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Ascend Wellness Holdings, Inc.

(AAWH.USD.CA)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good evening, and thank you for standing by. Welcome to the AWH's Fourth Quarter and Full Year 2021 Investor Call.

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

Rebecca Koar

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

Thank you. Good evening, and welcome to AWH's fourth quarter and full year 2021 investor call. The presentation that accompanies this call can be found on our website, www.awholdings.com/investors. I'd encourage you to go to the website and download the slides if you're having any trouble.

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 our filings, including our registration statement on Form S-1 and our 10-K, which we expect to file within the next week. 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 prospects constitute forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ from historical or anticipated results. Any forward-looking statements 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. 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 CFO.

With that, let's turn the call over to Abner

Abner B. Kurtin

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

Thanks, Rebecca. Good evening, everyone, and welcome to our Q4 and full year 2021 earnings call. I appreciate the continued support from all of our stakeholders as we fulfill our mission of bettering one's life with cannabis. Some of you have been with us from the beginning when we acquired our first cultivation license and facility in Barrie, Illinois. We've come a long way in just over three years and 2021 was an exceptional year, where we more than doubled revenue and delivered strong EBITDA margins. I am proud of the team for everything we accomplished in 2021. It was a sensational year for Ascend, marked by several significant milestones.

Earlier in the year, we completed our initial public offering, making AWH the first US MSO to go public by filing an S-1 with the SEC rather than buy a stack or RTO. We commenced trading on the CSE and OTC on May 4. During the year, we released all lockup restrictions on the stock. 100% of the stock is now freely trading. We added 100,000 feet of canopy across our portfolio, more than doubling our cultivation capacity.

We opened six new stores and completed the acquisitions of two new additional dispensers, bringing our total store count to 20. We entered the promising Ohio market through three separate acquisitions this year. We launched a delivery program in Massachusetts and Michigan and are excited to eventually bring delivery to all of our states in the future.

We strengthened our balance sheet, raising $210 million of senior debt financing and ended the year with over $155 million of the cash and equivalents with no maturities in the near term. This represents one of the strongest balance sheets in the industry. 2021 was a year marked by tremendous growth and geographical expansion. As we enter 2022, we will continue growing our footprint and scaling our asset base. But we will also focus on continued margin expansion through economies of scale and operational improvements.

Before I discuss the company's performance for 2021, I want to highlight the impressive growth and traction that the cannabis industry has generated. Today, over 70% of the states have adult use or medical programs. In 2021, the US cannabis industry grew by over 30%, putting the sector on track to reach over $46 billion in legal sales in 2025. We also want to comment on the current state of cannabis public markets. Industry participants appear to be caught off guard by the current price competition in the market. This competition is entirely expected, albeit a little sooner than anticipated, as the industry becomes more mature.

In addition, growth has been stalled in some key states. For instance, in Illinois, growth has been delayed as the state awaits the second tranche of 185 licenses to hit the market. We always knew that because of our reliance on regulatory approvals, growth in the industry would be uneven and choppy. That doesn't reflect the considerable long-term growth opportunities for Ascend and other US MSOs. Notwithstanding the growth opportunity, the industry trades at a massive discount to any comparable industry.

The sector has declined about 60% since a year ago today and now trades at about 9 times analysts estimates for 2022 adjusted EBITDA and about 6 times analysts estimates for 2023 adjusted EBITDA despite EBITDA growth of over 150% in 2021. This is cheap on an absolute and relative basis and, in our opinion, provides an opportunity for investors entering the space. Further to that, AWH trades at a 35% discount to peers based on 23 multiples of analyst estimates. We are hopeful that some of that value will be realized in the medium term.

A large reason for the industry discount is because only a small percentage of institutional investors can participate in the industry. This will change as we continue to grow and legalize state by state. According to Leafly, almost half a million people now work in the cannabis industry. Cannabis workers outnumber insurance salespeople. There are more people employed in the cannabis industry than there are hairstylists, barbers and cosmetologists combined. This industry isn't going anywhere, and it's only a matter of time before more institutional investors enter the space.

I also want to address one valuation hurdle that we face in the recent past, our liquidity. I am happy to report that we recently pre-released the remaining stock from lockup restrictions imposed at the IPO. 100% of our pre-IPOs are now free from these restrictions and have been added to our flow. We are hopeful that without this hanging over our heads, we will begin to see liquidity improve. In 2021, Ascend's growth far surpassed the industry's growth, solidifying our position as a formidable player.

