# Glass House Brands Inc.

## Third Quarter 2022 Investor Conference Call

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Length: 57 minutes

## CORPORATE PARTICIPANTS

**John Brebeck**
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**Kyle Kazan**
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**Mark Vendetti**
*Glass House Brands Inc. — Chief Financial Officer*

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*Glass House Brands Inc. — Co-Founder, President & Chief Cannabis Officer*

## CONFERENCE CALL PARTICIPANTS

**Aaron Edelheit**
*Mindset Capital — Analyst*

**Michael Walsh**
*Vesuvian Holdings — Analyst*

**David Liptz**
*Northbound Investments — Analyst*

## PRESENTATION

**Operator**

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Glass House Brands Third Quarter 2022 Investor Call. I now would like to turn the conference over to Mr. John Brebeck, Glass House Brands' Vice President of Investor Relations. Please go ahead, sir.

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

Thank you, Julie. I'd like to welcome everyone to Glass House Brands third quarter 2022 conference call for the three-month period ending September 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 also like to remind everyone that this call is being recorded today, Thursday, November 10, 2022.

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

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

Thank you, John. Good afternoon, everyone, and thank you for joining us for today's call. I'd like to give a special hello to my teammates at Glass House Brands who make great things happen seven days a week, our long-time investors who trust us when we were private equity funds, and our investors who came in during and after going public. We thank you all for your trust and commitment.

We believe that we own and operate the best cannabis greenhouse in the United States at 5.5 million square feet in size, of which 1.5 million square feet is planted and in production. When Graham and I first laid eyes on the SoCal farm in October of 2018, we felt that whoever was able to buy the facility would be a long-term winner, not only in California, but in the entire U.S., and we are excited to show the first evidence that we have the unicorn of greenhouses. In the third quarter and the first full quarter of cultivation and harvesting at the SoCal farm, we grew biomass production by 164% year over year and volume sales by 265% to approximately 69,000 pounds. In just one quarter we nearly matched the total amount of wholesale biomass we sold in all of calendar 2021.

But even more remarkable is our cost structure. Despite a 21% sequential drop in cannabis flower prices, our costs fell even faster to a remarkable $134 per equivalent dry pound of production. This enabled our gross margins on our wholesale business to soar from 5%, which excluded start-up costs in quarter two, to 36% in the third quarter, despite the price drop. This is precisely why we were so excited about this greenhouse. We are only operating at 20% capacity utilization of the entire farm in a market with falling sales pricing and our gross margin is still almost 40%. Furthermore, we sold all the cannabis that we grew in the third quarter. And more importantly, we discovered that the SoCal farm works as well or better than we expected. Our business is sustainable selling only in California, which is the most competitive market in the country and has the lowest prices in the entire U.S., and we did all of this while using only a fraction of our SoCal farms capacity. If we can do that now, you can imagine how tantalized we are by the thought of what we'll be able to do when the gates to interstate commerce are inevitably thrown open.

We are also excited that, despite a vicious bear market, especially for cannabis stocks, we raised $19.5 million through the end of September and so far in the fourth quarter we have raised and received an additional $3.24 million, leaving only $3.76 million available before we close it up. It should be noted that we sincerely appreciate the confidence of our investors, since most was raised before the results came in at our unicorn greenhouse. I'm excited to tell you more about our third quarter.

We achieved record revenue and grew 65% versus last year and 72% versus the second quarter during one of the fiercest downturn seen in the cannabis industry ever. We have integrated PLUS, our recently acquired edible brand, into our operation and greatly reduced its operational costs. We have expanded our retail footprint from three locations at the beginning of the quarter to seven currently. At the end of July we closed on the purchase of the remaining equity interest in The Pottery and in September we closed on three Natural Healing Center, NHC, locations, including the flagship store in Grover Beach and the Lemoore and Morro Bay locations. We expect to complete the acquisition of the NHC franchise with the opening of the Turlock store during the quarter. The acquisition of NHC, widely recognized as the top cannabis retailer in California's Central Coast area, advances our goal of becoming one of the largest cannabis retailers in the state of California and adds further support to our recently acquired PLUS edibles business and provides incremental outlets for CPG sales as the SoCal farm continues to expand its output.

Importantly, the NHC dispensaries are expected to be strong performers with the average EBITDA margin across all stores projected to exceed 20% next year. Two additional Farmacy locations, Isla Vista and Santa Ynez, are almost fully built out and slated to open by the end of the fourth quarter, bringing our year-end total number of locations to 10. Additionally, Farmacy Eureka has been put on temporary hold due to market conditions and we will provide updates on future earnings calls if the status changes. And finally, it seems as if the regulators at the state and federal level are intent on taking away some of the regulatory headwinds. In signing a bill to legalize interstate trade for California producers, Governor Newsom emphasized that his purpose was to clear the way for California to supply cannabis to the rest of the United States.

