greenhouse 5, the impacts of which will start to be seen in the second quarter.

Adjusted EBITDA was negative $1.6 million compared to the negative $2 million to $4 million we projected.

And operating cash flow was negative $1.9 million versus the negative $3 million to negative $4 million we originally guided for.

As I mentioned on our last call, Greenhouse 5 incorporates everything we have learned to date at the SoCal farm. It has better airflow, enhanced climate control, and is more complete than Greenhouse 6 was at start-up, which is why we expect an improved ramp versus that of Greenhouse 6.

Since commencing cultivation at Greenhouse 5 in late January, we have planted, harvested, and replanted two-thirds of Greenhouse 5's nearly 700,000 square-foot of canopy, with the first harvest of the final one-third of the greenhouse expected soon. Initial yields have surpassed our expectation.

I'd like to provide updates on our sub-$10 out-the-door, including taxes, Allswell brand eighth-ounce of fresh flower, plus the strategic pricing plan that were both rolled out mid-first quarter in all of our retail stores.

These new endeavours have been making a significant impact on our retail and owned brand sales.

The Allswell eighth has been one of our most successful launches ever. In early March, we introduced this new pricing into all of our stores, and it resulted in the Allswell eighth becoming our best-selling product by unit sales volume, up from the number two position in January and February.

This offering dovetailed nicely with our retail dispensary strategic pricing plan, driving increased foot traffic to our dispensaries across the board in March.

Thanks to our vertical integration, we are able to focus in on targeting the California consumers who patronize the illicit market through our commitment of giving all consumers the best everyday deals in the state.

Thanks to these changes, our Allswell and Glass House brands are the most consumed cannabis brands in the state of California, the world's largest cannabis market, in April, according to Headset analytics.

The positive impact of these initiatives can be seen in the continuous improvement of our year-over-year same-store sales, which exclude our Turlock NHC dispensary that was opened in May of 2023.

The progression was from a 7 percent year-over-year decline in January, up to a 5 percent decline in February, and just a 1 percent decline in March, and most recently April, where we achieved slightly positive year-over-year growth.

This, importantly, is in comparison to the California market that, according to Headset data, declined 6 percent year over year across the first four months of the year, including a 7 percent decline in April.

As expected, our retail gross margin declined somewhat to 53 percent in the first quarter from 54 percent in the fourth quarter and will likely see a further reduction in the second quarter, given that the strategic pricing plan will be enforced for the entire second quarter.

This 4/20 holiday was one of the most promotional we've seen in years and, in fact, retailers are employing deep discounts to gain market share.

We suspect that much of the discounting activity we are seeing amongst our California peers is motivated by the need to pay first quarter excise taxes, which are due on May 1st. And we believe that a substantial number of stores have used the excise tax collected to float working capital expenses and may soon face liquidity challenges. This same pattern occurred when cultivators were under massive financial pressure a couple of years ago.

We view the strategic pricing plan as a rational response to current market realities. Glass House Brands is in a limited subset of operators well positioned to survive, as our vertical integration allows us to sell our popular brands in our own stores at a robust margin, even when offering deeply discounted products to consumers.

I am particularly proud of our CPG team, who showed remarkable grit as we saved at least 5 gross margin points in our CPG business in the first quarter of 2024 versus the first quarter of 2023 from reduced costs after transitioning from HERBL to our own internal distribution management. And while doing this, the team was able to grow first quarter CPG sales by 14 percent year on year and 4 percent sequentially.

Regarding funding strategy, investor sentiment towards the cannabis industry has improved and seems likely to remain positive as long as the rescheduling process continues to move forward.

Whether it be for debt or equity, cannabis funding costs are more favourable now than ever, leaving us with increasingly diverse and attractive options for enhancing our capital structure and for funding expansion. We will provide more details on potential funding initiatives when the timing is right.

The story is similar when it comes to our expansion strategy. With the ramp-up of Greenhouse 5 completed, we have a clear runway for growth.

We are currently evaluating the degree to which we will outfit Greenhouse 2 with advanced capabilities and technologies, along with necessary investment in supporting infrastructure such as packhouses and warehouses for post-harvest needs.

While we have long planned for Greenhouse 2 to be the next up for capital improvements to be operational, it should be noted that we have Greenhouses 3 and 4 in the queue and the ability to add upgrades to Greenhouses 5 and 6 to increase yields as well—lots of very good options.

This means that at present, with Greenhouse 5 fully online, we have 40 percent of our flowering greenhouses in operation today, which leaves us very excited about the massive potential revenue ahead in the 60 percent currently rented to growers of tomatoes and cucumbers.

We will continue to be conscientious capital allocators and monitor market conditions for our increased biomass as we make these plans.

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, over to you.

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.

Briefly recapping our first quarter financial highlights.