Net revenue was $332 million for the full year. This represents 131% growth over 2020. Retail growth was driven by increased traffic at existing stores and the opening of six stores in the year. Adjusted EBITDA for the year was $79 million. We are pleased to be among the more profitable MSOs, achieving full year adjusted EBITDA margins of 24% even before a number of our assets come online.

Let's turn to Slide 5 to review our key priorities. In 2022, we will continue to scale our asset base of premier retail locations and state-of-the-art cultivation facilities while increasing our focus on optimizing our existing assets. In Q4, we began to see high single-digit year-over-year wholesale price declines across the United States and have seen this trend persist into Q1. With more competitive pricing and slower than expected growth, we will need to focus on margin and cost reductions. Improving operations will be a crucial lever that will allow us to expand margins despite competitive conditions.

We continue to execute on the ongoing cultivation expansion in New Jersey to scale our operations in these primary markets. Building out these facilities' manufacturing capabilities is also a key priority as it will help us broaden our offering with a full suite of form factors. Branding will come into focus this year as markets get more competitive. We remain committed to providing a good, better, best brand portfolio to provide options to all customer segments.

I often say that this industry represents stairstep growth as new assets coming online and new markets open. Due to competitive market conditions and a lack of new assets coming online in the first half of this year, we do not anticipate any revenue growth or margin expansion. Rather, the next stairstep in our business will be in the second half of the year when we will benefit from harvesting our new expanded canopy and the start of adult use sales in New Jersey. Solidifying our position as a top player in this emerging market is critical and will be among our top priorities for the year.

To offset the delays in New Jersey and competitive market conditions, we are implementing a robust cost-cutting program. Although we have a strong cash position, I have also elected to take all of my 2022 comp as stock to preserve cash in this dynamic environment. Dan will provide more detail on the cost-cutting program. While a key area of focus will be the start of New Jersey recreational sales, we will also look to expansions in our existing markets. We have the ability to acquire three more dispensaries in Ohio and two more dispensaries in Illinois before reaching state caps.

Let's review slide 6 to review our current footprint. We believe the markets in which we operate are better positioned to succeed in an increasingly competitive industry. Our thesis remains to deploy capital in highly populous states that are already or expected to be adult use with license cap restrictions imposed by state regulators. We are very happy with our current footprint and still see opportunities to grow into strong, contiguous limited license markets. While it's difficult to do acquisitions given public MSO multiples, we are still actively pursuing strategic acquisitions.

Before moving on, I want to address our pending New York transaction and ongoing litigation related to the license we are under contract to purchase from MedMen New York. As you likely know, we are in litigation with MedMen regarding what we contend was their invalid termination of our investment agreement. The case is plain and simple. The lawsuit is just a desperate attempt to throw everything but the kitchen sink at us to make a quick buck. It's a case of seller's remorse. You can't back out of a home sale once you realize you could have gotten a better deal. This is no different.

In January, after we filed our lawsuit against MedMen, the parties agreed to maintain the status quo until the trial. Today, MedMen dropped at least two false and disparaging allegations regarding a meeting and a fundraiser with representatives of the governor's office and Ascend that MedMen included without any basis in their original counter claims. This is just further proof that MedMen will say anything, including make false accusations, to try to get more money from us.

At the beginning of the action, together with MedMen, we agreed to an accelerated trial schedule. Just yesterday, we filed a cease and desist letter to stop MedMen from marketing the asset, which is a brazen attempt to violate the status quo. We are very confident in our position, and we have no doubt that the lawsuit will end in our favor with MedMen obligated to proceed with the transaction and pay our legal fees. Once the dispute is resolved, we intend to proceed with our canopy expansion plans and ready the assets for the start of adult use sales in New York. It is time for MedMen to honor its obligations under the agreement so we can proceed building the business for the benefit of medical patients in New York that MedMen has failed to do while owning the license.

Now let's move on to Slide 7 to discuss updates relating to the New Jersey market. 2022 will be the year of long-awaited adult use market in New Jersey. New Jersey has over 9 million people and a projected market size to be close to 2 billion by 2025. The Cannabis Regulatory Commission is expected to meet March 24 where we hope that they will approve some alternative treatment centers to begin to sell adult use cannabis after a 30-day waiting period. Ascend is among five ATCs in New Jersey which have completed their applications and are in the substantive review process with the state.