We have been and remain laser-focused on reaching cash flow positive operations, even in this challenging climate, and are confident that we will achieve it with the resources we have. Every decision we make is with that priority in mind. While this was an excellent quarter, it wasn't perfect. First, our overall CPG revenues, excluding PLUS, increased 48% sequentially in the third quarter but were still down 32% year over year. We are recovering from the inventory distribution and strain management issues encountered in the first half of the year, but on a slower pace than initially planned. We also have a distribution contract which shields us from non-payments and, given the severe strain currently being suffered by store operators, our distributor could not make deliveries to all who ordered our products since the payment issues were not fully resolved. Both contributed to a slower recovery than anticipated. The PLUS acquisition was completed in April and we have since fully integrated the company into the Glass House Brands platform. PLUS is a recognized leader in edibles and is the number-four edibles brand in the California per Headset. It is a key component of our growth strategy as we further expand our product portfolio and build stronger brand awareness. The PLUS product line is now available in our retail stores as well as across our distribution network and we see significant opportunity for further expansion on a national level.

As part of our relentless focus on COGS, we also closed the PLUS Adelanto production facility and terminated the lease in the fourth quarter, transitioning the production of PLUS edibles to our Lompoc facility to allow for a further streamlining of operations and the elimination of overhead costs. The PLUS brand is our top marketing focus in the fourth quarter. We are excited about this re-launch and are bullish on the brand's prospects of increasing market share.

Thanks to our new capability of making edibles, we also launched the Allswell brand with a full line of vegan gummies targeting younger, cost-conscious consumers with our Allswell brand. Focusing on low price, we also launched the Allswell flower line, which we believe will be one of the most competitive offerings in the market. Allswell products are priced very aggressively, yet we believe they have better quality and consistency than competitor offerings in this category.

Beginning in August, we completed the full integration of the PLUS sales team into Glass House. We now have one sales team and one distributor selling our entire brand portfolio and we are fully leveraging PLUS' strength in the marketplace. In September we held training sessions for our distributor on how to sell PLUS products and these were enthusiastically received. Our new trade marketing team is now calling directly on the dispensary staff who influence consumer purchases and early results of this strategy have been encouraging. Glass House Farms brand deliveries distributed to end accounts showed month-on-month growth in September despite the market declining 2% month on month.

Fourth quarter cannabis biomass output will be affected by the remnants of a hurricane in Mexico which caused an unprecedented weather fluctuation. In early September, we experienced a heat wave that saw temperatures reach 106 degrees Fahrenheit, which was 13 degrees higher than record temperature ever recorded in Camarillo. This in combination with the fact that we were still climbing the learning curve in terms of operating the SoCal farm resulted in a loss of clones in the nursery and stunted some plants in the greenhouse. We have made adjustments and, if a similar event happened today, we are confident that we could weather it without similar output disruptions. Despite the weather issues, we still expect production in the fourth quarter to be in line with the third quarter, again showcasing how truly impressive our new greenhouse is. The good news is our cultivation team is confident we will be able to substantially raise production on a year-over-year basis in the fourth quarter of 2023.

A key development within our wholesale biomass business and for our branded CPG business was the signing of a new partnership with another California company, Seed Junky, one of the premier breeders globally to breed and select strains that will be exclusively made available in Glass House branded products, including Glass House Farms, Forbidden Flowers, Field extracts and others. We're excited to formalize and expand our relationship with Seed Junky and have great respect for the outstanding quality and strain library that JBeezy and Wes Vazquez have built. Seed Junky Genetics is behind some of the best-selling and most widely-known strains in the cannabis industry and now we will be licensing the newest genetics exclusive to Glass House Brands products starting early next year. Their partnership is highly complementary and should yield synergies for both companies. Additionally, we look forward to offering their genetics and clones grown in Camarillo to California cultivators.

Mark Vendetti, our Chief Financial Officer, will now discuss our financial results for the quarter in detail, following which Co-Founder, 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 MD&A, which are reported in U.S. dollars and prepared in U.S. GAAP. We expect these documents to be filed by November 15th.

Total revenue for the third quarter of 2022 was $28.3 million, near the midrange of our guidance for the quarter. These results represent 65% growth versus last year and a 72% increase versus the second quarter. The key driver of the sales increase was a dramatic jump in wholesale revenue. This was the first quarter of production at our SoCal farm and the result was a 164% increase in production versus last year.

