Acreage Holdings

First Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Steve West – *Vice President of Investor Relations*

Kevin Murphy – *Founder, Chairman and Chief Executive Officer*

Glen Leibowitz – *Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to the Acreage Holdings Fiscal First Quarter 2019 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 your telephone keypad. To withdraw your question, please press star then two. Please note, this event is being recorded.

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

Steve West
Good morning, everyone, and welcome to the Acreage Holdings First Fiscal Quarter 2019 conference call. Joining me today are Kevin Murphy, our Founder, Chairman, and Chief Executive Officer; and Glen Leibowitz, our Chief Financial Officer. Today's call is being recorded and will be archived for approximately 30 days on our Investor Relations website, located at investors.acreageholdings.com.

As a reminder, today's call may contain forward-looking information for purposes of applicable securities laws. These are subject to various risks, uncertainties, and other factors that could cause our actual results to differ materially from those forward-looking statements, which include certain material factors and assumptions. Any such statements should be taken in conjunction with cautionary statements in our press release and risk factor discussions in our public filings that can be found on SEDAR and EDGAR, as well as our investor website. Any forward-looking statements made on this call speak only as of today, and we assume no obligation to update any of these forward-looking statements or information.

For your future scheduling purposes, our fiscal second quarter 2019 earnings release is tentatively scheduled to be issued after the market close on August 13th, and our earnings call is tentatively scheduled to be held on the morning of August 14, 2019.

I will now turn the call over to Kevin.

Kevin Murphy
Thank you, Steve, and good morning, everyone. It's been a couple of months since our last update, and I am pleased to report that we continue to achieve significant milestones. Over the past two months we closed on our Form Factory acquisition, acquiring one of the largest vertically integrated operators in Nevada, and announced our recent industry-changing agreement with Canopy Growth. 2019 is already proving to be another unprecedented year, not only for Acreage, but for the industry as a whole.

During the first quarter, we continued to execute on our business strategy of growing sales, expanding our national footprint and creating national brands. We remain the largest cannabis company in the US, now with a 20-state footprint, up from 19 last quarter. We will continue increasing our industry-leading position, with future acquisitions from our robust M&A pipeline that is growing at an accelerated pace due to the recent agreement with Canopy Growth.

Today our 20-state footprint covers a population of 179 million Americans. By year 2022, this addressable market is estimated to be as large $17 billion. Our current footprint encompasses more than 81% of all Americans where cannabis is legal, and we will continue to grow that number significantly by the end of this year.

Before discussing the Canopy agreement, I would like to briefly update you on two significant M&A milestones that were overshadowed by the Canopy announcement.

First, we closed on our Form Factory acquisition in April. We expect to further develop our Form Factory capabilities this year, with continued expansion in 2020.

While our peers are making headlines with billion-dollar announcements to acquire distribution companies primarily focused on the west coast, I'd like to point out that we acquired Form Factory for a shareholder friendly $160 million, and will subsequently replicate its capabilities and brand distribution across the nation far more efficiently and at substantially less cost. We have always strived to be the best stewards of our shareholders' capital, and Form Factory is another example of our prudent spending. Acreage will be able to take any cannabis brand, in any form, across our expansive national footprint of 20 states, where permitted, which we believe will make us the Procter & Gamble of cannabis.

Second, I would like to discuss our recent Deep Roots acquisition. As I discussed last quarter, we continued our M&A focus in the west. Deep Roots is one of the largest vertically integrated cannabis operators in Nevada, with a world-class team of operators. Their Mesquite dispensary is one of the top producing dispensaries in the state. They have a second dispensary in the development stage in West Wendover, which is also expected to perform well, given there is no dispensary within 120 miles of this location. The Deep Roots retail portfolio is rounded out with five additional dispensary licenses - four in the Las Vegas area, and another in Reno.

The deal also includes 18,000 square feet of canopy for high end flower cultivation, and an extraction and processing facility housed in a 40,000 square foot building in Mesquite. This facility also has plenty of space to house our Form Factory capabilities in the future. As a cannabis industry leader in the state, the Deep Roots team has also developed some of the most respected brands in Nevada including: Deep Roots, a line of high-end flower; Chillers, a line of THC infused candies; Bluebirds, a line of pre-rolls; and Helix Twist, a line of "Gummies."

Deep Roots has one of the most comprehensive wholesale and distribution businesses in the state, currently distributing products to more than 80% of all dispensaries in Nevada. The Deep Roots team has also entered exclusive manufacturing and distribution agreements with some of the best-known brands in cannabis, including Cheeba Chews.

We have very high expectations for our Nevada business, and I could not be more pleased to be partners with the Deep Roots team.

At this point I will address our agreement with Canopy Growth and why this is another game changing event in the course of our company's history. I will briefly review the strategic rationale, and Glen will follow up with an overview of the deal terms.

Thinking about the deal from both a fiduciary and strategic standpoint, this agreement was an easy decision for both myself and our board of directors. Having been a fiduciary of other people's money for nearly 20 years, I have always strived to achieve the highest rate of return for my investors, while minimizing risk. Let's start with the immediate benefit.