As Kyle mentioned earlier, net revenue for the first quarter of 2024 was $30.1 million, above the high end of our guidance of $28 million to $29 million.

This represented revenue growth of 9 percent year over year, and a sequential decrease of 26 percent.

As expected, the sequential decline was driven by the typical seasonal reduction in production of biomass, due to lower sunlight levels for plants harvested in Q1 compared to Q4.

Consolidated gross profit was $12.5 million or 42 percent of net revenue, ahead of our guidance of 40 percent and compared to $12.6 million or 46 percent in the first quarter of 2023.

The lower gross margin is mainly due to a lower gross margin in our wholesale biomass segment, caused by a higher mix of trim relative to flower and smalls that we anticipated when providing Q1 2024 guidance in our Q4 2023 earnings call.

General and administrative expenses were $13.5 million in Q1 2024, up 19 percent from $11.4 million last year and up 2 percent from $13.3 million last quarter.

The increase versus 2023 is almost entirely driven by an increase in stock compensation from new equity grants effective January 1, 2024. Excluding stock compensation, general and administrative expenses increased 2 percent versus the same period last year.

G&A was up slightly in Q1 versus Q4 2023 because the Q1 2024 increase in stock compensation was offset by lower salary expenses in Q1 versus Q4 2023, as there was no bonus accrual in Q1 2024.

Sales and marketing expenses were $0.48 million, down from $0.65 million during the same period last year, and also down from $0.63 million in Q4 2023.

Professional fees of $3.7 million compared to $1.9 million in Q4 2023 and $1.5 million in Q1 2023.

The $1.8 million increase versus Q4 2024 is related to incremental expenses from the restatements for 2021, 2022, and the first quarter of 2023, that were completed in Q1 2024, and higher legal fees during the quarter related to litigation.

Depreciation and amortization in Q4 2023 were $3.7 million, up slightly from $3.5 million in Q4 and down from $3.8 million in the same period last year.

Adjusted EBITDA was negative $1.6 million in Q1, compared to guidance of negative $2 million to negative $4 million.

The sequential decrease from positive $3.8 million in Q4 was mainly due to lower gross profit, due to the seasonal decline in revenue and a lower gross margin percent.

Now turning to the balance sheet.

We started the year with $32.5 million in cash and ended Q1 with $24.4 million in cash, ahead of our guidance of $21 million, as operating cash flow for the quarter was better than originally anticipated at negative $1.9 million versus guidance of negative $3 million to negative $4 million.

Both inventory and accounts receivable were slightly lower than budget and Q1 CapEx spending also benefitted ending cash relative to our guidance, as it came in at $2.4 million versus guidance of $4 million, as some of the expected CapEx payments were pushed into the second quarter.

Other cash outflows include $1.9 million in preferred stock dividend payments and $1.9 million in interest payments, which is included in operating cash flow.

In addition, we paid back $1.9 million in principal on the WhiteHawk senior secured loan and will continue the principal payments at a rate of $625,000 per month through November 2026, followed by the final balloon payment of $27.5 million in principal on the loan in December of 2026.

Now diving a bit deeper into specific business segments. The core wholesale biomass business achieved $15.9 million in revenue during the quarter, up 10 percent year over year and down 40 percent sequentially.

The 61,300 pounds of biomass produced was a 28 percent year-on-year increase.

Average selling price for the quarter was $282 per pound compared to guidance of $280 per pound and $290 in Q1 2023.

The sequential improvement from $272 last quarter was due to improved pricing in Q1 versus Q4.

Given the seasonal drop in production typically experienced in Q1, we've seen pricing steadily increase since the beginning of the year.

The cause behind the slightly lower average selling price in Q1 2024 versus Q1 2023 was due to a higher sales mix of trim relative to flower and smalls.

Flower and smalls as a percent of the volume mix for wholesale biomass sales was about 7 percentage points lower in Q1 2024 versus both Q1 and Q4 of last year.

We sold 56,000 pounds of biomass in Q1, up 13 percent from Q1 of last year. Cost per pound was $182, 7 percent below Q1 last year.

Wholesale gross margin was 39 percent, below the Q1 2023 level of 43 percent, due mainly to the lower percentage of flower in our sales mix.

We continue to see a war of attrition in retail and branded CPG space, driving retail pricing pressure and high competition for shelf space amongst brands. This is making both the retail and wholesale CPG space difficult. With retailers and branded players experiencing cash flow and liquidity issues, we expect this situation to deteriorate further throughout 2024.

Retail and CPG revenue combined was $14.2 million, better than our guidance of being slightly below Q4 2023's $13.7 million. It was also up from $13.1 million in the same quarter last year.

First quarter Retail revenue was $9.9 million compared to $9.6 million in the previous quarter and $9.4 million in Q1 2023.