Although we are readying the assets to prepare for adult use 30 days from March 24, we are not budgeting for the benefit of New Jersey adult use until the summer where adult use seems more likely. This timeline is not materially different from our view of the start of New Jersey sales as we discussed on our last earnings call. Our Rochelle Park store, just minutes from Garden State Plaza, the second largest mall in New Jersey and the third largest in the Greater New York City area, is open and operating with 20 points of sale. We've also received approval from the town of Rochelle Park for adult use.

We are waiting to break ground on the expansion of our Montclair store and for the municipality to formalize its resolution to support the adult use market. Our Montclair expansion will more than double our square footage and points of sale in the store. Our Fort Lee store has the potential to be one of the top stores in the country. It is on a central artery just 5 minutes from the George Washington Bridge. The store is still under construction and is expected to be complete by early summer. 2022 will be an exciting year for the patients and customers in New Jersey, with the opening of adult use. We are excited to be an important player in the market.

Now, I would like to turn the call over to Frank Perullo. Frank and I founded the company together in 2018. Frank played a pivotal role in the success of Ascend. Over the past three years, Frank has served as Chief Strategy Officer, securing several critical acquisitions and partnerships, as well as overseeing construction and regulatory aspects of the company. We wouldn't be where we are today without Frank's pivotal role in helping to build the company. Going forward, Frank will be responsible for AWH's day-to-day operations with retail, sales and marketing and operating teams. He will be responsible for the growth and margin expansion goals, while I will continue to focus on capital allocation and strategic alternatives. I can see no better steward of the company than Frank as we move forward into the next phase.

With that, I'll turn it over to Frank.

Frank Perullo

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

Thanks for that, Abner. It's a pleasure to be here today. I am excited to update the investment community on the status of Ascend's operations and plans for my new role as President. As President, I will now be responsible for managing the health of our revenue generation in the business operations. I have already begun to refine our existing practices and procedures and implement a much more rigorous approach to managing and overseeing the business. We have set clear internal goals for each organization and will measure and hold people accountable to these goals on a more frequent cadence. As a result, we expect to see improved cost structure, enhanced product quality and improved sales.

As Abner mentioned, we have been acutely focused on scaling our business and expanding into new geographies over the past several years. More recently, the markets have become more competitive as supply catches up to demand, increased competition and production challenges put pressure on our Illinois wholesale business, and we have struggled to scale sales in our Massachusetts wholesale business in a competitive market. We are confident that our new management approach combined with our greater emphasis on cultivation and retail operations, our recently top rated wholesale talent and our enhanced focus on brand and product positioning will help offset these headwinds in these more competitive market dynamics.

With that, let's move to slide 9 to discuss the canopy we have coming online. We ended the year vertically operating in each of our five states, with 176,000 square feet of canopy, 100,000 of which were built in 2021 alone. In December, we received approval to plant in our newly completed greenhouse in Illinois, which houses 58,000 square feet of canopy. We kicked off 2022 with plants in the ground. We plan to harvest the first crops planted on the greenhouse in Q2. To date, all of our canopy in Illinois has been double stacked indoor and this is our first foray into greenhouses. The picture in the top left quadrant depicts the plants in the vegetative phase in the greenhouse. We are in the process of adding HVAC systems to the greenhouse to enhance climate control.

In Massachusetts, we ended the year with 17,000 square feet of canopy. The quality of our Massachusetts flower has been significantly improving over the past several months since our rough start last year. We now have higher testing flower, higher percentages of AB flower and better terpene profiles. Earlier this month, we completed and received approval to plant an incremental 37,000 square feet of canopy. Just last week, we began to plant in the new space. You can see one of the new flower rooms in the bottom left quadrant.

We completed our canopy build in Michigan earlier in 2021 and that continued to refine our cultivation procedures. As a result, we saw significant improvement in quality and yield in the back half of 2021. Here, you will see flower from our most recent harvest, Harvest 19. In New Jersey, we have 16,000 square feet of operational canopy and are acutely focused on completing the next phase of the canopy built, which we anticipate will be done by the end of Q2. Once complete, Phase 2 will have 42,000 square feet of canopy in New Jersey for preparation in the launch of adult-use sales.

Let's move to slide 10 for our retail update. The retail business performed well throughout the year. The year-over-year average weekly traffic was up across the board, and we saw Web traffic on our letsascend.com retail page increased over 100% year-over-year, which drove more traffic to our stores. We continue to target having 50% of retail sales come from our in-house or partner products. In Q4, 33% of sales came from products we manufactured. We see this number expanding as we add lab and kitchens and build out all of our capabilities and product offerings.

