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Ascend Wellness Holdings, Inc.

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Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good evening, and thank you for standing by. Welcome to the AWH's First Quarter 2022 Earnings Call.

I now would like to hand the conference over to your first speaker today, Rebecca Koar, Head of Investor Relations. Please go ahead.

Rebecca Koar

Vice President-Investor Relations, Ascend Wellness Holdings, Inc.

Good evening, and welcome to AWH's earnings call for the first quarter of 2022. The presentation that accompanies this call can be found on our website, www.awholdings.com/investors.

Before we proceed, I would like to remind you that there are several risk factors and other cautionary statements contained in our SEC and SEDAR filings, including our Annual Report on Form 10-K for the year ending December 31, 2021. We expect to file the Form 10-Q for the quarter ending March 31, 2022 within the next few days. We will not review those risk factors and other cautionary statements on this call. However, we encourage you to read them carefully.

Various remarks that we make on this call concerning expectations, predictions, plans, and other prospects constitute forward-looking statements or information. These forward-looking statements or information are subject to risks and uncertainties that may cause actual results to differ from historical or anticipated results. Any forward-looking statements or information reflect management's current view only and we undertake no obligation to revise or update such statements or make additional forward-looking statements in the future. During today's call, we will be referring to non-GAAP measures as defined and reconciled in our earnings materials in the appendix of the presentation. These non-GAAP measures as defined by AWH may not be comparable to measures with similar titles used by other companies.

On today's call, we have Abner Kurtin, Chairman, Founder and CEO; Frank Perullo, President and Co-Founder; and Daniel Neville, our Chief Financial Officer.

With that, I'll turn the call over to Abner.

Abner B. Kurtin

Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

Thanks, Rebecca. Good evening, everyone, and welcome to our Q1 2022 results call. As always, I would like to express our sincere gratitude for the tremendous support we receive from our customers, employees, partners and shareholders as we continue to fulfill our mission of bettering lives with cannabis. The cannabis industry remains one of the fastest growing sectors in the United States and continues to motivate the Ascend team to reach new heights every day.

Cannabis is now a staple in this country. In 2021, legal cannabis sales officially surpassed sales of Starbucks despite the fact that coffee is sold in all 50 states and cannabis only 39. State by state, the industry is taking the country by storm with the legal cannabis market in the US projected to reach $33 billion by the end of the year. Cannabis economies remain siloed by state and subject to the ebbs and flows as the various supply and demand curves evolve. However, even on the industry's worst day, the economics remain stronger than most sectors. Although federal legalization remains far out on the horizon, the industry is making meaningful strides which suggest positive momentum.

Notably in Q1, ScottsMiracle-Gro, a company listed on the New York Stock Exchange, leveraged a creative structure to acquire Etain, a US plant-touching company with a New York license for $247 million. This says to me that New York Exchange – New York Stock Exchange listed companies are not afraid to acquire US plant-touching assets. While just one transaction, this does signal a move in the right direction that indicates the potential for renewed investor interest by strategic acquirers in the sector.

We remain pessimistic about the chances of any federal cannabis legislation passing this year. While the House of Representatives has passed the SAFE Act and other legislative proposals numerous times, the Senate has failed to act. Senator Schumer, Booker and Wyden seem completely willing to let nothing happen if they can't get full legalization measure through Congress. Like anything in Congress, you can never be sure. And we hope this analysis proves to be incorrect. It is not lost on me that the equity markets have been difficult and the cannabis equities are a complete disaster. The sector has completely degraded as institutional investors are largely unable to buy in this space because of custody-related issues. While those that can are boycotting the space due to the lack of progress on federal reform, valuations are completely divorced from fundamentals. We remain confident this will change in the intermediate term, but we acknowledge that this is a challenging period for investors.

Quarter one was a mixed quarter financially as Ascend continued to lay the groundwork for solid growth beginning in Q2 of this year related to the start of New Jersey adult-use. The wholesale markets in Mass and Illinois continue to be very difficult both in pricing and volume, which we expect to continue for the foreseeable future. Our Q1 results reflect our investments in the business and the growing pains required to take the next giant leap forward in our expansion plan. Subsequent to the quarter, we commenced adult-use sales at our dispensary in Rochelle Park, New Jersey. Frank will provide a detailed update on New Jersey later, but I am proud of the team for their near flawless transition to adult-use. Our first day of adult-use sales at the store contributed around 1,500 transactions and an average basket size of 135. We believe that New Jersey will be our main retail growth engine for 2022, and Ascend has the potential to have outsized impact from New Jersey compared to other MSOs due to our size and exposure.