Upon the approval of the transaction, our investors will get cash up-front. Then, Acreage will take full advantage of everything Canopy has learned, their amazing brand portfolio, their technology, and their intellectual property, all for a zero-fee license agreement.

As we build-out our footprint, we will have all the tools and advantages to do everything much more effectively than our peers. We will also have available an additional 63.2 million shares of Acreage stock for M&A and corporate activity that will eventually convert to a more liquid Canopy stock. That message is already registering in the market, and our phones are ringing more than ever from cannabis operators across the country stating their desire to be a part of our organization. And all of that is BEFORE we combine with Canopy.

Now let me touch on the value of the transaction, which has been the subject of a great deal of confusion. To eliminate any shareholder doubt, this agreement is not capped at a specific dollar value! The $3.4 billion that continues to make headlines was simply the value of the transaction based on a 30-day VWAP on April 17th.

We agreed to receive a fixed ratio of Canopy shares at a point and time in the future. Today, the value of the deal based on the fixed exchange ratio and the upfront option premium payment is approximately 50% higher than Acreage's closing stock price this past Friday.

Assuming a $50 share price for Canopy Growth when the deal closes, which is significantly less than analysts' average price target of $78, and assuming we issue the additional 63.2 million shares available, the deal would be valued at approximately $5.3 billion on a fully diluted basis. That is more than a 100% increase in our market cap compared to when we accessed the public markets just six months ago.

What does that mean for Acreage shareholders? Using the same $50 Canopy Growth price assumption, your shares would be worth $29.09 each, plus the approximate $2.55 upfront payment, for a total of $31.64 per share. This would imply an upside of about 67% to Acreage's closing share price this past Friday.

I will now advance the call to give a quick operations and brand update. During the first quarter, six Botanist dispensaries were opened, and we acquired an operating dispensary in Nevada. Including our pending Deep Roots acquisition, we finished the first quarter with 26 total dispensaries in operation, including nine Botanists, across 13 states. Thus far in the second quarter, construction on four dispensaries has been completed and are just awaiting final state regulatory approval before officially opening for business.

In California, operations began in an extraction facility in Oakland, and our toll processing business is ramping rapidly. And, we continue to work to close our Kanna acquisition, a retail dispensary in Oakland. We expect it to open as a Botanist branded dispensary this summer.

On the brand and product front, we plan to launch three new brands in California this summer. Live Resin Project, a premium line focused on live resin, an exciting subcategory of concentrates from the team that actually invented the live resin process. The Botanist Herbalist Series, an innovative line of targeted, effect-based products melding cannabinoids and all-natural botanicals designed to heighten their effectiveness. Natural Wonder, our line of sublingual sprays that are convenient, discreet and are formulated for rapid onset and easy micro-dosing, which was developed using Form Factory's proprietary technology. We believe this line will provide an alternative to the huge vape market, as many consumers move away from inhalation-based consumption.

In Florida, we have begun the pre-construction process on five dispensaries in Miami, Miami Beach, Hollywood, Springhill and Daytona. We have an additional six dispensary locations under LOI and will give more details as they develop further.

In New Jersey, we completed construction on the expansion of our cultivation facility in Egg Harbor, increasing its size from 3,200 square feet to 5,600 square feet, which will more than double our capacity from 120 pounds per month to 250 pounds per month.

Our larger Sewell cultivation facility should be completed late this summer, and should produce an output capacity of more than 1,500 pounds per month.

In New York, we opened three Botanist dispensaries, bringing our total to the maximum four allowable dispensaries in the state. Our cultivation facility is fully operational, and we are completing the installation of lab equipment in our processing facility, for which we anticipate final regulatory approval this summer.

I will now shift the call to give an update on federal and state policy initiatives as they relate to the cannabis industry. The momentum discussed on previous calls continues to accelerate. At the federal level, the SAFE Banking Act, which makes it federally permissible for large national banks and insurance companies to do business with legal cannabis companies in the US, is gathering support from both sides of the aisle. The House Finance and Banking Committee approved the SAFE Banking Act with overwhelming bi-partisan support, which continues to grow, and now stands at 184 co-sponsors.

Additionally, the SAFE Banking Act was introduced to the Senate Committee on Banking, Housing and Urban Affairs in April by Senator Jeff Merkley. The bill currently has 21 co-sponsors, including 15 Democrats, 5 Republicans and an Independent. We expect the committee to begin hearings in early June. While the legislation as written today does not address access to capital markets for U.S. cannabis companies, we are very hopeful an amendment can be added before it goes to the floor for a full vote. We are cautiously optimistic Congress will finally act on behalf of the 93% of Americans who now believe cannabis should be legal.

Moving on to the STATES Act. We still believe it will pass the House of Representatives in late 2019 and the Senate sometime in early 2020. According to a recent CBS News poll, 56% of Republicans are among that group supporting cannabis legalization, and two-thirds of those polled rightly believe cannabis is less harmful than alcohol. The time is now for Congress to finally act on behalf of their constituents.

Moving to the state level. While New Jersey encountered a setback in their push for legalizing adult use, we believe it is a matter of not "if" but "when" they legalize adult use in the foreseeable future. Additionally, New York also experienced a setback in their momentum to legalize cannabis for adult use, but there is still a slim hope the issue can be revived this year. In the interim, we are working with legislators from both states to expand existing medical programs to further prepare them for adult use legalization.

