FINAL TRANSCRIPT

Glass House Brands

Fourth Quarter and Year-End 2021 Investors Call

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CORPORATE PARTICIPANTS

John Brebeck
Glass House Brands — Vice President of Investor Relations

Kyle Kazan
Glass House Brands — Chairman and Chief Executive Officer

Mark Vendetti
Glass House Brands — Chief Financial Officer

Graham Farrar
Glass House Brands — President

CONFERENCE CALL PARTICIPANTS

Scott Fortune
ROTH Capital — Analyst

PRESENTATION

Operator

Good morning. Thank you for standing by. Welcome to the Glass House Brands Fourth Quarter and Year-End 2021 Investors Call.

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

John Brebeck — Vice President of Investor Relations, Glass House Brands

Thank you, sir. I'd like to welcome everyone to Glass House Brands' fourth quarter and year-end 2021 conference call for the 3- and 12-month period ending December 31, 2021.

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, March 17, 2022.

And I would like to introduce Mr. Kyle Kazan, Chairman and Chief Executive Officer of Glass House Brands. Kyle, please go ahead.

Kyle Kazan — Chairman and Chief Executive Officer, Glass House Brands

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

I would like to take a few minutes to review our strategic priorities and provide an overview of our business; positioning vis-à-vis the conditions of the California market. I will give an update on our facilities. Mark Vendetti, our Chief Financial Officer, will then discuss our financial results for the quarter and year in detail, following which, Mark, Graham Farrar, our President, and I will take your questions.

I'd like to start with a highlight of 2021, the acquisition of our 5.5 million-square-feet SoCal facility located in Camarillo, California, which well positions us to produce, at scale, the highest-quality craft cannabis at the lowest cost. Phase I is operational, and construction is on time and on budget, with a price tag of $30 million, and includes approximately 500,000 square feet of nursery and a propagation facility.

The nursery, which we believe is the largest for cannabis in the world, uses advanced operational approaches such as an ebb-and-flow system, which is a technology designed for efficiency and thus, not commonly used for cannabis. The system allows for automated plant-handling as well as the capture and recycling of both water and fertilizer. This reduces COGS and helps insulate us from inflationary pressures. This an example of our approach to making CapEx investments to lower our COGS, which is key to our goal of producing the highest-quality and lowest-cost craft cannabis.

Beyond the nursery, Phase I includes an approximately 900,000 square-foot Kubo Ultra Clima high-efficiency greenhouse. We're also building a new distribution centre, which will support the entire operation through all future phases of expansion.

Phase I of the SoCal facility is expected to increase our greenhouse footprint by approximately 1.6 million square feet, enabling us to produce an additional 180,000 dry pounds of craft cannabis. When Phase I is fully operational, the SoCal facility will make us California's largest and most efficient greenhouse grower. Our total targeted long-term footprint is 6 million square feet.

I'm happy to report that we have received all necessary approvals to operate Phase I of the SoCal facility, including all California State licences for nursery cultivation and processing operations and the local cannabis business licence from Ventura County.

Phase I also includes a packhouse for distribution and the automation of clone transplanting, and a second packhouse for processing to be completed in the near future. We have already commenced nursery activities, and these plants will be transitioned to flower in Greenhouse 6. We look forward to our first harvest and sale from the facility, which we project will occur in the third quarter of this year.

We expect that the SoCal facility will allow us to significantly reduce our cost of production. This quarter, we reported production costs of $166 per pound, down from $179 per pound in the third quarter of 2021, a savings of more than 7 percent. And we believe we can eventually lower production costs to $100 per pound in the SoCal facility.

Please note, however, that quarter one typically shows lower volume biomass output due to seasonality. So a quarterly uptick in cost of sales per pound is possible in that quarter.