This morning we announced that we signed a term sheet to settle our lawsuit with MedMen related to the New York transaction. After a few months in litigation, it became apparent that the process could take a significant period of time to complete. Although we're confident that we could have prevailed in court in the long run, we decided to settle to ensure we received the assets in time to be ready for adult-use expected in 2023. We settled for what we view as a nominal amount in relation to the recent precedent transactions for New York assets. We plan to fund the additional $69 million needed to close the transaction this year with cash on hand and by expanding our existing credit facility. Also, after the quarter, we announced the close of a transaction providing us with vertical access to the Pennsylvania market. I will review that transaction in more detail momentarily. But before doing so, let's turn to slide 4, to review our updated consolidated footprint.

With the Pennsylvania acquisition closed and the MedMen litigation soon to be behind us, we can say we have seven states in our footprint. Our future is looking greener. We're developing a leading presence from the Midwest through the Northeast and remain committed to being a top five player in each of the states which we operate with a focus on limited license, recreational or near-recreational, highly populous states. Ascend has achieved a mature vertical market in Illinois and is doing over 40% EBITDA margins in the states. The rest of our states are rapidly coming up to J-curve as we execute our model of purchase, invest, churn-on, drive vertically and scale. As of today, we've 20 operating dispensaries and 5 grows with licenses or definitive agreements across 7 states. By the end of 2023, we plan to have 34 operating dispensaries, including the 4 in New York, the 6 Pennsylvania and 4 more that are under construction.

Turning to Pennsylvania, core to our investment thesis is being disciplined allocators of capital, and our recently closed acquisition of Story of PA, a clinical license registrant in Pennsylvania illustrates that. This affords us vertical capabilities with one cultivation and six dispensary licenses in an attractive, limited license market that we believe has strong potential to legalize recreational sales in the near term. This limited license state has a population of roughly 13 million people and generates over $1.4 billion in legal sales annually, with only 155 operating dispensaries. The uniqueness of the clinical registrant's license and the ability to place five of the six stores anywhere in the state, the only location restriction is the one store that must be in the same area as the affiliated medical school which for us is in Scranton. By citing our locations in 2022, we're able to leverage second-mover advantage over older medical stores that were cited a few years ago, enabling us to pursue our strategy of scouting and seeking the best locations for new adult-use market in highly sought after retail quarters with ample parking. We plan to position the remaining five dispensaries in the suburbs of Philadelphia and Pittsburgh in municipalities that only more recently become amenable to cannabis retailers.

We have been a nominal shareholder in Story of PA since prior to its application for the license and have been watching the Pennsylvania market closely. We've recognized that the supply and demand balance has shifted in the past year and as a result, we have repriced this transaction prior to closing. We now plan a moderate wholesale strategy in the state by building just 25,000 square feet of canopy to support our retail operations, before making the decision to expand and invest for an adult-use market. We intend to fund the build-out by drawing on our existing credit agreement and with the sale leaseback of the cultivation facility. Pursuing accretive opportunities is at the heart of what we do. We acquired Story of PA for $53 million comprised of 12.9 million shares and $10.2 million of cash. We value stock early, especially given the current pricing, and I want to assure you that we would only issue stock at these levels for a material transaction that we viewed as both highly strategic and attractively value.

Let's now move to slide 6 to discuss the New York settlement details. We were very disappointed in this litigation from the get-go because we felt it was a case of seller's remorse by MedMen and I am pleased to report that they have surrendered. We've always been highly confident we would prevail in court, but we decided to settle so we could move forward with improving the acquired New York operations, to begin supporting the medical patients and to begin to build additional supply in anticipation of the adult-use market.

While the $15 million is essentially an extortion payment, it is a significant discount from the outrageous sums that MedMen was asking for. So we view this as a win. As part of the settlement, MedMen will withdraw its counterclaims against Ascend, and we expect to close on the transaction shortly. Under the revised terms, we will receive almost 100% of the controlling interest in MedMen for $88 million, $74 million of which will be due at close and we will make a subsequent $14 million payment upon the first sale of recreational cannabis in a MedMen New York dispensary. The revised $88 million all-in for the transaction is so incredibly cheap compared to recent comps like the Etain transaction I mentioned earlier, further illustrating how we create value through smart acquisitions at attractive prices in late-stage medical markets before the flip to adult-use. We are thrilled to have the distraction of a lawsuit behind us so we can focus on integrating the four dispensaries and one grow into our portfolio and we look forward to deliver high-quality cannabis and retail experience to the patients and citizens of New York.