Despite pressure in Illinois, we have gained market share within the state. This trend has continued into early 2022. In January, for example, Illinois State sales as a whole were down 15% month-over-month. However, Ascend sales were only down 10%, implying a gain in market share. Our southern Illinois stores continue to be blockbusters. After extensive R&D, we have launched concentrates in the Illinois market to serve the consumers who want high potency, broad spectrum products. We also introduced live resin-infused pre-rolls and continued to expand and elevate our product offerings across the portfolio.

In Massachusetts, our Friend Street Downtown Boston store continues to improve, and we recently added delivery. We plan to open the second floor of this store in the coming weeks. The second floor will provide an enviable Instagrammable experience, offering an elevated service level. In November, we launched a delivery program in Newton, Massachusetts. The program has been gaining traction and contributes over 20% of our sales out of our Newton store.

Abner discussed New Jersey earlier, and we are anxiously awaiting the start of adult use. The potential for our assets is tremendous. Notwithstanding adult use, our two open stores are continuing to do well in the medical market. In Q4, our Montclair store traffic was up 90% year-over-year and our statewide basket sizes are standout, averaging above $150. In Ohio, we are integrating the two assets we acquired in 2021 and have migrated the brand names over to the Ascend brand. Ohio continues to be an impressive medical market and we are hopeful to see positive movement towards adult use in 2022. Finally, in Michigan, we recently launched a delivery program out of our Ann Arbor and Grand Rapids dispensaries, where we are delivering within a 10 mile radius of the stores. We plan to launch delivery throughout the rest of the state over the quarter. We have also completed all branding over from Michigan Supply & Provisions to Ascend.

Let's move to slide 11 to discuss an exciting new brand we are launching to fill a gap in the market that we see. Simply Herb, we have always segmented the markets with a good, better, best CPG-like approach. Our Ozone brand plays in the better category, catering to the cannabis consumer looking for quality, trusted everyday brand. In our Ozone Reserve, brand plays in the best category, catering to that canna-connoisseur premium products, premium form factor. To date, the good category has been a gap in our offering, as we have lacked a product for the value-oriented consumer who wants a great product at a great price.

We have been getting increased demand from retailers and consumers for an affordable cannabis offering. This week, we launched a new brand, Simply Herb, to fill that void. Today, 25% of industry sales in the markets we operate are driven by the value category. There is a tremendous need for us to offer a great everyday value product. That is why we launched Simply Herb to target the value driven consumer. The Simply Herb brand is easygoing, simple, clean with no frills. It is meant to be read for everyone who knows that a good time doesn't have to come at a high price. Simply Herb isn't for the special occasion, it's for every occasion.

With that, let's move to slide 12 to review the pipeline of assets for 2022. We have a lot of assets coming online this year. We recently completed the second floor of our Downtown Boston dispensary and are awaiting approval to sell in that space. We plan to open four additional stores throughout the year. From a wholesale perspective, we do not anticipate any meaningful assets to come online and benefit revenue in the first half of 2022. By the end of the year, we plan to complete Phase 2 of our canopy expansions in New Jersey and complete a lab and kitchen. Adding these capabilities allows us to produce a full suite of form factors to have a robust product offerings.

With that, I'll turn it over to Dan to review the financials.

Daniel Joseph Neville

Chief Financial Officer, Ascend Wellness Holdings, Inc.

Thanks, Frank. Good evening, everyone. As Abner mentioned, we are pleased with the company's performance for the full year. However, in Q4, the wholesale business faced sequential headwinds, particularly in Illinois and Massachusetts, as we alluded would be the case during our last earnings call. Total system revenue was $102 million, representing a 2.9% sequential decline, but a 70% improvement year-over-year. Net revenue, which excludes the intercompany sales of wholesale products to our own dispensaries, decreased 6.2% quarter-over-quarter to $88.5 million. The sequential revenue decline was driven by lower realized wholesale pricing per unit in Illinois and lower wholesale volumes in Illinois and Massachusetts, partially offset by higher wholesale volumes in Michigan and New Jersey and increased retail sales. Despite the sequential decline, net revenue was up a healthy 63% year-over-year as we opened six new dispensaries, experienced increased traffic at existing dispensaries and sold an increased volume of products in the wholesale business.

Adjusted gross profit margin decreased 389 basis points quarter-over-quarter to 42.4%. These declines were driven by lower margins in our Massachusetts and Illinois wholesale facilities as we staffed up ahead of expansions and because of lower realized wholesale pricing, but was partially offset by higher retail gross margins. We incurred approximately $6.6 million of rent expense in Q4. The majority of which was related to sale leasebacks. Since we provide GAAP financials, not IFRS, these are accounted for above the line, and most of this is represented in COGS impacting gross margin.

