Glass House Brands Inc.(Q2 2024)
August 20, 2024

Corporate Speakers

- John Brebeck; Glass House Brands Inc.; Vice President of 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, President and Board of Director

Participants

- Luke Hannan; Canaccord Genuity; Analyst
- Michael Regan; Excelsior Equities; Analyst
- Aaron Grey; Alliance Global Partners; Analyst
- Scott Fortune; ROTH Capital Partners; Analyst
- Howard Penney; Hedgeye Risk Management

PRESENTATION

Operator^ Good afternoon, ladies and gentlemen. And thank you for standing by. Welcome to Glass House Brands Second 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^ Thank you, Operator. Welcome everyone to the Glass House Brands Second Quarter 2024 Conference Call for the period ending June 30, 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, August 13, 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^ 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 second quarter 2024 press release, where you can review our results in more details.

I'd like to start the call by congratulating our cultivation team, led by our co-Founder, Director and President, Graham Farrar for their outstanding performance at the recent California State Fair Cannabis Awards.

Glass House Farm strain Lilac Diesel, the star of the show in the Greenhouse flower division was awarded the best of California Golden Bear Trophy, as well as three gold medals in one silver in all Glass House Farms won Golden Bear for the best of California Greenhouse flower gold medal for the most total terpenes, gold medal for the highest osamine concentration, gold medal for the highest terpinolene concentration, and silver metal for the highest CBGA content.

If these terms are foreign to you, don't worry and you aren't the only one. Though it is a good reminder that the growers at Glass House need to operate at a PhD level to keep up with the California consumer, but genders and buyers who are the most educated and discerning on the planet.

If our growers can satisfy the refined taste of California, then we know they can more than satisfy the rest of the world. Winning the Golden Bear Trophy and multiple gold medals at California State Fair's Cannabis Award is a testament to the exceptional quality and expertise of our cultivation team.

As this competition highlights the best of the best in California craft cannabis farms, and it is yet another demonstration that we mean it when we say that our aim is to produce premium cannabis at the lowest cost.

Next, I am excited to announce that we have begun the planning process to bring the same award-winning California cannabis products and experience that Glass House is known for to consumers across the nation.

As we've mentioned in the past, we expect Greenhouse two to be our next greenhouse expansion. To that end, we've given notice to the tomato and cucumber farm company to vacate and they have already moved out of approximately one-third of Greenhouse 2.

Since the Farm Bill of 2018 passed was signed into law, many companies including large cannabis companies, have entered into the business of selling hemp. The biomass which is hemp is defined in the federal statute to mean the plant cannabis sativa L.

All of the cultivation experience we built would apply just as well in producing high quality hemp-derived cannabis in fully federal legal form.

We find the possibility of continuing to serve the California market as we do today in our existing operating greenhouses and at the same time expanding into a new greenhouse which can bring our products to the rest of the country to be quite interesting. There are a few differences in the capital improvements made to a greenhouse to grow hemp-derived cannabis than the cannabis we currently cultivate. This will allow us a longer timeline to decide exactly which of those we will plant as it is either or.

We are actively having meetings with large distributors of hemp-derived cannabis and we are considering [DTC] or direct to consumer products shipped from our farm in Southern California directly to people in the states which legally allow it.

While we are very excited about the prospects as growing this plant is right our wheelhouse and the market is anxious for California grown biomass, return on investment drives our ultimate decision.

We look forward to having more to report on these exciting developments soon. Turning now to our second quarter 2024 results, we met or exceeded our guidance across almost all major operating metrics. Record quarterly highs set during the second quarter include consolidated revenue of $54 million, consolidated gross profit of $29 million, wholesale biomass revenue of $39 million. Retail revenue of $11 million.

Biomass production of over 149,000 pounds, biomass sales of over 137,000 pounds and wholesale biomass gross profit of $23 million. These results speak to the hard work and dedication of our entire Glass House team.

I want to personally thank all of them for their untiring commitment to excellent and sustained continual growth and improvement.

On our first quarter call we stated that we were implementing our learnings from the first two years running Greenhouse 6 into our retrofit plants for Greenhouse 5 and that we expected the Greenhouse 5 ranch proceed more smoothly than that of Greenhouse 6.

Our cultivation team accomplished that and more as quarter two production from Greenhouse 5 outstripped our expectation in terms of quantity and quality enabling the team to significantly outstrip our wholesale biomass production guidance for the quarter.

At this early stage, Greenhouse 5 is already our most efficient greenhouse.

Flower yield per square foot is already significantly higher than Greenhouse 6.

As a result, we have made plans to backboard a number of the modifications made in Greenhouse 5 into Greenhouse 6 over the next six to 12 months. The team continues to shine as a great group who are constantly willing to experiment with new ways of doing the same things.

I'd also like to give a shout out to our post-harvest processing team, which remarkably increased throughput, keeping up with the additional production of Greenhouse 5.

This ensured that post-harvest processing remained efficient. The team managed to keep processing and trimming hours in line with our typical norms despite the record high volume of production. These often-unsung skilled professionals must expand to fit the needs of the growers and do so successfully to keep the high-quality standards which they previously set. Kudos team.

We also integrated two cutting edge photo optical sorters into our production process in the second quarter and early third quarter, marking a significant step forward in automation.

The sorters are capable of processing 80 pounds of cannabis per hour, translating to approximately 2,500 pounds per day and 900,000 pounds annually, assuming only two shifts per day.

We expect these orders to not only increase throughput, but to also improve sorting accuracy and reduce costs while improving quality through fewer product touches.