While this facility is extremely cost effective, it also enables us to produce cannabis in an energy-efficient and environmentally friendly manner. Situated in arguably the best agricultural area for cannabis cultivation in California, and with 20 acres of supplemental light, we'll have the ability to grow indoor-quality cannabis at outdoor costs, using the site's solar and cogeneration capabilities.

Our facility uses 95 percent less energy and generates 95 percent less carbon dioxide per kilogram of flower compared to the average indoor grow. ESG is more than a commitment for us; it's a competitive advantage.

Turning to our retail footprint, we are currently operating four dispensaries and expect to open our Eureka location during the third quarter, as well as our Isla Vista and Santa Ynez locations in the fourth quarter. The Eureka location extends our retail reach into the heart of the Emerald Triangle, which some may refer to as the Cannabis Capital of the World. Isla Vista and Santa Ynez are in prime areas, which are both limited to a single licence, providing the advantage of regulatory loading in what we expect to be robust retail markets. And these dispensaries will offer the same award-winning customer experience as our existing stores.

All three of these properties will be branded as pharmacy locations. We are extremely excited about these stores, and after a 9-to-12-month ramp-up period, we expect the revenue performance to be similar, on average, to the three existing pharmacy stores that we consolidate in our financials today.

I would like to note that, after additional due diligence, we decided not to pursue the Dunsmuir retail opportunity. We are well positioned to continue investing in and expanding our retail presence. We remain focused on exploring new opportunities and potential targets to scale our retail network through a mix of acquisitions, new licence wins, and partnerships.

Adding these stores to our portfolio provides what we refer to as the vertical advantage. By increasing the number of owned stores, we expect to maximize our brand penetration. We have historically sold 15 times more volume of our own brands in stores we operate, compared to non-Glass House-operated stores.

While we will increase our wholesale production, adding more to our CPG business is a core focus because it leverages our vertical advantage through higher margins and tax efficiency.

Late last year, we announced a definitive agreement to acquire PLUS, a leading cannabis edibles company in California. PLUS is one of the state’s top-ranked brands in the gummy segment, such that our combination with the company would place us in a top-five position in both the flower and edible categories. We’re extremely excited about this transaction, which we expect will close during the month of April.

Finally, I will address the current market conditions in California. Wholesale flower prices bottomed in November, but extreme challenges remain. To be clear, we expected these conditions would come, as commoditization is natural in all industries as they mature. I would describe the wholesale pricing today as destructive, as there is too much flower on the market. Following in the pattern of other states which experienced this part of the cycle, many growers will be forced to cease operations.

Knowing this was coming was precisely why we set our sights on and eventually purchased the SoCal facility, since low COGS is our strategy to not only survive but to thrive going forward. I expect that the most efficient growers will persevere, and pricing will continue to slowly rebound, but not to the levels we saw pre-commoditization. For clarity, we are not experiencing a demand issue, as that remains quite strong. Oversupply is causing the price disruption.

Because of the continued strong demand in the market for our flower, we exceeded our original projections for top-line revenue growth, driven by a 27 percent increase in dry products sold versus the third quarter. Our push now is to lean in and fully expand into our first-phase expansion at SoCal, as we expect the transition will position us to have positive margins, even if this unsustainable low pricing continues for a prolonged period. In other words, this new facility will allow us to grow profitably when almost nobody else can.

The strength of our Glass House Farms brand is also another factor that should ensure Glass House Brands’ continued success. Since late 2020, we have maintained a top three or above ranking based on BDSA data, and we were ranked number one at the end of the fourth quarter.

With that, I will turn the call over to Mark for a view of our financials for the quarter and the year. Mark?

Mark Vendetti — Chief Financial Officer, Glass House Brands

Thanks, Kyle. And good morning, 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 US dollars and prepared in US GAAP.

Total revenue for Q4 2021 was $18.4 million and beat our guidance for the quarter of flat to down slightly by $1.2 million. These results represent a 7 percent increase over Q3 ’21 and an 8 percent increase over Q4 2020. The sequential revenue growth was driven by wholesale biomass sales, which increased 31 percent compared to Q3 2021. Retail sales declined 2 percent, and CPG sales declined 4 percent versus Q3.