It should be noted that during the quarter, we made changes to our retail loyalty program that reduced our points liability by approximately $300,000 and improved sales and margin by the same amount.

Retail gross margin was 53 percent in Q1, down slightly from 54 percent in Q4, as Kyle mentioned.

It is likely that the strategic pricing plan will result in downward pressure on our retail dispensary margins for the balance of the year.

We saw some positive momentum out of CPG in Q1, with revenue rising 4 percent, quarter on quarter and 14 percent year over year to $4.3 million, and gross margin expanding to 25 percent versus 8 percent for all of 2023.

Thus, we saw almost immediate benefits from focusing our CPG effort on Glass House Farms, Allswell, and PLUS, and from the work we did at the end of last year to improve our inventory situation.

As we noted on our last call, we are committed to our strategy of selling only to dispensaries that are current on payment. As a result, we have not experienced material accounts receivable payment defaults, even though there have been some highly publicized store closures in recent months.

When we took over our own AR management in April last year, many of our retail customers were used to liberal credit policies. We reined that in over the course of the initial four to five months and are now maintaining a credit policy that focuses on payments rather than sales.

As a result, during the first quarter, over 70 percent of our accounts on average were current on their payments, a percentage we believe is among the best in California cannabis.

Our credit department was also a leader in founding the industry’s Credit Management Association, which now has 18 members and produces a Dun & Bradstreet-type report that allows distributors to submit anonymous data on customers to the CMA's database. Members can now draw credit reports on potential customers, allowing them to screen and avoid bad debts from chronically non- or late-paying customers.

We continue to see a modest decline in overall cultivation licences, as we believe the weaker, inefficient cultivators left the market during the second half of 2022 and in 2023.

During the first four months of 2024, the number of active mixed-light and outdoor cultivation licences declined by 5 percent, with a total of 198 licences leaving the market.

Taking into account the fact that cultivators are moving to fewer large licences, we estimate that an equivalent of approximately 300,000 square feet dropped out of the market so far this year, compared to a decline of 2 million square feet in Q4 2023.

As of April 30th, there were currently 3,938 active mixed-light outdoor cultivation licences, compared to 7,190 on June 30, 2022.

Now I'll provide second quarter 2024 guidance for key operating metrics. We provided initial Q2 guidance on our Q4 2023 call and are expanding it here.

Given that Greenhouse 5 will have its first full quarter of production and sales in Q2, we expect to set a new record high for single quarter revenue in Q2 of $52 million to $54 million, up 76 percent sequentially and 19 percent year on year, at the midpoint of guidance.

We are raising Q2 biomass production guidance to 128,000 to 130,000 pounds from a previous 125,000 to 127,000 pounds, as initial production levels have somewhat outperformed expectation, with most of the increase coming from trim.

This will represent 110 percent sequential and 25 percent year-on-year growth at the midpoint of guidance.

We expect visibility on Greenhouse 5's production capabilities to improve as we move through Q2, and as we complete several planting and harvest cycles in the greenhouse.

We project the average selling price for wholesale biomass will be in the range of $330 to $335 per pound, which is down from our prior guidance of $350 to $355, due to a higher mix of trim being sold compared to prior guidance.

The new guidance assumes that pricing of flower and smalls remains at the same levels seen during the second half of Q1 2024.

Q2 '24 cost of production is projected to fall to $150 per pound, down 18 percent, sequentially, but up 8 percent year on year due to start-up costs from Greenhouse 5.

We expect Q2 Retail and CPG revenue to be roughly flat to Q1 as we continue to plan for a highly promotional and price-driven retail landscape.

We expect consolidated gross margin to be approximately 50 percent, which is up about 8 percentage points versus Q1 level of 42 percent, driven mainly by a higher margin in wholesale biomass as a result of the higher mix [audio gap] flower production during the second quarter.

In addition, we expect adjusted EBITDA to be positive $10 million to $12 million and operating cash flow to be a positive $8 million to $10 million.

We expect to see cash end the quarter at around $25 million as Greenhouse 5 output and sales ramp up in May and June.

Within the quarter, we expect CapEx spending to be approximately $4 million, as we make the final payments associated with Phase 2 and add some additional investments in automation and infrastructure at the Camarillo Farm.

Similar to Q1 ‘24, we will make $1.9 million in dividend payments and $1.9 million in debt amortization payments.

We provided initial guidance for fiscal year 2024 during our Q4 2023 earnings call, and I’ll go over that guidance here, along with some revision.

We are maintaining revenue guidance of $215 million to $220 million for 2024, which is 35 percent growth at the midpoint of guidance.

Combined with the increase in revenue, we expect adjusted EBITDA to exceed $50 million during 2024 and operating cash flow to be in the mid-$30 million range.

Cash flow will grow at a slower rate than adjusted EBITDA due to working capital associated with start-up of Greenhouse 5.