Connecticut, Maine, New Hampshire, and Rhode Island also continue to discuss adult use legalization, and all could pass legislation by end of 2020. And importantly, Illinois Governor Pritzker announced he had a deal to legalize adult use beginning in January 2020, and a vote could happen this week before the current legislative session ends.

That's it for now on the legislative front, and I will now turn the call over to Glen, our CFO.

Glen Leibowitz
Thank you, Kevin, and good morning, everyone. Last night we reported our fiscal 2019 first quarter results. Reported revenue was **$**12.9 million, which was an increase of 487**%** versus the comparable prior year period and was driven primarily by acquisitions and new dispensary openings.

Gross profit was $8.6 million, up 580% versus the comparable prior year period, and gross profit excluding fair value items, was $4.5 million, up 521% versus the comparable prior year period. This increase in gross profit was driven primarily by the acquisitions and new dispensary openings. Our gross profit margin was 66.6%, which was 910 basis points higher versus the comparable year ago period, and gross profit margin, excluding fair value items, was 35.2%, which was 190 basis points higher than the comparable period a year ago. This gross margin improvement was driven primarily by fixed cost leverage and positive sales mix of higher margin products. Our first quarter net loss was $31.2 million, or $0.39 per share, and our EBITDA loss was $26.6 million.

Moving to our adjusted and pro forma results, I'd first like to remind everyone that our managed financial measures include the underlying results of operations from entities with which we have managed services or consulting agreements, and our pro forma measures include results of pending acquisitions as if they were consolidated as of the beginning of the period.

Our first quarter 2019 managed revenue was $20.6 million. Our pro forma revenue was $33.1 million, which was up 44% sequentially versus the fiscal fourth quarter of 2018. Our adjusted net loss, when excluding certain non-cash and non-recurring items, was $15.5 million, or $0.20 per share.

Our pro forma adjusted EBITDA loss was $9.2 million, which represents a slight decline from our fiscal fourth quarter pro forma adjusted EBITDA loss of $7.1 million. This sequential deceleration is primarily as a result of regulatory delays in Massachusetts and Ohio. As Kevin indicated, we own or have managed services agreements in place with four dispensaries – two in Massachusetts and two in Ohio – that have completed construction and are just awaiting final regulatory approval to begin operations in those locations.

Moving to the balance sheet. We ended the quarter with a strong balance sheet, with nearly $140 million of cash and highly liquid investments on hand. During the quarter, we deployed approximately $106 million in capital to expand our footprint, with approximately $89 million related to business acquisitions and license purchases, about $8 million in capex for footprint buildout and the remainder is advances to our managed entities to facilitate their own footprint buildouts.

For the full fiscal year of 2019, there are no material changes in the comments we provided last quarter. We continue to expect 50 to 60 dispensaries in operation by the end of the year. The new dispensary openings will be significantly weighted to the second half of the year. And we continue to expect financials in the second half of 2019 to be significantly more heavily weighted than the first half.

As a follow up to Kevin's discussion regarding Canopy, I would like to now touch on the deal terms of the Canopy agreement. First, upon shareholder approval by both companies and the British Columbia Supreme Court, Canopy Growth will pay $300 million to Acreage SHAREHOLDERS – not to Acreage Holdings. This $300 million will be paid on a pro-rata basis and equates to a range of $2.51 to $2.63 per share, depending on when our pending transactions close. Once shareholder and court approval are secured, it will create a binding agreement between Canopy Growth and Acreage. Then, once a qualifying event takes place that would trigger Canopy's acquisition of Acreage, all Acreage shareholders will receive 0.5818 shares of Canopy Growth.

Second, as an important part of the agreement, Acreage can issue a total of 63.2 million shares that upon closing will become Canopy Growth shares for mergers and acquisitions and other corporate uses. That equates to more than a billion dollars of attractive capital to fuel our M&A activity, which will increase the value of the post-closing company.

Before turning the call over to Kevin, I would like to note that given the pending agreement with Canopy Growth, we may need to revise our growth plans for the year. It's too early to provide specifics, as we have not yet had those discussions. However, it could entail accelerating our buildout in some states and potentially slowing down in others, all of which could have an impact on our financial results. We will give more color once we have something definitive.

And with that, I'll turn it back over to Kevin for a closing comment.

Kevin Murphy
Thank you, Glen. Before closing, I want to comment on a shareholder letter recently published in the media. This shareholder holds less than one percent of our fully diluted shares outstanding – far less than the 2.7% the mainstream media erroneously reported.

I am pleased to tell you that we already have very strong indications of overwhelming support from shareholders that are for the agreement with Canopy. In fact, we announced yesterday that shareholders holding an aggregate of 91% of votes eligible to be cast have indicated in writing their intention to vote "FOR" the agreement. Additionally, shareholders holding an aggregate 38% of votes eligible to be cast for the "Minority Approval" have already expressed their support in writing "FOR" the arrangement.