Innovations such as these continue our tradition of leveraging the best of modern agricultural cultivation technology and applying it to cannabis.

As we sell premium Greenhouse wholesale cannabis, our objective is to obtain a sales price above the average market price, our sales team strives to sell for the best and the highest price every single day, and our consistency and scale is an important tool in accomplishing that. The consistent quality and inventory availability that we provide for a wide variety of strains is a key selling point, and over the past two years, our customers have begun to place a greater value on our reliability, as well as on the ease of picking up most or all of their supply at one location, rather than multiple locations spread out around the state.

However, we have also upheld our strategy of meeting market pricing where it is.

We believe in our ability to continually improve efficiency, and we are committed to ensuring that Glass House flower is always the undeniable best value in the market. The second quarter decrease in pricing was due to our sales team continuing to execute this sale at market pricing strategy, and Mark will discuss this in more detail when providing our quarter three and full-year guidance. Turning our attention to our retail stores. The retail dispensary strategic pricing plan implemented late in the first quarter helped our stores outperform the California market in the second quarter.

While the broader market saw a year-over-year decline of nearly 8% and modest sequential growth of roughly 1.5% or 1% per headset data.

Our same store retail revenue grew by nearly 6% year-over-year, a rate that was 14% better than the overall market and by 10% sequentially.

We have completed the rollout of the retail dispensary pricing plan across all dispensaries between mid-February to early March and introduced the Allswell $7.50 price on the shelf and $9.99 taxes paid out the door one eighth pricing at all Glass House retail locations on March 4th.

As a result, transactions at our stores increased by 20% year-over-year on the same store basis versus quarter two 2023.

We regard the plan as a velocity play focused on improving customer traffic, the aim is to deliver the best value to the consumer and sell more products, and so far, it has exceeded our expectations.

Pricing in the market is still highly promotional with some brands and retailers giving discounts of up to 50%, but we were seeing that such aggressive discounting is frequently done on aged inventory, which undermines consumer trust and loyalty.

In contrast, we have made it a point to maintain fresh menus and products, which resonates better and creates greater loyalty with today's sophisticated consumers who closely scrutinize batch freshness dates and product quality.

Furthermore, our reputation for paying bills on time and maintaining strong partnerships with brands is making us a preferred retailer. Many retail chains are now forced to operate on cash on delivery terms given their poor payment records further exacerbating their struggles. The current market environment is starting to favor larger retail chains while smaller operators with two or three stores are finding it more difficult to get favorable pricing from brands and or to offer attractive pricing themselves.

Our Allswell brand has played a particularly important role in driving growth in our retail dispenser revenues.

Strong sales of the 14 gram and 1/8th ounce packs helped propel Allswell into the top three of California flower brands by units sold in the second quarter per headset data. The recently introduced Allswell vapes surpassed expectations in its initial launch, becoming the number four selling vape by units in our stores.

As a result, we've already made the decision to increase the strains offered from six to 12 and we are stepping up volume production of this product, which is a favorite of younger consumers.

Some of you may recall the inventory issues we experienced in our CPG business in the first half of 2022.

We were forced to undertake a BOGO fire sale in the second quarter of 2022 as a total of 52% of our first quarter 2022 CPG inventory was older than three months with 37% of total CPG inventory aging at six months or more.

Our Chief Revenue Officer, Hilal Tabsh, and his team responded with a disciplined sales and operational planning process which has been maintained with a consistent focus since then. And as of the end of second quarter of this year, inventory older than three months of age accounted for only 9% of total inventory with product over six months old accounting for only 2%.

I am extremely proud of our team's accomplishments by seeking to build a durable competitive advantage in all areas of our business, we are enhancing advantages that are inherent in our vertically integrated model.

I'm also very optimistic about what the future holds for Glass House Brands and thank all of you who have supported us as shareholders and creditors.

With that, I will turn the call over to our CFO, Mark Vendetti.

Mark Vendetti^ Thanks, Kyle. And good afternoon, everyone.

As a reminder, the results on sharing will be filed today. They can be found in our financial statements and MD&A, which are reported in U.S. dollars and prepared according to U.S. GAAP.

Briefly recapping our second quarter financial highlights.

As Kyle mentioned earlier, net revenue for the second quarter of 2024 was $54 million coming in at the high end of our guidance of $52 million to $54 million. This represented revenue growth of 21% year-over-year and a sequential increase of 79%, which was driven by record quarterly performance in wholesale biomass revenue and in retail revenue. Consolidated gross profit was $29 million or 53% of net revenue, ahead of our guidance of 50% as compared to $24 million or 55% in the second quarter of 2023. The higher gross margin versus our expectation was mainly due to a 19-percentage point increase in wholesale biomass gross margin to 58% from 39% in first quarter, coupled with a 145% quarter-over-quarter increase in wholesale biomass revenue.

General and administrative expenses were $17.4 million in second quarter 2024, up 33% from $13.1 million last year, and up 28% from $13.5 million last quarter. About 60% of the sequential increase was due to the bonus approval for projected 2024 performance with most of the remainder due to an increase in wholesale cannabis sales taxes caused by the $23.1 million increase in sequential wholesale biomass revenue.

Sales and marketing expenses were $0.68 million down from $1 million during the same period last year, and up from $0.48 million in first quarter. Professional fees of $1.9 million compared to $3.7 million in first quarter 2024, and $2.2 million in second quarter 2023. The $1.8 million decrease versus Q1 2024 is because incremental expenses were occurred in Q1 2024 from the restatements for 2021, 2022 and the first quarter of 2023, and from legal fees related to litigation.

