Acreage Holdings

Q2 2020 Earnings Conference Call

August 12, 2020 at 8:30 a.m. Eastern

CORPORATE PARTICIPANTS

Steve West - *Vice President, Investor Relations*

Bill Van Faasen - *Interim Chief Executive Officer*

Glen Leibowitz - *Chief Financial Officer*

PRESENTATION

Operator

Good morning and welcome to the Acreage Holdings Second Quarter 2020 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation there will be an opportunity to ask questions. To ask a question, you may press star, then one on a touchtone phone. To withdraw your question, please press star, then two. Please note today's event is being recorded.

I would now like to turn the conference over to Steve West, Vice President of Investor Relations. Please go ahead, sir.

Steve West

Good morning, everyone and welcome to the Acreage Holdings Second Quarter 2020 Conference Call. Joining me today are Bill Van Faasen, our Interim Chief Executive Officer and Glen Leibowitz, our Chief Financial Officer.

This call is being recorded and will be archived on our Investor Relations website at investors.acreageholdings.com. Today's call contains forward-looking statements subject to various risks, uncertainties and other factors that could cause our actual results to differ materially from those forward-looking statements. Any such statements should be taken in conjunction with cautionary statements in our press release and risk factor discussions in our public filings found on SEDAR and EDGAR, as well as our investor website. Any forward-looking statements speak only as of today and we assume no obligation to update them.

Now, for your future scheduling purposes, our third quarter 2020 earnings release is tentatively scheduled to be issued after the market close on November 11th and our earnings call is tentatively scheduled for the morning of November 12.

I will now turn the call over to Bill.

Bill Van Faasen

Thank you, Steve, and good morning, everyone. While it is only been a few weeks since our earnings call, in cannabis years that truly feels like a few months. I am very pleased to deliver some good news that our focused plan is working as expected. As indicated in the positive inflection in our pro forma adjusted EBITDA that we reported last night. Having now served as Interim CEO for roughly 45 days, I can say we have been hard at work on executing our refocused strategy.

We have continued our focus on improving our processes and protocols in project execution with a focus of putting our best talent on our top priorities, while allowing for more seamless collaboration between teams and departments. I have been impressed with the quality and dedication of every Acreage employee I have met, and we are all laser-focused on executing our shared vision to help us reach our goals and deliver shareholder value.

The industry continues to be faced with significant operating and regulatory challenges related to the COVID-19 pandemic and Acreage continues to lead with respect to working with regulators to ease restrictions and maintain cannabis operations as essential.

As with rest of the industry, Acreage experienced significant pantry loading at the beginning of the second quarter as the country began to implement quarantine protocols. This was evident in our sequential transaction declines versus the first quarter, which was offset by a larger check average as customers increased their basket size by more than 25% quarter-over-quarter with no price increases.

Both the industry as a whole and Acreage specifically are navigating the COVID-19 challenges and growing sales, when so many consumer and retail concepts around the world are struggling.

Looking ahead to our next earning calls, which is a week after the U.S. presidential election, the one forecast I can make with certainty is that there will be many twists, turns and challenges for the cannabis industry. But I am confident that they will culminate in positive longer-term outcomes at both the federal and state levels. The momentum is building faster than ever towards federal permissibility for cannabis and these next three-to-six months should be an exciting time in the cannabis industry.

Now moving on to our second quarter highlights. We ended the second quarter with 27 operational dispensaries. Additionally, our second quarter pro forma same-store sales comparisons were up more than 46%, indicating the core health of our retail business remains very strong.

In the back half of the year, we anticipate opening an additional three dispensaries across Massachusetts, Illinois, and New Jersey. If we are successful in opening all three additional dispensaries, this would bring our total new openings to 5 in 2020, which is a 19% increase versus the 27 we owned or had management or other consultant arrangements with at the end of 2019. This, combined with the very strong same-store sales growth we have been experiencing should continue to drive strong top-line growth for the foreseeable future.

During the second quarter, we continued the roll out of our house of brands. We launched several new CBD products under our Innocent brand in Illinois and our partners in Ohio continued to roll out new products under The Botanist brand, including edibles. We continue to make strong progress on our Tweed roll out as we expanded our sales through wholesale channels in Illinois and we are hearing positive feedback from our customers.

