Glass House Brands Inc.

Second Quarter 2022 Investor Conference Call

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Length: 55 minutes

CORPORATE PARTICIPANTS

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Kyle Kazan
Glass House Brands Inc. — Chairman & Chief Executive Officer

Mark Vendetti
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CONFERENCE CALL PARTICIPANTS

Scott Fortune
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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Glass House Brands Second Quarter 2022 Investor Call. I now would like to hand 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, Sylvie. I'd like to welcome everyone to Glass House Brands second quarter 2022 conference call for the three-month period ending June 30, 2022. Listeners are reminded that certain matters discussed in today's conference call or answers that may be given to questions asked could constitute forward-looking statements that are subject to the risks and uncertainties relating to Glass House Brands' future financial or business performance. Actual results could differ materially from those anticipated in these forward-looking statements. The risk factors that may affect results are detailed in Glass House Brands' periodic filings and registration statements. These documents may be accessed via the SEDAR database.

I'd like to remind everyone that this call is being recorded today, Thursday, August 11, 2022. I'd also like to give everyone a heads up that the press release has been a little slow in coming across the wire. We've been advised by Cision that it will be hitting the wire shortly; however, it has been posted on our website on the IR portion of our website under News and Events, Press Releases. And when it hits the wires, we will notify you.

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

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

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

Almost one year ago to this date, we held our first quarterly conference call after having listed on June 29th of 2021. I would like to take this opportunity to reflect on the progress we've made over the past year and the milestones we plan to achieve over the course of the next year.

Within three months of going public, we used the funds raised in that transaction to acquire the cornerstone of our expansion strategy, the 5.5 million square foot state-of-the-art greenhouse facility in Ventura County, California, which we refer to as our SoCal farm, in the process negotiating the cash purchase price of the farm down from the agreed option price of $118 million to $93 million, saving $25 million. By December we arranged a $100 million senior secured debt facility to finance all three phases of our retrofitting plan at the new site.

Retrofitting work commenced immediately upon the acquisition of the property and by March 11, 2022 we had acquired all licenses necessary to begin commercial operations. The very next day, our cultivation team transferred 30,000 clones into the SoCal farm. We had our first harvest in late May and we had our first sales in June, all well ahead of schedule and significantly faster than the previous ramp-up of our Casitas and Padaro farms. I wish I could say that more often.

We believe that there are very few cannabis companies that are built like we are, to be able to win first in our home market of California and, eventually, thrive in the future where federal legalization opens interstate commerce. We believe that all the investments and acquisitions we are making will help Glass House win both now and in the long run. Whether federal legalization is de facto via SAFE or via a broader legalization bill, Glass House is ready. And when the time comes, unlike others, we will not have to shutter or dispose of assets that no longer make sense.

That being said, while we are positioned for eventual federal legalization that will open interstate commerce, we are not forecasting nor are we dependent on it. We already grow our cannabis in the best cultivation location in the world, which also has the most experienced growers, management, and worker pool, as well as the most coveted strains and culture in the world. Glass House's total potential Southern California cultivation footprint is far larger than the cultivation footprint of many of the biggest MSOs in the country. Furthermore, our cultivation footprint is concentrated in three facilities, all in prime growing locations within a 30-minute drive of each other. Many industry peers have facilities spread around the country in states which are less than ideal for cannabis cultivation.

In the run to going public we told our investors that we intended to aggressively build out our retail dispensary network and acquire attractive brands. In the past several months we have done that. In late November we announced that we had agreed to purchase PLUS Products and we closed that acquisition early in the second quarter of 2022, becoming the first California operator with top-five brands in both flower and also edibles. We are now the only edibles company that controls the process from plant to product and our marketing team is already developing products that leverage our unique ability to make self-grown strain-specific products.

We started last year with three dispensaries and we anticipate that we will have at least eleven by year-end 2022 via acquisition and organic expansion. We've already closed our acquisition of the remaining 50% equity stake in The Pottery transaction. We expect to open three new Farmacy locations in Isla Vista, Santa Ynez, and Eureka in the fourth quarter of this year. And we are moving forward on closing the acquisition of three Natural Healing Center dispensaries announced on May 12th. In addition, we are very happy to announce that we have agreed to acquire Natural Healing Center's flagship Grover Beach store for $15.9 million with $8.1 million of the purchase price in assumed debt, $7.7 million in stock, and $100,000 in cash net of working capital. The Grover Beach store is the crown jewel of NHC's dispensary and netted US$16 million in revenue in 2021. It is one of only four total dispensaries in Grover Beach and it is the number-one taxpayer in the city given its high sales volume and strong cash flow generation. The deal multiple based on the annualized EBITDA of the Grover Beach store in the first half of 2022 is 4.8x.