Wholesale biomass revenues reached $14 million, an increase of 180% year on year and 109% quarter on quarter. As Kyle mentioned earlier, we sold nearly 69,000 pounds in the third quarter or 245% more equivalent dry weight than the second quarter and 265% more than the same period last year. The third quarter was truly a watershed quarter for the wholesale business, demonstrating the potential of the SoCal farm with a gross margin of 36% in only its first full quarter of operations under the most difficult wholesale conditions California has ever experienced. Please note the cultivation tax was eliminated effective July 1, 2022; therefore, to make comparisons with prior periods easier, I have removed the impact of the cultivation tax on both revenue and cost of sales in my discussion.

While price per pound blended across flower, smalls, and trims fell by 14% versus the second quarter to $204, our cost of sales per pound fell by 15% versus the second quarter to $134, resulting in gross margin for the wholesale business improving to 36% from negative 28% in the second quarter or from an adjusted 5% second quarter gross margin when excluding start-up costs. Please note the Q2 cost of sales number was adjusted to exclude the impact of start-up expenses in Q2 and did not include production and costs from the SoCal farm. This is our first view into what the post cultivation tax error with our new SoCal farm looks like for Glass House and it's clear that our ability to harvest high-quality, sun-grown cannabis in high volumes at low cost will be a formidable and durable competitive advantage.

Here I'd like to add an observation on potential signs of consolidation in the market. We have been tracking license data in California and from July 1st to October 31st. The number of active outdoor cultivation licenses dropped by 624, representing a 15% drop in total and a 44% drop of the total licenses up for renewal during that period. The number of licenses for mixed-light greenhouse decreased by 86, or 9% of the total licenses up for renewal during this four-month period. It is difficult to know exactly how many square feet of mixed-light greenhouses dropped out of production, but at maximum square footage the number exceeds the square footage of our SoCal farm brought on line in Q2. It is worth pointing out that even more farmers may have stopped growing than the data indicates, because license renewal is on an annual basis. Many cultivators may have stopped growing with the intent not to renew once their license is up for renewal.

Before I move on to our retail and CPG business, I want to provide data on the state of the California cannabis market using Headset data. The environment for the California retail market remained challenging in the quarter with the total market down 10% versus Q3 last year, which makes our Q3 results even more remarkable. Flower sales declined 23% year on year while edibles declined 1%. Pre-rolls and vape pens showed the highest year-on-year growth growing 5% and 2%, respectively. On a sequential basis, overall California market sales fell 4%. We feel the third quarter was negatively impacted by continued high rates of consumer inflation, as the inflation rate hit 8.2% in September. 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 fourth quarter, we believe there will be continued negative effects from a challenged consumer, which may keep market growth constrained or declining.

Moving on to retail for the third quarter, our retail footprint consisted of three Farmacy dispensaries that have been opened since early 2021, plus the four dispensaries that we began consolidating after finalizing the acquisition. These are The Pottery and the three Natural Healing Center locations. There were 92 calendar days in Q3, consolidation results for each location was as follows: 65 days for The Pottery, 24 for Grover Beach and Lemoore, and 16 for Morro Bay. All together, these four new stores contributed $1.7 million in sales during the quarter. We expect a noticeable sequential jump in retail revenues in the fourth quarter as these four locations will contribute for a full quarter. First quarter 2023 retail sales should receive a further boost as NHC Turlock, Farmacy Isla Vista, and Farmacy Santa Ynez will have their grand openings before the end of the fourth quarter this year. By the end of Q4 we expect to have ten operating dispensaries. With the boost from the four new dispensaries, retail sales jumped 33% sequentially and 23% year on year to $6.4 million in the third quarter. On a same-store sales basis, total revenues reached $4.7 million, falling 3% sequentially and 10% year on year versus a 4% sequential decline and a 10% year-over-year decline in the market. Our three Farmacy stores have been performing at or slightly better than the market for most of the year.

Turning to our CPG business, third quarter sales were $7.9 million, up 59% sequentially and 13% year on year; however, PLUS, which was only included for part of the second quarter but all of Q3, accounted for roughly 40% of that amount and PLUS revenues benefited approximately $900,000 from an initial order as we moved PLUS distribution from Nabis to Herbl at the end of August. Subtracting PLUS from both the second and third quarter, CPG wholesale revenues were $4.7 million, up 48% sequentially and down 32% year on year.

Now moving to gross margin, please note that we began reporting our gross margin by business line in the first quarter of this year. Gross margin in the third quarter of 2022 was $8.7 million or 31% versus $0.3 million or 2% in the second quarter this year. This is the highest gross margin percent starting in Q3 2021 when wholesale prices began their large decline and over $6.3 million higher than any quarter during this time period. Our Q3 2022 gross margin provides insight into where we think we can take the gross margin of the business longer term. We are extremely pleased with our 31% result for the quarter.