We are continuing to build out our wholesale business at an accelerated pace. We ended the second quarter with reported wholesale revenue mix of about 26%, which was generally in line with our first quarter 2020 sales mix.

While wholesale sales mix is exceeding our initial internal expectations for the year, we believe we still have significant room to grow the share in this category and beyond, as we look to operationalize more cultivation and processing capacity in Illinois, New Jersey, and New York. We are just starting to find our groove in this higher margin business and with our house of brands being well received in the market, we expect continued sales growth and margin expansion over time.

Let me now touch briefly on a few key state updates. First in Illinois, we received state approval to open and operate three new grow rooms in our cultivation facility. This is crucial to the continued growth and success of our overall wholesale business. We expect to open additional cultivation and processing capacity throughout the year as we continue to ramp up our wholesale business and build inventory for our future dispensary in Chicago's West Loop.

As I mentioned earlier, we launched an extensive line-up of new CBD formularies under our Innocent brand, including whole spectrum CBD, CBD isolates, and CBM formularies. Through these formularies, we launched several new CBD products under the Innocent brand, including a line of chocolates, honey, coconut oil and an expansion of our line of topicals.

To help support our virgin wholesale business in Illinois, our team launched Leaf Trade, an ecommerce platform for ordering and fulfillment platform to manage our wholesale cannabis and CBD businesses.

Moving on to Massachusetts, we obtained provisional approval for adult-use sales in our Worcester dispensary, which currently operates as medical-only and our Shrewsbury location, which is fully built out but not yet opened for business. We are hopeful for the local approvals within the next couple of months, and if all goes well, we will receive final state approval to begin our adult-use sales in October.

On the branding and wholesale front, we launched our Live Resin Project branded products in our retail location as well as through our wholesale channels. The feedback has been overwhelmingly positive and reorders from our wholesale customers have exceeded our internal expectations.

In New Jersey, we closed on our acquisition of Compassionate Care Foundation and have officially transitioned them from an MSA agreement to an owned entity and fully consolidated their financial results into our own. We have very high expectations for both short and long-term organic growth in New Jersey and that is even before contemplating adult-use, which we believe will pass in the state's November referendum. Additionally, we expect to open our third and final dispensary allowed by state law in the fourth quarter in Williamstown.

Finally, I would like to touch on Ohio again. Our partners there continue to lead the state in terms of retail sales and progress towards full vertical integration. We believe our partners are the market leaders in Ohio with an approximate 12% of retail medical cannabis sales and expect them to further their market-leading position once their cultivation facility comes online, likely in the fourth quarter of this year.

This will allow our Ohio partners to fully take advantage of vertically integrated operations and the margin accretion they afford, as well as the addition of wholesale operations. In the meantime, our partners continue to build out The Botanist brand in the second quarter with additional gummy flavors, including a new 20 milligram THC Wild Elderberry flavored gummy, and we expect additional flavors in edible form factors in the near future. To me, Ohio is one of the most under-rated cannabis markets in the U.S. and I could not be more pleased with our partners' leading position in that state.

I'd now like to give some more color and updates on our refocused strategy to accelerate our path to profitability. As previously announced and discussed on our first quarter call, we've pivoted our operating strategy to focus on operations and geographies that offer the quickest path to profitability and long-term upside. Our belief was this intense level of focus on profitable operations would greatly accelerate improvements in our margins and returns and ultimately deliver profitability and create shareholder value. With this in mind, we took steps to shutdown unprofitable operations across our footprint and made significant headcount and spending reductions across the entire P&L.

Glen will give more detail to help frame the magnitude of the changes we have contemplated and begun to execute. But I'll give you a preview and just say we are expecting to eliminate $30 million to $35 million in annualized losses in 2020 versus 2019. Now we won't realize all those savings in 2020, but the actions we have taken will have a significant positive impact on 2020 and carry forward into 2021 and beyond as they annualize and we ultimately leverage such positive impact with increased organic sales over time.