The cannabis market was in the early stages of what would turn out to be a severe downturn when we listed in June of last year. This strongly impacted our ability to deliver on our revenue and margin projections and not everything went as planned; however, operating in California, the most competitive cannabis market in the world, we worked tirelessly to execute our key strategic initiatives over the past 13 months. We are now poised to triple our annualized revenue run rate to $200 million by 2023 and we are on a path to be free cash flow positive by the first quarter of next year, excluding capital expenditures for facility expansion. Few California operators have assets as attractive as ours, even fewer can say that they will soon be free cash flow positive, and even fewer still have a clearly articulated and focused strategy that they are executing as consistently as we have executed ours, and of course none of them have cannabis that taste quite like ours.

I'd like to take this opportunity to give a status update on some of our strategic initiatives. Regarding PLUS Products, we have already begun integrating PLUS into our organization. In the short few months since closing, it is proving to be accretive to our financials and has shown the potential to be a strong contributor to Glass House's overall cash flow generation. We recently moved PLUS Products distribution from Nabis to our existing Glass House distribution partner HERBL. We've integrated the PLUS sales force into our sales team and invested in training HERBL's team to market PLUS Products. They are excited to be selling PLUS edibles due to the high degree of customer loyalty and strong brand recognition amongst consumers. We expect to realize synergies in distribution of both Glass House Farms and PLUS in the second half of this year. Additionally, Hilal Tabsh, our CRO has major product innovations planned for the fourth quarter. Other benefits of the transaction are the kitchen facilities and edible production expertise, which immediately proved helpful in launching new product lines like our Allswell gummies. They're also in the process of relocating manufacturing of PLUS Products to our Lompoc processing facility, allowing us to eliminate leasing and overhead costs of the current PLUS processing facility in Adelanto.

On the retail front, regarding Natural Healing Center, or NHC, the NHC management team has built a retail brand with a tremendous customer following coupled with a world-class retail experience. While it has been suggested that we merge the NHC dispensaries and all other new Glass House dispensaries under our Farmacy brand to unify our retail brand offering, we plan to keep the NHC retail brand and the outstanding management team. We are extremely excited about the NHC brand and its loyal customers. When you buy a franchise with a strong reputation and following from customers, you want to further leverage and optimize what has been built. We are considering opening more dispensaries under the Natural Healing Center name, using and learning from the retail expertise of that team while also leveraging the full value of the NHC brand.

Regarding the current macroeconomic environment, we are operating under the belief that we are already in a recession. And if not, one is coming. We are seeing consumer spending have it shift from mid- and high-tier products to more affordable products, driven in part by inflation. We launched Allswell to meet the needs of the new consumer purchasing habits. The brand will feature flower, pre-rolls, and edibles. We look forward to providing more detail on Allswell's performance in upcoming quarters. It covers an important segment of our product portfolio and we believe it will make a robust contribution to our long-term market share growth.

Although it is still early days, we are pleased with the results we have so far at our SoCal farm. It is already producing cannabis with a higher and more consistent quality than our existing Casitas and Padaro farms, which have a strong reputation for quality. The SoCal farm has also shown particular promise at growing high-quality genetics at extremely close to indoor quality. Production volume has also ramped up quickly. In our first quarter earnings call we projected total capacity for our two existing farms plus phase one at SoCal at 270,000 pounds per year. In July we produced 22,000 pounds of biomass across all three facilities compared to a total of 25,000 pounds of biomass in the entire second quarter, which came from Padaro and Casitas. We sold a total of 18,000 pounds of biomass in July, a figure which is just shy of the 20,000 pounds of biomass we sold in all of the second quarter.

Before handing the call over to our CFO, Mark Vendetti, I'd like to discuss our cash position. As you can see, we've made significant investments into our SoCal farm and in our future growth. We have decided to raise additional capital. The use of the proceeds will be to pay off the $10 million WhiteHawk bridge loan and provide $16 million for working capital. In addition to the new proceeds, we plan to roll $23.5 million from existing preferred equity into this preferred equity class. Mark will get into more details in a few minutes. I strongly believe in eating our own cooking and we anticipate that insiders will account for approximately 17% of this new preferred equity class and I will account for 10% personally.

Mark Vendetti, our Chief Financial Officer, will now discuss our financial results for the quarter in detail, following which, President and Chief Cannabis Officer, Graham Farrar, Mark, and I will take your questions. Mark?

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

Thanks, Kyle, and good afternoon, everyone.

