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Ascend Wellness Holdings, Inc.

(AAWH.USD.CA)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

I would now 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 third quarter of 2022. The presentation that accompanies this call can be found on our website, 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 will not review those risk factors and other cautionary statements on this call. However, we encourage you to read them carefully.

Various remarks on this call concerning expectations, predictions, plans and prospects constitute forward-looking statements or information. These forward-looking statements of 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. We undertake no obligation to revise or update such statements or make additional forward-looking statements in the future except as required by applicable law.

References made by – made during this call to future oriented financial information and financial outlooks, all of which are subject to the same assumptions or assumptions, risk factors, limitations and qualifications. While we believe that such estimates have been prepared on a reasonable basis, reflecting best estimates and judgment, the actual financial results of the company may vary from the amounts discussed herein.

During today's call, we will be referring to non-GAAP measures such as adjusted gross profit, adjusted EBITDA and adjusted EBITDA margin as defined and reconciled in our earnings material appendix. 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, Executive Chairman; Frank Perullo, Interim Co-CEO and President; and Daniel Neville, our Interim Co-CEO and Chief Financial Officer.

With that, I'll turn the call over to Abner starting on slide 4.

Abner B. Kurtin

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

Thanks, Rebecca. Good evening, everyone, and welcome to our third quarter 2022 earnings call. Since Ascend was founded in 2018, the cannabis market has evolved enormously and Ascend has experienced impressive growth across all aspects of the business. When we began, only 10 states have legalized recreational cannabis, while only 25 states had cannabis available for medical use. At the time, market sales were just over $10 billion, with 250,000 employees working in the sector. Fast forward to today the US cannabis industry employs over 428,000 workers and the market topped $25 billion in sales last year. Just this week voters approved adult use in two states, bringing the total to 21 states having adult use representing nearly 50% of the population of the country. This is a further indication that the march towards legalization continues throughout the United States with or without federal legalization. We have seen state market dynamics ebb and flow but ultimately people want this product and they are voting for it. It is only a matter of time before the federal government follows suit.

Over the same period, Ascend has grown fast. Our Q3 revenue and adjusted EBITDA run rates were $445 million and $111 million, respectively, representing impressive compounded annual growth rate of 147% and 225% since the company's first full year of operations.

and 225% since the company's first full year of operations. This quarter, the entire business contributed to the success. We achieved same store sales growth in our retail businesses as well as considerable growth both our gross and net wholesale revenue. We achieved this growth through a strategy we call MSO 2.0. Our model has been to enter late stage medical markets, build in at scale grow facilities to supply our stores for the onset of adult use and as soon as permitted open stores in high traffic retail locations with parking and top tier operations to manage customer flow. This is the playbook we used in Illinois, where we have executed to become among the top three operators with two of the highest revenue generating stores in the state and one of the top brands. This same playbook allowed us to immediately become a leader in adult use in New Jersey, despite having a moderate medical presence. We plan to use the same blueprint in Ohio, Pennsylvania and additional states we planned to enter such as Maryland. We don't always get it right. We entered Michigan and Massachusetts markets, which were more competitive than we anticipated, and we have not achieved state leadership in either. Even with those setbacks, we are profitable in all our markets and are reallocating capital to the best opportunities. We come from financial backgrounds and the best way to improve returns to investors is by quickly pivoting and moving capital to the highest return opportunities as we see them today. It is becoming more and more apparent in this industry that the winners are going to be the ones that will allocate capital most successfully. We are building a track record of execution to become a top tier operator. Our 25% adjusted EBITDA margin achieved this quarter puts us in the top quartile, solidifying our position as a top US MSO. At the same time, we are almost breaking even cash flow from operations, signifying the transition of the company's hyper growth to one of more moderate expansion with a focus on cash generation. We have one of the strongest balance sheets of our peers, with $91 million in cash and are nearing cash generation as new operations come online. The company is currently in transition from founder-led management to bringing in successful operational leaders with experience, managing growth and cash flow generation as we continue to scale to an industry-leading position.

We recently engaged Russell Reynolds to support our search for a CEO to lead our next phase of growth. In the interim, Frank Perillo and Dan level continue their work as leaders of day to day operations with the additional responsibilities of interim co-CEOs, as I assume the position of executive chairman.