Without getting too deep in the weeds, we believe the continued improvements in our reported financials are positive indicators and quantitatively validate the decisions we made last quarter to focus on our profitable operations.

That concludes my prepared remarks. I will now turn the call over to Glen for his financial discussion.

Glen Leibowitz
Thank you, Bill, and good morning everyone. Last night we have reported our second quarter 2020 results. Our reported revenue was $27.1 million, which was an increase of 53% year-over-year. This increase was primarily driven by growth in the Midwest and Mid-Atlantic regions.

And on a sequential basis, our reported revenues grew 12% versus the first quarter of 2020. While this was a slight deceleration versus our first quarter sequential growth rate of 15%, this was expected, as we closed several underperforming operations. Our pro forma same-store sales comparisons for the second quarter were 46%, the sixth consecutive quarter of double-digit compound growth.

Gross profit was $11.2 million, which was an increase of 47% year-over-year, driven primarily by our reported revenue growth. Gross margin was 41.4%, which was a 150 basis point decrease year-over-year and a 30 basis point increase sequentially. I would note that, due to our decision to close Form Factory, we wrote-off a significant amount of old hemp inventory and significantly discounted the sale of other finished products. This negative impact was approximately $620,000. While we did not adjust this out of our expenses as a one-time item, this expense will not repeat, but negatively impacted our gross margin by approximately 230 basis points in the second quarter.

In short, had we not closed Form Factory our gross margin would have been about 43.7%, or up 80 basis points year-over-year. We think this is already an indicator that our new refocused strategy is already delivering improved margins and profitability.

Moving to our adjusted and pro forma results, our second quarter managed and pro forma revenue were both $43.8 million, up 70% versus year-over-year. These increases were primarily a result of new dispensary, and same-store sales growth. Geographically, our pro forma revenue growth was once gain driven primarily by our Midwest and Mid-Atlantic regions. Our adjusted EBITDA was a loss of $6.7 million and our pro forma adjusted EBITDA was a loss of $1.4 million.

I am pleased to note our pro forma adjusted EBITDA improved to both year-over-year and sequentially. We believe these continued significant increases, both year-over-year and sequentially, are yet more clear indicators that our refocused strategy is already having a significant positive impact.

Moving on to the balance sheet, we ended the quarter with approximately $14 million of cash on hand. Year-to-date, we have deployed approximately $13 million in cash to our MSA partners. And additionally, we invested about $8 million in CapEx to build out our dispensaries and cultivation footprints. We currently have about $47 million in short-term debt, including $23 million for the Poppins loan, which is largely offset with restricted cash, leaving a net of approximately $24 million of short-term debt.

I would like to note that we continue to have discussions for long-term financing and we anticipate paying down the short-term debt with a combination of longer term, lower interest rate financings or proceeds from operations and asset sales that we have classified as held-for-sale.

Before I turn the call back over to Bill for his concluding remarks, I would like to give some additional thoughts on how we expect the remainder of the year to play out to assist your modeling efforts. As our financials showed, we believe we have turned the corner toward accelerating our path to profitability. As Bill said, there is still much work to do, but we are very encouraged with the results thus far.

Keep in mind we have set aside several licenses and operational assets as held-for-sale including Maryland, Michigan, Florida, and Oregon. We are confident once we divest our held-for-sale operations and assets, we will be positioned to achieve positive pro forma adjusted EBITDA in short order. But as you know, the timing of asset divestitures and regulatory approvals cannot be predicted.

Remember, we will lose significant top-line revenues, but we will more than offset that with elimination of associated losses, as Bill detailed earlier. As we continue to make progress on our refocused strategy, whether it be divestitures, revised financings or cost controls, we will of course continue to update you as always.

That concludes my prepared remarks. I will now turn the call over to Bill for his concluding comments.

Bill Van Faasen
Thank you, Glen. Before opening the call for questions, I wanted to touch briefly on the amended arrangement with Canopy. I can tell you since I've been the CEO these past few weeks, we have been engaging with Canopy very constructively on a regular basis as we move forward with the shareholder meeting and work towards closing of the amended transaction.