As a reminder, the results I will be sharing today can be found in our financial statements and MDA, which are reported in U.S. dollars and prepared in U.S. GAAP.

Total revenue for the second quarter of 2022 was $16.5 million. These results represent a 12% decline versus last year and an 18% increase versus Q1. Excluding a $1 million loyalty program true-up in Q2 of last year, revenue declined by only 7% year on year.

In order to understand our wholesale results for the quarter, it is important to recall the seasonal pattern our greenhouses demonstrate. The second quarter is our second lowest quarter for production, primarily because of decreased sunlight and lower sunlight intensity in the wintertime and early spring with productivity and THC content increasing with each month in the second quarter; therefore, it is our second-lowest output and second-highest cost quarter. It also skews the output more toward low-value trim and away from high-value flower compared to our peak growing season of Q3 and Q4. Wholesale revenue of $6.7 million increased 8% versus Q2 last year.

We sold almost 20,000 pounds, which is 38% more equivalent dry weight in Q2 this year than last year. Demand for our product remains strong and inventories are low. The increase in weight available for sale was driven by a 9% increase in production versus last year and additional weight available to sell due to lower-than-anticipated need for biomass for CPG.

Average price was 13% lower than last year but would have been much worse if our greenhouses hadn't produced a much higher percentage of flower this quarter than the same quarter last year. Compared to last year, we experienced a 45% decrease in flower pricing and a 53% decrease in pricing for smalls. If pricing had remained constant from last year to this year, wholesale revenue would have been $5.7 million higher, representing an increase of 100% year over year.

Sequentially, wholesale revenue increased 31% as equivalent dry weight sold increased 11%. We saw a mild deterioration in wholesale pricing versus Q1, but the total average price increased 18% due to a higher mix of flower. Consistent with last year, and assuming similar weather, we expect our greenhouses in Padaro and Casitas to increase production, lower their production cost per pound, and improve their mix of high-value flower, which will help improve the average selling price as the year progresses if pricing by segment remains consistent with prior quarters.

Before I discuss our retail and CPG businesses, I want to provide data on the state of the California cannabis market using Headset data. The total market was down 10% versus Q2 last year, but

Q2 2021 was a record high for quarterly sales in California as the market benefited from COVID-19 lockdown-related demand and stimulus spending. Flower sales declined 25% year on year while edibles grew 4%. Pre-rolls and vape pens showed the highest year-on-year growth, growing 14% and 5%, respectively. On a sequential basis, overall California market sales increased only 1%, an unusually low seasonal increase in demand as Q2 contains the 4/20 holiday. The second quarter was negatively impacted by highest rates of consumer inflation in 40 years with inflation currently at 8.5%. Based on Headset data, we saw sequential decreases in year-over-year growth in each month during Q2. In addition, we expect consumers will begin to feel a larger impact from the increase of interest rates as the Fed continues to raise rates. All of these factors contributed to a reduction in consumers' willingness and ability to spend in the quarter. Looking into the third quarter, we believe there will continue to be negative effects from a challenged consumer, which may keep market growth constrained or declining.

Moving on to retail for the second quarter, in this quarter our retail footprint consisted of three dispensaries, one each located in Santa Barbara, Santa Ana, and Berkeley. All three have been opened at least since the beginning of the first quarter 2021. They are performing in line with the overall cannabis market sales trends in the state. Retail sales in Q2 of $4.8 million were flat to Q1, which was slightly below overall market growth of 1%. On a year-over-year basis, retail sales fell 24%. Note, however, second quarter 2021 retail revenue included a true-up in our loyalty program, which improved sales and gross margins by $1 million. Adjusting out the effect of the true-up, Q2 2022 retail sales fell by 10% year on year, in line with the overall market.

Turning to our Q2 2022 CPG business, sales jumped 24% sequentially but decreased 19% from last year. Most of our CPG business is in the flower category and is being impacted by declines in the cannabis market previously discussed. The quarter also includes two months of PLUS edibles revenue of $1.7 million, which helped comparisons to prior periods. During the quarter we made significant progress cleaning up aged inventory, rebalancing our strain management issues that hurt sales in Q1 and Q2. This came at the price of heavy discounting, resulting in a level of discounting reaching 41 percentage points of gross sales versus the prior four quarters of approximately 10%. Cleaner inventory to start of Q3 should reduce markdowns to levels closer to other recent quarters. As mentioned in our Q1 call, we have taken steps to improve inventory and strain management, and these steps were institutionalized in Q2. Sales and marketing are now the determining factor in strain selection with input from cultivation ensuring a closer connection to the market and consumer. We believe these changes will make us more agile in responding to the continually changing market; however, we expect the difficult sales environment that hurt performance in the first half of 2022 to persist through the rest of the year. Our dispensaries are experiencing reduced foot traffic and fewer transactions, which are negatively impacting sales.