Let's move to slide 5 to discuss the industry valuation headwinds and ways. MSO stocks remain depressed because of the lack of institutional ownership due to the inability to trade on major exchanges and access to custody from most banking institutions. We hope that changes soon, but are awaiting movement at the federal level as one of the fastest consumer, fastest growing consumer product groups in the United States. It's a question of when, not if, the sector will develop strong institutional support.

Despite our success, as mentioned above, we are valued at less than four times next year's EBITDA based on consensus estimates, while Tier 1 MSOs are valued north of ten times next year's consensus forecast EBITDA and Tier 2 was traded [audio gap] (00:07:53 – 00:08:28

Thank you, [indiscernible] 00:08:32

Unverified Participant

Thank you, Abner. Q3 was another strong quarter for Ascend. Thanks to the hard work and dedication of our now over 2,000 team members. I am incredibly proud of our team's remarkable achievements. Today, Ascend is a leading MSO that has benefited from our collective ability to execute strategic growth opportunities while maintaining our disciplined approach to capital allocation. Ascend has a bright future ahead with many opportunities to create value for our stakeholders. We continue to stand out from our peer group as we demonstrated meaningful growth in tough macro and microenvironments. We delivered record revenue, adjusted gross profit and adjusted EBITDA margin for the company. We also delivered impressive growth with revenue up 14% sequentially and 18% compared to last year and an adjusted EBITDA margin expansion of 354 basis points. In addition to delivering strong performance in the quarter, we continued to strengthen our bench and improved all aspects of our operations. We recently added to the leadership team on the operations side to improve productivity and enhance our cost structure. Improving the bench is a critical element to increase profitability.

enhance our cost structure. Improving the bench is a critical element to increase profitability going forward. In our wholesale sales operation, we have put a number of pieces in place to up level of the organization and are already beginning to see results from these improvements, as evidenced by our 30% sequential wholesale growth. In the retail business, we are expanding AWH penetration, combating ticket erosion and increasing transactions by providing optimized menus, better customer experiences and improved in-store merchandising. These actions have helped drive an increase in same store sales quarter over quarter. We have some of the most productive stores in the industry, as demonstrated by our average annual annualized revenue per dispensary, which grew to $15.3 million this quarter.

Let's move to Slide 7, to review the business in the Northeast region in more detail. New Jersey's our leading growth driver of 2022 densely populated state, has over 9 million people in the market, is expected to grow north of $2 billion in the coming years. Our Rochelle Park store continues to outperform and embodies the investment thesis for our business. Enter medical markets and then benefit from a significant sales multiplier when the business converts from medical to adult use. Our Montclair store was our second New Jersey store, opened its doors to adult use customers in August. The stores in the heart of downtown and is off to a steady start. Finally, our Fort Lee New Jersey store located just steps from the New York border with over 4,000 square feet of selling space, opened its doors to medical patients in August. We have been working closely with the town and they have advised us that we can begin selling to recreational customers on November 17. The team has been preparing and gearing up for the highly anticipated start of adult-use operations at New Jersey's closest dispensary to New York City.

In Q3, we expanded production to include edibles from our Franklin, New Jersey cultivation facility, giving us the full assortment of products and form factors throughout the state. We also launched simply our herb our value brand in Miss Grass, a premium pre-roll brand partner. The cannabis program in a state is in its infancy, but we are proud to be delivering such a robust product offering right off the bat. We set out to generate 50% of our retail sales from products that we produce so we can capture vertical margins and manage our supply chain. I am pleased to report that we have surpassed this goal in New Jersey. In addition to increased AWH manufactured product penetration, our third party wholesale sales continued to build in the state and we now sell to 26 of the 28 dispensaries in New Jersey.

Moving to Pennsylvania. Last quarter, we closed the transaction of Story of providing a license for one cultivation in six retail locations. We recently completed the construction of the first phase of our Pennsylvania cultivation facility located in Smithfield, a town in the state's southwest. We are now planting the initial 6,000 square feet of canopy, leveraging the best cultivars from our network to produce top of the line products to support our planned medical stores. We will consider additional expansion in wholesale operations once we have a line of sight to adult use.