This guidance does not include the $11.5 million ERTC refund we expect to receive later this year.

We are raising our guidance for wholesale biomass production by 5,000 pounds, to 525,000 to 535,000 pounds, which represents a 49 percent increase over 2023 at the midpoint of guidance.

Cost per pound is projected to be $135, which is roughly flat to our 2023 costs of $136 per pound.

The increase in guidance for 2024 wholesale biomass production reflects the higher-than-expected production in Q1 and the increase in our Q2 guidance.

Although Greenhouse 5 is delivering ahead of expectations, it is nonetheless still in its first quarter of operations. Therefore, we are maintaining our current production guidance for the second half of the year until we have additional experience from which to develop a more robust baseline of expectation.

We expect pricing to drop in the second half of the year as compared to the first half of the year, following a similar pattern to last year, as industry production increases in the second half of the year.

We are planning on flower and smalls pricing to be modestly lower than last year in the second half. But we expect our average selling price in the second half of 2024 to be up—to be about flat to up slightly, as a result of an improved product mix versus the second half of 2023.

We are revising our projected selling price to be between $310 and $315 per pound for the year, down slightly from the previous $315 to $320 per year, due to a higher percentage of trim we are seeing in our sales mix.

Combined revenues from Retail and CPG are projected to be up mid-single digits in the second half of the year, as we expect our retail pricing initiative will drive higher sales as foot traffic builds. However, we are planning for the difficult market conditions in both retail and the branded business to continue in 2024.

And with that, I will turn it back over to Kyle.

Kyle Kazan

Thank you, Mark.

With the news of the DEA recommending rescheduling of cannabis, we must not forget the prisoners of this war on cannabis, a war which was essentially declared over by the vast majority of states and the District of Columbia. These people who are still serving murderers' time for this plant, while a multibillion-dollar industry is being built around them, need for a full pardon.

It's time for President Biden to make good on his promise to right the wrongs for the men and women who are still sitting in federal prison. As of today, he has released a grand total of zero during his more than three years as president.

I recently participated in the keynote Fireside Chat with Jesse Redmond of Water Tower Research at the Benzinga Capital Conference. We had a great discussion surrounding our position in the world's leading cannabis market, California, the potential for interstate commerce, and the need to advocate for those still behind prison walls.

Following the keynote at Benzinga, I made the trip north to Washington, D.C., and spent quality time with South Carolina Congresswoman Nancy Mace and California Congressman Robert Garcia, as well as Don Murphy and Gretchen Gailey of the American Cannabis Collective.

These advocates are working hard in D.C. to pass sensible cannabis policies, and it's people like them who are helping to end the war on cannabis. We need many more people like Nancy, Robert, Don, and Gretchen to move the ball forward. It is incumbent upon all of us to let those who represent us know what we need for them to do.

During the same trip to Washington, I stood outside the White House and urged President Biden to take out his pardon pen and release Daniel Trevino. Daniel was an early advocate for cannabis legalization in Michigan, running medical cannabis dispensaries to serve the medical needs of people from all walks of life, sentenced to a nearly 16-year prison term, when his daughter was just three. His family has been fractured with his mother forced to care for his young daughter.

Please join me, alongside Weldon Angelos, project MISSION [GREEN], REEFORM, and Luke Scarmazzo, to demand change and justice for those like Daniel Trevino, who have been unjustly jailed.

I also held signs for nine other names. If you follow me on Twitter or Instagram, you can see those videos produced by my wonderful marketing and social media team.

Moving forward, we do have some events happening in the coming weeks and months.

First, our executive team will be featured in the Making It Work in California panel hosted by Managing Director and Senior Research Analyst Bobby Burleson, at the Canaccord Genuity 8th Annual Global Cannabis Conference on May 23rd in New York City.

The team will also be participating in one-on-one meetings with investors, and we suggest reaching out to your Canaccord representative if you would like to arrange a meeting.

Additionally, as I mentioned on our last earnings call, the date for our third Investor Sesh is June 21st, which will be held concurrently with our annual general meeting at our SoCal farm.

For those shareholders who have not attended, as well as those who have joined in the past two years, I warmly welcome you to come visit our farm in Camarillo and see what the future holds for Glass House. We will be hosting tours of our greenhouses, and you'll be able to see a robust canopy of flowering cannabis in our newly retrofitted Greenhouse 5.

Come meet our executive team, who'll be on hand for the traditional Investor Sesh question-and-answer session. This is a great way for you to experience our industry-leading transparency, update your knowledge, conduct your diligence, share your ideas with the senior team members.

And we're excited for you to attend what will be an interactive day at our Camarillo, SoCal facility, including food, exclusive merch, and Glass House products available for purchase under the beautiful California sun. I hope to see you there.