We are pleased with the results as we continue to navigate the difficult California cannabis landscape. From a market perspective, Headset estimated total cannabis sales declined 4 percent in the quarter compared to Q3. This compares to our retail sales decline of 2 percent, which includes our three consolidated dispensaries in Santa Barbara, Berkeley, and Santa Ana. Please note, The Pottery dispensary is a partnership and accounted for using the equity method.

Within the cannabis market, flower sales decreased 11 percent compared to our 4 percent decrease in CPG revenue. In both cases, we beat our relevant benchmarks.

In biomass, revenue increased 31 percent over Q3, despite continued wholesale price declines that started earlier in the year. Prices continued to fall in the fourth quarter of 2021 when compared to the third quarter. Average pricing for our flower fell 27 percent in the quarter, while smalls dropped 59 percent. This resulted in a $3.2 million drop in revenue and gross margin versus if Q3 prices had held into Q4.

As Kyle mentioned, within the quarter, our wholesale prices reached their bottom in November but have since rebounded in January and February, with flower pricing up 20 percent and smalls up 12 percent verse our Q4 average.

The current pricing is consistent with our forward-looking internal budgeting for biomass prices for the remainder of the year. We were able to achieve these results by selling 27 percent more dry weight than the prior quarter and increasing our mix with higher-priced flower and smalls sold from 27 percent of total weight sold in Q3 to 47 percent of weight sold in Q4.

These results continue to reinforce our belief that the current pricing environment is caused by overproduction and not by a lack of demand.

Revenue for the fiscal year 2021 was $69.4 million, an increase of 44 percent verse the prior year. The increase was driven primarily by our CPG business, which increased 93 percent as a result of the strong growth in Glass House Farms brands. Again, per BDSA analytics, the brand grew from a flower brand ranked below number 60 in California flower sales in the first quarter of 2020 to a consistent top-three brand during each quarter in 2021.

Retail sales increased 50 percent, driven mainly by the full-year impact of our Berkeley store, opened in January of 2021.

Wholesale biomass increased 8 percent but was negatively impacted by large declines in wholesale prices, particularly during the second half of 2021. On average, for the fiscal year, we experienced a 38 percent decrease in our flower prices and a 45 percent decrease in smalls between 2020 and 2021.

If 2020 average pricing had been unchanged versus 2020, our 2020 wholesale biomass revenue would have been $12.1 million higher, and we would have shown a 67 percent year-over-year increase in our biomass revenues versus the actual 8 percent growth. In other words, we lost $12.1 million in potential revenue due to the declining prices in 2021.

Gross margin for the fourth quarter was negative $0.4 million or negative 2 percent. The quarter included roughly $3 million of non-cash expenses related to inventory reserves for obsolete or slow-moving product, as well as inventory revaluation for our biomass live plants to lower values to reflect current production costs.

These expenses reduced gross margin by 16 percentage points. These costs are reflected in the inventory values on our balance sheet as well, which decreased by almost $5 million versus Q3.

In addition, the $3.2 million of lost wholesale biomass revenues, due to price declines that were discussed earlier in the revenue comments, reduced margins by an additional 15 points in Q4 ’21 versus Q3.

Gross margin for fiscal 2021 was 23 percent compared to 39 percent for fiscal year 2020. The decrease in average biomass pricing in fiscal 2021 versus 2020, most of which occurred in the second half of 2021, accounted for the majority of the decrease in gross margin and decreased gross margin by approximately 11 margin points. The gross margin was also hurt by the earlier referenced $3 million inventory reserves and revaluation.

Q4 ’21 general and admin expenses increased by $5 million when compared to Q3 ’21. The current quarter contained $3.2 million of nonoperational notes receivable charged to bad debt reserve; $2.2 million of the reserve is related to the Element 7 transaction and an additional $1 million is related to a note issued to our Pottery venture.

