GLASS HOUSE BRANDS

TRADITION INVESTMENT MANAGEMENT

Glass House Brands Offers Opportunity at Scale

Price $8.73 **Growth Holding** **October 21, 2024**

- Largest producer of Cannabis in California, with approximately 1.5 million square feet of space for Cannabis and Hemp, producing over 500k lbs per year.
- Owns 5.5 million square feet of cultivation facilities, ready to hyper-sale once federal legalization or rescheduling occurs.
- Moving Cannabis across state lines could soon be legal with the DEA announcing its intention to potentially reschedule Cannabis from I to III, with an expected date in 2025.
- Some of the lowest production costs in the US, with ~$130/lb in cost expected for the full year 2024 with 50% gross margin.
- Improving competitive conditions in California as less efficient competitors withdraw from the market; both wholesale and retail markets are shrinking.

Investment Thesis

Glass House Brands (GLASF) operates 10 wholly owned retail locations, 1 manufacturing facility, and more than 5.5 million square feet of cultivation facilities. Currently GLASF is one of the largest Cannabis producers in the US and is the leading provider of Cannabis wholesale to the California market.

There are several key developments ongoing in the Cannabis market, including the DEA announcing it may reschedule Cannabis to III from I and potential legislation regarding banking. With superior economics including a sub $150/lb production cost with 50% gross margin, favorable growth season length in California, and the ability to rapidly scale we feel that GLASF is a good play for regulatory arbitrage.

Estimated Fair Value

EFV (Estimated Fair Value) = EFY26 EPS (Earnings Per Share) times P/E (Price/EPS)

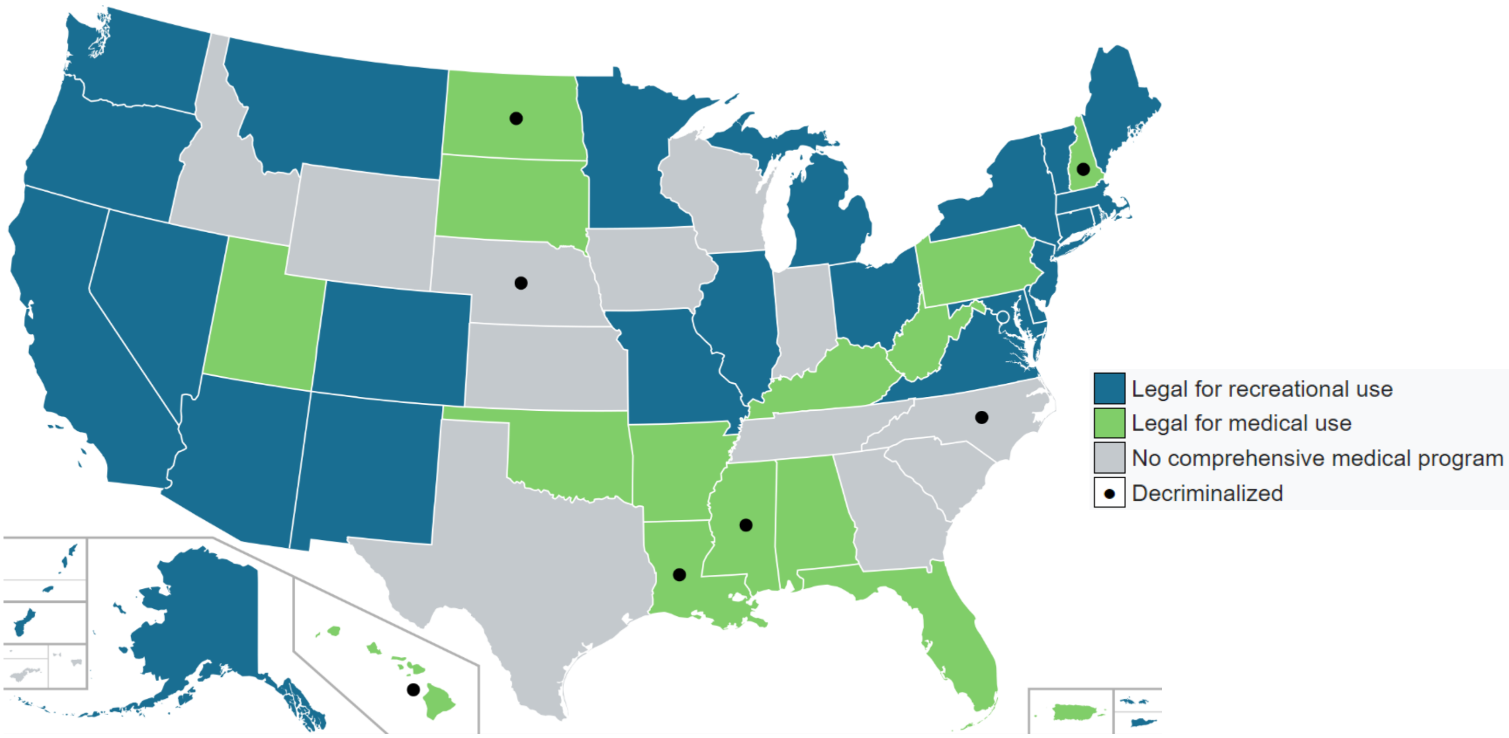
EFV = E26 EPS X P/E = $0.35 x 42.0x = $14.70