Two weeks ago, we opened our doors to medical patients and our first Pennsylvania dispensary in Scranton, a busy college town located in the northeast part of the state. The store boasts 70 parking spaces right off Route 81. We are piloting a sends first ever outlet store model in this location parking spaces right off Route 81. We are piloting Ascend's first ever outlet store model in this location where we offer everyday lowest price. Our objective is to be a destination for medical patients where they are guaranteed to find value offerings of premium quality. In the coming days, we expect to open our second Pennsylvania dispensary located in Wayne, Philadelphia suburb. We will continue to sign additional retail sites in Pennsylvania over the coming year and we'll use our second mover advantage to add additional prime retail locations in high traffic corridors. Lastly in the northeast, Massachusetts, we are pleased to receive approval from the state just earlier today and look forward to opening our third Massachusetts dispensary in New Bedford by year-end. The store will also follow the outlet store model. We think Massachusetts is ripe for an opportunity searching for shoppers for everyday low prices. On the wholesale front, we are aggressively expanding our wholesale to third-parties through our value product Simply Herb, supporting our customers in increasingly value conscious market.

Let's slide over to slide 8 to discuss our business in the Midwest. Starting in Illinois, our bread and butter state that has fueled the growth of our business. During the quarter, we announced the signing of two licenses in Illinois, bringing us to 10 dispensaries in the state, the state imposed cap. Going deep within the states we operate and being a top player in each state is critical to obtaining the highest potential profitability. These stores will cement our scale within the state. We recently commenced construction of a dispensary in Tinley Park, one of the fastest growing suburbs in Chicago. We are working to site a second location in the greater Chicago area. Our Illinois cultivation and wholesale operations are one of the top performers in the state. We continue to supply our full product portfolio to our eight operating stores and maintain a presence in over 99% of the dispensaries in Illinois. As pricing pressure persists, we were able to increase volumes enough to offset the pressure this quarter. We don't anticipate material relief until the additional social equity licenses begin to come online at the end of this year and into next year.

In Michigan, our seven retail stores continue to be standouts from the state. In Q3, we grew Michigan retail revenue by 23% sequentially compared to the state – total state growth of 10%. We are pleased with our retail execution in a crowded market and our delivery program continues to show promise. We also expect to open our eighth store located in Grand Rapids, Michigan, to come online in the first half of next year.

During the quarter, we experienced a pest problem in our Michigan cultivation facility. We use this incident as an opportunity to reset operations. We have since replanted the entire facility and expect the first harvest in January. Fortunately, due to the ample supply of moderately priced biomass, our operations were not impacted.

Moving on to Ohio. Home to nearly 12 million people with just about 60 operating dispensaries today. Our two medical dispensaries continue to perform strongly. We plan to soon break ground on three dispensary built and highly trafficked retail locations in anticipation of a future adult use program. Our production capability in Ohio continues to develop as well. We recently began the production and wholesale of our Ozone vapes. Just a few weeks ago, we closed in our Ohio processing facility now, enabling us to consolidate these financials.

With that, I will turn it over to Dan for review of in detail financials starting on slide 10.

Daniel Joseph Neville

Chief Financial Officer, Ascend Wellness Holdings, Inc.

Thanks, Frank. Good evening, everyone. Q3 was another solid quarter for us and we continue to stand out from the pack by demonstrating double digit growth despite challenging markets. Total system revenue increased by 14% sequentially to $134 million. Net revenue, which excludes intercompany sales of wholesale products, increased by 14% quarter-over-quarter to $111 million. The growth was primarily driven by an increase in third party wholesale sales and the full quarter benefit of newly opened dispensaries and dispensaries that recently converted to adult-use retail. We expect more moderated sequential growth in Q4 as Fort Lee Adult-Use will not kick in until late November.

Total retail revenue increased 10% sequentially to $83 million, representing 74% of net revenue. This growth was driven by the first full quarter of AU sales in Rochelle Park, New Jersey and the start of adult-use sales in Montclair, New Jersey. Also driving the growth was the low single digit increase in same store sales, with increased transactions outweighing a small decline in basket size. Customers are proving that, notwithstanding the pressure on their wallets, spending on cannabis is a priority.

Gross wholesale revenue increased to $51 million across our five cultivation sites, representing an increase of 22% sequentially as we expanded third party sales in Illinois, New Jersey and Massachusetts and inter-company sales in New Jersey.