These shareholders know with absolute certainty that I have always valued their investments above mine and have always subordinated my personal interests to theirs. I would like to thank all of our shareholders for their enormous trust and support for our decision to partner with Canopy in this innovative and exciting transaction, which I believe secures our place as a leader in this industry now and for years to come.

Finally, I would also like to thank all the Acreage employees for your continued hard work and dedication to building the largest and most respected cannabis operation in the United States.

With that, I will have the Operator open the line for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

The first question will come from Jesse Pytlak of Cormark.

Jesse Pytlak
Good morning, everybody. Just starting on Canopy first, when you think about that access to their brands, technology and IP that you'll be getting, what have you seen there that makes you most excited?

Kevin Murphy
I think the exciting aspects of the Canopy transaction for us is they've had the opportunity not only to be a global leader and one that was, frankly, the first G7 to federally legalize cannabis, and they have spent hundreds of millions of dollars not only on IP cannabis know-how, but they've also learned very, very early how to scale, to a great extent.

We are very, very excited about their IP as it relates to predictability, doseability, and we believe it will be, in Canadian terms, where the puck is going in the future. Today you can buy a bottle of wine and it's basically 14% to 16% alcohol, and you can buy a beer anywhere from 8% to 6% alcohol. We believe going forward regulators will step in to regulate the space and they will look to cannabis providers that will basically be providing doseable, predictable experiences with cannabis. Cannabis has historically had a very bad name. People have basically taken more than they should. There's no real rulebook for the space. We believe with Canopy, our sales, we will write that rulebook, which will further lead us to be a dominant player in responsible consumption of cannabis.

Jesse Pytlak
Okay, great. That's helpful. Then just maybe moving on to the GreenAcreage Real estate, the REIT initiative, can you just give an update in terms of where they are in the process of financing that and maybe when we can see your first transaction with them.

Glen Leibowitz
Good morning, Jesse. It's Glen. Just around GreenAcreage, they've been on the road doing their road show presentations and gathering interest in their raising. As far as timing is concerned, probably closing that transaction is probably middle of June and then financing that to us as assets would be sold is probably in and around that timeframe. And I missed the second half of the question.

Jesse Pytlak
It was just around when you can probably see your first transaction with them in terms of a sale leaseback or something similar.

Glen Leibowitz
Yes, probably middle June. But I think the great opportunity is, as we all appreciate, this business is very capital intensive, with the plans that we have with M&A and further transactions it could be real estate heavy. Having a resource such as GreenAcreage to actually help us execute on those transactions would be significant, that would obviously facilitate a lot of the capital needs that we would have to actually go out and raise on our own as a function of what the REIT would do. Really excited to be partnering with them and helping grow our business by using those dollars to redeploy into M&A activity, which could significantly add shareholder value.

Jesse Pytlak
Great. Then just one last question for me. Maybe just an update on Massachusetts adult use licensing. I know you mentioned you had some stories still waiting, and I think last quarter you had indicated probably sometime in late Q2. I'm just wondering if that's still the case.

Kevin Murphy
I think we're making progress in Massachusetts. We were fortunate to receive some positive news from our Worcester and Sterling facilities. The process continues to be slower than we would, frankly, like. But we are seeing tremendous progress being made in Massachusetts on our front. I know that some of our competitors have voiced the same frustration as we have, but the story with Massachusetts is quite straightforward. The road to prosperity is a crooked road, and, it's been a lot of twists and turns. But we believe that we're going to be in great shape going into the third and fourth quarter in that state, and we believe it sets us up beautifully for 2020.

Jesse Pytlak
Great. That's all for me. Thank you.

Operator
The next question will come from Graeme Kreindler of Eight Capital.

Graeme Kreindler
Hi. Good morning. Thanks for taking my questions. The first one, just going back to the Canopy transaction here, I was wondering if you could elaborate, with respect to the timing of the arrangement

and doing a deal like this, what was the thought process behind doing this transaction now versus waiting when the Acreage portfolio would be a bit more mature?

Kevin Murphy
Why now? I think that as a company we have always been of the mindset, be early and be right. In 2011 when we got involved with this business, many people looked at us and said, geez, Murph, it sounds like it's a little early to be involved with cannabis. Well, no one else was doing it in 2011 and we were one of the first to be involved. That proved to be a very sound thought.

Going forward, when we asked John Boehner and Bill Well to join our board, we basically were first in assembling a world-class board of directors that changed the industry in the US, not only for ourselves but for everyone else. Keep in mind, when John Boehner joined our board it was roughly one month after then Attorney General Jeff Sessions rescinded the Cole Memorandum. We did that for the benefit of ourselves. We did it for the benefit of everyone else in the US cannabis industry.

We put forth a Super Bowl ad this year. People said, geez, it's a little early to be asking CBS and the Super Bowl to be airing cannabis ads. Well, we were early and, we were right. We never aired that ad, but three days post that release of the ad it had over 2 billion impressions, again, sending a message that the time is exactly now to Congress and the Senate, not only helping our own selves but helping the US cannabis industry.