There is an additional $1 million G&A related to start-up expenses associated with our SoCal facility and the expansion of our retail footprint within the quarter.

Q4 ’21 marketing expenses increased $0.3 million compared to Q3 ’21, primarily due to seasonal promotions, digital marketing, and trade marketing.

Professional increased by $0.4 million, primarily relating to spending to support the Company’s expansion initiatives.

Depreciation and amortization increased $1.7 million in Q4 ’21 versus Q3 ’21 because of the capital spent at our SoCal facility during the fourth quarter.

We define adjusted EBITDA as earnings before interest, taxes, depreciation, and amortization, adjusted for transaction cost, restructuring cost, share-based compensation, and other non-cash operating cost.

Adjusted EBITDA was negative $9.1 million in Q4 compared to negative $5.4 million in Q3. The decrease of $3.8 million is primarily caused by lower wholesale pricing and inventory reserves in Q4 that negatively impacted gross margin.

We ended the quarter with $54 million in cash, including $3 million of restricted cash, up from $28 million at the end of Q3.

During the quarter, the Company entered into a credit facility with WhiteHawk Capital Partners to provide up to $100 million in gross loan proceeds. The Company closed on the initial term loan with gross proceeds of $50 million in December, resulting in $47 million net addition of cash.

We spent $11 million on CapEx during the quarter, with the majority of that spent on Phase I at our SoCal facility.

Operating cash flow in Q4 was negative $8 million. Net loss for the quarter of $19 million was offset by non-cash items, including bad debt expense of $3.3 million, depreciation and amortization of $2.5 million, and share-based compensation of $3.2 million. This compares to operating cash flow of negative $10 million in Q3.

Looking into 2022, we are assuming, for budgeting purposes, that the difficult market conditions and current level of wholesale pricing will persist throughout the year, which makes the addition of the SoCal facility even more critical to Glass House Brands. As Kyle mentioned, we expect to begin generating revenue from the new facility in the third quarter of the year, with output ramping up through the rest of the year and approaching annualized production rates for Phase I in Q4. The ability to produce high-quality craft cannabis at an extremely low cost of sales will allow us to succeed in these difficult conditions.

We are in the final stages of our PLUS acquisition and expect to close this in April. This brand has an annualized revenue run rate of $14 million based on 2021 trends.

We have already begun integration planning and are also actively developing plans to use both Glass House Farms and PLUS gummies' respective retail distribution presence to help improve the other distribution and get incremental sales.

In addition, we have plans to aggressively manage overhead as we look to combine organizations. The acquisition of this brand, when combined with Glass House Brands, is expected to increase our CPG revenue to approximately $40 million on a pro forma basis, based on 2021 results.

Kyle and I can both discuss the difficult state of the California market on this call. As the year unfolds, we believe there will be many opportunities to make additional acquisitions of good assets at distressed values, and we will rigorously continue to evaluate opportunities as they arise.

It is very important we acquire assets at the correct price and with the right strategic fit. This effort will be led by our Chief Business Development Officer, Erik Thoreson. As part of the acquisition strategy, we will evaluate additional sources of capital to help fund this expansion as needed. With our size and scale, we feel we can be attractive partners in most potential acquisitions.

Finally, with cultivation having started in our SoCal facility, we are even more focused on the cash flow potential of the Company. Assuming wholesale and CPG pricing remain stable throughout the year and into next, and we were able to deliver our current production metrics and fully utilize our Phase I production capacity, we believe we are on a path to generate positive cash flow from operations by early 2023.

I will now turn the call back over to Kyle.

Kyle Kazan

Thanks, Mark. Finally, I'd like to take a moment to talk about a cause I'm particularly passionate about, The Weldon Project.

The Weldon Project is a nonprofit organization co-founded by former cannabis prisoner Weldon Angelos. The organization is dedicated to gaining the release and pardon of all nonviolent cannabis prisoners, along with ending the federal prohibition of cannabis.