Moreover, I want to once again invite our institutional investors and sell-side analysts to join us at our first-ever investor and analyst day on September 12th. We will provide more details as we get closer to the date.

And lastly, before we take your questions, with 4/20 now in the rearview mirror, I would like to take a minute and thank all of our team members at Glass House for our continued success. From the cultivation teams, marketing, retail, sales, and manufacturing, as well as our budtenders, growers, sales associates, events, and financial teams, we could not do it without you. I'm truly humbled to have such an amazing team of people as my teammates.

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

Q&A

Operator

Thank you. Ladies and gentlemen, we will now conduct the question-and-answer session. If you have a question, please press *, followed by the number 1 on your telephone keypad. If you wish to cancel your request, please press *, 2.

As a reminder, please limit your questions to the two questions only at a time.

Your first question comes from Bobby Burleson from Canaccord. Your line is now open.

Bobby Burleson — Canaccord Genuity

Thank you. And thanks for taking my questions and the shameless plug on the event coming up.

So I was wondering, as we look at this environment in California and the attrition that you guys talked about for retail and CPG. I'm wondering, like do you guys think at some point, you maybe get more aggressive with broadening your retail distribution, kind of opportunistically, based on some acceleration in attrition?

Or do you feel like kind of the balance of assets and the distribution of assets that you have now is kind of optimal for the next couple years?

Kyle Kazan

So, Bobby, thank you for the question. And for all the listeners out there that heard the Canaccord and Bobby plug, will there be a receiving line that you'll be hosting if people come out to New York to meet you?

Bobby Burleson

I will shake hands and kiss babies.

Kyle Kazan

Okay. All right. So it's on record now. So that's a great question.

We are at the point of not wanting to own any more than our 10 retail, but we do think that, given what we can provide an owner of a store or multiple stores in terms of pricing power and what we can put on their shelves, is extremely attractive, like nobody else in the industry can do.

And so we anticipate that we'll be expanding our footprint of stores through management and not ownership. And we think that, that will allow us to garner even more margin.

Bobby Burleson

Fantastic. That makes a lot of sense.

And then just my quick follow-up on Greenhouse 5. You guys are monitoring kind of the activity out of that greenhouse for the balance of this quarter and then as additional plantings occur. And I'm wondering, is that a source of potential upside? Like, just based on the metrics so far, I think, have outperformed your expectations. Do you feel like you have a conservative kind of placeholder for that asset's contribution this year, that could be eclipsed based on, so far, the trend that you're seeing?

Kyle Kazan

That's our hope. We just turned on a brand-new spigot that has a lot of biomass coming out. So we're still getting our arms around. I mean, there's so much new biomass that we're just trying to see what it all means. But so far, we're very excited. How about that?

Bobby Burleson

Great. Thank you—

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

And I think I can add onto that, Bobby, just a—

Bobby Burleson

Yeah. Please.

Graham Farrar

—kudos to the team for the way that they've brought that on. It's a ton of work turning on a greenhouse of that size. And they got it done on the front end of our target, and they've been operating it really well.

So to your question, we're really liking what we're seeing come out of Greenhouse 5 so far. So it's still early days, and we want to keep it on the conservative side. But I think in likelihood, we think it's the best greenhouse that we've put together so far.

Bobby Burleson

Fantastic. Thanks for taking my questions and congratulations on the strong results.

Kyle Kazan

Thanks, Bobby.

Operator

Your next question comes from Mike Regan from Excelsior. Your line is now open.

Mike Regan — Excelsior

Hi, everyone. Thanks a lot. So in terms of, I think you mentioned that you've seen pricing on like-for-like basis, small versus smalls and flower versus flower, increasing year to date. And I guess the guidance for Q2 assumes, I guess, flat pricing within categories and—correct me if I'm wrong—I guess the second half assumes that's declining. I guess, sort of what trends are you currently seeing sort of right now on that pricing?

And what sort of changes that in the second half?

Kyle Kazan

So, Mike, we try and use the last couple years as a guide, and we watch licences and things like that. But again, we just increased a lot of biomass that we're selling. So we're tracking everything. And I would tell you, if I told you week by week, I would not be giving the team enough credit that we sometimes even talk day by day.

But yeah, as we head towards the third and the fourth quarter, like seasons past, that's when the sunshine here in California delivers the most biomass in the state. So we usually see pricing pressure. But I would say we're still monitoring and watching, and I would say the trends are pretty much the same that we're heading towards the third quarter.

Mike Regan

Okay. And then just on the costs, it sounds like the G&A and the professional fees had some one-time aspects to them in the first quarter. So is there any reason why—is there anything I'm forgetting that would keep them sort of at the continued level of the first quarter? Or if those one-time things aren't there, presumably, they would decline? Or am I thinking about that incorrectly?