Cultivation gross margin of 36% was the highest since Q2 of 2021 when the average selling price was $340 per pound. This was 67% higher than it was in the third quarter of this year. As discussed earlier, the margin improvement was driven by record low cost of sales and cost of production. In retail, gross margin fell slightly to 41% Q3 versus 42% Q2. The retail landscape remains ultra-competitive with higher levels of promotional activity in the quarter. This is particularly the case in the L.A. market where our Pottery store competes.

CPG gross margins increased to 14% in Q3, up from 2% in Q2. The increase was driven mainly by two factors. The first is that the aged inventory issue in the second quarter has largely been resolved. Markdowns and discounts fell to 16% in Q3 compared to 35% in Q2. The second positive impact is a full quarter of PLUS sales, which have a higher gross margin than our flower brands. The Adelanto shutdown had a minimal impact on Q3 gross margin as it did not occur until early September.

Finally, on our flower brands, we use the elimination of the cultivation tax to reduce our wholesale price by an amount roughly equal to the cultivation tax. This reduced the average gross selling price by about $1.25 per unit on our benchmark 3.5 gram jar. Because of the fragmented nature of the California market for flower, we felt we needed to remain price competitive in the market as the average price of flower has been declining.

Regarding our cost per equivalent dry pound of production calculation, the Q2 cost of $158 per pound included only Casitas and Padaro farms, as start-up costs distorted the second quarter cost structure for the SoCal farm. In the third quarter, all three farms were fully included in the calculation for the first time and the cost per equivalent dry pound production fell to $134 per pound with 74,000 pounds produced. This represented our lowest ever quarterly production cost and is a 25% reduction in cost per pound compared to Q3 2021.

General and admin expenses were $11.5 million for the quarter compared to $10.9 million in Q2. The $0.6 million increase is primarily attributable to increased operating expenses at the SoCal farm related to cannabis taxes and the addition of three NHC dispensaries in The Pottery. Sales and marketing expenses were $0.8 million, a 10% decline compared to Q2 2022, primarily driven by the streamlining of marketing spend. Professional fees were $2.8 million, consistent with Q2 2022. Depreciation and amortization in Q3 2022 was $3.4 million compared to $2.8 million in Q2 as a result of having additional CapEx placed into service during the quarter.

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 shrunk to $2.7 million in the third quarter, a $7.1 million improvement over a loss of $9.8 million in the second quarter of 2022. The improvement in gross margins to 31% in Q3 from 2% in Q2 resulted in an $8.5 million increase in gross profit and was the key driver of the substantial reduction in Adjusted EBITDA loss.

We ended the quarter with $17.5 million in cash, including $3 million of restricted cash, up slightly compared to Q2 2022. Cash used in operations was $7.3 million compared to $7.8 million in Q2. With the increase in revenue, the Company used about $2.4 million of working capital in cash across accounts payable, accounts receivable, prepaids, and Inventory compared to Q2 when the Company gained $4 million in cash from these same accounts. In addition, cash usage from net income decreased to $7.5 million in Q3 from $13.5 million in Q2. Capital spending dropped to $4.2 million in Q3 compared to $7.6 million in Q2 as the focus of CapEx spending shifted to the build-out of our Isla Vista and Santa Ynez dispensary and as phase-one retrofit spending was winding down. The Company raised $19.5 million from the new Series B preferred equity and an additional $3 million from an equity investment in The Pottery.

Part of these proceeds were used to pay off a short-term note payable of $10 million to our senior secured lender.

With the NHC and Pottery transactions and the preferred equity raise, this was a very busy quarter for the Company’s balance sheet. Total assets grew $42 million to $350 million with the majority of the increase coming from the acquisitions of The Pottery and the three NHC store. This included a $34 million increase in goodwill and intangibles due to the acquisition and a net $7 million increase in operating lease use of right assets. Current assets grew by $0.5 million as notes receivables related to the closing of the three NHC transactions was reduced by $5.5 million. This was offset by growth of $6 million in accounts receivable, prepaids, and inventory caused primarily by the Company’s growth. Total liabilities fell by $13 million as we reduced the contingent earnout liability by $31 million, with $28 million related to the SoCal farm, which will be discussed in more detail in a bit. And we paid off the $10 million note from WhiteHawk Capital that was used to help fund the acquisition of the Natural Healing Center dispensary. This was balanced out somewhat by an $11 million increase in accounts payable and accrued expenses, mostly relating to an assumed liability of $7 million from the NHC transaction, $6 million of operating lease liabilities, $5 million in shares payable mostly related to hold back shares on the NHC transaction, and the $4 million increase in income tax payable.

Mezzanine non-controlling interest, which is our new Series B preferred equity, is being broken out on our balance sheet separately. At the end of the quarter, the total was approximately $43 million, consisting of the conversion of $22.7 million of existing preferred equity and the new raise of $19 million plus accrued interest. Shareholder equity increased $12 million, primarily as a result of our increase in net income in the quarter.