The cost from completing the restatements did not recur in Q2 and legal fees from litigation decreased. Regarding the catalyst lawsuit that was dismissed on June 24, 2024, please note that on August 7th, 562 Discount Med, Inc. filed a notice of Appeal of the Judgment of dismissal following an order granting a motion for judgment on the pleadings without leave to amend.

We will discuss further developments in this case as merited. Depreciation and amortization in second quarter 2024 were $3.7 million consistent with first quarter and up slightly from $3.6 million in the same period last year.

Adjusted EBITDA was a record high $12.4 million in second quarter above the high end of our guidance of $10 million to $12 million. The increased versus our expectations was due primarily to the higher gross margin discussed earlier.

Operating cash flow is $8.9 million consistent with our guidance of $8 million to $10 million.

Factors affecting operating cash flow included a $4.9 million sequential increase in accounts receivable caused by increased sales from Greenhouse by production, and a $3.3 million increase in inventory. The increase in AR in inventory was somewhat balanced out by a $7.4 million increase in accounts payable and accrued liabilities, and this figure includes the bonus of accrual discussed earlier.

Now turning to the balance sheet, we started the quarter with $24.4 million in cash and restricted cash and ended second quarter with $25.9 million, slightly better than our guidance in $25 million.

We spent $3.9 million in CapEx and second quarter mainly on completing our phase two expansion of Greenhouse 5 and expanding nursery capacity in Greenhouse 1. The Company also paid $1.9 million in preferred stock dividend payments and $1.9 million in principle on the WhiteHawk loan.

Now diving a bit deeper into specific business segments. The core wholesale biomass business achieved $39.1 million in revenue during the quarter, accounting for a record high of 72% of total revenue.

This was up 28% year-over-year and up 145% sequentially. The approximate 150,000 pounds of biomass produced was a 45% year-on-year increase.

We exceeded the high end of our guidance by almost 20,000 pounds as Greenhouse 5's first quarter production exceeded our estimates. Average selling price for the quarter was $283 per pound compared to guidance of $330 to $335 per pound and $340 in Q2 2023.

We sold about 138,000 pounds of biomass in Q2, up 53% from last year.

Cost per pound was $148 per pound, slightly below guidance of $150 per pound and versus $139 per pound in the same period last year.

As discussed on prior calls, we expected the cost of production in the quarter to be above last year as we are still in a startup mode for Greenhouse 5. Wholesale gross margin was 58% despite the lower than anticipated average selling price. This was our third highest quarterly gross margin on record behind only 61% in Q2, 2023 and 60% in Q3, 2023. Retail and CPG revenue combined increased 5% sequentially and 6% year-on-year to $14.9 million better than guidance and flat sequentially.

We are pleased with the progress we saw during the quarter relating to our strategic pricing initiative in retail. Based on headset data, the California retail cannabis market saw total revenue of $1.05 billion in Q2 2024, reflecting a year-over-year decline of 8%, although there was a modest seasonal sequential increase of about 0.5%. Price compression continues to be a significant factor in this revenue decline despite the inflationary macro environment affecting the country as a whole. The average item price in June decreased by 9% year-over-year to $20.29 while the total number of units saw a slight increase of 1% year-over-year, indicating that consumers continue to purchase cannabis at steady rates.

As a result, pricing pressure and competition for sale space amongst brands and retail and branded CPG space remain acute and many retailers and brands are facing cash flow and liquidity shortfalls.

We expect the situation to deteriorate further throughout the remainder of the year.

Second quarter retail revenue was $10.9 million compared to $9.9 million in the previous quarter and $10.1 million in Q2, 2023. Retail gross margin was 47%, Q2, down from 53% Q1.

As we have noted before, it is likely that the strategic pricing plan we implemented earlier this year will result in downward pressure on our retail dispensary margins for the balance of the year. CPG revenue was $4 million down 6% sequentially.

It was up 1% year-over-year with a gross margin of 22%. Based on California Department of Cannabis Control data, during the first six months of 2024, the number of active mixed light outdoor cultivation licenses declined by 368 or approximately 61 per month.

We estimate roughly 2.4 million square feet of cultivation left on market during this period or approximately 400,000 square feet per month. Although the number of licenses continue to fall, the rate of decline has slowed considerably compared to 2023, when an average of 174 mixed light and outdoor cultivation licenses left the market on a monthly basis. With an average for the area under cultivation falling by about 900,000 square feet per month.

During the two-year period, beginning July 1, 2022, and ending June 30, 2024, the number of outdoor and active mixed light cultivation licenses declined by 3,422 or 48% to 3,768 active licenses.

Now I'll provide third quarter 2024 guidance for key operating metrics, as well as our outlook for the remainder of the year. This guidance does not contain any impact from Potential Greenhouse two expansion. Moving into our peak growing season of Q3 and with Greenhouse 5 still ramping up production, we expect Q3 revenue to be $65 million to $67 million, an increase of 22% sequentially and 37% year-on-year is the midpoint of guidance.

We anticipate Q3 biomass production of 185,000 to 195,000 pounds as production levels in Greenhouse 5 have exceeded expectations.

This will represent 27% sequential and 87% year-on-year growth at the midpoint of guidance.

We expect visibility on Greenhouse 5 production capabilities to improve as we move through the remainder of the year, and as we complete several more planting and harvest cycles in the Greenhouse.