Despite continued pricing pressure in Massachusetts, we were pleased to see sequential wholesale growth. Net wholesale revenue of $28.4 million increased 30% sequentially, driven by previously mentioned third party sales increases in Illinois, New Jersey and Mass. Based on the pressure competitors are seeing in their wholesale businesses our wholesale performance stands out. Adjusted gross profit increased 14% sequentially to $50.6 million, and adjusted gross profit margins remained relatively flat sequentially at 45.5%, driven by improvements in utilization and production in Mass, as well as expanded offerings in New Jersey being fully offset by price.

Our Q3 adjusted EBITDA was $27.8 million, which represents a 33% sequential increase. Our adjusted EBITDA margin for Q3 was 25%, which represents a 354 basis point increase quarter over quarter. I am extremely proud of the team for their contributions to driving this notable margin expansion. We leveraged SG&A as we optimized existing overhead, leveraged shared – our shared services infrastructure and executed on cost savings initiatives. Of note, we had $8.3 million of rent expense related to sale leasebacks, which are considered operating expenses. The majority of these expenses are in COGS.

Let's move on to discuss the balance sheet on Slide 11. Ascend has one of the strongest balance sheets in the industry positioning us to weather this capital drought and take advantage of consolidation in the sector.

consolidation in this sector. We have no material near-term maturities or nearing positive cash flow from operations and have $91 million of cash on hand.

Our cash flow from operations was use of $1.8 million this quarter, a significant improvement compared to the prior quarter. We are running the business, so we're not reliant on outside financing going forward and are anticipating having significantly positive cash flow from operations in 2023. In Q3, we used approximately $46 million of cash for investing. This amount is outsized for the quarter due to the accelerated build out of our Pennsylvania assets and the timing of financing we expect to receive to fund these projects. We are in negotiations for financing to recapture a portion of this cash invested. These investments include the purchase of real estate for the Pennsylvania cultivation site in Smithfield, the build out of phase one of the Smithfield cultivation and construction of our first two dispensaries in Pennsylvania, as well as $15 million in cash payments related to the pending acquisitions of the licenses for three dispensaries in Ohio and two Illinois dispensaries.

We ended the quarter with $91 million of cash and $219 million of net debt relative to $111 million of adjusted EBITDA at our run rate. We have no material near-term maturities and a very manageable outstanding tax liability balance with cash flow from operations generation on the horizon and significant potential upside from assets owned in our pipeline that have yet to be turned on. 2023 is an inflection point for Ascend. We are focused on generating positive cash flow from operations and limiting capital expenditures. We are budgeting for a significant decline in capital expenditures next year with a program to manage working capital and inventory more efficiently. We are targeting 30% adjusted EBITDA growth for the next year by executing on our existing pipeline. While we are very comfortable with our balance sheet and financing alternatives and do not have immediate plans to issue equity, we view it as best practice to have a self-registration statement effective, and we plan to file an S-3 in the coming weeks to participate in capital markets opportunities should they arise.

Thank you all for joining the call this evening and continuing to support our mission at Ascend. With that, I'll turn it over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] We ask that you limit yourself to one question and one follow-up to give everyone a chance to participate in the Q&A. One moment, please, for your first question. First question comes from Russell Stanley of Beacon. Please go ahead.

Russell Stanley
Analyst, Beacon Securities Ltd.

Q

Hi. Good evening. Thanks for taking my questions. Maybe first time on Illinois. Just wondering what your latest outlook is there for the additional retail licenses, the 185 and how quickly or how slowly you envision those opening and driving growth for the addressable wholesale market?

A

Frank, do you want to take that?

A

Sure. Yeah. Yeah. I mean, we know that there's going to be between, let's call it a half dozen, dozen opening up later this year. And the majority will come online next year, probably mid to late in the year because of the – just how much it takes and how difficult it is to get stores open. So, we think of this as a second half of 2023 more than anything else as again, they're really trickling in and you're going to see a few opening this year.

Q

Got it. And just my follow up on Illinois with the recent approval of adult use in Missouri, just wondering how much risk you see that for Collinsville and revenue base there, how competitive you think the region might be or how sticky you think that customer base approved be? Thank you.

A

Yeah. I mean, fair question. Yeah. The products and services available from Illinois are going to be a better opportunity for customers to get what they want across the river. The tax rate will drive some customers to stay in Missouri. So I think there's a material effect on some of our retail in the southern part of Illinois. And we're planning on it, but I'm not sure if Dan or Abner want to add to that?