Given the strength of our third quarter operating results, we are excited about our future prospects, but we are revising our forward-looking guidance to reflect current short-term trends in our business and in the market. We are adjusting our guidance for Q4 sales to $30 million to $32 million from $50 million and our wholesale biomass cost of production to $135 per pound, or roughly flat to Q3, from the prior Q4 target of $125 per pound. Although this is a disappointment, it doesn't diminish the significance of our third quarter results nor does it invalidate one of our key investment thesis that we can produce large amounts of high-quality cannabis at extremely low cost and sell all of it. Our ability to generate 36% gross margins, produce 74,000 pounds, and sell 69,000 pounds in our wholesale biomass business in the third quarter are proof of that. I'd also like to highlight that we fully expect Glass House's fourth quarter gross margins to be close to or better than the third quarter.

Our revised downward guidance is split approximately evenly between our three businesses. In the wholesale business, we now expect to produce about 20,000 pounds less than originally projected due to the issues described by Kyle above. That being said, fourth quarter wholesale biomass production and costs will be roughly equivalent to our strong third quarter results. Despite this short-term setback, we believe the lessons learned and adjustments made at the SoCal farm will improve our cultivation results long term and we remain confident we can achieve our long-term cost of production goal of $100 per pound. We are assuming our wholesale prices from Q3, which were down 14% from Q2 average pricing, to carry forward for the rest of the year and through 2023.

In retail, we are reducing our fourth quarter revenue projection to account for delays in opening our new stores, which will cost us about $4 million lost revenues versus our original fourth quarter projection. We originally assumed our new stores would be open for the majority of Q4. Because of the difficulty predicting the local permitting and licensing process, we have eliminated revenue from these new stores in our Q4 projections. This includes our Farmacy stores at Isla Vista, Santa Ynez, and Eureka, as well as our Natural Healing store in Turlock. We are also adjusting our estimate down to reflect continued softness in the retail market.

In CPG, we are revising our estimates down to reflect recent trends and expect a sequential decline of approximately 25% in the fourth quarter. Our original assumptions assumed we would be able to recapture lost share from the first quarter and build momentum during the third quarter into the fourth quarter, but we have not been able to achieve that as Glass House Farms share of the California market has dropped from 2.5% in Q1 to 1.9% in Q3. Our inventory position was too low for the first half of this quarter. To help address this, in August we hired a VP of supply chain to improve our planning process and create operational efficiency. As we begin the second half of the fourth quarter, we are comfortable with our inventory position on Glass House Farms and no longer expect this to be an issue for the brand.

Taking all of these factors into account, we are pushing our target for positive free cash flow from operations out by two quarters to the third quarter of 2023. These factors have also caused us to change our annual run rate estimate to $160 million by 2023, down from $200 million. We remain confident that the incremental capital we have raised thus far and the additional funds we intend to raise to complete our $26 million fund raise will provide the necessary run rate to achieve this guidance. Additionally, we are now providing a summary table of our cap table in our press release. This information is disclosed and detailed in our consolidated financial statements for the third quarter, which are published in SEDAR.

Before turning the call back to Kyle, I'd like to provide two additional pieces of information related to the SoCal farm. At this time, we are postponing the start of our phase-two retrofit at the SoCal farm, which was originally projected to begin in Q1 2023. Although we are extremely pleased with our phase-one results, we feel it will be more prudent to wait and gain more experience with the farm and given the continued market pricing pressure, which is impacting financial results, monitor the state of the California cannabis market. Of course, this could change quickly based on regulatory changes from Washington.

The second item is the contingent earnout liability for the SoCal farm of up to $75 million in share-based compensation on the price of Glass House shares at the end of the earnout period. The minimum hurdle to pay this is EBITDA of $82 million generated by the SoCal farm over a 12-month period ending April 30, 2025. The EBITDA needed to make the maximum payout of the $75 million is about $103 million. For every $1 million in EBITDA earned above the minimum, 3.5 million in shares are earned. Since the issuing price of the shares will not be determined until the end of the earnout period, it is unknown how many shares will be issued if any earnout is earned. Due to market conditions, we reduced the contingent liability for the SoCal farm earnout to $1 million from $29 million in the third quarter.

Finally, I'd like to end my commentary by commenting on cash flow improvement initiatives Glass House recently implemented. The manufacturing consolidation of Adelanto into Lompoc discussed earlier will save the Company over $600,000 annually with the full benefit materialized in Q1 2023. Additionally, we recently made the difficult position to eliminate 19 positions across the Company. These savings will be approximately $2.5 million in annual salary and estimated benefits and begin positively impacting results in the first quarter of next year. While taking such measures is never easy, we are determined to reach cash flow positive operations as soon as possible and will continue to take the measures necessary to achieve that goal.