With that, I would like to turn the call over to Frank Perullo, President and my Co-Founder, to dive into further updates.

Frank Perullo

President, Co-Founder & Director, Ascend Wellness Holdings, Inc.

Thank you, Abner, and good evening, everyone. I'm delighted to review some of the key developments in the business, starting with New Jersey. New Jersey, the most densely populated state in the country, began allowing adult-use sales for 7 alternative treatment centers at 12 dispensaries on April 21. Ascend is the smaller operator with exposure to the adult-use market in New Jersey, rendering us the potential to benefit from an outsized impact on the New Jersey recreational – on New Jersey recreational sales. Additionally, our locations are prominently located in highly trafficked Northern New Jersey. I argue we have optimized our stores to handle high throughput better than our competitors.

On that first day, there were nearly 12,400 recreational customers across the state. Sales gross nearly $1.9 million among the 12 stores. of which our Rochelle Park store alone generated $200,000 of sales with close to 1,500 transactions. In the first seven days, we generated close to $900,000 in adult-use sales. I credit our retail teams who work together to optimize and enhance the retail experience. And I want to thank every staff member at the Rochelle Park location.

Despite high demand, Ascend had little to no lines on the first day, a testament to our emphasis on online ordering and customer appointment scheduling. We purposefully selected and built the location to handle heavy traffic. It is equipped with 23 points of sale and nearly 130 parking spots, enabling us to maintain our quality of service to our valuable medical patients who have come to expect that from us. I'm looking forward to continued success Rochelle Park in opening up our other two New Jersey stores for adult-use customers.

We are currently serving medical patients at our store in the heart of downtown Montclair. On May 3, Montclair adopted the resolution we've been waiting for in order to apply with the stay. On May 4, we submitted our completed application with the Cannabis Regulatory Commission of New Jersey for state approval to sell recreational-use cannabis. We hope to receive state approval from the state at the May 24 meeting. We would then commence recreational sales at our Montclair store shortly thereafter.

Our Fort Lee store remains on track for completion by late summer. The location is the closest of any of the alternative treatment centers to New York City and is a stone throw from the George Washington Bridge. The store plans to have 29 points of sale and significant parking to handle the anticipated customer demand.

Our New Jersey cultivation continues to expand. Today, we have 16,000 square feet of canopy online to support our own retail network. We have made significant purchases of flower from third-party partners to help us meet our retail demand while we build out the rest of our facility. Our extraction lab came online April 1 and we plan to have the kitchen online producing edibles by late summer. For Ascend, New Jersey is a key driver of our 2022 growth. As is the case with each of these states until recreational sales commence, our New Jersey operations have been operating at a loss since we entered the state, but immediately following the start of recreational sales, the operation becomes profitable. This is the name of the game with this business. It's the reason why the financials resemble a stairstep.

Let's move to slide 9 for a more detailed update on the business operations, starting with retail. We've always followed the target and whole foods models. While we sell our own brands in our stores, we also sell many other brands. No customer leaves our store without their favorite product, whether we produce it or not. Last year, Abner discussed a goal of achieving 50% of our retail revenues from AWH branded or produced product to capture vertical margins. As our SKUs have expanded, so has our ability to achieve our goal. In Q1, 43% of our retail sales were derived from our own brands, Simply Herb, Ozone Reserve or the brands of our partners for whom we produce. We are confident that the 50% goal is achievable as we continue to strengthen our offerings and build out our capabilities. Our retail stores continue to be among the most productive in the industry. In Q1, our average revenue per dispensary was close to $13 million. I attribute this to our unwavering approach to finding prominent retail locations. Our emphasis on order had our elevated retail experiences and our commitment to providing consistent access to high-quality products. We continue to strengthen these pillars of success and improve our retail execution.

As far as our retail pipeline, we expect to open our East Lansing, Michigan store in the coming weeks and one additional store in Michigan by early next year, which will bring us to eight stores in Michigan. Since we became vertical in the state, we have been seeing potential and it would be advantageous to selectively add retail locations to increase the verticality in the state. We're also on track to open New Bedford, Massachusetts dispensary this fall, which would increase our Massachusetts footprint to the maximum of three recreational stores. We also recently opened the second floor of our Friend Street Boston location, creating an immersive experience for customers to explore the Ascend offering. Finally, as mentioned earlier, with the opening of our Fort Lee, New Jersey location, we will also increase our New Jersey footprint to the maximum three adult-use stores with all three expected to begin selling adult-use cannabis in the coming months.