A

Yeah. Let me just say our – with two downstate stores that are two of our grocery stores, only about 50% or 50% of those customers are Missouri. So that's the potential at risk, because that's those customers have been regular customers of ours for what now close to three, four years by the time stores open. And we have a few hundred SKUs on the menu. So obviously over time that we definitely face [ph] cannibalization from Missouri. But we think given where Missouri is we don't see it kind of hitting that hard really until 2024. We could be wrong, but it's about half the sales in two stores. And by the way, at the same time, we're adding two stores in Illinois to go from 8 to 10. So when you – so if you take some cannibalization out of those two stores out there, but then you add two new stores we think we end up in a pretty neutral position in Illinois, even with the Missouri [indiscernible]

Operator: Thank you. The next question comes from Kenric Tyghe of ATB Capital Markets. Please go ahead.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Thank you and good evening. Congrats on the quarter. If I could, first question just in terms of New Jersey, could you help us – could you help level set the New Jersey wholesale market dynamics? Just trying to understand how you've managed to differentiate your offering to the extent you have, but also sort of the demand pull you're seeing in that market would be interesting to better understand?

A

Yeah. Frank?

A

Sure. New Jersey is an interesting market due to you have some – you have a few growers and producers that are really – that are at scale and ready to go. There was a lot of products that were sitting in vaults waiting for adult use to start. And I think what you see because of that is some things like vapes, for instance, are more commoditized than I've ever seen in the start of an adult use market and full capabilities and products like edibles are more starved. So for us, it was about getting that full suite of products, including all of our flowers, use brand partners and edibles as quickly as we could to take advantage of the market, and we were able to get that up and running within months after the launch.

So it's an interesting dynamic when due to typical adult use markets, you see just, you know, product tough to get high prices here with flowers still at a premium. Other products were commoditized and we were able to enter the state pretty quickly with all of our product launch.

Q

I don't understand that.

A

Yeah. Sorry go ahead.

Q

Yeah. One thing I'd say to as well is that we've seen tremendous success with some of the brand partners that we brought in to this day. I think there is between aero pro and the mispriced that we want. Recently, our own reformulated ozone got edibles. We've seen the customer demand for newness. And I think new brands in the state, there's, you know, a lot of MSO and MSO brand offerings. I think there is there has been very good acceptance to some of the brand partners that we brought in the state, and that stuff has literally flown off the shelves for us. So we're excited about those initial successes and some of the new product launches that we've had recently.

A

Yeah, I would also say, look, when you look at New Jersey, we're really early days. Remember, the regulators would only allow you to open when you know when they know that you were able to fill your shelves because they do have shortages. And we saw Airo got delayed because of the [indiscernible] 00:31:35. That's going to change going into next year where a number of stores start to come online that don't have problems. And that's where you're going to see a real opportunity for everyone to grow wholesale. Right now it's really people trading with each other to provide more selection for their customers. But you're going to see a real fight from the independents to try to get product on their shelves. You know, clearly clearly Verano and TerrAscend probably the strongest position with the largest growers. But we've expanded our grow quite well. And as Dan and Frank said, we have a whole suite of products offering at the start of wholesale. So we're excited about that opportunity for us and for the industry in 2023.

A

Clear. Thank you. And then just closing out on New Jersey. When you think about the three star footprint, Fort Lee coming online, could you give us some sort of indication of how you would rank all of those stores by way of contribution or importance on a full quarter contribution basis, whether it's, looking at the first full quarter or the last full quarter of 2023, not to show how you want to frame it. But just want to help us understand the rank order of their relative importance and contribution would be great. Thank you.

A

Dan, do you want to give the numbers as we see them?

A

Yeah, look, I'd say it hard to be Rochelle Park. We've talked about some of the numbers coming out of that store. Last quarter we highlighted it's our most productive box in the network. And then Montclair is a good store, but it's on Main Street. There was limited parking and the box is relatively small. It's only about 1,500 square feet.

So that kind of limits the upside with the amount of POSs we have in there and a lack of parking, capping some of that upside. So I'd put, right now, Fort Lee is somewhere in the middle of those two stores in terms of order of importance. For those of you have had a chance to drive it, it is literally a stone throw away from the GW Bridge. The closest dispensary to New York. So we're pretty excited about the store and the opportunity and think it will do well. But at the same time, we already have a store in Rochelle Park doing incredibly well and probably one of the more productive dispensaries in in the US. And so, I think slotting Fort Lee somewhere in the middle to start is probably the right place to be.