Many of you have asked about our new CBD strategy. While we anticipate a combination of store-within-store retail sales to our current dispensary base, as well as some wholesaling and/or distribution efforts, we will provide additional details in due course. In the meantime, we continue to move forward with our refocus strategy and rolling out Canopy brands and form factors across our footprint.

Finally, and importantly, I would like to thank all of our Acreage employees who continue to work so hard to grow, process, and deliver cannabis products to those who need it.

And with that, I will have the operator open the lines for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then one on a touchtone keypad. If you are using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question, please press star, then two.

Today's first question comes from Aaron Gray with Alliance Global Partners. Please go ahead.

Aaron Gray
Hi, good morning and thanks for the questions and congrats on the improvement in the quarter. First question from me is, it's nice to see the lift in ticket, something that we also saw from the peers that have reported. I would be interested to know in terms of what I saw different in terms of how that ticket turned in terms of adult-use markets or medical markets or just any additional detail on what states might have drawn that more specifically than others, even though I know part of it was due to the pantry load we saw amid COVID? Thanks.

Glen Leibowitz
Bill, I'll take that comment. So, Aaron, thanks for the question. For Q2, the split between medical and adult-use for us was about 80% was related to the medical and 20% was adult-use. And that's a mix compared to prior quarter, which was about 84% on medical and about 18% on adult-use, give or take.

So, there's a shift between growth in the adult-use and the medical is, if you compare that back to Q2

‘19, it was about same-store sales was 43% on medical and 59% on adult-use.

Aaron Gray
Okay. Alright. Great. Thanks. And then, if I could just follow-up with that, Glen, more on the margin side, and you mentioned in terms of $30 million to $35 million in savings you guys will have on the divestitures, just any help you could provide in terms of how much of that might be split between the SG&A side? And then, also a potential incremental margin improvement you are going to have there, just as we think about the implications on the model between the gross margin and the SG&A and where we can see improvement there, just as we see those divestitures come about? Thanks.

Glen Leibowitz
Yeah, I’d say, broad strokes, you are probably looking at $8 million on the corporate spend and the balance that’s somewhere in the 22 to 25 range coming out from the regions where we’re divesting from those different state assets. So, that’s the sort of the cost savings side of the equation.

And then, on the margin side, as we continue to get vertically integrated in the various states, such as Illinois and continue to expand capacity and capabilities as we built out that cultivation, we’ll see some margin improvement. I think the guidance we’ve previously given, margin expected to be somewhere in the 41% to 45% range for this year.

Aaron Gray
Alright. Great. Thanks. I’ll jump back in the queue.

Operator
And our next question today comes from Matt Bottomley with Canaccord Genuity. Please go ahead.

Matt Bottomley
Good morning everyone. Congrats on the quarter. It seems like things are progressing nicely in the industry as a whole, based on some of your peers that have reported, it looks to be going very, very strong. So, just wanted to touch base on some of the commentary you made last quarter that was calling for a bit of a more modest expectation. What changed in the interim? And from what we’ve seen sector-wide, it seems like July, going into Q3 is also very strong in a number of the markets that you’re in. So, just any commentary on those two things would be helpful.

Bill Van Faasen
Glen, you go ahead and comment on that.

Glen Leibowitz
Yes. So, Matt, thanks for the question. At the moment we don’t have any forward-looking guidance in July although, just the touch points with the different regions is looking favorable. But we’ll obviously give you more detailed insight, once we close out the quarters.

As far as the average expected trends, where we originally gave guidance and then the slight increase here for the second quarter, just, as we continue to refocus the business, we’re excited about the cost measures and the opportunities on the revenue generation, as Bill mentioned in his comments. As some of the states did implement some closures as it relates to the COVID or the stay-at-home rules, we did see some pantry loading, so there has been additional revenue from that perspective. But just generally, as we normally see as the longer we keep the stores open, the more traffic we get into those stores. So that’s what we are seeing. And then, Illinois continues a strong state for us as adult-use continues to be in that market and continues to expand across the population for adult-use.

Matt Bottomley
Great. [Overlapping voices].