Last quarter, we discussed the launch of our value brand, Simply Herb. The brand has been well-received in the market and was a welcome addition to our offering for consumers who want quality and in affordable price. On the cultivation front, we continue to build out our canopy and expand our capabilities. We recently brought online our lab and kitchen in Michigan. Also, we brought our lab in New Jersey online and are working to produce all form factors in each of the states we operate. Not only are we broadening our capabilities, we're also expanding our canopy.

We ended the quarter with 213,000 total square feet of operating canopy, including 37,000 square feet of canopy were recently added to our Massachusetts cultivation. We just began planting in this new space and expect to begin harvesting and selling this incremental canopy over the summer. After the quarter, we made our first sale from the canopy we built in late 2021 in our Barry, Illinois greenhouse. Unfortunately, we brought the canopy in

Massachusetts and Illinois online while the markets were saturated. In Illinois, we believe the market is temporarily oversupplied as the industry awaits the release of social equity retail licenses, pending a lawsuit with the state that we don't think will be resolved until sometime in 2023. Along with Michigan, these markets remain competitive, but we continue to make progress to build our business although we do expect a longer period of ramp-up to achieve our initial objectives. I'm proud of the continued progress the cultivation team has made across our markets.

With that, I'll turn it over to Dan to review the financials in detail starting on slide 11.

Daniel Joseph Neville

Chief Financial Officer, Ascend Wellness Holdings, Inc.

Thanks, Frank. Good evening, everyone. Although, we made foundational progress in Q1, financially, it represents the valley for the year. In Q1, our sequential growth and margins were disappointing as we faced pricing headwinds in parts of the wholesale business and invested to support the growth we expect to realize during the remainder of the year. Total system revenue was $101 million which was flat quarter-over-quarter, primarily due to a decline in third-party wholesale sales which is near – which was nearly fully offset by an increase in intercompany sales. Net revenue, which excludes the intercompany sale of wholesale product to our own dispensaries, decreased 3.8% quarter-over-quarter to $85.1 million, but increased 29% year-over-year. Total retail revenue was $63 million, representing 74% of net revenues, a 2% sequential decline that was primarily driven by lower average baskets in each of our states except for Ohio.

Gross wholesale revenue increased to $38 million across our five cultivation sites, representing an approximate increase of 2% quarter-over-quarter as we expanded intercompany sales to our own retail stores. Net wholesale revenue after intercompany sales was $22 million representing about 26% of net revenues, a sequential decline of 8%. This decline was primarily driven by pricing in Illinois and Massachusetts. As Frank mentioned, these markets, particularly Mass are oversupplied with an abundance of wholesale products and we expect prices to continue to face pressure. We aim to partially offset this pressure by expanding our wholesale distribution network and partnering with local players on supply agreements. Adjusted gross profit decreased by $1 million to $36.5 million, a 2.7% sequential decline. Retail gross profit and wholesale gross profit both decreased sequentially, driven by smaller basket sizes in the retail business and pressured wholesale pricing in Illinois and Mass. The consolidated adjusted gross profit margin increased 50 basis points sequentially to 42.9% as a result of our efforts to increase vertical acquisition.

Adjusted EBITDA for Q1 was $16.4 million, which represents a $3.4 million or sequential 17% decline. Our margin for Q1 was 19.2%, which represents a 309-basis-point decrease sequentially. We continue to make progress on our cost optimization program announced last quarter. And as of 03/31, we've realized about half the targeted cost savings compared to our initial budget. As a reminder, approximately $7.4 million of rent expense is related to sale leasebacks which are considered operating mix.

We're now entering a better period as New Jersey becomes a positive contributor to EBITDA that will grow over the course of the year. We ended this quarter with approximately 1,600 valued employees, 155 of which are in corporate as we continue to leverage the shared service model.

Let's move on to discuss the balance sheet on slide 12. On the top of the slide, you'll see our standard waterfall, which bridges Q4 cash to cash at the end of the quarter. During the quarter, we reduced cash by about $12 million. We used approximately $10 million for operations and $1 million in cash for investing, driven by payments for acquisitions closed in prior quarters for both Midway in Illinois and OCC in Ohio, net of proceeds received from sale leasebacks. Based on our current timeline and projections, we intend to invest approximately $40 million of

CapEx, net of proceeds from planned sale leasebacks to fund the build-out of our second phase cultivation expansion in New Jersey, completion of four in-flight dispensaries and the build-out at Pennsylvania. And finally used $1 million in cash for financing, primarily for a small seller financing repayment.