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

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

Thanks, Mark.

I would like to take this opportunity to update you on our latest efforts to push for the release of nonviolent cannabis prisoners in both state and federal prisons. On October 19th, Mission Green, an initiative of the Weldon Project, announced the filing of a clemency petition for Parker Coleman Jr., who is currently serving a 60-year federal sentence for marijuana-related offenses. This filing, along with several other petitions, comes on the heels of President Biden's historic mass pardon of anyone previously convicted of a federal charge of simple possession of marijuana. Supported by Glass House Brands, Mission Green is working with the Academy for Justice at the Arizona State School of Law, which has begun submitting clemency petitions with the hope that the President will follow through on his promise to release those convicted of nonviolent marijuana offenses.

One such submission was for Mr. Coleman and is part of a new campaign, the Cannabis Clemency Initiative, that seeks to help people still incarcerated on marijuana charges, beginning with those locked up in federal prison. The initiative brings together criminal justice scholars and reform advocates to achieve its ambitious goals. The petition urges the President to commute Mr. Coleman's sentence, an act that would be a powerful, tangible step in affirming the President's commitment to ending federal incarceration for nonviolent marijuana fences. Furthermore, I have personally guaranteed housing and employment upon release for at least one year to bolster their applications for clemency and because I believe it is a moral imperative to assist those who have been directly affected by the war on cannabis.

The duality in the law where we just announced selling almost 35 tons of cannabis in the last three months while at the same time thousands of Americans are serving hard time for breaking the same schedule and law that is still on the books, imbrues both our justice system and us as citizens of this country. If you would like to learn more about this, we encourage you to go to the press releases page on our IR website to view the entire release and also to consider donating to the great work of Weldon Angelos of Mission Green, whose sole purpose is to gain release of nonviolent cannabis prisoners. More information can be found at www.projectmissiongreen.org.

With that said, I will turn the call over to the operator to begin the question-and-answer portion of the call. Julie, I'm turning it back to you.

## Q & A

**Operator**

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. If you would like to withdraw your question, please press the star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the one.

And we have a question coming from Aaron Edelheit from Mindset Capital. Please go ahead.

**Aaron Edelheit** — Analyst, Mindset Capital

Hey, guys. Great news on the unit-level economics. Amazing progress. My question really is around pricing, in that pricing falling 21% sequentially. Where is pricing generally today compared to the end of Q3? Is it stable? Is it up a little? Is it down a little? How would you describe it?

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

Hey, Aaron. Why don't I ask Graham, who's up at the farm, so he can give you the hot off the presses news on that. Graham, do you mind?

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

Yes, sure. Hey, Aaron. Great question. I would say it's at least stable right now, which is an actually pretty bullish sign as we're now into November, so call it halfway through the Croptober season. If anything, it's actually inching up in a positive direction. So we're still staying pretty conservative with that, as this is a turbulent time, but generally this time of the year the expectation would be for a softening in the market and we're not seeing that at all. I think partially due to the reduction in licenses and the actual acreage being cultivated. Also, the economics out there make it less economically viable for people to harvest, trim, and sell finished flower. So we believe that more of that biomass is being frozen for extraction. And then I also think we're starting to get a bit of a lift from the quality that we're capable of doing at the new SoCal farm, which is helping stabilize and lift our prices as well.

**Aaron Edelheit** — Analyst, Mindset Capital

Okay. And so generally what we would expect just seasonally is that you'd have a lot of outdoor production come out, Croptober would hit, pricing would hit a bottom from now until January, and then seasonally you would have kind of an improvement in Q1 and Q2 when there is just less outdoor production. Is that generally the cycle (inaudible)?

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

From a 30,000 foot view, in general you're right. Typically call it Croptober, because that's when the full term our outdoor plants are typically harvested, and so you'll see a significant influx of supply from that harvest all kind of happening at once. This year, if anything, I think we're probably on the early side, because of the heat that we saw that sped up in maturing of the plant, so the harvest tends to be a bit earlier. Then you need a period of that to dry and then it would typically hit the market. So I'd say from kind of like early to mid October through, call it, January is typically what they call the flood part of the season, that biomass, you know, the flower gets smoked and digested by the market, and then there's not another full term behind it so the supply typically drops, prices statistically go up, would be the historical cycle. So you'd kind of expect softness from here through February and then you'd expect it to tighten up and kind of prices to be sturdy and appreciate up through September and then you'd see the next year's Croptober come and cycle through. We have seen a little bit of smoothing of that as mixed-light is more on a continual harvest, so it's a little bit less seasonal, but that's the general trend, and so far we're not really seeing that softness at all that we would expect this time of year.

**Aaron Edelheit** — Analyst, Mindset Capital

So potentially, by not seeing the softness now, it bodes well for what Q1, Q2 pricing might be, and just to reiterate is that none of that pricing increase is in either your Q4 guidance or for next year.