Bill Van Faasen
And just, Matt, could I [overlapping voices], yes, I would also state that, we are going to be cautious about any forward-looking statements we make. Our goal is to continue to perform, improve our performance, weekly, monthly, quarterly and really let the improved performance do the talking for us.

Matt Bottomley
Great. Thanks. And just a second question on my end, just if you could outline any near-term cash that's been earmarked for various—whether it's just capex, or other expansion initiatives? Obviously, the theme here has been paring back on some of the things that have been a drag on getting to profitability, but the markets that are going the way that you would like and where you're carving out market share, if you could just comment on what you think you need?

And I understand you might not quantify actually dollars, but maybe just regions that do need additional CapEx and how that's looking over the next quarter or two?

Glen Leibowitz
Yes. And Bill, I can take this one.

Bill Van Faasen
Yes, yes.

Glen Leibowitz
So, as we mentioned previously, Illinois is a cultivation facility that we're actively working to finish. It's an 80,000 square foot building to take advantage of the adult-use in the state, assets that we already have positioned and ready to open once we get regulatory approval.

In New Jersey, we've built out—there's a 100,000 square foot building that has been retrofitted for cannabis use of that in addition to the existing operating assets that we acquired in New Jersey. So, we're really excited about New Jersey. And then, just holistically, capital needs, that'd be Illinois, another New Jersey retail, and then the Chicago retail is the laser focus that we have for the second half of the year.

Matt Bottomley
Okay. I'll jump back in line. Thanks guys.

Glen Leibowitz
Yes.

Operator
And our next question today comes from Vivien Azer with Cowen. Please go ahead.

Vivien Azer
Hi. Thank you. Good morning. My first question is on the Tweed rollout in Illinois, a two-part question please. Number one, can you offer any additional detail on your percent ATV or what percentage of dispensaries that offering is already in and what you are ultimately targeting? That's the first question. And the second question is, if you could offer some color on the price positioning of that offering? Thanks.

Bill Van Faasen
Go ahead, Glen.

Glen Leibowitz
So, on the Tweed brand, we'll probably have to do a little bit more detail digging for you, Vivien, on that question and we'll come back to you on it, because I don't have the information readily available. So, we'll come back to you on that detail.

Vivien Azer
Okay, that'd be helpful. Thank you very much. And, Bill, I appreciate your desire to do more work on CBD and better articulate kind of that strategy down the road when you report in November, fully appreciate that. But, I do have a more strategic question around your interest in CBD.

That category has really not met expectations from a development standpoint and while there might be more incremental margin opportunity, if you're not vertically integrated and you can benefit from deflation in the underlying commodity, it just seems like there is a much bigger opportunity for you guys in THC. And so, given that you are trying to take a tighter focus on THC, does it really make sense to add another initiative that's not THC related? Thanks.

Bill Van Faasen
Yes. Really good question. Part of our life and a life that we chose is our very constructive partnership with Canopy, who is very interested in building a branded CBD business. And they are pursuing their own path, but they have also asked us to pursue a path with the notion that eventually when our transaction completes after permissibility, that we will have a base in the CBD business, as will they.

Left to our own devices, I think implicit in your question is the notion of whether we would pursue it, but we're not left to our own devices in regards to our partnership with Canopy. We would read with them to pursue currently constructive initiatives, whether it's beverages, CBD. So, we're working actively with them to build out a U.S.-based CBD business. More to follow.

Vivien Azer
Understood. Thanks for the additional color.

Operator
Our next question today comes from Graeme Kreindler with Eight Capital. Please go ahead.

Graeme Kreindler
Hi, good morning and thank you for taking my questions. I just wanted to clarify, you might have mentioned it in the prepared remarks, but I just want to make sure I have the details here. With respect to assets that are being held-for-sale, could you just confirm which states are included within that held-for-sale bucket?

Glen Leibowitz
Yes. Thanks for the question. Yes, it's disclosed in the earnings release. So it's Michigan, Maryland, Oregon, Florida.

Graeme Kreindler
Great. Thank you. And just to follow-up with respect to Maryland, your press release was out this morning and there were no specific details on what the potential transaction terms might look like. But, I was wondering if you could provide some more detail with respect to some of the structuring of that

agreement?