Now moving to gross margin, please note that we began reporting our gross margin by business line in Q1. Our gross margin in the second quarter of 2022 was $300,000 or 2% versus 17% in the first quarter of this year and 46% in the second quarter of 2022. Our Q2 2022 gross margin, when compared to our Q1 2022 gross margin, was negatively impacted by two major factors. The first was the high level of CPG markdowns within the quarter. If markdowns had been similar to recent performance at 10% of gross revenue, revenue and gross margin would have increase by $1.7 million sequentially. In addition, the quarter contained approximately $2.2 million of start-up expenses related to the commencement of the commercial operations at the SoCal farm. It takes approximately 90 days from clone to completion of processing. As a result, the SoCal farm had three months of expenses to go against less than one month of sales. Excluding these impacts, gross margin in Q2 would have been 23% versus 17% in Q1. In addition to the impact these items had on gross margin in Q2 of this year, Q2 last year benefited from a $1 million loyalty program true-up, which improved margin by three percentage points. Lastly, much stronger wholesale pricing, which was discussed earlier, negatively impacted Q2 this year by $5.7 million worth of revenue and gross margin if wholesale pricing was the same as last year.

Within our Q2 2022 gross margin, we expensed $2.7 million for cultivation tax. This tax was worth 16 margin points in the quarter. Within wholesale, the Q2 cultivation tax was $99 per pound. Please note this is not included in our reported cost of production. Governor Newsom and the California legislature provided relief to legal cannabis industry and officially eliminated the cultivation tax effective July 1st, a development that we suggested was highly likely in our previous earnings call. Our current projections assume the elimination of cultivation taxes will result in lower prices for consumers for potentially higher profits for retailers. The former would increase the competitiveness of the legal market versus the illicit market and hopefully increase legal sales, benefiting both retail and brands, while the latter will more directly benefit cash flow in the bottom line of cannabis companies. We now are forecasting the entire impact of the elimination of the cultivation tax will flow through as a reduction in wholesale prices. Note the cultivation tax rates were $161 per pound for flower and smalls and $48 per pound for trim through June 30th. So far in Q3 we have already seen this play out in lower biomass wholesale prices. In our CPG business, we will utilize the elimination of cultivation tax to improve our pricing and promotional competitiveness within the market and we expect retail to become increasingly promotional. For perspective, within our main SKU, the 3.5-gram jar, elimination of cultivation tax reduces cost by $1.24 per unit at the wholesale level and by up to $4 per unit to the end consumer.

Our cost per equivalent dry pound of production in the quarter was $158 per pound with 25,188 pounds produced. This represents our lowest ever quarterly production cost, an 18% reduction in cost per pound and a 9% increase in the number of pounds produced compared to Q2 2021, all before the expected positive impact on cost reductions from the SoCal farm has kicked in as this cost per pound of $158 only includes the greenhouses at Padaro and Casitas. The start-up expenses referenced earlier greatly distorted the results of SoCal production in Q2 and we will begin including the SoCal farm in the third quarter cost per pound calculation.

General and admin expenses were $10.9 million for the quarter compared to $9.4 million in Q1. The $1.5 million increase is primarily attributable to a $1.1 million increase in stock comp and salary and benefits related to the PLUS acquisition and $200,000 associated with increased cost of cannabis licenses. Our full integration of costs will occur mainly during the third quarter. Most of the SG&A expenses from PLUS employees will be eliminated with the exception of those related to the sales team.

Sales and marketing expenses were $0.9 million, roughly equal to Q1 2022. Professional fees were $2.7 million compared to $2.6 million in Q1 2022. Increased legal fees due to acquisitions and deal-related costs were offset by a reduction in accounting fees related to year-end audit expenses in Q1, which did not carry into Q2.

Depreciation in Q2 2022 of $2.6 million was essentially flat to Q1 as very little of the CapEx spending in the quarter was placed into service.

We define adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, adjusted for transaction costs, restructuring costs, share-based compensation and other non-cash operating costs. Adjusted EBITDA loss widened by $3.4 million to $9.8 million in the second quarter compared to a loss of $6.4 million in Q1 2022. The major impact was from gross margin, which fell to 2% from 17% in the first quarter of 2022.