We feel that the current analyst consensus is a worst-case, and that once interstate commerce is permitted, or legalization occurs at a federal level, GLASF will quickly be propelled into the largest wholesale producer of Cannabis in the US.

	E2024	E2025	E2026
Price-to-Sales	3.1	2.6	2.2
Price-to-Earnings	Neg	Neg	42.0

Regulatory Conditions

More than 75% of Americans now live in a state that has recreational Cannabis. There are currently 14 states that allow only medical use, with 24 states plus DC allowing recreational use. The 2024 Election has 3 ballot measures in place, with Florida, North Dakota, and South Dakota having recreational use as a ballot measure. Politically, the legalization of Cannabis is popular, polling at 70%. Kamala Harris says she would sponsor the passage of the legalization of Cannabis at a federal level, with Donald Trump stating he supports it continuing to be a states-rights issue but decriminalizing on a federal level.



On the federal level, there are several potential shake ups for the industry. One of the most talked about is the moving of Cannabis from Schedule I, where it currently shares a spot on the DEA's "severity" list with the likes of Fentanyl and Cocaine, to Schedule III, the same level as pharmaceutical grade cough syrup. This reclassification is a huge boon, anything Schedule III and below can theoretically be moved across state lines with a nod from the FDA. We feel that the likelihood of the FDA approving Cannabis for interstate transportation is good. The FDA has already approved of the movement of CBD products, some drugs utilizing Cannabis products as a base, and has largely had a hands-off approach to synthetic-THCs.

Upon rescheduling, which is expected to occur sometime in 2025, it will also create substantial tax benefits for GLASF. Currently, Section 280E of the IRS code prohibits businesses engaging with Schedule I or II drugs from getting any federal deductions or credits. Currently, GLASF puts the sum of unrecognized tax benefits at $6.6 million as of the quarter ending June 2024.

The largest follow-on effect could be the passage of the SAFE (Secure and Fair Enforcement Banking Act) which would improve GLASF's ability to access credit and the traditional banking systems. The bill has existed in one form or another since 2019, though with little support up until now. With Cannabis still federally illegal, financial institutions that are federally chartered cannot accept money from Cannabis sales and will therefore not extend credit. The SAFE act would open a safe-harbor provision, protecting federally chartered banks from regulatory action or liability for taking on customers engaging in Cannabis-related activities. We feel that the likelihood of this passing will increase with the rescheduling.

Growing and Wholesale

Across California GLASF owns more than 5.5 million square feet of greenhouse space. Typically, GLASF only utilizes around 1.0 million square feet of greenhouse space, leasing the rest. The large amount of greenhouse space is a long-term play on the easing of federal regulation. We expect utilized space to increase over the next year, as GLASF has announced its intention to begin wholesale operations of federally legal Hemp across state lines. For the quarter ending June 2024, greenhouse utilization jumped by 59% to 1.5 million square feet.

This number will likely climb to the full 5.5 million over time, provided interstate commerce is eased. However, the startup and conversion costs to bring this space into full production would likely require a substantial, but temporary, ramp of Capex. Currently, $17.3 million per year is spent on capex, or around 10% of revenues.