Is there potential where you guys could receive some proceeds upon entering into an MSA and getting that in before any official transfer of the ownership of the license?

Glen Leibowitz
Yes. Actually, the announcement this morning with Maryland is actually one of those cases where we will enter into an MSA, once approved by the state. And then until full license transfer which could take some time through the regulatory process. So, that's definitely possible and has happened already. The others, I think they'll probably be just due to timing and regulatory approval, I think we could just go ahead and get those approved and sale closed without having to do an MSA.

Graeme Kreindler
Okay. Understood. Thank you. And then, just another question. I was wondering with respect to the ongoing search for a full-time CEO, I was wondering if you could provide us with an update on that, on the timing of the process and just, if criteria has changed or stayed same at all in terms of what types of industry background skill sets you are looking for in light of the amendment agreement with Canopy, as well. Just be curious to get updated thoughts there. Thank you.

Bill Van Faasen
Yes. We've initiated the activity, hired an internationally recognized search firm that we're going to work with. We're obviously looking for someone with very senior executive experience if not CEO experience in the packaged goods, consumer retail area. And hopefully someone who has relevant experience in our sector.

My sense is the search really gets started in earnest probably mid-to-late September, I think probably makes sense for us to get past the Canopy vote, so that uncertainty will be behind us when we begin talking to candidates, and I think an appropriate target date for having somebody brought into the organization would be towards the end of the year.

Graeme Kreindler
Okay. Understood. That's it for me. Thank you very much.

Operator
Ladies and gentlemen, as a reminder if you would like to ask a question, please press star, then one.

Today's next question comes from Glenn Mattson with Ladenburg Thalmann. Please go ahead.

Glenn Mattson
Hi. Thanks for taking the question. So, curious of the assets listed for sale. It seems like the biggest piece there is Florida. So, I guess, I was just curious about—I don't know how far along you are on the process, but maybe just give us an update for how robust the market is there for this type of asset sale.

I know there has been a number of companies who have either look to get into Florida and then maybe backed away because adult-rec is maybe on the back burn or down there for a little while and there are a couple very large incumbent players. So, just maybe a little bit of a sense for how far along that process is? And how it's going in general?

Glen Leibowitz
Bill, do you want me to give a little intro and you can?

Bill Van Faasen
Sure. And then I will comment.

Glen Leibowitz
Okay. Yes. Thanks for the question. So, the conversations have been very active. The benefit that we have with our license is it's very clean. It's one of the licenses that doesn't have any other joint ventures or other partial ownerships to it. So, it's a sought after license. We're actively in discussion with some folks. So, I think in pretty short order we should be able to have some presentation disclosure about the status of that sale.

And as we mentioned, our re-energized and refocused plan is at this point in time to enter that state there is obviously a couple of incumbent license holders that have a dominant position in the marketplace. And to really perform well in Florida, you do need a lot of capital. And in the current state, that's not the focused plan for Acreage. So, that's the driver on the plans to sell the Florida operations.

Bill Van Faasen
Yes. I would just emphasize, actually the interest in our assets in Florida has been very high. And there is a lot of interest in Florida, given the nature of the market there and its prospects. And as Glen just mentioned, unfortunately the status of our assets in Florida are relatively immature, so to speak, requiring a fair amount of CapEx. And it's our judgment, that given the nature of the states we're going to focus on, trying to accumulate the capital to support the growth in Florida just didn't end up being a priority for us.

Glenn Mattson
Sure. And then, I haven't seen that chart that you've put out in the prior press releases in a while now, just the state-by-state license counts. But I noticed you put the 71 dispensary licenses in this slide deck. So, what would the licenses count look like, once all these assets are sold, versus the 27 or 30 you expect to have stores open by the end of the year?

Glen Leibowitz
That would be less, obviously. Florida and some other assets. So it's somewhere in roughly the 50 neighborhood. But we can get you a better number, but it would roughly after a reduction of Florida, it's probably where it would be.

Glenn Mattson
Great. Thanks. That's it for me.

CONCLUSION

Operator
And ladies and gentlemen, this concludes today's question-and-answer session and today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.