Now today, we've been approached by the global leader in cannabis in Canopy and they are affiliated with the most iconic beer, wine and spirits company in the world. And from our vantage point, being the number one player in the United States, having the opportunity to couple our efforts with these other like-minded individuals and companies, you can choose your opportunity, you just can't choose the timing, but for us the timing is right now. That's exactly why we entered into this transaction now.

Graeme Kreindler
Okay. I appreciate the color there. As a follow up to that, is there any sort of expectations for timing in terms of when we could see Canopy's brands, if at all, integrated into Botanist stores or potentially taking on a brick-and-mortar retail brand of its own using Acreage's licenses?

Kevin Murphy
We still have a little bit of road work to do. We have an upcoming vote that takes place on June 19, and we will shortly thereafter re-think our entire strategy here and come with more clarity probably on our next phone call.

Graeme Kreindler
Thanks. Last question before I hop in the queue here, with respect to the work that Canopy is doing on the hemp-based CBD side of things, what are Acreage's thoughts on that opportunity? How might that also interplay with the company's own efforts moving forward?

Kevin Murphy
Sure. Nothing but accretive. We see it as a very symbiotic relationship to what we're looking to accomplish. We believe that the CBD side of the business is equally as important as the THC side of the business. We could not be more excited about the fit for us. We have a very modest CBD program here, and coupled with their very robust efforts here in the US and, again, our number one footprint with 20 states in the US couldn't be a better combination of efforts. Another reason why now is an exact right time for us to be coming together with Canopy.

Graeme Kreindler
Okay. I appreciate that. Thank you very much.

Operator
The next question will come from Brett Hundley of SeaPort Global.

Brett Hundley
Good morning, guys. Thanks for taking my questions. Glen, I had an SG&A question for you. Given your gross margin performance during the quarter, that implies some higher SG&A relative to what I was expecting. I think a lot of us on this side are trying to look at all of you guys across the spectrum and take a look at when the potential is for positive EBITDA, and so if I just isolate SG&A and consider how you guys are going to be growing in coming quarters, can you just help me out a little bit in understanding how SG&A trended during the quarter and why, I know you guys closed on a number of things during the quarter, and then in periods ahead how we might expect that to trend as well sequentially or year-over-year, however you want to look at it.

Glen Leibowitz
Sure. Great question. I think you'll see a little bit more once the financial statements are issued, which will be the close of business tomorrow. But just to give you a snapshot of some of the SG&A pieces that are coming in play this quarter, as you can appreciate, there's a significant amount of M&A activity and the speed at which we're doing it, the attorneys obviously don't work for free, when we're doing a lot of M&A activity and ask them to work late hours, our legal costs for this quarter are reflective of that, it was probably about $1 million of extra legal. Then partnering as a result of that our due diligence efforts, we have a third party that help us in assessing transactions, and that's probably about another $1 million impact in this quarter. Then just generally there's some other costs, whether it's insurance or some other miscellaneous SG&A, which was probably about another half a million this quarter that impacted us as we look forward.

I guess the takeaway here is this quarter was impacted through a lot of M&A activity, and to the extent we'll continue to do that, you will see continued legal and due diligence costs be incurred in those periods. But on a run rate, it sounds like you're in the right neighborhood. It's just that once we have M&A activity we're going to obviously see increases in those costs.

Brett Hundley
That's really helpful. I appreciate you going through that. That segues nicely into a question that I actually had about M&A. If I look at the 63 million shares that you guys have at your disposal to spend on M&A, can you just help us a little bit by discussing what the overall strategy is related to the types of assets, channel exposure, etc. I imagine that that might change a little bit, if and as you get this agreement signed at least, approved and signed with Canopy. But just a window into how your thought process might change on M&A. And just to clear up, are those shares only earmarked for M&A, or could you use them for other allocation?

Glen Leibowitz
I'll start with the second question first. That's shares that have what I'll call a soft cap with Canopy. Those shares we can issue up to the 58 million, and obviously if we're doing accretive deals we would go back and discuss the next several opportunities with Canopy to increase that soft cap. The shares that we would be issuing would be not only for M&A transactions, but also equity issuances for cash, the cash could obviously be used for M&A activities or operating activities as well.

Then the first question, which is, what are you looking at? As we've said, our goal is to be number one in every market that we're in, and to do that that means we have to go into states we're not in and go deeper in the states that we are in. If you look across our spectrum here, if you look at the map, there's obviously flags in states that we don't have, obviously Arizona, there's Colorado, there's many states that are still open for opportunities as opportunities present themselves, whether through regulatory change or through transactions that might present themselves.

Then if you look at states where we have a single dispensary or a single cultivation facility, just referencing our portfolio, whether it's Maryland, Pennsylvania, we would look to bolster those to get those to be fully integrated. That is the strategy, to be number one in every state we're in and every market, and expand into the markets that we're not in. Those are the types of assets, and I'll have Kevin give you more color.

Kevin Murphy
I'll also add on the M&A front as it relates to this industry changing transaction, we are now seeing a lot of incoming calls from, folks that are either independent or in two or three states that are looking to align with what we've been able to [audio drops] today when the phone rings as opposed to picking it up [audio drops] call, generally the terms are better than the acquirer. But I think that a lot of people are seeing the wisdom that we see in the transaction, that they are coupling their efforts with the number one player in the US and the number one global leader in cannabis housed in Canada. Everyone wants to be a part of the, winning team and it's our belief that that is going to help us dramatically as we go forward and do more acquisitions.