We ended the quarter with $144 million of cash and equivalents and net debt of $90 million. We're in the final stages of securing financing under the expansion feature in our term loan for Pennsylvania and New York. We've seen good support from existing and new lenders, and we expect to fund in the coming days. Our strong balance sheet, combined with our unique asset footprint, positions us as a premier multi-state operator. Ascend is one of the only MSOs with growth estimated to accelerate into 2023, driven by its size and significant exposure to the growing Northeast markets with a near-term potential for adult-use.

Thank you to everyone for the time today and for continuing to support Ascend. With that, I will turn it over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] Your first question will be from Stanley – Russell Stanley at Beacon Securities. Please go ahead.

Russell Stanley
Analyst, Beacon Securities Ltd.

Q

Hello, and thanks for taking my question. Just wondering if you can elaborate on the wholesale pressure you're seeing in Illinois. Wondering if you're seeing retailers there start to consolidate the number of suppliers they deal with in order to trim costs and perhaps leverage the saturation you spoke to and what you're seeing on that front. Thank you.

Frank Perullo
President, Co-Founder & Director, Ascend Wellness Holdings, Inc.

A

Yeah. I mean, I think Illinois is on – the ability of the State of Illinois not to license over 150 new social equity retail licenses when all of the cultivators have expanded to meet the demand of those dispensaries opening up has caused there to be an oversupply. The pricing pressure is not what we see in Michigan or Mass, but there's still pressure. And, really what you want is get those social equity licenses retailers operating and open. It's been two-plus years, almost three years now I guess, they've got to get open. That's what's driving that.

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

Did you have a – Russell, do you have a follow-up?

Russell Stanley
Analyst, Beacon Securities Ltd.

Q

Yeah. I guess my – just to follow up on the question, are you seeing any consolidation by retailers? Are retailers trimming the number of wholesale suppliers that they deal with, is not coming through yet or do you anticipate that happening?

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.
A

Yeah. It's happening. I think the first thing you're seeing is that they're expanding their shelf space that they give to their own products, right. I think they were always doing that, but I think just as we announced proudly that we're increasing our share of our own products, they're trying to do the same thing for the vertical sales. So that's something you see most likely. I mean, if you – we're not in Pennsylvania, but you see to be an independent wholesaler without distribution is a tough place to be. I mean it's – just in an oversupplied market, that's a tough place to be. I think some of those people are facing additional pressures.

Curaleaf just mentioned that they brought online their grow expansion. They didn't have – they had a pretty small grow. So that definitely add – that's the one add to the market that we see. And they'll be able to fill their shelves a little bit more. But that's – I think, it's been a market about the top five or six players. It continues to be. Those are kind of the micro-changes that we se.

Russell Stanley
Analyst, Beacon Securities Ltd.
Q

Got it. Thanks for the additional color. I'll get back in the queue.

Operator: Thank you. Next question will be from Matt McGinley at Needham. Please go ahead.

Matthew Robert McGinley
Analyst, Needham & Co. LLC
Q

Thank you. So Dan mentioned that the first quarter will be a valley for the year in terms of operating performance. I guess now that your facility expansions are complete in Illinois and Massachusetts and New Jersey adult-use sales are open, would your adjusted gross margin begin to improve into the second quarter or are the pricing pressures so great that it'd be hard to push that rate higher at this point.

Daniel Joseph Neville
Chief Financial Officer, Ascend Wellness Holdings, Inc.
A

Yeah, Matt. I think we should look – we should see gross margins start to improve. Obviously, New Jersey opening up is – we're a few weeks into it. But the gross margins in New Jersey are strong across the market. We do have some canopy today. We have 16,000 square feet of flower and canopy, that is enough to kind of service our existing footprint as it stands today, with one store being recreational.

As Fort Lee and Montclair open up, we did buy some bulk biomass in the quarter to kind of prepare and have sufficient access and biomass to meet the sales of that before a Phase 1 expansion comes online. Phase 2 adds an additional 26,000 square feet. It allows us to achieve full verticalization in the state and have a wholesale business. So I think what you'll see is, some help on the New Jersey side of things with adult-use and in early-stage market with strong pricing and margins, and then an additional uptick in Q4 of this year once we achieve full verticalization in that market.

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.
A

Yeah. I would also say on the Illinois and Mass, we just have the unfortunate situation of expanding our new capacity coming online into these saturated markets. The business remains healthy, especially in Illinois, where we're the third or fourth largest wholesaler. Pricing is pretty solid. It's just the new capacity coming online without the stores coming online. Mass is a different issue. It's a really, really tough market. We expect Mass to – the oversupply to be a real problem for the industry and people exposed to it. However, for us, it's a small business. So for the time being, it doesn't – it's not like we're losing share because we were small. It's about us trying to pick up share in a saturated market.