Having worked with The Weldon Project since 2020, Glass House was honoured to donate $25,000 in December, and I was equally honoured to join the project's Board of Directors to further support the organization's ongoing mission to assist individuals incarcerated for nonviolent cannabis-related offences.

We look forward to spearheading fundraising initiatives for this important cause, while I lean in to support the organization as a member of the board.

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

John Brebeck

Thank you, Kyle. At this point, I'd like to turn the call over to the Operator to begin the question-and-answer portion of the call. Operator, turning over to you.

Q&A

Operator

Thank you, sir. Ladies and gentlemen, we will now conduct the question-and-answer session. If you would like to ask a question, press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press *, 2. If you are using a speakerphone, please lift the handset before pressing any keys. One moment, please, for your first question.

Your first question comes from Scott Fortune with ROTH Capital. Please go ahead.

Scott Fortune — ROTH Capital

Good morning. Very early here in California but appreciate the update on the SoCal facility and the plannings and timings. Like could you provide a little colour on the quality and the ability to compete with kind of indoor-quality flower with your post-harvest processes that you put in place, from that standpoint?

And then kind of a follow-up question on that. And how and what are you looking at for in the California market to eventually start developing the Phase II of your facility from that standpoint?

Kyle Kazan

So, Scott, thank you. Thank you, number one, for getting up early because we feel your pain. So thanks for that. I'm going to ask Graham to answer the first question and even start with the second, then I can follow up.

Graham Farrar — President, Glass House Brands

Sure. Hey, how's it going, Scott? Thanks a lot for the question. Yeah. So, going after indoor quality is very much our goal, particularly with the SoCal facility. I would note that, in the past, even with our existing greenhouses, we did a Glass House Farms Grower's Choice product, which is kind of our premium line there. And part of that, our actually marketing campaign on that was to do blind taste tests with cannabis influencers and connoisseurs between the flower that we grew in our existing greenhouses and indoor-cultivated flower.

At the SoCal facility, we think we're going to get even further along on the quality path because of the design of those greenhouses. If you think about indoor, it's really just shorthand for good climate control, and the entire SoCal facility is built for ultimate climate control that's doing that leveraging that Mother Nature gives us, naturally. So we take Mother Nature, and then we polish her and supplement her—that high positive pressure greenhouses, humidity controlled, temperature-controlled, C02 supplementation. Our goal is not at all to be competing with outdoor. It is entirely to be competing with indoor and providing consumers a product that, to them, is functionally the same, at a much lower cost, and in a way that's a lot more sustainable for the planet.

To your second question, our expectations, we're basically just going to continue the retrofit. We're going to roll through Phase I, which is the first flowering greenhouses. There's four more (phon) flowering greenhouses behind it. I think we have a really great setup there, where the greenhouses, the square footage that's not used for cannabis is currently leased to a vegetable grower in a way that covers all the carrying cost. So we can be excited for additional expansion, but not anxious, and not having a burn from parts of the facility that aren't yet converted.

So our expectation is, with the quality and costs that we're targeting, that there's going to be plenty of demand for what we're growing, in which case—just like now, where we could sell three times as much as we are, if we had the supply—we think, after we finish Phase I, the market's going to see the quality, going to see the cost, and we're going to be excited to do the additional phases after that.

Kyle Kazan

Hey, Scott. Let me ask Mark. He's got a little bit of colour on the numbers on the second question.

Mark Vendetti

So, Scott, within our credit agreement with WhiteHawk, we do have certain, I'm going to say, performance metrics, that were called out, related to sales and EBITDA. The sales target is $15 million over a 90-day period, and the EBITDA target is, I think, $2.25 million over that same period. So, as we ramp up the facility, our expectation is we should hit that before year-end. And once we hit that, we'll move on to the second phase of the project.