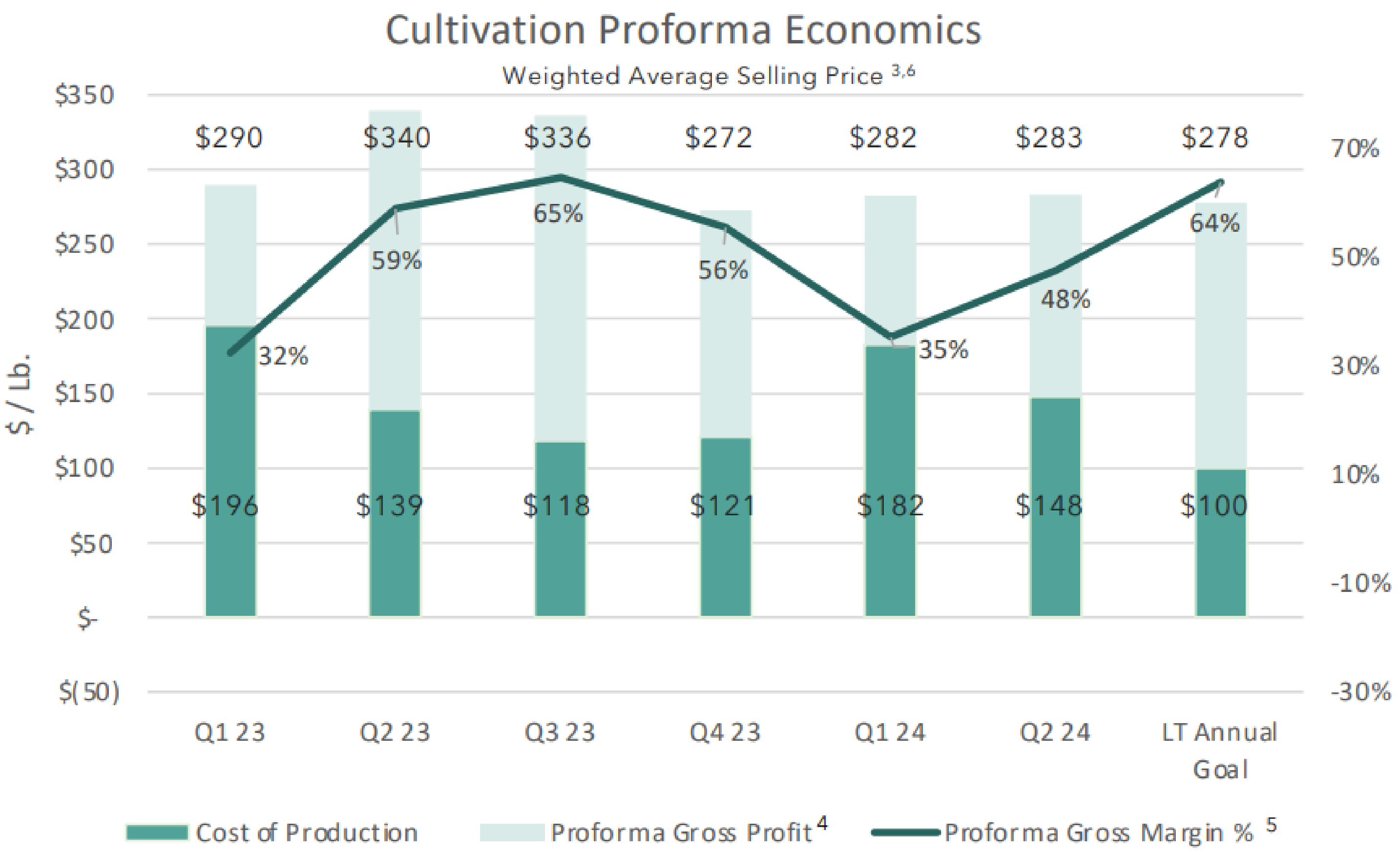
Competitive conditions in California are improving for GLASF, estimating that 2.4 million square feet of cultivation space exited the market for the first 6 months of 2024 due to the soft consumer market. The total number of grower licenses over the trailing two years has declined by 48%.

GLASF has an average production cost of $148/lb for the quarter ending June 2024 and expects a long-term production cost target of $100/lb. If cross-state commerce is legalized, it would be an incredible windfall for GLASF. In our view, GLASF likely has one of the lowest-operating costs in the country. GLASF estimates that the whole US has an average of $800/lb in production costs.

Type of Operation	Wholesale Price for Flower (Average/lb)	40% Gross Margin Production Cost ($/lb)	60% Gross Margin Production Cost ($/lb)
Outdoor	$520	$312	$208
Greenhouse	$921	$553	$368
Indoor	$1694	$1016	$678

Wholesale Data from Cannabis Benchmarks. Data is the average price for wholesale flower for the 1st half of 2024, average for the entire US. Production costs are author's estimate based on publicly listed Cannabis stocks and CohnReznick.

The edge for costs that GLASF enjoys is the use of large-scale greenhouse operations in California, which means the energy usage per harvest is low given the sunny and dry climate. Estimates put the cost of energy as 20-50% of the total cost of Cannabis growth, with GLASF reporting 95% less energy use than the average grower. Another benefit of the favorable climate of California, it is likely that GLASF sits on the upper end of the estimated 4-6 Cannabis harvests per year. Given GLASF's economies of scale and focus on yield-enhancing investments, it also likely sits on the upper end of the yield per square foot, estimated to be 20-80g/sqft across the US.



For the quarter ending June 2024, a record 72% of total revenue was wholesale, with sales going up 28% year over year. Guidance for the full year is between 575-585klbs of production, which represents a 63% year over year increase from 2023, with a cost per lb falling to $130/lb for the full year. Though, it does expect some decline in realized price due to muted consumer demand in California.