Matthew Robert McGinley Q
Analyst, Needham & Co. LLC

Got it. And if I could ask one more on the cost savings that you mentioned, I think it was a $10 million savings for the full year. And you mentioned that you saved half of that by March 31. How much dollars did you actually save in the first quarter? And should we assume a full $5 million run rate in cost savings into the second?

Daniel Joseph Neville A
Chief Financial Officer, Ascend Wellness Holdings, Inc.

Yeah. We didn't realize too much of it. It was kind of a work in progress that really got inside on – as of the earnings call where we had some separations. But there were – there was some cost associated with that. So I think you can start to look at that flowing through to the P&L starting in Q2 for part of that. We didn't get much of it in Q1, a little bit, but there are – one just word of caution. I mean, we're expanding in New Jersey. We're adding additional people at the Franklin grow. We're adding additional support. We added a new state in Pennsylvania. So there is some additional head count that has come back in as we flipped to adult-use and also expanded into a new state.

Matthew Robert McGinley Q
Analyst, Needham & Co. LLC

Got it. Thank you.

Operator: Thank you. Your next question will be from Kenric Tyghe at ATB. Please go ahead.

Kenric Tyghe Q
Analyst, ATB Capital Markets, Inc.

Thank you, and good evening. Abner, congrats on what is a lower cost to more timely outcome than was expected in New York. Can you speak to just in the context of that, how timely this was, your preparedness with respect to potential New York adult-use, and your comfort level with not only being able to get there, but to be able to get there in a manner that you would expect and in time to fully capitalize on what could even be an earlier than initially expected adult-use start in New York. Any additional color there would be greatly appreciated.

Abner B. Kurtin A
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

Sure. I mean, first of all, I think we've said on previous calls, we're looking most likely to relocate the grow facility in New York. We have secured a grow facility that we think will be very attractive and can move quickly because it's a better industrial shell that we can work with. And we've already moved ahead with power and other types of upgrades on that basis. That – for that reason, we think we can meet our original goals of hitting the start of adult-use. In terms of New York's plans, we like everybody else read what New York is saying and get confused, right. They want to issue a lot of licenses to social equity and they want to move quickly, which is great. We're not exactly sure how they're going to do that. We're not exactly sure when and how stores will get open on that basis. We don't have any regs. We don't have any color. We're still shooting for mid-2023 and we wait to hear what

OCM and the CCB plan and we'll work accordingly. We think we'll have a great suite of products to hit the market next year and we think that's going to be in line with the start of adult-use.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Thanks, Abner. Just a thought there with respect to how much of that you will be able to service from your expanded cultivation at the start and then perhaps what you expand of cultivation in New York will look like existing 2023?

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

Yeah. I mean, I think it's a little bit too early to give the phase-up plan. I would say that we plan a moderate grow in New York. We are – we think New York is a great opportunity. We think there is a great opportunity for premium indoor flower like there are in other markets. The decision of New York to license all these hemp operators and to allow for that much outdoor grow definitely has refined our view of building a lot of biomass in the state. We think the much more prudent opportunity is to grow high-quality in grow – indoor flower and work with other operators to purchase biomass and generate really high-quality manufacturing products. Should – as we get more clarity if it makes sense to add a Phase 2 or Phase 3 to that grow, we're prepared to do it. The facility that we're looking at can handle it. But for us, we think, as you see in other markets, the prudent way of moving forward is vertical sales and premium indoor flower that has the – in what is a very kind of uncertain and high-risk state right now, that is the most prudent and highest return on capital plan for us.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Great color. Thanks, Abner. I'll now get back in queue.

Operator: Thank you. Next question will be from Andrew Semple at Echelon Capital. Please go ahead.

Andrew Semple
Analyst, Echelon Wealth Partners, Inc.

Q

Good evening. Thanks for taking my question. First one here, could you maybe just spend some time discussing on New York and Pennsylvania, two new states the portfolio, obviously going to be some pretty heavy list there associated with CapEx. How will this shift the CapEx budget for 2022 and into 2023? And will the incremental credit facility drawdown that you're anticipating, will that be able to cover all of the additional CapEx that might need to go into those two states?