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

Correct. I'll let Mark correct me if I say something wrong here, but we're basically predicting flat pricing. And if we get through the end of this year without seeing a price drop from the Croptober season, I would actually start to shift into a little bit more bullish perspective on where pricing goes for 2023.

**Aaron Edelheit** — Analyst, Mindset Capital

And maybe this is a question for Mark, but I'm curious, is it as simple as, if I just think about your biomass pricing and I think about where pricing was in Q2 versus Q3 or I think about what it was last year, is it possible, if pricing had stayed flat with Q2, that you would have reported a positive EBITDA number? Am I calculating things the right way? Can you give a mental model of how to think about?

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

Yeah, in its simplest form, Aaron, we now have a table we've added into our press release that shows the actual average selling price across flower, smalls, and trim, and so in Q2 the average price was $237. So if you just said $237 minus $204, so $33, times the weight we sold, that would be a very simple way to go, oh, there would have been, what we sell 69,000 times $33 is, what, two point something. So, not quite there, but very close to breakeven. That's the simplest math.

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

Yeah, it's about $2.3 million would be the math or that.

**Aaron Edelheit** — Analyst, Mindset Capital

Gotcha. And then a follow-up question for you, Mark, is I think I understand just you made progress on reducing the cash flow burn. For Q4, what are you expecting in terms of rough operating cash flow if you hit your forecast? And I'm assuming there is not much in the way of CapEx as well, but do you have any thoughts on just guidance and what cash will be used in Q4?

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

Two things. First, with sales being relatively flat Q3 to Q4, the use of working capital should be flat quarter to quarter. So we won't absorb or we won't need working capital to grow. So that's a positive. And then we hopefully can do a little bit better on EBITDA. So, apples to apples, the cash flow should improve decently, still not above zero or we wouldn't have changed the guidance, but it makes significant progress from the $7 million to a number that's, let's call it, somewhere halfway in the middle.

**Aaron Edelheit** — Analyst, Mindset Capital

Gotcha. So we're not talking about, so when you delay, ah, when we're thinking about the delay and when you'll hit free cash flow positive, we're talking about $2 million, $3 million a quarter, maybe $3.5 million. It's not some incredible cash burn for you to get to that.

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

I think, again, and even if you look at the pattern within our Q3, the wholesale biomass business didn't really start ramping up until August and September, and once we kind of get to that going number, our cash flow situation improved dramatically. So again, using the analogy of a letter and you think about a U, we're, I'm going to say, still a little on the downside of that U, but it's not a steep drop anymore and the losses should be much narrower or the cash flow usage should be much narrower until we hit Q3 of next year.

**Aaron Edelheit** — Analyst, Mindset Capital

Okay. Great. And I just want to congratulate you guys. I live in Santa Barbara, so I know the heat wave we had was pretty crazy with the humidity, but the idea that, in such a brutal market, with pricing coming down so fast, that at $200 a pound biomass, $400 flower, you could put up 36% gross margins when you have competitors announcing negative gross margins, it's a pretty impressive result, and so kudos to everyone who helped make that possible. And thanks.

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

Thanks a lot. And I think it's an awesome opportunity to point out two things. One is just how amazing the team that we have and the dedication and the experience and the hard work that they've put in to getting the new SoCal farm online. And it was a record time really. Easy to forget that eight months ago we didn't have a single cannabis plant at that farm. It is now the largest cannabis farm ever in the history of the United States, right? And that's just with its first phase up and running. And it is truly a unicorn facility and a unicorn location with a unicorn team and that's really what made all that possible.

**Operator**

Your next question comes from Michael Walsh from Vesuvian. Please go ahead.

**Michael Walsh** — Analyst, Vesuvian Holdings

Graham, could you go into some detail on the mitigation efforts you put in place for the adverse weather so it doesn't happen again?

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

Yeah, sure. So, just to take a step back, in general, it's sometimes easy to forget that SoCal is not a factory, right? It's a farm. And that means one of the amazing things about it is that you're dancing hand in hand with Mother Nature, right? And that has incredible upsides, which is it's the most environmentally friendly, it is the lowest cost of production, it allows us to do it on a massive scale, I think it's capable of growing some of the best weed out there because it's working with the sun, we're recycling our water, we've got our own on-site power plants to supplement things, solar panels, et cetera. But it's still a farm, right, and so you're doing this kind of dance, which means on the outdoors you kind of live with what you get and indoors you set exactly what you want and this is this really amazing hybrid in the middle.