Adjusted EBITDA for Q4 was $19.8 million, which represents a decrease of $3.8 million or 16% sequentially. Our adjusted EBITDA margin for Q4 was 22.3%, which represents a sequential decrease of 261 basis points. This sequential decline was exacerbated by the ramp in staff to support the scaling of this business. Despite the sequential margin decline, year-over-year adjusted EBITDA margin increased by 242 basis points as we levered G&A by over 170 basis points, which helped to reduce the negative gross margin impact. We ended the year with approximately 1,500 employees in total, with 11% supporting shared services.

Let's move on to slide 15 to discuss cost saving initiatives to offset the competitive market dynamics. Throughout 2022, we plan to remove over $10 million of spend from our business. These savings will span head count, HR, procurement, IT and professional services. Most of these savings initiatives will be relatively straightforward to execute. The most significant savings will be driven by corporate head count, restructuring and staffing optimization at the site level, where we're finding our organizational structure to operate more efficiently. We started [ph] the reorgan in Mass. (27:23), our original market where we had some duplicative infrastructure and have moved this over to our shared services model.

We also expect to see significant savings from moving to a centralized procurement function for both cannabis and non-cannabis inventory and supplies. We will leverage centralized purchasing and better plan buying decisions across packaging, operating supplies and other consumables used to operate our business. And finally, we'll reduce the scope of certain third-party vendors and professional services providers.

Let's move on to slide 16 to discuss the retail and wholesale businesses. Total retail revenue increased to approximately $64.9 million, representing an increase of 2.1% quarter-over-quarter. This was driven by increased traffic at existing stores and the impact of the Newton, Massachusetts and Carroll, Ohio stores. Notably, retail revenue was up 70% compared to Q4 of 2020. Annualized revenue per dispensary was $14.7 million, ticking down slightly as Newton opened in November and we added our Carroll, Ohio medical dispensary to the portfolio.

Gross wholesale revenue decreased 11%. Net wholesale revenue decreased 23% sequentially to $23.6 million, which represented 27% of our overall net revenue. Importantly, the decline in net wholesale revenue was exacerbated as intercompany sales grew 27% sequentially. Declines were also driven by reduced price per unit in Illinois and reduced volumes in Illinois and Massachusetts, partially offset by higher volumes sold in Michigan and New Jersey. Although the decline is disappointing, we will work to gain market share throughout [indiscernible] (29:26) 2022.

Let's move on to slide 17 to discuss the strength of our balance sheet. We ended the quarter with $155 million of cash and equivalents, $259 million in total debt, and net debt of $103 million. Our fully diluted shares outstanding are $181 million. In Q4, we used approximately $19 million of cash from operations. The use of cash from operations increased compared to the prior quarter as we made a large federal tax payment in October. During Q4, we invested $28 million, $9 million of which was related to acquisitions, namely in Ohio, and $18 million of which was net CapEx primarily used to support our cultivation expansions. This CapEx was net of $7 million of tenant improvement reimbursement. For the full year, we invested $113 million of cash, $88 million of which was net CapEx driven by our cultivation expansions in Illinois, Massachusetts, New Jersey and Michigan. These were partially offset by over $40 million in TI reimbursements received throughout the year. As Frank and Abner mentioned in their remarks, we anticipate wholesale pricing pressure to persist through 2022. We don't foresee the next material stair step in revenue until the start of adult use sales in New Jersey, which we budgeted to occur in July of this year. We expect 2022 net CapEx to be close to $30 million.

In summary, we started the year with $58 million in cash and ended with over $155 million. We're pleased with our strong cash position. We continue to have the option to pursue the [ph] $65 million (31:29) expansion feature of our term loan and are happy to see the debt markets remain open with a number of recent cannabis debt deals completed in attractive rates. Our focus has been and remains on being good stewards of this capital and maintaining a disciplined capital allocation approach. We'll continue to keep ROI at the forefront of our capital deployment decisions. As we look to 2022, we still expect meaningful growth and margin expansion. However, we don't anticipate this to occur until New Jersey recreational sales commence. The start of recreational sales in New Jersey will be an exciting ride and we're thrilled to be well-positioned with three of the best located retail assets in the state.