Brett Hundley
I appreciate that. Just finally for me, Kevin, I always like when you guys talk on the regulatory environment because of the people that surround you and your views there. Your comment on the STATES Act, for multiple reasons, in part this is a question more for Canopy, but the STATES Act seems like it could be a triggering event. And your comment this morning about potentially getting through the Senate in early 2020, I'm just wondering if you can put a little bit more color on that as to why you think that could happen at that particular time. Thank you.

Kevin Murphy
Sure. Politicians like to be elected. Ninety-four percent of the country believes cannabis should be available for medical use. Sixty-three to Sixty-four percent of the country believes that cannabis should be available for adult use. That is a clear majority. Historically, when politicians were asked about cannabis, they would avoid the question because it really didn't apply to them. Well today it applies to them. The reason it applies to them is because 23 million veterans want cannabis and they make up a large portion of the voting pool.

Now that politicians would like to be elected, they are now being asked the question, where do you stand on cannabis? And now they're going to have to voice their views and opinions on cannabis. That's why you see conservative Republicans saying, well, I actually believe in the constitution so in fact I'm going to vote for the fact that it should be left to the states. On the Democratic side, they believe in social justice and are a little bit more liberal, and they believe that it should be available for recreational and medical use. You see both sides of the aisle coming together in, what's probably the only bipartisan issue in Washington today. And we believe it's not a matter of are you for it or against it, it's who's going to take credit for being on the STATES Act to push this through? That's why we believe it's going to take place much sooner than later.

Brett Hundley
Thank you.

Operator

The next question will come from Matt Bottomley of Canaccord Genuity.

Matt Bottomley
Thanks for the insights and for taking my questions. Maybe just on the state legislation you were speaking to, any more color on the Illinois market? If that's going to kick off, or at least start ramping up in January of 2020, and what you guys are doing to prepare for that, and what you've heard from the state with respect to preparations for that?

Kevin Murphy
We believe that Governor Pritzker is certainly on the right path, and he believes that he has all of the support that he needs to get it done by 2020. We, in turn, are very focused on the Illinois market, as we are very, very focused on New York, New Jersey, and the rest of New England. But we believe that Illinois being the fifth largest state in the United States, when that turns over it's going to certainly be a very, very good example of why other states will be wanting those tax dollars, will be wanting to regulate it in their state.

We believe that today Illinois probably has the most momentum going into the new wave of adult use. But we believe that New Jersey and New York will be shortly behind in 2020, and we also believe that Connecticut, Rhode Island and Maine are going to be leading the New England states along with Massachusetts. We believe, not a matter of if but when, but very, very excited for all markets because in fact we are in all markets.

Matt Bottomley
I appreciate it. You mentioned New York, and is there any other color you have? I understand that it's close to the end of the legislative session right now, but I think there was a recent potentially proposed bill for adult use recreation, and I understand 2020 adult use revenues is not in the state budget. But is there any other color or insights you have on that draft?

Kevin Murphy
I think the issue with both New York and New Jersey has been on a social front. I think everyone believes in the economics of the trade. But I think it's really getting the language correct for the social side of it. We are working very, very hard in our organization to be much more involved on the social side of this business. We are strong believers that not only people should have access to cannabis, but also that people, of all walks of life, should have an opportunity to participate. We will look to work with state legislators to do our part to, not necessarily give people hands out in a state, but further giving them hands up in a state. People need help, but they don't need to be handed something, and, we will do everything we possibly can in all the states that we're in to do just that.

I think that we are coming online with that thought. I think that, coupled with some of the thoughts around New Jersey and New York and other states, we believe that will be the tipping point for these states to push through adult use.

Matt Bottomley
I appreciate that. Then lastly for me, just more of a housekeeping item, but just on your pro forma revenue bridge, it looks like this quarter there's a good amount of a pro forma adjustment coming from the west, about 7 million, an increase from last quarter. Just so I understand, is that coming from Nevada, is it Deep Roots, or is it an accumulation of some of your California stuff?

Glen Leibowitz
Yes, Matt, that's right. The pro forma from the west there is related to Deep Roots. Again, just as a reminder, when we have a definitive agreement in place we pro forma back to the beginning of the period,

in this case this would be their Deep Roots Q1 revenue amounts that they've earned during the period. Just to clarify.

Matt Bottomley
Yes, that's very helpful. Then just one quick follow up on that, it's around the increased quarter-over-quarter in that line item is about $7 million, can you give us any color on where Deep Roots is today? I know that seven dispensaries and some production, and just based on your deck here it looks like one or two are open, is there still upside for another five or so dispensaries? And then where the wholesale market or the wholesale contribution contributes as well.

Glen Leibowitz
The state of operations is one operational facility or dispensary in Mesquite, and we're, in the second half, looking to have a second dispensary in West Wendover. There's also a current cultivation facility that's open that is supplying about 80% of the retail in Nevada, a pretty chunky distribution channel that Deep Roots has currently.