And so what happened is we had, as Kyle mentioned, the highest recorded heat ever in Camarillo. It was about 106 degrees, so very hot and unseasonable and uncommon for Camarillo. It's part of the reason we like that place is that that doesn't happen frequently. And then you put that together with, as I just mentioned, the largest cannabis greenhouse in the U.S. but only seven, eight months of experience, or maybe even less than that, six or seven months at the time that the heat wave happened. And so what we found is a couple of things, all not particularly hard to address, but kind of you don't know what you don't know until you learn about it. Experience is what you get right after you needed it sometimes.

So wet walls, which is how we do cooling in the greenhouse, we found after 14 years they'd never been replaced and so we weren't getting the airflow that we wanted. Drippers, which is what wet those walls with the water that gives you the cooling capacity from the water evaporating, were clogged up and not giving us the water we wanted. So, since then, we've replaced the wet walls in the entire greenhouse, both sides. The dripper lines have been replaced on one side and then in progress of being replaced on the other side. And then in the nursery what we're doing is we're installing misters and automated shade curtains, which would, if the same conditions happen again, we'd be able to close the shades to reduce the solar gain in the greenhouse, we'd be able to turn on the misters to cool through evaporative cooling in the flower houses, those wet wells are allowing all the air that they're supposed to now, and we can get plenty of water on them to do the cooling.

So I think not to say we wouldn't be sweating our asses off if it happened again, but we certainly wouldn't be in a position where we needed to have a conversation about it and I don't think we'd see it affect our output or quality at all. I mean really—

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

Michael, I was going to give more detail, but I don't know if that's possible.

**Michael Walsh** — Analyst, Vesuvian Holdings

No, thank you. I appreciate it, guys.

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

If anything, it's really a testament to the greenhouse that it could go through a weather event like that and only, you know, we're still going to be on par with Q3 production and we are now back on track with our current harvest. So very clearly it was isolated or event-driven and we've made changes and now we're humming along again, which is exactly what we want to see.

**Michael Walsh** — Analyst, Vesuvian Holdings

Excellent. Thanks, guys.

**Operator**

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the one.

Your next question comes from David Lipps from Northbound Investments. Please go ahead.

**David Lipps** — Analyst, Northbound Investments

I hope you can hear me. This is Dave. I just wanted to kind of confirm revenues right now are tracking the same as Q3 with the current environment that we're living in. I know that I'm in the rental housing business as well as a CPA for other retail clients and I'm seeing more tenants not being able to pay their rent and I know that revenues of many of my retailers are down, so I just wanted to confirm that you guys are still seeing sales and revenues to be consistent. Because I mean I saw in the last six to eight weeks is when everything started tumbling for me and my clients.

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

So, Dave, thank you for the question. I understand it's like, hey, 111, you don't get the World Series, but let me ask Mark to answer the question.

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

Hi, Dave. How are you? So the trend from September, right, if we just look at our monthly trends, July, August, September and into October, we're tracking right where we should be to hit the guidance we provided. And each of the businesses behave a little bit differently, but we're right on track for the quarter.

**David Lipps** — Analyst, Northbound Investments

So we're halfway through the quarter and so we're on track, revenues, cash flows coming in, just like you expected it.

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

Yes.

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

Remember, there's no eviction moratoriums at a retail marijuana dispensary, so we have a little bit of a break there but, yeah, we're tracking it closely. And also we think that cannabis is a little bit more resilient than a lot of other products out there and that had been our guesstimation when we got into this business and it's proving to be true.

**David Lipps** — Analyst, Northbound Investments

Yeah, I just get concerned about disposable income of the human being that's purchasing the products, you know, whether or not that's going to be sustainable with the costs of everything else going up. Thank you.

**Graham Farrar** — Co-Founder, President & Chief Cannabis Officer, Glass House Brands Inc.

One of the reasons, David, that we launched our Allswell product is exactly for the concern that you have. I think our general sense is that people may trade down, but they're not going to trade out. One of the nice things, you know, you might not say cannabis is completely recession-resistant, which I think is a positive, because it's not an addictive product, which some of the other recession-proof products are, but it is something that people enjoy and it can also be one of the less expensive escapes. You know, if you're not going on vacation, it could be a joint instead. And the Allswell product really, I think, is the right product at the right time. We've got our Allswell gummies, for example, our 10-milligram gummies out the door typically for $9 or $10, including tax, which makes them cost competitive with even the illicit market and you're getting a product that's tested and you know what's in it and you know the dosage is right. So I think we're making moves on the CPG side to be in the right spot for where the puck is going in line with your concerns there. I'm happy to see that happening.

**David Lipps** — Analyst, Northbound Investments

Thank you.

**Operator**

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the number one.

Presenters, there are no further questions at this time. Please proceed.

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

Thank you, Julie. Thank you for joining us to discuss our third quarter results. We remain focused on the opportunities ahead and look forward to updating you on our next call. Thank you again, guys.

**Operator**

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