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

I'll turn it over to Dan to run through the CapEx and financing. But I'll say conceptually, the way to think about it is that we plan to fund the grow facilities in Pennsylvania and New York with sale leaseback transactions. So, the net CapEx back to us will not dramatically increase. There could potentially be some spending on the retail side, but that wouldn't be huge. We obviously have just under $150 million on the balance sheet. We have $65 million of available capacity on the credit line to expand and we think both of those put us in good shape and we're working accordingly.

Daniel Joseph Neville
Chief Financial Officer, Ascend Wellness Holdings, Inc.

A

Yeah. And so, that $40 million of net CapEx as Abner mentioned sale lease – cultivations funded by sale leasebacks and then dispensaries funded out of pocket by CapEx. We did contemplate $10 million for dispensary CapEx and PA to build out those dispensaries. And then there is – and that $10 million would come as part of that expansion line. And then, really in 2022, we shouldn't see too much on the CapEx side on the retail side for New York. We are – the regs are not written yet, things are not finalized. But there is talk of getting additional dispensaries for the registered organizations. Those would have to be sited and built out. But I would expect most of the retail CapEx in New York to fall into the 2023 bucket.

Andrew Semple
Analyst, Echelon Wealth Partners, Inc.

Q

Got it. Great. Thanks. And then just want to return to the SG&A spend. Just want to – there's a couple of moving parts there with the operating cost synergies being worked for as well as there's obviously expectations for a growth ramp to the back half of the year. How should we think about the SG&A trajectory for the remainder of the year? Is it fair to say that beginning next quarter, we should begin to see that moderate as a percentage of revenue, but probably still climbing on a absolute dollar basis.

Daniel Joseph Neville
Chief Financial Officer, Ascend Wellness Holdings, Inc.

A

Yeah. I think, that would certainly be fair. We added two new states. We're picking up an operating business with MedMen New York, which comes with some cost in overhead that we're obviously picking up. We'll also have to hire NPA in advance of revenue. So those are the pressures and the offset is really – so we're continuing to expand the business. We're going from five states to seven states. We're going to have some additional heads, but that'll be offset by revenue growth with the big driver being adult-use in New Jersey, getting the two additional stores online, turning on the additional 26,000 square foot of grow.

I would say on the cost savings side of things, we are adding some additional heads, as I mentioned to Matt, as we pick up these two new states. But look, we're not stopping at $10 million. There's – it's not just nickels and dimes. There is dollar bills lying all around this company in terms of the cost structure, whether it's banking fees, whether – there's a lot of stuff that we can do on the SG&A side of things that we're just going to continue to attack. And quite frankly, it's a lot easier when the growth is a little bit more moderated like it is this year than when we were growing 100% and turning on multiple facilities like we had last year.

One other just thing to mention, I think in the SG&A this quarter, is that there was four-point – the lawyers that we have for MedMen New York and the litigation are excellent. They did a great job here, but they ain't cheap. And so we spent about $4.2 million in the quarter on litigation between the issues that we had out there that are settled. And then we had about $1 million of severance expense related to some of the cost – expenses related to the cost savings opportunities that we realized.

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

I would also say more on the strategic side related to your questions. Look, we think we're getting to after-tax operating free cash flow positive in the second half of the year. But when you look at our acquisitions, our acquisitions are really not going to be accretive to us this year, but they have a lot of strategic value and growth potential in 2023, 2024 and potentially beyond. We look at our core area of the Northeast, mid-Atlantic, Midwest, as being really the most exciting areas of the sector. We're seeing, just very shortly what New Jersey is able to do. And we've got a lot more to go there.

New York comes next. Pennsylvania and Ohio are on the medium-term horizon. We are really well-positioned to take advantage of that, as are other companies. But when you look at our size and leverage to those businesses, we can be an accelerating grower with a rapidly expanding free cash flow profile in the out-years. This industry is still new. We are taking advantage of that growth opportunity. We don't think now is the time to focus too much on the short-term operating results. Obviously it's important, but we also need to position ourselves to take advantage of this amazing opportunity.

Andrew Semple
Analyst, Echelon Wealth Partners, Inc.

Q

Great. Understood. And thanks for taking my questions.

Operator: Thank you. [Operator Instructions] And your next question will be from Ty Collin at Eight Capital. Please go ahead.

Ty Collin
Analyst, Eight Capital

Q

Hi. Thanks for taking my question. Now you've introduced Simply Herb and you have a true good, better, best SKU assortment. Can you share any insights into whether you've seen your customers moving around between those pricing tiers at all, given the higher cost of living and are you seeing any trade-down into your more value-oriented brands and formats?

Frank Perullo
President, Co-Founder & Director, Ascend Wellness Holdings, Inc.