Kyle Kazan

Let me throw that out to Mark. Mark?

Mark Vendetti

So, Mike, thanks for the question.

So a big chunk of Q1 was driven by the restatement that we went through. So hopefully, we won't go through that restatement again, as a CFO. And we did incur some slightly higher litigation fees. We just don't want to comment on the forward view of where that goes.

So the restatement clearly, hopefully, is a one-time thing, and that will not happen again. So we should see a piece of that dissipate as we go into the second quarter.

Mike Regan

Got it. Great. Thanks. I'll hop back in the queue.

Kyle Kazan

Thanks, Mike.

Operator

Your next question comes from Scott Fortune from ROTH MKM. Your line is now open.

Scott Fortune — ROTH MKM

Good afternoon and thanks for the questions. I want to follow up on like the capacity absorption of your added production here. And what are you seeing from the customers? Is the production being taken by the kind of established customers that you've been working with? Are you seeing new customers come on board for your flower production?

And just kind of a follow-on with that, more for Graham. Any different strains that you are implementing in Glass House 5 that's driving more demand from that standpoint? How are you looking at kind of Glass House 5 as far as growing versus Glass House 6 in your flower and strain production from that standpoint?

Kyle Kazan

So, Scott, great to hear your voice. And we do know your motivation is to try and get an advance on the newest strains, as always. So I'll turn it over to Graham with the proviso, Graham, we can only treat Scott so special.

Graham Farrar

Hey, Scott. How are you doing? Thanks for the question.

So on the first question, market remains receptive. As Mark mentioned, licences continue to decline. So we're seeing—I think we mentioned in our last call that, in some cases, we were even rationing product to buyers, and we weren't able to satisfy the orders that everybody wanted to place at the same time.

So we're seeing those buyers pick their buying back up. We continue to see licences leave the market. So we're seeing other producers exit. Demand, I'd say, is staying consistent to slightly up. So in general, things are flowing in the market as we would expect.

Seasonally, as we head into the back half of Q2 and Q3 and Q4 is when the supply in the state typically goes up. So we will see some or expect to see some seasonal softness in the pricing, as we would in other years.

But in general, I think, at least the way that I look at it, is there are less licences today with Greenhouse 5 producing than there were when we decided to start the project of bringing Greenhouse 5 online. So if you look at that on a net basis, what we've added back is just a small piece of what is left. So from a supply-demand balance, I don't think we're shifting things in any drastic way, so demand remains good there.

On the strain side, we definitely do have some new genetics. One of the upsides of having Greenhouse 5 added onto Greenhouse 6 is it gives us, we think, in bays or valves, which is the segments of the greenhouse that we plant and harvest. So having two greenhouses instead of one means twice as many options, which means that we can have twice as much variety without having to shrink or mix valves together. So we've got a bunch of new genetics.

We've actually significantly ramped up kind of our R&D work on phenol hunting and finding new genetics, leveraging our greenhouse—one of our greenhouses up in Carpinteria, for that now, has a dedicated R&D space. And we're testing about 20 new strains a quarter and vetting those to see what qualifies, and then starting to build strain bibles and strain metrics around them that we can use for forecasting for production in the future.

So there's lots of good stuff coming, is the short answer to your question.

Scott Fortune

Great. Appreciate the colour. And then just sort of want to kind of shift on—your strategic pricing evolves well. You said that's led to increased foot traffic and better same-store sales here. But can you provide a little more colour on kind of the overall basket size, the dollar amounts?

And are you seeing more visits from repeat customers? Kind of a little bit of colour on—you said you're going to change some of your loyalty program, but are continuing to drive that traffic?

And is the Allswell strategy temporary? Or are you going to see that consistently kind of going forward?

Kyle Kazan

Let me ask the—let me answer the last part of the question first.

We're planning on that being a permanent thing, that this is just our everyday value plan for our customers, and we think the $9.99 is resonating. I'll tell you, we don't have at our fingertips, or at least we didn't come into this meeting prepared to answer the question as far as repeat customers, things like that. So I looked around the room. None of us have that data right now.

Scott Fortune

Okay. I appreciate it.

Graham Farrar

Maybe to add on to that, Scott, just a reminder, our goal is always to bring the absolute highest quality to the consumer at the lowest possible cost. So while $9.99 might be today's number as we continue to improve our operations, but that is—that's not the end of where we're trying to get to.

So our goal is to continue to push forward on that and find even better value for consumers in California and, eventually, we think, across the country.

Scott Fortune

I appreciate it. Thanks.

Operator

Your next question comes from Colin George from Haywood Securities. Your line is now open.

Colin George — Haywood Securities

Hey. Thanks for taking my question, and I'll try and be quick here. I know we're getting up close against the hour.