We project that the average selling price for wholesale biomass will be in the range of $280 to $285 per pound versus an average of $283 in Q2 this year and $336 in Q3 2023.

Flower pricing has been weaker than expected since the second half of Q2 and in recent weeks has fallen below the lowest level seen in 2023.

In 2022, flower prices bottomed in July and recovered over the remainder of the year, while in 2023, they bought up in September and October before recovering into year end.

We think that the current level of flower pricing is approaching an economically unsustainable level for many growers.

But after rationalization of the prior two years, we realized that surviving cultivators are better operators and our forecast for the remainder of the year assumes pricing will be between 2022 and 2023 levels.

If our thesis that surviving operators are larger and more efficient growers than those who drop out of the market in 2022, in 2023 is correct, then it remains to be seen how quickly this round of consolidation will occur and when prices will rebound.

We feel that lower prices in the short term favored Glass House over the long term given our position as the low-cost producer.

We also believe it is unlikely prices will remain at these depressed levels over the long run.

We project that Q3 2024 cost of production will be $120 per pound, roughly flat versus $118 per pound in Q3 2023. This will be only the second quarter production from Greenhouse 5, and we are still in the initial ramp up here.

We expect combined Q3 retail and CPG revenue to increase by a low single digit percentage versus Q2, as we continue to expect a highly promotional and price driven landscape.

We expect consolidated gross margin to be in the low 50s versus 53% in Q2. Q3 typically sees our highest production in sales of flower versus trim, and that should provide a level of resilience in gross margin.

We project that adjusted EBITDA and operating cash flow will be in the $18 million to $20 million range in the third quarter, helping to push our cash balance to $38 million to $40 million by quarter end, a new high since we bought, retrofitted and began cultivation at the [SoCal farm]. Within the quarter, we expect CapEx to come in at approximately $2 million.

We will also make $1.9 million in dividend payments and $1.9 million in debt amortization payments.

We provide guidance for fiscal year 2024 during our Q1, 2024 earnings call.

I'll review that guidance here along with some revisions we made based on our future results and expected trends for the remainder of the year.

We are revising revenue guidance for 2024 down to $205 million to $210 million versus the previous $215 million to 220 million which is a 29% year-on-year growth at the midpoint of guidance. This revision is entirely due to the current wholesale biomass pricing environment and the resulting downward revision to our guidance for average wholesale pricing for the remainder of the year.

We are reducing projected 2024 adjusted EBITDA to $40 million to $45 million from the previous exceeding $50 million and moving operating cash flow down to the low $30 million range from the previous mid $30 million range. Consistent with our previous guidance, we expect cash flow to grow at a slower rate than adjusted EBITDA due to the increased working capital requirements associated with starting up Greenhouse Buy. This guidance does not include the $11.5 million ERTC refund we expect to receive later this year.

We are revising our guidance range for full year wholesale biomass production by 50,000 pound to product and rig 575,000 pound to 585,000 pound, which represents a 63% increase over 2023 at the midpoint of guidance as Greenhouse 5 output has exceeded our original expectations. Cost per pound is projected to be $130 which is lower than the 2023 cost per pound of $136.

We are revising our projected average selling price down to $2.75 to $2.80 per pound versus the prior guidance of between $3.10 to $3.15 per pound due to the current pricing trends as described earlier. Combined revenues from retail and CPG are projected to increase by mid-single digit percentage in the second half of the year, as we expect our retail pricing initiative to drive higher sales as foot traffic builds.

In closing, we continue to be laser focused delivering against what we can control, which is operational excellence and producing high quality cannabis at the lowest cost.

We are prepared for the difficult California market conditions in wholesale, retail and the branded business to continue in 2024 and still expect to deliver significant increases in 2024 results versus 2023 as we build our business for the long term.

We influence pricing but can't control it.

Instead, we focus on what we can't control executing in a difficult environment while delivering record results in the present and striving to continue delivering record high performances in the future.

If pricing has been consistent with our previous guidance, we would be raising guidance by $10 million to $15 million for revenue because of improving production from our SoCal farm, and we would not be dropping guidance as we are now. With that, I'll turn it back over to Kyle.

Kyle Kazan^ Thank you, Mark. I have a few final remarks before we begin the question and answer session.

On July 22, 2024, the Drug Enforcement Administration, DEA, comment period on its recommendation to reclassify cannabis from a Schedule one to Schedule three drug ended over 42,000 public comments received by the DEA more than for any other DEA proposal in history.

While the public comments were overwhelmingly in favor of the DEA proposal to remove cannabis from Schedule 1, it is also clear Americans view rescheduling alone as insufficient. Almost 70% of the public comments supported removing cannabis from the Controlled Substances Act completely.

This makes sense over 74% of Americans live in a state where marijuana is legal for either recreational or medical use, and because of this, the American public now sees cannabis as another product like tobacco and alcohol and not like an illicit or even pharmaceutical drug. Americans are divided on so many issues, but one thing that the vast majority of both Democrats and Republicans agree on, is that it is time to reform federal cannabis laws.

Our nation has spoken and it wants complete descheduling at the federal level.

So two weeks ago, Graham and I wrote an open letter to President Biden, former President Trump and Vice President Harris, urging all three of them to make the right choice to embrace descheduling cannabis.

We believe whichever presidential candidate takes on this mission will be rewarded at the ballot box.

As such, it is critical that the American public know where each of them stands on the federal legalization of cannabis.