We ended the quarter with $17.5 million in cash, including $3 million of restricted cash. This was down from $24.8 million in Q1 2022. Cash burn during the quarter fell significantly to $7 million from $29 million in the prior quarter. Operating cash flow was negative $8 million, an improvement from negative $15 million in the first quarter. The improvement in operating cash flow was driven by improved working capital compared to Q1, which resulted in an $8 million improvement between the quarters due to higher AP and lower prepaids.

Capital spending dropped to $8 million in Q2 compared to $13 million in Q1 as the spending for phase-one retrofit of SoCal is almost complete. The Company raised $8 million of incremental cash from the WhiteHawk bridge loan proceeds, from a sale leaseback of retail locations in Santa Barbara and Eureka, and from cash from the PLUS acquisition. The balance sheet grew $34 million with the majority of the increase created by the PLUS acquisition, which includes $25 million of goodwill and intangibles within the assets of the balance sheet. Within liabilities, we added a $10 million note payable from WhiteHawk Capital, which was used to help fund the acquisition of the Natural Healing Center dispensaries and $16 million note payable of convertible debt as part of the PLUS acquisition.

Today we announced a private placement of preferred equity shares with a target range of $26.5 million. We intend to use $10 million of the proceeds to retire the bridge loan from WhiteHawk and the remainder for working capital, including CapEx to complete the build-out of the new Farmacy stores.

Glass House currently has received $10.7 million in cash in hand and signed agreements and additional commitments of $8.7 million for a total of $19.4 million of Glass House Brands preferred shares. Additionally, the Company will convert the existing $23.5 million of preferred equity issued by the Company's subsidiary into Glass House Brands preferred shares to create a $50 million series. The Company currently has commitments to convert $22.5 million out of the $23.5 million of existing Glass House Group preferred equity. Holders of the new preferred shares will be entitled to a 20% dividend, which gradually increases to 25% by year four. The dividend will be paid quarterly with 10% cash and the additional amount accruing to the principal. In addition, with each $10 of preferred equity investment, the holder will receive two warrants of Glass House, each warrant being exercisable to acquire one share of Glass House at a price of $5 for a term of five years following the issuance. The first closing of the preferred equity share offering, subject to the approval of the NEO Exchange, is expected to occur by the end of August 2022. A final close is targeted for 30 to 60 days thereafter.

We are confident this incremental capital will provide the necessary run rate to achieve our guidance of reaching free cash flow positive operations, excluding expansion CapEx, in early 2023. Despite the continued difficult market conditions, we are reaffirming this guidance. In addition, we are providing the following new guidance for the balance of the year. In prior calls we provided a longer-term target of reducing cultivation cost to $100 per pound. Based on our start-up at the SoCal farm and strong quarterly results from Casitas and Padaro, we are now ready to provide projections for the average cost of production across our three farms for Q3 and Q4 of this year. Our estimates for cost of production are $150 per pound in Q3 and $125 per pound in Q4. Please note that our SoCal farm is completing its ramp up through Q3. The improvement to $125 per pound in Q4 represents a 25% reduction from Q4 last year.

Lastly, with the commercial start-up of the SoCal farm and full quarter PLUS edibles, we are providing revenue guidance for Q3. In Q3 we expect to achieve revenues of between $27 million and $30 million for the quarter, which is a 64% to 82% increase versus Q2 this year. This assumes the wholesale pricing we are currently experiencing in Q3 remains constant through the balance of the quarter. Our Q4 revenue target is $50 million and assumes Q4 wholesale pricing remains consistent with Q3 and includes revenue from our NHC acquisition as well as a partial quarter for our new Farmacy stores.

As we are almost halfway through the third quarter, our primary focus is on execution for the balance of the year. We have the pieces already in place to achieve $200 million in run rate revenue by 2023 and to be cash flow positive, excluding expansion CapEx, by early 2023. With our base business, SoCal 630 square feet of cultivation joining our existing 307,000 square feet of cultivation, the addition of PLUS Products, four Natural Healing Center dispensaries, and four new Farmacy dispensaries, we are well positioned to be successful in California and to deliver against our financial goals.

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

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

Thank you, Mark.

I would like to take this opportunity to update you on the latest industry progress in pushing for the release of non-violent cannabis prisoners. Sue Taylor, Glass House Brands ambassador and founder the Mama Sue of CBD tinctures, attended Cannabis, Criminal Justice and Clemency Symposium on Glass

House's behalf on Wednesday, July 20th in Washington, D.C. In the words of Weldon Angelos, President and Co-Founder of The Weldon Project, it is unthinkable that our country continues to incarcerate non-violent cannabis offenders in federal prisons. The symposium was an opportunity for us to come together and discuss the path forward to securing justice for the individuals who have been hurt by the war on criminals. We know the Biden administration is dedicated to criminal justice reform, or so it says, and now it is time for action. The symposium broke down into working groups to discuss the mechanics of the successful release of non-violent drug offenders and the subsequent expungement of their records. We will continue to work tirelessly until all non-violent cannabis prisoners are released and their lives are given back to them. To that end, Glass House is committed to hiring released prisoners on to our team to the extent that they are allowed. For more up-to-date information on all that goes on, you can follow Weldon Angelos on his Twitter account or follow me on my Twitter account as he and I post often and this is a very big deal to both of us.