I guess we don't give forward-looking guidance, but you can put the pieces together with one of the dispensaries is opening up the second half of this year, and then we have another five dispensaries that can open up between Reno, I think there's one—

Kevin Murphy
One in Reno and four in North Vegas.

Glen Leibowitz
North Vegas. With that total of five, we would see more accretion from that enterprise for sure.

Matt Bottomley
I imagine there's meaningful wholesale then in that current number?

Glen Leibowitz
Yes.

Matt Bottomley
Okay. Thank you very much.

Glen Leibowitz
Yes, there's significant retail, but there is a wholesale component in the $7 million.

Matt Bottomley
Great. Thanks, guys.

Operator
The next question will come from Vivien Azer of Cowen.

Vivien Azer
Good morning. Murph, I wanted to follow up on the STATES Act too. I totally appreciate the popular support, but if we look at the current legislative session, the House has passed 100 bills, they're ranging in topic from gun control, where you have strong Republican and obviously Democratic support, and nothing is getting hearings on the Senate floor. No bills. I continue to struggle with your confidence that the Senate Majority Leader wants to accomplish anything.

Kevin Murphy
Well, that's Politics 101. I think if you look to Washington, it gets very, very confusing once you get inside, that region. But I do believe that there is going to be compromise on cannabis, again, because we believe it is so popular, not only on the state level, and these states need guidance and they need direction, and so at the end of the day I think it's going to be SAFE Banking first and STATES second. I think everyone is certainly entitled to their views and opinions. We certainly have good intel in Washington, given some of the folks surrounding our organization. But we believe with full confidence that it's going to be a 2020 event and we're optimistic that it's going to be a real key debate as it relates to going into a major election year in 2020.

Vivien Azer
Okay, fair enough. We will stay tuned on that. There's certainly plenty of time for the House to start their hearings this summer. On the Canopy deal, any thoughts on regulatory scrutiny? We've talked a lot about shareholder approval and that seems well articulated, but any topics or points that you can offer on how regulators are looking at this, and in particular on the licensing, given that you'd be licensing brands from Canada that would add value to your portfolio?

Kevin Murphy
I think at this point it's early in the transaction, we'll have more color as we progress. But today we probably wouldn't comment on it, the specifics. It is a brand new structure. It is innovative and novel. And I think today it's a huge advantage for us to basically keep that, frankly, pretty close to the vest. Respectfully, I'll pass on that, with more color to follow.

Vivien Azer
Okay, fair enough. Last one for me, on the rapid onset spray—actually two more—can you just qualify or quantify what constitutes rapid in your mind? Number one. And number two, does that technology have applications across other form factors? Thanks.

Kevin Murphy
It does. It's a proprietary recipe that the Form Factory has brought to us. They are very, very sophisticated as it relates to deliverables. When we talk about rapid onset, we're talking about within five minutes of ingestion, and we believe that it does provide a very strong alternative to the vape market. We also believe, given that folks would like to basically be inhaling less but getting the same effect, we believe it's going to be a game changing product in the marketplace, and couldn't be more excited about it. But when we talk about early onset, we're talking about within five minutes of application.

Vivien Azer
Excellent. Yes, that will be quite fast at five minutes. Last one for me, Murph, you had said in response to another question that you view hemp-derived CBD and the adult use cannabis opportunity as equally important. I was a little bit surprised to hear that, just given some of the market sizing work that we've done. Can you just expand on that, how you're thinking about the addressable markets for each? Thanks.

Kevin Murphy
Sure. I think that when you think about THC you think about pain, you think about pharmaceutical, you think about social consumption. When you think about CBD, you think about wellness and you think about the size and breadth of that marketplace, I think that it's a very good stepping stone for people to get comfortable with the cannabis plant. I think a lot of folks that are new to the space would be inclined to want to basically leg into a CBD product that gives you some medicinal value, but not the high effect. We believe over a period of time it will become a lot more mainstream and a stepping stone to the THC markets.

We had early on captured a lot of our enthusiasm for the space in the THC markets because that's where the low hanging fruit was. But today we believe that all walks of life are now stepping into CBD, whether it's the Pro Golf Tour or professional sports, and now you see the NFL giving consideration to thinking about CBD in a whole new light. From our vantage point, we think it's a very broad, vast and deep marketplace that covers a lot more of the population, and that's why we believe it will be equally as important as the THC market.

Vivien Azer
Terrific. Thanks for the questions.

Operator
The next question will come from Russell Stanley of Beacon Securities.

Russell Stanley
Good morning. Thanks for taking my questions. Thanks for the update on the buildout on Florida. I just wanted to get your views, on dispensary locations and any color you can provide, as to how easy or how difficult it is to obtain and lock down dispensary locations now. I'm just thinking in the context of a market where additional licenses have been issued and should become a bit more competitive.

Kevin Murphy
Sure. Well, in every marketplace it's competitive, right? We have secured the five retail locations that I had mentioned on the phone previously: Miami, Miami Beach, Hollywood, Springhill and Daytona. We also have an additional six under LOI, which I'd prefer not to identify because I think it's a competitive advantage for us. We're looking for high traffic locations at the corner of Main and Main. We believe that we have a very, very good team down in Florida. We are newer to that market. Where some may view it as a slight disadvantage, we see it as somewhat balanced, given that many of the folks that were in that marketplace early have made some vital mistakes, particularly on the cultivation side of the business. But from our vantage point, we've been able to learn from those mistakes and enhance what we're going to be doing going forward.