We also called on President Biden to honor his campaign promises to decriminalize marijuana through descheduling release nonviolent cannabis prisoners from jail and expunge cannabis convictions from their records and to do so immediately.

I urge him to fully pardon all of the approximately 3,000 individuals currently incarcerated federal prison for nonviolent marijuana offenses, many of whom are serving life sentences. The continued incarceration of these individuals prolongs the legacy of the war on drugs and improve our justice system.

We have been consistent as an advocate on this issue including in early 2021, when we urged then President Trump to pardon Parker Coleman, and there are many others who deserve their freedom, such as Jerry Austin, Jose Valera Jr.; and Jerry Hayman IV.

So it is that we were heartened to hear former President Trump say the following at his press conference in Mar-a-Lago last Thursday.

As we legalize it, I start to agree a lot more because you know it is being legalized all over the country. He added, Florida has something coming up.

I'll be making a statement about that fairly soon. If legalization becomes a bar bipartisan issue, we can only hope that the current momentum towards rescheduling evolves into momentum towards full descheduling.

Such a development would be a positive for the entire country.

We recently welcomed Hector De La Torre back to our Board of Directors, an original member of our Board, Hector stepped down in 2023 because of time constraints connected to other commitments. Hector recently expressed his desire to rejoin our Board, and I'm extremely happy to welcome him back.

He was an impactful Board member during his first tenure. He is one of the earliest vocal advocates for cannabis policy reform in California when he was a member of the state assemblies. With his proven track record in public health and public affairs, his expertise will be invaluable as the cannabis industry evolves and we continue to execute on our growth plans.

I'd also like to share my thoughts on Investor/2024 which was held on June 21st at our SoCal Farm concurrent with our Annual Shareholder Meeting. This was our 3rd annual investor session and was the biggest investors date.

Attended by over 200 investors, we've got a firsthand view of newly retrofitted Greenhouse 5.

I want to thank all of you who joined us.

We enjoyed spending time and having casual conversation with you including long time holders as well as those who became investors more recently.

We have begun preparation for analysts and Institutional Investor Day on September 12 to be held at our (inaudible) SoCal facility. Many of you have received invitations for this upcoming event and I hope you can join us for an interactive day of informative sessions and a tour.

Lastly, in regards to the federal legalization of hemp-derived cannabis through the Farm Bill, which I discussed earlier, Glass House Brands has been consistently in favor of consumer-friendly policies like Homegrown and farmers markets. Therefore, we also believe that the Farm Bill was the right thing to do.

We simply want all cannabis to be fully legal and accessible to adults worldwide. With that, I'll hand the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Your first question comes from the line of Luke Hannan of Canaccord Genuity.

Luke Hannan^ I wanted to start with the discussion on hemp-derived cannabis.

Scott, I think you mentioned that you're in conversations right now with several distributors.

Of course, you're evaluating the ROI of that opportunity.

So I guess my question is, it's a two-part question.

One is, how far along exactly are you in these discussions?

And then maybe secondly, as part of the ROI discussion, are you concerned that there could be legislation or something similar, some other factor variable out there that potentially closes the loophole that allows for hemp-derived cannabis to be in the market currently?

Kyle Kazan^ I would tell you that we've been watching this now for a couple of years.

We've seen things and thought maybe that there would be a closing or change in the law. Thus far, we haven't seen that. And so, as we decided on our next expansion, we felt it was high time to go ahead and have those conversations.

I would say, we're still in the relatively early stages, and I would say that it is quite possible that legislation that was already discussed federally at potentially making some changes, all part of our calculus and risk as we look at this.

Mark Vendetti^ Jumping there with one comment.

One is, so I think first and foremost, right, is we sometimes joke that we are a regulatory company who sells cannabis on the side.

So anything that we do is need to be fully compliant with all laws and our analysis on that.

One of the great things about it is if everything that Glass House is good at on the cultivation side applies is 100% portable between the two regulatory systems.

So whether that's Prop 64, descheduling or the Farm Bill, what we do and what we're good at, is exactly the same because we're working with -- for the most part, the same plant.

The other great thing about that is from an optionality and from allocation of capital point of view, what we would do in the Greenhouse in terms of retrofit or operations is no different between the two markets.

It's really just a different set of regulatory standards.

So what we're looking at here would give us basically maximum optionality with minimal increased cost so that we can be potentially in both markets at the same time.

Or if there is a change, as you mentioned, what we would do is we would just pivot back to what we've already been doing for the last eight years.

If the chain becomes more liberal, then we could pivot further into the Farm bill side of things.

So it really is -- it puts us in an optimal position, because our skillset is exactly the same and implies that a 100% portable way between the two regulatory frameworks.

Luke Hannan^ And then my follow up question here and then I'll pass the line. You mentioned, backporting some of the modifications that you have in Greenhouse 5 to 6, and I think that's going to take place over the next six to 12 months. How I guess, significant are these modifications? Is there a lot of capital that's acquired to make these modifications, or is it simply just timing and process and that sort of thing?

Kyle Kazan^ Yes. I can take that one.

So the modifications, let's see how to, how to frame it.

I would say that they are kind of inter intermediate terms.

We're certainly not talking about a Greenhouse retrofit.

I'll give you a tangible example.

In Greenhouse 6, when we first set it up, we had three gutters per row. And we thought that was based on our analysis, the initial, the ideal spacing.

What we did in Greenhouse 5 is we had the same number of plants, but only but split them between two gutters. And what we've seen from that is, it’s less labor because you don't have to work on a center gutter, it's better airflow because there's less restrictions. That's actually more about, for example, more about taking something away than it is putting something in.