A

Sure. Thank you for the question. So like most shoppers, they're THC shopping. We only have about a month or so of data. So I don't want to make some drastic conclusions. But we're seeing the larger formats on our Simply Herb products really pick up. And we're seeing the higher-end THC shoppers continuing to shop by THC. So wherever the product biomass is going into for that, that's where a majority of the shoppers are sticking to, but when it comes to the value shopper looking for your 7 grams or 14 grams, they're transitioning to Simply Herb, they're transitioning to the high-quality product for the best value for sure.

Abner B. Kurtin
Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

I also think people are looking at some pricing pressure and kind of the consumer. I mean, there's another issue here which is that the industry is growing better product. If a couple of years ago in a lot of markets, maybe not in California, if you were buying popcorn or some lower-quality product, you were in the 12% to 15% THC. We have a lot of products as do our competitors in the low- or higher-percent THC. The customer is smart. The customer knows they can get a little bit more for their money. So, that is part of the equation here as well.

Ty Collin
Analyst, Eight Capital

Q

Okay. Thanks for that. And then just circling back to New Jersey, can you maybe provide some more detail on the arrangements that you had in place to purchase supply from the wholesale market, was that just a one-off purchase of biomass or do you have an ongoing sort of offtake agreement in place? I'm just trying to get a sense of how secure that supply is until your own capacities are up and running.

Abner B. Kurtin

Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

A

Yeah. Look, we looked at – the state was very focused on making sure there was enough supply availability going into adult-use. They wanted to protect the medical patients and they didn't want shortages, which is totally understandable. Every state has gone through that exercise. We have a great grow, but we have this gap before Phase 2 comes online, let's say, in late summer. So we modeled out under very conservative circumstances what we would need potentially to make sure that under any possible scenario, we'd be able to fully supply our stores ourselves which we don't think we need to do because of the wholesale market. But we wanted to create a situation on that basis. We were able to contact our friends at Curaleaf and TerrAscend who're excellent wholesalers in the state, and we were able to make large purchases prior to the start of adult-use. Those companies had increased their production and were – had too much supply because of the delays of the state. They were building their inventory for a market that was supposed to happen three to six months before. We were able to help them out by buying. They were able to help us out by selling and we were able to, I think, create a win-win scenario for both parties.

Going forward, we think that that really solves our gap situation until we get till Phase 2 of the grow becoming online, but we're buying wholesale every day. We want to – our competitor friends, they've got great products. We've got Curaleaf, TerrAscend, I think a few others on the shelf already. We plan to put everybody on the shelf and we think that the wholesale market is going to open up over time. That's going be good for our stores, good for our customers, good for everybody. So we don't think that we'll need to do any more bulk purchases. But we're always opportunistic. If somebody has extra supply or supplying something that we're not producing, we're happy to work on them and buy bulk that can be an attractive business for us. And we hope, as Frank said, to enter the wholesale market maybe by the fourth quarter, beginning of the first quarter as we own in and get the Phase 2 going.

Ty Collin

Analyst, Eight Capital

Q

Yeah. That's really helpful. Thanks for taking my question, Abner.

Operator: Thank you. And at this time, we have no further questions. I would like to turn the call over back to Mr. Kurtin. Please go ahead, sir.

Abner B. Kurtin

Chairman, Founder & Chief Executive Officer, Ascend Wellness Holdings, Inc.

Thanks. Well, look, thank you, guys, for taking the time. We're really excited. While this was not the best quarter we've ever had, it was a good quarter as we ramped up into the period of growth in New Jersey. I mean, it's been a year-plus since we've had this kind of growth and to see the store turn on and the type of financial impact is huge. And for those of you who have seen new adult-use markets, it's a great time. The customers are thrilled. The employees are thrilled. The town representatives who've been dealing with, they're happy to see it and get some tax revenues on the board. It really is an exciting, positive experience for everyone. And I think, every operator in New Jersey is really enjoying it on a business level, personal level and benefiting financially as we continue to move forward and build that business in New Jersey.

We look forward to working with the state, helping them get social equity licenses on board, carrying other people and wholesale. This is a very exciting time. And for us to put on really the two largest states in our region that we weren't in that are both probably going to go – New York definitely and Pennsylvania probably go on adult-use. I – this business isn't just about maths, obviously, it's about numbers. But I would put our license portfolio up against anyone in the industry right now. We are incredibly well-positioned to growth. We won't have the highest margin this quarter and next quarter. But when you look out, we're – I think we've got the best portfolio and we've got the best opportunity to create value for our investors.

So with that, everybody, thank you for joining us and have a good night.

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