You talked about the California market landscape quite a bit, mostly on the supply side. But what are you guys seeing on the—with regards to retail store openings? You talked about some high-profile ones closing. But ideally, we would probably like to see points of sale increasing.

And with the latest DEA announcement, do you think that provides a tailwind for certain municipals to let their band or potential tax reform to try and keep the legitimate operators and legitimate jobs in the market versus the illicit market?

Kyle Kazan

That's a great question. I would tell you, right now, we get plenty of inbounds of people that are winning licences. But most of those are not in new cities. They're in cities that already exist, and they're looking for help for build-out. I think there's not lots of money to do that. But I would say there's nothing really earth-shattering. It's just sort of dribs and drabs.

Let me give you an example. In the South Bay of Southern California, meaning basically the city south of LAX, all the way down to the Port of Los Angeles, it's got over a million residents. That happens to be where I live.

For years, there have been no licences. Now the city of Hawthorne, they passed something last year, and it's going through the process, so stores will be opening imminently. And then Redondo Beach will be opening up two stores but, again, that's probably next year sometime. So we are seeing a little bit of progress. It's just, again, dribs and drabs in regards to Schedule III.

I think that might really help with new states for sure. I think, more importantly, in mature states like California, the fact that the wheels never came off the bus, for those that thought the sky would fall, I think that will help. And more and more cities and the state and the county needs tax revenue. California's hurting.

And I think, if you look at these—if you look at earnings and some of the callouts for like McDonald's and other value companies, they're all saying the same thing, that the wallets are getting strained of the consumers.

And so, what I think happens is necessity is the mother of invention. And I think, more than anything else, that will open up new revenue channels from cities that just need revenue or need tax.

Colin George

Okay. Yeah. That makes sense. I think that's all for me. You guys did a great job with your granularity of your reporting and going through a lot of different market aspects that you guys are seeing. So I appreciate the time.

Kyle Kazan

And really, thank you for pointing that out. The one thing is our financial team, because the restatement has been under mass amounts of pressure with that, plus they had to do our year-end and our first quarter, and the fact that they just rolled along was absolutely amazing. We just have a great team. So thank you so much for calling that out.

Operator

Your next question comes from Aaron Grey from Alliance Global Partners. Your line is now open.

Aaron Grey — Alliance Global Partners

Hi. Good evening and thanks for the questions. The first one for me, just want to go back to Allswell and impact on the retail stores, ask it a little bit of a different way. Maybe just in terms of cannibalization, if you can speak towards what that's had maybe on some other brands, either your own or other value brands you're selling in the stores. Is that within the expectations that you were having? Has it been greater than you were expecting? So any colour there?

And then, whether or not, within that ticket, are you seeing some of the consumers buy an extra item, whether it be in flower or another format, with the extra dollars they have? Or is that overall ticket going down? Thank you.

Kyle Kazan

Hey, Aaron. So great question. I would say we're still kind of within that first 30 to 40 days to evaluate. What we did see was we lost less customers than did the state, meaning that our revenue stayed better by far than the state did.

We're still analyzing the best way to look at this. We intend the $9.99 eighth to be an attractive brand and offering to bring customers in, but when they get in, we're certainly hoping to show why they have more money to increase that basket. But I would tell you, we need another few weeks, but our retail team is looking at the best ways to capitalize on the continued sustainability of our revenue.

Mark Vendetti

Aaron, I'll just add in a few other data points just from a market perspective. So we wanted to get both the Allswell eighth and the change in our pricing approach in, in time to make sure it was up and going as we went into 4/20. And 4/20 is such a big week, it does make it a little difficult to really read the true impact.

But within 4/20, 4/20 was the best week that we had from retail of any week. It blew away what we did with 4/20 a year ago. And if we look at the surrounding weeks, it was up around 50 percent that week. So given 4/20 is a highly promotional week within the cannabis calendar, our results during that week and that time period show really well for what we think the long-term benefit of the initiative's going to be.

Aaron Grey

Thank you. That's helpful colour there. Second one for me, just in terms of overall cultivators in the state of California. You mentioned the number of active licences earlier on the call with some stats. We're tracking some of the monthly here. It does look like there continues to be a trend down, though it has decelerated a bit. It's still been going down each month.

So just any line of sight in terms of whether or not we're getting towards a bottom in terms of the number of cultivators we're going to have in the state? Or do you think there's going to be some continued shakeout there? That'd be appreciated. Thank you.

Kyle Kazan

I'll start—

Mark Vendetti

Do you want me to take that—

Kyle Kazan

Let me provide a little bit, and I'll turn it back to you.

So yeah, the rate has slowed. One of the things that has happened too is the way the state is now dealing with licensing, it actually, in some cases, makes sense to go from a small to a medium or from a medium to a large. So that's one of the reasons why we look at a slowdown in terms of the size or the square footage we think is under cultivation, relative to the number of licences.