Scott Fortune

I appreciate that colour. That's helpful. Thank you. And then switching to kind of the California regulations. Obviously, there's onerous taxes that the legislators and even the governors are looking to potentially repeal here. Can you provide any little bit of colour on that?

And then, how are you looking at the organic retail store potential in California? It's a still slow bureaucratic process for a lot of these cities that have approved bringing stores on board. Kind of the organic side, and then also the M&A side, what are you seeing? Are you seeing retail owners approaching

Glass House now and the valuations starting to get at more depressed levels that make it interesting from that standpoint to expand your retail presence?

Kyle Kazan

Yeah. So, Scott, good questions. I would tell you that, as you could imagine, being California-focused, we are very engaged with our state representatives and leaders. If you ask me just—I think it's—people asked me at the Raw conference what I would pin (phon) that, I would say probably 95 percent chance that we're going to see cultivation tax go away, and I think that—and that's our second-largest cost to grow, if you throw that in. So, it'll be great for the market. It'll be great for us, will make us more competitive with the illicit.

In regards to one of the other big callouts, 65 percent of the state of California is still illegal when it comes to retail. I will tell you, from watching the governor and the legislature, their action, they got frustrated when cities were not allowing development, and they went ahead and they just took away local control and passed an ADU law, which allows any real estate owner to look at just adding units and ignore what the local city does. They haven't threatened it, but I will tell you, it caught the ire of many mayors that I talk to here in LA. And so, I would tell you that the governor and Nicole are serious about increasing. So I think what we'd see is—my expectation is you'll see a little bit of that velocity pick up where more and more cities are opening. So that's what we're looking at.

And the last question in regards to acquisitions, if you're not vertically integrated in California, it is—right now, as we've said, kind of acknowledging on the call—it's a destructive environment. Most companies are losing money. And so, if you're a retailer faced with 280E, and you have one or two stores, or even if you have five stores, it's a really tough go right now. And you don't have SAFE Banking.

So I would tell you that there is interest to speak with us, for sure, and I'm sure a couple other large companies too. But I would tell you that I think you're going to start to see more consolidation over the next 12 to 24 months than we have thus far.

Mark Vendetti

Yeah. I can add just a little bit to that too, Scott. On the legislative side, there's currently four bills circulating on tax reform, and there's basically two topics that the governor's asked for: lower taxes and more retail, which we believe are exactly the right spots to be aiming at. So there's four bills circulating on the tax reform side. Every single one of them proposes removing the cultivation tax. So, on the most conservative side, they want to put the tax elsewhere, which would still be an improvement. On the most aggressive side, not only do they want to remove cultivation tax, but they're proposing cutting the excise tax from 15 percent to 5 percent. So I think there's a lot of positive reform out there.

The additional thing they're doing is they're doing some development so that cities and municipalities—as Kyle mentioned, 65 percent still ban cannabis—would have a very easy pathway and not have to build an ordinance on their own, which has been what a lot of the friction is, from going from prohibited to allowed. And so the State would basically give them a template that they could tack onto.

And on the retail side, I think we're in a really good position because the vertical integration that Kyle mentioned, where even a door—a retail store that's breakeven on a unit basis can be accretive to us because we sell—about 25 percent of the revenue is our own brands in our stores. So even a store that's breakeven still represents a significant increase in CPG sales for us. And that's the power of the vertical integration, where there's lots of different ways and synergies that we can find by taking everything from cultivation, processing, brands (unintelligible).

Scott Fortune

No. I appreciate that. Thanks for unpacking that. And I will jump back in the queue.

Operator

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

There are no further questions. Mr. Brebeck, back over to you.

John Brebeck

Okay. Thank you very much. This has been our call for Q4 ’21 earnings. We welcome you to join us in about a month’s time when we’ll be reporting our earnings for Q1—in two months’ time; apologies.

So thank you all for joining us at this early hour, and this concludes our call. Operator, turn it back to you.

Operator

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