So for example, in that as we go through and harvest, when we have an opportunity and there's a bay that's open for a few days, we're just going to send in a crew and bring out that third -- that center gutter repositioned. The other ones adjust the slur.

So the air hole pattern is an appropriate spot and we'll just kind of slowly roll through the Greenhouse.

So from a CapEx point of view, it's really just labor that will insert opportunistically. Another example might be the shade screen that we have in Greenhouse 5 that we found useful in our, it gives us a more dynamic ability to react to changes in light levels.

So now you're talking something in the kind of, in the million-dollar range to retrofit that back in, to add that screen to six.

So you're talking about projects, some of which will just fit in and some of which will be kind of medium scale CapEx retrofits that will add to the existing structure. Nothing really would need to get thrown away and not, certainly not as something that would stop production.

We would be running the Greenhouse as we did the retrofit.

Operator^ Your next question comes from line of Mike Regan of Excelsior Equities.

Michael Regan^ In terms of the pricing, can you give us some insights into sort of what's driving sort of the lower-than-expected pricing or what surprised you? Is there like greater supply in California or declining demand and sort of what then reverses or changes that to have that pricing stabilize or increase in the future?

Kyle Kazan^ Graham, you want to take that from Mike

Graham Farrar^ So I think first thing to say is consistent with our perspective, right.

We know that we do not control pricing cycles and we actually expect there to be cycles as we kind of oscillate between prices going up and better margins making more money and prices going down, which we expect to thin the herd and reduce the supply.

As we mentioned, we see consumption on a unit basis staying fairly consistent to growing as additional consumers come into the market.

So it's kind of going to be this cycle of prices up great, prices down long-term great, because we're going to have the reduction in suppliers.

So we have never claimed the deal to forecast pricing.

What we have always focused on is the things that we do control, which is our cost and our efficiency and our quality and most things thankfully are forever.

So once you make cost savings, you hold on to that regardless of the pricing cycle.

So this year, what we saw, is that the pricing declined a bit earlier and a bit more drastically than it did last year. The crystal ball on that is certainly made out of salt.

We are tracking pretty close to estimates in the front half of the year and then saw things fall a bit quicker.

It could be expiring licenses out there.

If you had a license and you want to finish your harvest, you're certainly going to sell all your product before your license expires and you can no longer transact.

We're probably seeing some overlap from the Farm Bill and (inaudible) market as there's producers growing in that market that are satisfying some of the demand. And you might have even seen some FOMO for lack of a better word.

At the beginning, the first part of last year, we were seeing massive extinction in terms of licenses leaving the system.

So you might have seen some people kind of rushing to fill orders in a quickly declining supply side that was a bit more moderate this year.

So in the long term don't really see it as being an issue and believe that it leaves us even better position because the lower prices go, the rare air that we're in and the fewer people and operators who are able to compete with us.

So we're confident in our ability to continue to drive down our long-term costs, which is where we're going to really win overall.

Mark Vendetti^ And Mike, I think in the past we've talked, I owned some pecan farms down in Southern Georgia for -- since before I was in cannabis. And this is the healthy sign of the market in California which is this is an agriculture commodity. And I would just point out that we're anxious for the walls to come down because we grow it like an agriculture product. And as Graham said, we're focused completely on COGS. The rest of the country is growing closer to $800 a pound while we're in the low 100s.

So we kind of think we are where the world is going to go eventually. And so, this is just sort of what we've been expecting for years and years.

Michael Regan^ It sounds like you're still being able to see a lot of demand for the new production out of Greenhouse 5 anyway.

So just taking a lower price to clear it, there's you're still selling all the production, so?

Mark Vendetti^ No issues in demand.

Kyle Kazan^ And just to reiterate that, I think we've kind of made an intentional choice that we are going to keep inventories at a level of our choosing and that that means moving with the market to make sure that the Glass House product is the undeniable best quality cost intersection, we're prepared to do that.

So again, while we focus on our COGS is the bigger we get, the more efficient we get, the higher quality, the better consistency, the more competitive we can be.

Michael Regan^ And then on Greenhouse 2, I guess you've asked the tomatoes to back out so you can start to convert that. Any thought on just the cost and the timing on that conversion? It sounds like it's already started to begin.

Graham Farrar^ Yes. So one note on that, it is -- the process has started, the Greenhouse is currently being vacated. Again, the way that we set that Greenhouse up would be no different, working towards the cannabis side or the Farm Bill side.

So we don't need to make any choices or the bifurcations at this point, we can just do it the way that we normally would. Greenhouse two is a bit older of a Greenhouse than five and 6, so we do anticipate it being a bigger project from a construction point of view.

So timing will be not quite as quick and the cost will be a bit higher than what we've done before.

We'll also probably upgrade some of the supporting infrastructure to bring on that additional square footage.

So we'll be going through kind of think of it as like a Phase two retrofit to bring that next capacity online in whichever market it is that's fitting in.

Operator^ Your next question comes from line of Aaron Grey of Alliance Global Partners.

Aaron Grey^ So first one for me, just want to attack a little bit differently in terms of potentially going into the hemp category.

So you guys are known for kind of growing quality [smokable] flower at scale, which an advantage you guys have for TAC.

So curious with the potential, change to hemp, how do you think about approaching the market, given hemp can be geared more towards the derivative products with less focus on the flower side and more competition from outdoors? So wondering if that would have any impact just in terms of how you would approach the market there? Thank you.