With that said, I will turn the call over to John Brebeck. John?

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

Thank you, Kyle.

I'd like to give everyone a heads up that the official press release has crossed the press release service, so it's on the wires and it's also on our website.

I'll now turn the call over to the operator to begin the question-and-answer portion of the call. Sylvie, turning it over to you.

Q & A

Operator

Thank you, sir. Ladies and gentlemen, if you would like to ask a question, please slowly press star followed by one on your touchtone phone. You will then hear a three-tone prompt acknowledging your request. And if you would like to withdraw from the question queue, you will need to press star followed by two. If you are using a speakerphone, we ask that you please lift the handset before pressing any keys. Please go ahead and press star one now if you have a question

Your first question will be from Scott Fortune at ROTH Capital Partners.

Scott Fortune — Analyst, ROTH Capital Partners

Good afternoon and thanks for the questions. You guys are bringing on a lot of supply, which is great, but I just want to get an update on the California market as far as the supply and demand dynamics. Looking out forward here, do you see a lot of cultivators, mainly small, without scale, not renewing licenses or not planning in 2022 here to kind of flush out that oversupply, but can you quantify or provide color on that dynamic?

And any color on your biggest competitor, obviously, the illicit market, and new measures being taken there to quell that supply, just a sense of how this plays out and helps pricing as we look into 2023 here potentially.

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

Scott, thanks for the question. I'm going to turn that over to Graham. A question for you, if you don't mind just shooting me a text, is Stanford going to join the Ivy League?

With that said, I'm going to go ahead and turn it over to Graham to answer your question.

Graham Farrar — President & Chief Cannabis Officer, Glass House Brands Inc.

Thanks a lot, Scott. It's a great question. So I think the most indicative thing, I would say, is referring back to Mark's numbers, which is, in July, on a production basis, we produced almost the entire Q2's production numbers. And also in July we sold almost the entire Q2 production numbers, right? So it's very close to a tripling of the business, which is essentially our goal. So what we're seeing there is the new farm is producing at very close to the pace that we expected and we're selling all that product, so the demand is staying steady. We also see a premium for the product coming out of the new farm, which is exactly what we were hoping to see. And then also, as Mark gave guidance on, we had $158 a pound of production costs in Q2, which is an all-time record for Glass House in Q2, which is not typically our best quarter, and then in Q3 we're aiming for $150 a pound and in Q4, which is $125 a pound in COGS, so well on our way to our $100 a pound COGS target and I would actually say ahead of schedule from what we've communicated.

In the market broadly we're seeing massive pain, right? I mean, I think it's public, so people saw Kings Garden with IIPR, Cresco has pulled out of a local greenhouse here, many of the producers are scaling back. The reports that we get from the nurseries are that they're selling half of the plants as they typically would. If the plants aren't sold, they're not going to be harvested. I mean we're seeing people who typically would buy from other suppliers that we've never met, and they're not new so they were buying from someone else, they're now calling us. So really seeing, you know, I think the front end of the kind of rationalization and reversion to the mean in terms of the supply/demand issues.

The other great thing that we see out there is, one way to say is over-supply. I'm actually a fan of saying under-demand. And the reason for that is we've got 1,000 dispensaries basically in California, right? Colorado has the same number of dispensers with a quarter of the people. If you look at Colorado, Oregon, Washington, the stats are pretty consistent. It's about one dispensary for every 5,000 people. In California we've got one dispensary for every 40,000 people. Now that's one legal dispensary, it's not really what we have. We actually probably have 5,000 dispensaries, but only 1,000 of them can be our customer.

So, what we are seeing, last two weeks of June, the State of California issued about 8% of the total retail licenses that have been issued under Prop 64. So, again, in two weeks in June they did 8% of what's happened over the last four years. So that's a massive uptick. June was bigger than the entire month of May. May was bigger than the Q4 of last year. So we really are seeing some acceleration on the retail license issuing side. And importantly, a number of those licenses, they're not just slicing up existing pies, they're actually opening up those cannabis deserts, places like Fresno. Fresno's got half a million people, right? Like that's Rhode Island in the middle of California. You had to drive an hour to get to a legal dispensary. They just opened up the first of what will be 15 dispensaries up there. So that's massive from being able to connect from the cultivator to the consumer. Also of course the cultivation tax going away at $161 a pound, that's good for almost $5 an eighth out the door to a consumer.