But I think one of the real telltale signs we're going to see over the next three months, in terms of where the second half of the industry goes, I'm going to say over a third of the licences in the outdoor and mixed-light licence group come up for renewal between now and the end of July. So we will see, in short order, an indication of if there's going to be another, I'm going to say, leg down in terms of licences dropping out, because so many are up for renewal, particularly a big month as June, where almost 900 licences come up for renewal.

Mark Vendetti

And real quick, there were some questions asked about what we're seeing. Our CRO was listening in and sent us some statistics. So our net sales are up since we started this campaign. Our transactions are up. And our basket size is down about 4.9 percent over the last three weeks. So we're seeing more foot traffic and a slightly less basket size, because I think they're just taking advantage of the lower pricing.

But we are very happy with the results thus far. And then as far as repeat customers, things like that, those are things that they're studying.

Aaron Grey

Okay. Really appreciate the additional colour you just added there.

Graham Farrar

Yeah. And back on the licensing, I think we were—we had over 8,000 licences, if I remember correctly, 18 to 24 months ago. We've now dipped under 4,000 licences. So still seeing attrition at 1 percent, 1.25 percent a month right now. And as Mark touched on, there's a giant slug of licences representing almost a quarter of those licences coming up in June.

And then throw on top of that, that the provisional licences are continuing to exit the system as there's now a requirement to clear CEQA, which is the California Environmental Quality Act, which is a very onerous standard of compliance that is required to transition from provisional to annual licences. And those licences are rapidly timing out. So I think we have a significant number of licences that we'll see attrition on.

There's also a regulatory change that the state made where they now allow people to pause licences. So they've lowered the barrier to turning off cultivation from where it was. And I think you probably will see some folks might have tried to hold on because it was so tough, if they let go, to restart. And the state has given an easier path to pausing those licences. They won't go away, but they will turn off more dynamically than they would have before. So I think we'll continue to see supply contract at this point.

Aaron Grey

Right. Appreciate the colour. And we'll keep out and look out for it. I'll jump back in the queue.

Operator

Your next question comes from Andrew Semple from Echelon. Your line is now open.

Andrew Semple — Echelon

Good evening. Congrats on the Q1 results. First question here would just be on the biomass production in Q1. You noted that up 28 percent year on year. I'm just wondering what proportion of that you would attribute to some of the operational changes and investments you've made in your existing asset base, and what proportion of that might be due to things that are a little bit more out of your control, such as weather and other variances.

Kyle Kazan

Now, Graham, do you want to take that one?

Graham Farrar

Sure. Yeah. So I think one note just to remind people that Q1 this year doesn't have any Greenhouse 5 production in it. So Q1 is like for like in terms of production footprint. So I think some of that is operational changes that we've made and getting more familiar with the greenhouse, as well as new tools that we've added and optimization.

The weather at the front half of this year was okay, but not—there was nothing fantastic about it. So I wouldn't call it unseasonably good. I'd have to look back and do the comparison of Q1 last year, which was also a very rainy and cloudy year as well. But Q1, again, was filled with a good amount of rain and clouds. So I'd say weather was fairly in line versus last year.

So most of that—some of that's process change, and most of it's operational improvements that are coming from the team figuring out better ways to do things, which would be kind of continuous incremental improvement is one of the models that we carry around here, where we're always trying to get a little bit better with every day that goes by.

Andrew Semple

Great. That’s helpful. And another just quick one, if I may, just in terms of the outlook for the CPG segment.

I noted in Q1, revenues are up 14 percent year on year, so off to a good start, though the full year guidance is pointing more to growth of the mid-single digits. But it also seems your commentary, especially around the Allswell brand, remains positive, so. To what extent is there perhaps some (unintelligible), given the strength we saw in Q1 for the CPG outlook in this year?

Or are you expecting some real challenges to emerge later in this year in terms of that CPG segment?

Kyle Kazan

I would say that the unknowns out there are the economy. I think that’s where our biggest concern is. I think that’s probably echoed by many of the Fortune 500 companies out there, Starbucks, McDonald’s.

That said, typically, when the consumer gets squeezed, this is one of those products that people will continue to buy during tough time. So we think, if we continue to provide good value, that we have the best chance of continuing to do well and, perhaps, even grow into this tough environment. But I would tell you that, again, less concern about our execution on that and more about the headwinds in the economy.

Andrew Semple

Understood, and that’s helpful. Thank you. I’ll get back into queue.

Kyle Kazan

Thank you. Thank you so much.

Operator

There are no further questions at this time. Speakers, please proceed with your closing remarks.

Kyle Kazan

Thank you, Operator, and thank you, everybody, for listening in to our quarter one results. We, the Glass House Brands team, thank you all. Operator, that'll be it.

Graham Farrar

Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for joining. You may now disconnect.