Kyle Kazan^ So excellent question and what I would tell you is in discussions that I've been part of the pricing right now for wholesale flower is higher decently than what we're selling our cannabis flower in California for.

Obviously it's a commodity, so we're expecting that to move, but there's plenty of demand out there. All you have to do is just Google and you'll see there's a lot of brands cookies, some of the stuff, some of the brands that we see out here in on the shelves have already moved into that.

So yes, there's different derivatives of it, but that's the same as you'd find in any dispensary here in California as well.

Aaron Grey^ All right, great. Appreciate that.

Sorry, go ahead, Graham.

Graham Farrar^ I mean just reminder that our big three on the brand size Glass House Farms flower, Allswell flower also Allswell edibles, and then plus on the edible side, so we've got a product catalog that spans the primary products that you see in the Farm Bill side.

Obviously our expertise and where we really excel, is on the cultivation of high quality, consistent flower at scale and that industry leading cost.

I think that everybody in the Farm Bill side of the market will appreciate those things. And then when you grow great flower, you get great byproducts which help you make great derivative products as you call them as well.

So I think that again, one of the great things about this from our perspective is the skills that we've developed over the eight plus years of living in the hardest cannabis market on the planet, apply 100% to either regulatory system.

Kyle Kazan^ And Aaron, a lot of people have been saying, we get a lot of questions about this privately and we've got it for quite a long time.

But as you just pointed out, everything we do is pretty sizable.

So we are being extremely, deliberate because should we make the decision to go forward this way, we'll be bringing a lot of biomass to the hemp-derived cannabis market.

Aaron Grey^ A second question for me just in terms of Allswell $9.99 out the door, appreciate the color there in terms of the impact for some of the dispensaries and rolling it out to more of the stores there. Just wondering if you could provide some additional color in terms of expanding that out to third party retailers.

Still sounds like it's a tough environment out there in California.

So any update on that in terms of being able to partner with other retailers and having the potential for that $9.99 out the door in stores outside of your own? Thank you.

Kyle Kazan^ Thank you again, Aaron.

I would tell you that our focus is to stores in which we are managing that that's something that we can bring to them.

We're not anxious to roll it out to every single dispensary in the state.

Operator^ Your next question comes from the line of Scott Fortune of ROTH Capital Partners.

Scott Fortune^ Just a follow-up on the Allswell strategy here. You said you've seen obviously nice traffic metrics picked up in your stores and you've seen other add-ons for that. How is the average basket side dollar amount kind of how is that increased or decreased in this kind of tough consumer environment? Just a little more metrics you can provide on Allswell within your stores and kind of the impact on the value brands that are those offerings in California would be helpful.

Kyle Kazan^ Scott, I'm going to hand it over to Mark.

But as we just finished with the Olympics and you're an Olympian with a medal, when you watch games do you actually wear the medal around the house?

Scott Fortune^ No, but you guys had a great showing obviously.

Kyle Kazan^ Sorry, Mark, I would have to ask because I think of you when I see Americans with Olympic medals.

Mark Vendetti^ We're not you don't deal with many analysts in that category. No.

We're fine there. And that's cool.

So if you just look at and talking about our stores, so all the while flower has become our largest unit driver in our stores and I think we had mentioned same store sales for traffic are up 20% since we've kind of gone to this new strategic pricing plan.

We have seen our ATVs drop slightly, not significantly a few percent. And I actually think that's pretty good when you think about how aggressive we've become in pricing and we've seen again the traffic more than make up for the drop in ATV which is really good, and even we are not as aggressive outside of our stores. Allswell has now moved into a top three flower brand from a unit basis.

So it's being accepted both in our stores and outside of our stores at a really strong level. And that's happened really in a couple of quarters.

So we can't be we're really pleased at what we're seeing out of Allswell.

Scott Fortune^ I appreciate color there. And then maybe a follow-up on Graham. Greenhouse two reminds us, is that the canopy with supplemental lighting already in place? And would you have to update the lighting or kind of use that? And then, how does kind of some lighting kind of play into your overall long-term structure a little bit here to complement, the growing and bringing down the yield or increasing the yield production from a standpoint within your greenhouses?

Just kind of remind us on that Glass House two kind of structure.

Kyle Kazan^ Greenhouse two is the Greenhouse that has existing lighting, and it has about 11,000 watts HPS or high-pressure sodium lights in there. Again, a great thing with our setup is that we have our three code generation power plants on site. They were designed to be able to use natural gas and produce electricity cheaper than we can buy it from the grid at to power those lights. And then in the process of producing that electricity, we also get heat, which we use for climate control and in the Greenhouse s as well as CO2, which again, allows to be very environmentally friendly and a very efficient from a production point of view.

So there's two paths that we could take there.

One path is basically to use the existing lights, and they would probably need some rehabilitation since they haven't been used as much as they normally would have replacing burned out bulbs and things of that nature.

So not a huge uptick cleaning things off and making sure that they're all in good working order. The other path would actually be to upgrade the lighting or replace it. LEDs have become much more popular in recent times. They have some great benefits producing more light for the given amount of electricity or more micromoles per joules, the way that they measure the efficiency there.

They also don't produce heat, and that can be a good or a bad thing depending on what it is you're trying to do with your climate.

So we'd have optionality there, to either keep the cost down and just keep the existing system or to do a partial or full upgrade depending on what makes the most sense.