The best thing with the illicit market, we firmly believe no one should be in jail for a plant. We should not be out there arresting people. That's not the solution. The solution is competitive access, making it easy. Not a lot of people are on the hunt for bathtub gin, but if that's all they can get access to, that's typically what they buy. So, opening those doors up will be a huge help. Reduction in the taxes to make the pricing more competitive will be a huge help. You do see a few things out there, like LA County approved a civil fine, so landlords who are aiding and abetting essentially, in their language, illegal cannabis dispensaries, you know, you shouldn't go to jail for plant, but you also shouldn't be able to profit by not following the rules, so they're doing some work to be able to take the financial incentive out of helping people run stores that don't pay taxes and don't have licenses. So I do think that will help over time, but really it's more access, less taxes, and us bringing our prices down so we can deliver something to consumers that they're happy about and don't have to pay much of a premium for.

Scott Fortune — Analyst, ROTH Capital Partners

Appreciate the color. And one quick follow-on on that was you see all the challenges and kind of, like you mentioned, the pain going on from the cultivators in California here, especially without scale. Are you looking at or seeing more opportunity for potential longer-term contract growing? Or how are other brands and those relationships starting to discuss or work with Glass House from a longer-term standpoint? How do you look at that strategy from that standpoint?

Graham Farrar — President & Chief Cannabis Officer, Glass House Brands Inc.

Yeah, we definitely are seeing that. We have some supply agreements in place. It's an interesting balance because, at least from my point of view, I'm very optimistic and confident in what we're going to be able to do with the new greenhouse. So I don't want to move too quick and sell ourselves short and not be able to show people what it is they're truly going to be getting. On the other hand, I don't want to miss opportunities. So, without saying names, we have a number of brands that we're working with, a number of those brands that have historically grown for themselves that don't necessarily need to. So, part of our strategy is to be able to enable brands to be more brand heavy and asset light on the philosophy that, hey, if you're not in a better climate, you don't have a better facility, you don't have a team that's more adept at quality, consistency and cost, you don't really—you shouldn't have to need to be a farmer to be a brand. And so I think we're seeing the front-end stages of that transition where we can leverage our platform, scale, quality, consistency, and cost to deliver to brands stuff that they don't necessarily have to do on their own anymore. So I think, in the next quarter or two, we'll be able to see a lot more tangible, you know, and we can speak more openly about some of those things, but the short answer is yes, we are seeing that transition start to happen.

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

And Scott, as a follow-up to that, both Graham and I are getting inbounds from folks that need things from a nursery, like clones. They need biomass. And one large player basically said, even though they had deposits down last year, they had some real issues, and so now there's sort of, ah, they're looking for stability in the supply chain and I think that's one of the things that we're able to bring to the table. In a very difficult market out there, we can provide a little bit of shelter in the storm.

Scott Fortune — Analyst, ROTH Capital Partners

Thanks for the color and congrats and I will jump back in the queue. Thanks.

Operator

Thank you. Once again, ladies and gentlemen, if you do have a question, please slowly press star followed by one on your touchtone phone.

And your next question will be from Aaron Edelheit at Mindset Capital. Please go ahead.

Aaron Edelheit — Analyst, Mindset Capital

Hey, guys. I wanted to ask about your production. It’s really impressive that not only did you produce but that you sold 18,000 pounds of cannabis in July versus 20,000 in all of Q2. So far in August, is that trend continuing in terms of whatever you’re producing you’re selling?

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

Short answer, Aaron, thank you for the question, is yes. If I had another second, I’d find it, but recent conversations with the buyer that we were talking to and send him the inventory and his answer was where all the weed? The inventory is very light, right? So, even with the increased production, we’re still sitting in a position where we’re playing an allocation game of our brands, supply agreements, and spot buys and trying to keep everybody happy. So it’s a great problem to have, I guess, I would say is that we’re still seeing demand for everything that we’re growing.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. And I just want to confirm that I heard correctly that your new greenhouse has higher, you're seeing higher pricing from the product that's coming out of the new greenhouse than your older greenhouses. Is that correct?

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

That is correct. We are seeing a premium out of the SoCal farm versus our existing farms and, again, that's exactly what we are hoping for, right? The entire strategy with the significant CapEx investment was to increase quality while reducing OpEx cost. Said another way, higher-quality cannabis for a lower cost.