A

I think what's important about Rochelle Park and Fort Lee will be the same way is that the customers of New Jersey know they can park their car, get into a stand and get their product and back in the store in about 10 to 12 minutes. We're one of the very few people who can do that. We've had a history of success doing that way back in Illinois. I think that's what's driven Rochelle Park to be the $55 million/$60 million kind of store that it is. And I think that will work in our favor in Fort Lee. And I think Dan's reluctance to project is just as you said, Rochelle Park is just a huge number like, we don't sit here and project $55 million stores. I mean, we thank the Lord if we get them, but we don't expect.

Operator: Thank you. The next question comes from Matt McGinley of Needham & Company. Please go ahead.

Q

Thank you. So the increase in the wholesale revenue is impressive given the magnitude of the sequential increase in the fact that was across three states. Were those gains weighted in New Jersey versus Illinois and Massachusetts and is the growth in Illinois and Massachusetts driven by distribution gains or that more demand coming from existing dispensaries in those markets?

A

Dan, do you want to take that?

A

Yeah. So, obviously, New Jersey was a decent driver in the quarter on a net basis. We didn't have much third party revenue in Q2 and had a more substantial wholesale business in Q3 this quarter. But the gains were – we had gains across the portfolio. Illinois was up decently and that's obviously a bigger business on a relative basis and Massachusetts, while we're starting off a small base, I would say that that was the highest growth on an absolute basis. Actually, New Jersey would be the highest growth on a quarter on quarter basis, followed by Massachusetts, followed by Illinois. But we have a much smaller base on the wholesale business in Illinois. So rank ordering them on an absolute basis that would have been New Jersey, followed by Illinois, followed by Massachusetts.

A

Yeah. Look, we were late to the game in Massachusetts. We have a reasonable sized grow and we have some very good biomass in a really competitive market. We kind of determined by the summer that it was a race to the bottom and a knife fight and we were going to win the race. We are employing a significant discount model with a really high-quality biomass to go after share aggressively. You know, that's our plan for math and so far starting one.

Q

And essentially think about your ability to drive gross margins higher from here. I would think that the gains in New Jersey would be fairly substantial over the next few quarters in terms of the benefit that you would get from a promo sales. But as you saw in the third quarter here, pricing was a powerful offset. What are the near-term drivers that might be able to push gross margins higher from here? Or should we assume that you're kind of in this in this range right now?

A

Yeah. I think the biggest driver, obviously, we have news stores coming in. You know, stores generally are lower gross margin than the gross margins you'd see on the wholesale side of the business. So that's a slight offset. But New Jersey, we are doubling our canopy at that site. So we're sitting here today at about 22,000 square feet of canopy will be planting over the course of the remainder of this year, an additional 20,000 square feet of canopy in New Jersey. So we obviously have a good retail business. We're turning on Fort Lee as that product starts to come down in Q1 and we increase our vertical visitation in the state that will be accretive to gross margins. You know, I think on the pricing side of things that will continue to be an offset. You know, our hope would be that we could drive it a drive our gross margins a little bit higher with the assumption that we'll continue to see some pressure on the wholesale side of things from a pricing perspective into 2023.

Operator: Thank you. The next question comes from Ty Collin, Eight Capital. Please go ahead.

Ty Collin
Analyst, Eight Capital

Q

Hi. Thanks for taking my questions. Abner, I wanted to follow-up on your comment at the top of the call on Michigan and Massachusetts being a little more competitive than you actually would have assumed. Is there any chance that we see Ascend to start any [indiscernible] size those markets or maybe even exit them altogether to free up capital to investments [indiscernible] better markets like Maryland, like you mentioned, assuming we kind of see them normalize in the coming quarters?

A

Look, we said before, we're here to make money for our investors and our stakeholders and to optimize the portfolio as best we can. If that makes sense, to exit the state and we can get an attractive valuation for it or – not attract just a fair valuation for it and can redeploy that into other states we're absolutely open to that and we've had one or two conversations. That probably makes more sense potentially in Michigan than in Mass, because in Mass unless they change the cap, unless it's a new entrant to the market, we get another shot [indiscernible] coming to the market like there aren't a ton of buyers who are in the cap. But certainly I think I would expect at some point, either with us or others you should start seeing some either sales or swaps or other things or other transactions like that between MSOs because it's just so critical to get the scale. And we know in all our states we have to get to scale or we have to do something. It's a matter of finding the right time and the right price.