We believe it's going to be a very, very important state for us. We've got a lot of resources dedicated to that state, but we also believe, with the affiliation with Canopy and a lot of what we believe we can bring to that marketplace from a product offering and from a process offering, we believe that we can differentiate ourselves from our peers not only in that marketplace but in the other 19 states that we are currently in, and the other states that we'll be in here shortly. That's going to be really the defining moment. I think this has been a business of land grab historically. Today, it's more of a consolidation business. And go forward it is going to be purely a performance business. We believe we've excelled at the first two, and we'll continue to excel on point number three.

Russell Stanley
Thanks for that color. If I could add one more question, a similar sort of update, if you can provide on New Jersey, and I apologize if I missed this earlier, but any update on the two additional dispensaries that you're able to open? And a second on that, your view on the provisions of the proposed expansion of the medical program there and your view on this market, whether the increase in the number of licensees should be more than offset by the provisions that improve patient access there.

Glen Leibowitz
Russell, it's Glen. I'll take the first half and then Kevin can talk to the landscape on the program and how they're looking at it. As far as the operations, we're under construction for an Atlantic City location. Then there's another location that we have under LOI, but we can't disclose the location. Then obviously we have our existing Egg Harbor cultivation and dispensary facilities, we'll have three dispensaries, along

with our existing cultivation up and running, probably all of it by the end of this year. We've mentioned before that we're building out our Sewell cultivation facility, which is over 100,000 square foot of Canopy building size, we'll be in a very good position if there's any political changes or regulatory changes to expand the medical program or ultimately if it goes to recreational use.

Kevin Murphy
Yes, I think they're going to expand the medical program from here, and then I think they will pause until 2020 to transition to full adult use in the state. Unfortunately, a disappointment for us, a disappointment for the patients of that state. It was a miss. But, again, the only thing that you can predict in this business is that things are constantly changing and it's our job to adjust as quickly and as seamlessly as we possibly can.

Russell Stanley
Great. Thanks for that color. That's all I have.

Operator
The next question will come from Aaron Grey of Alliance Global Partners.

Aaron Grey
Thanks for the questions. Just high level, can you talk about your strategy of how you look to execute in medical markets that could transition to adult use in the relative near to medium term, such as Illinois, New York and New Jersey, and how that impacts your analysis of real estate opportunities for how you look to enter the market on the medical side, knowing that the transition to adult use could be coming soon? Thank you.

Kevin Murphy
Sure. I think that when we look at this marketplace holistically, it's really about education. Whether you're a medical patient with cancer or you're someone who has trouble sleeping, we have found in our recreational market that more than half of the folks that we treat or the customers that we service in our recreational market are really self-medicating, whether they're having trouble sleeping, whether they're having trouble with anxiety, they just haven't gone the extra step to get a medical card. With that, it's pretty much the same process, although in a recreational market we obviously need a little bit bigger box. We have always looked to our real estate knowing that ultimately these states will go through that transition period, we're looking for bigger footprints so we can expand accordingly to meet the demands of those states.

There's not a huge differential between how we would think about educating the medical side of the business as it relates to the recreational side of the business. To give you a for instance, in some states, Connecticut being one state, you need to have a pharmacist in your dispensary to dispense cannabis. We have taken it upon ourselves to put a pharmacist as we go forward in every dispensary that we have. The reason we're doing that is because we'd like to have more of an education when someone walks into our dispensary. Interestingly enough, as they grade occupations in the US, more often than not a pharmacist is the most regarded occupation, which is a little bit interesting as it relates to the trust factor. That's where we were thinking about the business, and that's how we believe catering to our patient base best suits us.

Aaron Grey
Thank you. That's helpful. Then just one more on Canopy and the ability to leverage processing technologies and improve operating scale and efficiencies, just given the limitations on interstate commerce in the current regulatory environment, just how best to think about your ability to utilize that? Would it be best suited for larger markets, such as California and Florida, where those efficiencies can

be more beneficial versus smaller states? Just any color there would be helpful. Thank you.

Glen Leibowitz
Aaron, obviously where we can use technology, Kevin's mentioned the opportunity with Form Factory. Taking that technology across different states that allow for different form factors is obviously going to be a critical leadership ability for us, and hopefully will lead to success factors in each of those states that we bring a Form Factory into.

In conjunction with that, if and when the Canopy transaction is consummated and able to use that technology, we would also be using those IP as well as other technologies that they've developed over the years and bring those into the US and across the different states and roll that out across our platform. Where there's opportunities with technology, we will leverage those to the maximum ability that we can, because that will create cost efficiencies and production efficiencies in all the locations that we're in.

Aaron Grey
Okay, great. That's helpful. Thank you.

CONCLUSION

Operator
Ladies and gentlemen, that does conclude today's conference call. We want to thank everybody for attending today's presentation. You may now disconnect. Have a great day.