It'll basically be a balance of CapEx versus OpEx over time and whatever makes the most sense is what we'll do. And sorry, second half of your question there. Expectations, one of the big upsides for that is the increases output without increasing consumables other than electricity also typically will increase the ratio that you see.

So you have a higher ratio of larger flower, which sells for a higher price.

It also to puts you potentially in a different pricing category where a flower with supplemental lights gets even closer and potentially even surpasses, the indoor that people clamor for.

If you think about taking everything mother nature gives you and then adding light to that is potentially better than either one of those things on its own. And then the other nice thing it does is that it would help level out the season.

So rather than kind of the seasonal fluctuations that you see with less light being, less production, if you're able to supplement what Mother Nature's given you with your own lights, you can take some of that seasonality out.

And if you look at our pricing, our ASPs over time, you can see that having additional pounds to sell in some of the lower production times of the year has its own benefit, because pricing tends to be higher as well.

Operator^ Your next question comes from line of Howard Penney of Hedgeye Risk Management.

Howard Penney^ Graham, I just wanted to see if I can summarize the hemp opportunity.

So you said there's -- the plan is 1005 portable, hemp is 100% portable between the two plants in terms of growing, do you have some, the biggest difference for the rules you follow? So there's no taxes. Consumers use credit cards, there's a DTC opportunity and there's better wholesale prices. All of that suggests that hemp can have significantly higher gross margins than what the Company's putting out today.

Is that right? And then if that's the case, what would hold you back or what is holding you back from doing it? Or what would you need to see to take advantage of this opportunity? And lastly, one other thing.

What's the size of the market?

Graham Farrar^ Yes, great question.

So I think there's significantly less regulatory burn on the production taking it kind of section by section.

On the production side, there's significantly less regulatory burden, hemp license is $900 and covers a year and covers unlimited acreage versus cannabis licensing, which is annual and on a square foot basis. There's less overhead in terms of the things that you need to go through in terms of tagging plants and removing tags and things like that.

So we expect the cost of production to be able is the plant to be able to be produced more efficiently without some of those frictions.

On the direct-to-consumer side, you very much you can see other brands, cookies being a good example that are running direct to consumer options where you're able to capture full margin similar to how we do in our stores, but I think it's about 21 states that allow THCA flower to be shipped into them currently. You can use credit cards. You can ship it through the U.S. United States Postal Service.

So basically, think of it as regular commerce and maybe think of it not even too different than alcohol, right, where there's some states that you can ship alcohol into and some states you can't and that varies on a state-by-state basis.

So we would look to be able to capture those opportunities there.

As Kyle mentioned, you do see some variance in pricing state-to-state.

I think we would not necessarily count on that.

We would expect to see convergence, particularly with somebody of our scale moving into that.

So even if we forecasted pricing to be the same as we see in cannabis, lower overhead, lower taxes, a broader market, credit cards and all that should we believe would produce a, you know an exciting opportunity.

Beautiful thing again where we sit, it doesn't that we don't have to choose, right? We can operate in both paths.

We have six greenhouses. Three of the greenhouses are currently used being used for licensed cannabis. The other greenhouses are being -- tomatoes and cucumbers, clearly not the long term highest and best use.

And one of the nice things about the way that we see the market right now is that we would not have to turn off one opportunity necessarily to turn on the other.

So we'll continue to do our analysis. Regulations and compliance will drive our decisions.

We'll take advantage of opportunities where they are, where they are.

If things change, more conservative, more convenient, then the nice thing is the investments we make into the greenhouses aren't don't change at all.

And so, we can be pretty dynamic and pivoting to take advantage of wherever the best opportunity is.

Kyle Kazan^ And Howard, one question that we know we're going to get and we're expecting and again we haven't announced that's the exact step we're going to do.

We are looking very seriously at it.

But our feeling also is that once the state legalizes, we haven't seen one go backwards.

So our feeling is once people have access to Glass House products legally, it may be hard to actually put that genie back in the bottle because now you have to justify why you would do that and take away the rights that somebody had started to join.

So we kind of think that this if we move in quickly and correctly that might actually make this solidify this law which again we always agree with anything that's good for the consumer and we're very pro freedom.

Howard Penney^ What's the size of the wholesale market, Graham, do you know?

Graham Farrar^ Tough to get a great read on it.

I would say Bo Whitney out of Whitney Economics has probably done some of the best work. The number that I've seen thrown around is a $28 market, which, if you believe that would surpass the size of the licensed cannabis market and probably be somewhere in the order of after a third the size of the total, cannabis market.

So it appears to be growing pretty quickly. Again, stats, don't quote me on this, but do your research.

I've seen numbers upwards of 7,000 hemp dispensaries in Texas. You can see if you look at the states that allow THCA flowers, as well as hemp-derived gummies to be shipped to. You'll see Texas, the number two most popular state, populous state, Florida, I think is the number third most populous. New York is the number fourth most populous. All those currently have laws standards that would allow this flower and edibles to be shipped into them.

So the market size is potentially massive and frankly, it looks more like we would've expected and hoped cannabis to look at this point, five, six years post prop 64 and California than the license market does.

So in many ways happy to see the liberalization development. And at the end of the day, our goal is to make products that consumers love and help live -- help them live better lives.

So the more people that have access to cannabis is either for fun or as an alternative to pharmaceuticals the happier we are. And it's great to see this additional path open up to help make that happen quicker.

Operator^ 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, sir.

Kyle Kazan^ Thank you, Operator. And thank you everyone for your interest and for joining us on today's earnings call.

Operator^ This concludes today's conference call.

You may now disconnect.