Q

Okay. Appreciate the color there. And then, this is a question that's been asked on a few other earnings calls this quarter, but I wanted to get your take on it. I'm curious to hear your thoughts on the structure announced by Canopy Growth to kind of ring-fence their US assets while trying to maintain their exchange listings. Assuming that does end up getting approved by Nasdaq. Is that a route that Ascend would better pursuing maybe as a way to try to get some more liquidity in the stock?

A

Yeah. So we're – look, obviously we see what you say. If it's true, it will potentially allow other buyers to come to the market and potentially will allow certain kinds of holding company structures to be potentially listed. That would be good. We're going to let Canopy lead the road [indiscernible] (00:42:14) they're talking to these guys every day where we're kind of rooting them on from behind and looking for opportunities. But we see, as we see new entrants into the market, we see Ascend as one of the kind of perfect assets for someone trying to build an MSO because of our state portfolio and cash flow composition, et cetera. So we're really supportive of these kinds of structures, even if it's someone else starting a holding company or something like that, because we think we're going to be the absolute best asset that someone's going to go after. So we see it working in our advantage, even if we don't end up pursuing the listing ourselves.

Operator: Thank you. The next question comes from Andrew Semple of Echelon. Please go ahead.

Andrew Semple
Analyst, Echelon Wealth Partners, Inc.

Q

Hi, there. Good evening and congrats on the strong quarter.

I just want to return to Illinois. Great to see Ascend reclaiming some of its market share on the wholesale within the quarter. I just want to ask if you changed anything operationally or with the products mix that would have helped you within the third quarter? Were there any one-time items within the third quarter of Illinois and the expectation you can maintain your [indiscernible] 00:43:39 in Illinois wholesale going forward?

A

Yeah. Frank, do you want to talk about that?

A

Sure. I think we've launched Simply Herb previous in the year and that's our value brand. And I think you're seeing consumers definitely gravitate towards those value brands with larger formats. It's been a big success in all of the markets we're launching it in. I think that is responsible for or partly responsible for, for some of that success in Illinois. As well as just getting a little better at growing, we still have a long way to go, but I think we're we're you know, we are more productive in our canopy year-over-year. And that has also helped push out more volume to offset the pricing.

Q

Got it. Thank you. Second, I just hoping you could speak a little bit more about the [indiscernible] 00:44:39 model retail store? Is the idea to sell a set of the product in the store or at price points within those outlet stores? And if that's the case, I presume you would be stocking those stores more of your own products to offset some of that pricing that [indiscernible] 00:44:59. Could you maybe [Technical Difficulty] 00:45:04

A

Yeah. You're fading out. But I think the question was around the outlet model. Let me just say that, we think that Let me just say that we think this is – we're just trying it out in Pennsylvania, we're looking at doing it in Mass. We think it's the right strategy, particularly in a late stage medical market. When we come into Scranton there's not a lot of growth in medical patients, we need to convince the patients to switch from one dispensary to another. We think we can do that with an everyday low price with the model in the industry has been very kind of old school retail, 30% off here, two for one Fridays, three for one Sunday's blah, blah, blah. We're going to an everyday low price menu, we've got $25 and $20 [indiscernible] on sale in Scranton. We've got people driving an hour and a half. We're taking major, major share away from the other stores in that market. I'm sure we're not making any friends. But we feel Sam Walton did pretty well with this model. We think that there are times when it's going to make a lot of sense in this industry and it really creates a bang for the customer. We were able to get to a 100,000 in sales in Scranton after only a couple of weeks, which was our six-month goal. But yeah, no question, we're willing to eat a little bit of the margin, no doubt about it. And in the case of – we would like to do it on a vertical basis on a place like Mass, in Pennsylvania we don't really have our [indiscernible] (00:46:48) but Pennsylvania is a market with a lot of overcapacity, Massachusetts, too, and we're able to work deal with certain operators who want to be in the store and want shelf space just like a TJ Maxx or anybody else does in any other. As you get to overcapacity in these states, off price retailing is a way to move that to – that discount to the customer and to take share. And so it's early days with the outlet model but we think it has some legs.

Operator: Thank you. There are no further questions at this time. Ladies and gentlemen, this concludes your conference call for today. We thank you for your participation and ask that you please disconnect your lines.