Retail and Packaged Goods

The retail and CPG (consumer packaged goods) markets have seen some weakness, with recreational Cannabis being largely a discretionary consumer good. The broader market in California saw a year-over-year decline of 8% for retail sales, with prices to consumers decreasing by 9% year over year for the quarter ending June 2024 which was just enough to have volume increase by 1% year over year.

GLASF saw an overall increase of 10% year over year in revenue for the quarter ending June 2024 with 6% same-store growth. Aggressive pricing actions meant that GLASF saw a 20% year over year volume growth on a same store basis. GLASF attributes its continued growth even as the market declines to both price leadership and good terms with suppliers.

Cannabis is a discretionary spend for consumers, and the market is still new enough that we feel brand-loyalty and differentiation has not yet been established at a large scale. However, GLASF's Allswell brand has grown to be one of the top 3 in the state (though, this only equates to around 3.6% market share). The effect is that price is a large determining factor in what consumers buy, rather than the brand of the product. We feel that the relatively low production cost that GLASF enjoys certainly contributes to its price leadership, and will be a strong base even during down consumer markets.

According to GLASF, retailers are distressed, with 15.4% of California's retail licensees in tax-default. Given the high level of default, many retailers are forced to operate on cash-only terms with suppliers which limits inventory availability and further exacerbates distress. In short, this means that the retail environment has swung in favor of large retailers, like GLASF, who producers see as more reliable partners. GLASF expects the retail situation to continue to deteriorate for the rest of the year.

Risk

Competitively, we feel that if Cannabis is allowed to cross state lines, GLASF will still have an advantage. Climate wise, Florida would be the most competitive. However, Florida's current implementation of Cannabis legislation requires vertical integration which has been upheld by the Florida Supreme Court. Regulatorily Oregon could pose the largest threat in the area. Despite its lax laws for licensing, there is currently a moratorium on new licensure which has existed since 2022. Under the current moratorium, they will only begin re-issuing licenses once the ratio of wholesalers to smoking aged residents is 12,500 to 1, and for retailers to smoking aged residents 7,500 to 1.

Conclusion

Overall, we feel that GLASF is a bet on the continued liberalization of Cannabis policy in the US. Once it is rescheduled to III from I, we feel that it is likely the FDA will give the go ahead for interstate movement given it has previously taken a hands-off approach to Cannabis products like CBD and synthetics like Delta-8.

Once policy is liberalized, GLASF can easily scale its operations to its full 5.5 million square feet of owned space while also getting potential windfalls from better banking regulation and more favorable tax rules.

Disclaimer and Related Information

This article or video features Benjamin C. Halliburton, CFA or an investment idea(s) that Mr. Halliburton or Tradition Investment Management, LLC (Tradition) may invest in. Mr. Halliburton is the founder and owner of Tradition Investment Management, LLC, a registered investment adviser. Tradition is doing business as (DBA) Building Benjamins in the publishing, email, and website space. All material on the website should be considered paid advertising by Tradition. This article is a financial publication and is provided for educational purposes only. It is not an investment recommendation nor investment advice. It does not take into account your personal circumstances and whether this investment is appropriate for you, your objectives, or your risk tolerance. Under no circumstance is Building Benjamins or Tradition Investment Management LLC responsible for any actions that you may take after reading this educational information. Nothing from Building Benjamins should be considered personal investment advice. Building Benjamins and Tradition Investment Management LLC, the website, emails, interviews, social media pages, and other materials are published by Building Benjamins and do not necessarily match the opinions of the individuals or companies published or quoted herein. Investing, particularly stock or ETF investing, is risky and may result in losses and sometimes loss of your entire investment. Stock investing has company-specific operational risks like demand, competition, legal and regulatory, and broader financial market risks like liquidity, Economic cycle, and government policy. You may lose money in any stock investment or other investments and are solely responsible for those decisions.

Mr. Halliburton, Tradition Investment Management LLC, and/or the authors on this site may or may not have positions in the securities discussed in this educational report. Neither the author(s) nor Tradition Investment Management, LLC will knowingly trade ahead of any customer buy or sell resulting from this information. The information herein is shared as an educational endeavor. Mr. Halliburton, Tradition Investment Management LLC, and/or the authors on this site may transact in the security discussed at a later date, prior to, or without notification in this format. This is not investment advice but only a discussion of select investments for educational purposes. Building Benjamins is an investment website, blog, or newsletter, and the information contained cannot be reproduced, copied, or redistributed without the prior written authorization of Building Benjamins or Tradition Investment Management LLC. US copyright laws apply. We rely on information from sources we believe reliable, including the companies themselves, but cannot guarantee the accuracy of the information we provide. You rely on this information at your own risk and are responsible for the verification of the data.