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

Aaron, that becomes more meaningful as the year progresses and the SoCal facility becomes a higher percentage of the output, so that's a really good trend to have working for us.

Aaron Edelheit — Analyst, Mindset Capital

And while I've got you, Mark, there were no share counts or shares outstanding in the press release. Would you be able to share what the fully diluted share count for Glass House would be after this offering, assuming that you maxed out the preferred offering with the warrants?

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

Yeah. So, when our financial statements are released on Monday, we'll have 60 million shares outstanding. And that's in our share count. When we update, ah, our investor presentation also showed the potential effect from warrants and options and all of those other things. And that gets a bit tricky because you just don't know what the share price is going to be and a lot of the warrants and other things are priced at $10 or $11.50. But, as it relates specifically to the preferred equity, attached to the $50 million would be 10 million warrants. So we're going to accommodate people who want to do this as a cashless basis. So the simple way to think about it is everyone, let's say, we get to a $10 share price. If everyone wanted to pay cash for (inaudible), we would add ten million shares into our share count, so that would be about, what, 16% or probably closer to maybe 18%. If people exercised on a cashless basis, it would be roughly five million shares against the six million, so it'd be less than 10% dilution.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. And when this offering is done you'll have $50 million of WhiteHawk debt and then $50 million roughly preferred and then you'll have somewhere around 70, maybe with options, up to 80 million fully diluted shares. Is that correct? Is that the rough math?

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

Yes.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. And—? Go ahead.

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

I was going to say we updated that fully diluted (inaudible) in an investor presentation which will go up next week.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. And, so I understand guidance, is there any kind of color you could give in terms of what you expect EBITDA roughly in Q3 or Q4, how cash flow will, how the cash needs of the business will work in Q3 and Q4 post this financing? Is there any kind of color? Could you be EBITDA positive? Where could you be from a cash flow perspective when you're done with this? Another way of asking this is, as an investor, how do I not worry that this is just another offering and then another offering is coming and I'm just going to get diluted to debt.

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

So we're, I guess, I'm going to use, since there's been a lot of talk about whether we're in a recession or we're not in a recession, the way I would describe kind of our cash flow generating ability right now is think about kind of the letter U. And we're kind of at the bottom of the U in terms of the left side is we're using cash and then coming up on the right side to start generating cash. Our cash flow starts improving as we move through Q3 into Q4 because of the continued ramp-up of Camarillo and then, particularly PLUS now will be generating cash, it's been highly accretive, and the NHC stores will be highly accretive from a cash flow, so we're not quite turning the corner in Q3 but the numbers should get sequentially better from the negative $8 million of operating cash flow in Q3. It should get a little bit better each quarter and then it should have a positive when we get into Q1 of next year.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. So would you expect, just assuming we're in the same economic situation we're in now, would you expect, post this offering, that your cash, you know, would you expect, if I'm looking out at the end of the year, is the cash balance much different in your opinion? Is there any color you could give just towards the end of the year in what the balance sheet may or may not look like?

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

Well, I guess the simplest way to think about this is that the true raise is really $16.5 million, right? The $26.5 million, $10 million is going to pay down the WhiteHawk bridge loan. So if you go we're starting with $17.5 million and you say I'm going to add $16 million on to that, if I could say we were going to become cash flow positive in Q4 and was really comfortable with that, that would be the guidance we would have provided. So we're still going to burn some operating cash over the next couple of quarters. We still need some CapEx to finish building our stores. So I'm going to say we won't keep all $16 million on our balance sheet but we should finish above the $17 million we finished at Q2. And then, again, as we get into 2023 and we're in a cash flow generating mode, we should be able to build the cash balances as we go through the course of the year.

And I'll just make, again, one caveat. All of these assumptions pretty much assume the pricing we saw in July remains kind of constant through the period. The pricing in July has actually ticked down a little bit from where we were in Q2, so we're planning on that but, hopefully, as Graham discussed, we'll see some relief as people leave the market over the second half of the year.

Aaron Edelheit — Analyst, Mindset Capital

Gotcha. Thanks so much.

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

Look forward to talking to you tomorrow, Aaron. I hope everybody that's listening joins your Twitter spaces.

Operator

Thank you. And at this time, gentlemen, we have no further questions. Please proceed with closing remarks.

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

Hey, guys. So, thank you, everybody that listened to our second quarter results. We are focused, as you heard, and are providing more direction than we have in the past and look forward to continue to do that as we go forward. Thank you for listening and see you soon.

Operator

Thank you, sir. Ladies and gentlemen, this does indeed conclude your conference call. Once again, thank you for attending and at this time we do ask that you please disconnect your lines.