With that, we'd like to thank all of you for joining the call and supporting Ascend. Now, I'll turn it over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] And your first question will be from Neal Gilmer at Haywood Securities. Please go ahead.

Neal Gilmer
Analyst, Haywood Securities, Inc. Q

Yeah, thanks very much for taking my questions. Good afternoon. Maybe I'm going to try to dig a little bit further on your perspective of 2022 and some of the headwinds that you referred to in Illinois, Massachusetts, and you're saying you're taking refined approach to that. You referenced your growth rate you're expecting to pick up in the second half and you primarily cited New Jersey.

I'm wondering – I guess, a couple part question here. Number one is Illinois and Massachusetts expansions coming online. Is it fair to assume that's also going to be driving that growth in the second half of the year? And I guess number two is what are you seeing in the trends of Q1 and Q2? Are we going to see or do you see the potential for slight revenue declines are sort of maintaining at these levels before that growth in the second half of the year?

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

Hey. It's Abner, thanks for the question. Look, we don't have a crystal ball. It's hard to predict. But we have 95,000 feet of canopy that we – has completed expansion and is growing in both Illinois and Massachusetts, and that by the time it gets harvested and into the market by second half. That 90,000 feet is over a doubling of our biomass in those states and present a material opportunity. That said, without meaningful growth in those markets, it's going to be competitive for the market to absorb all that biomass. But we have exciting kind of wholesale strategy and additional form factors and additional penetration, as well as our own stores, to drive that sales. And then New Jersey. I mean, New Jersey, we think, is huge. We think we have three of the best stores. Our store in Illinois [ph] that's (34:56) $50 million a year. And I could argue that our three New Jersey stores have similar type opportunities. We don't project anything like that, but that's really the upside potential for us in 2022. What was your – what was the second part?

Neal Gilmer
Analyst, Haywood Securities, Inc. Q

No. You covered off most of it. I think maybe one sort of slight follow-up just on the improved cost structure that you're looking to achieve on the $10 million. Any sort of perspective on inflationary pressures on whether that will impact your ability to achieve the $10 million, or anything on the margin profile? Obviously, we're seeing inflation across the board [indiscernible] (35:37).

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

Look, I'll let Dan talk about the inflation, but I'll say, look, the $10 million is based on our projections, right? So we started with an additional plan for the year and we reduced it by $10 million. And we think that this is just part of an industry that's growing, but have some short-term competitive pressures, kind of rationalizing their cost structure to try to achieve the best margins. We want to get to that 30% margin target as quickly as we can, and we can't do all of that with growth. We've got to get better at everything we do. Dan, do you want to talk about inflation?

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

Yeah. I'd just say, look, I mean, there's certainly inflationary pressures where I think we're seeing a more kind of on building materials on the construction side of things, which obviously wouldn't impact the P&L as much. But it's a competitive environment for talent across the board. We have to go out there and wage battle every day, but we built in I think enough of a cushion on these cost savings initiatives that we feel comfortable being able to achieve these without any issues over the course of the year. And these are relatively straightforward savings to be realized. By March 31, we'll have realized about 40% of the target for the year and we're just going to continue to chase that quarter-after-quarter and get into fighting shape here.

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

I think the biggest inflationary risk to this industry is on the customer side, because if the customer has less money in their wallet...

Neal Gilmer Q
Analyst, Haywood Securities, Inc.

Yeah.

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

...that's going to be less money for us, right? And if the customer gets to spend more filling up their gas – the gas tank to get to us, then that's less money they have on there in the store. So to me, that's the biggest risk. That said, I feel that cannabis is something that's becoming essential to a lot of people and is a really desired product. So I don't see us having extreme sensitivity, but clearly, the customer's pocketbook is important to us.

Neal Gilmer Q
Analyst, Haywood Securities, Inc.

That's great. Thanks for taking my questions.

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

Matthew Robert McGinley Q
Analyst, Needham & Co. LLC

Thank you. So with the dip in the wholesale revenue you experienced in the quarter in Illinois, Massachusetts, do the recent capacity additions you made in those states give you any concern that you may have added too much capacity for the size of those markets? I think in Illinois, you could probably argue that's more of a timing issue with the retail addition. But I'm not sure that Massachusetts would necessarily have the same issue where there's a tremendous amount of additional retail that will be put up at some point.

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

Yeah. Look, I mean, in Illinois, there's a 110 stores. There's going to be a 185 and there's going to be more. It's, what I think, a $1.6-something billion market cap. It's going to be $4 billion. And also, we think, we can go after market share. We think we're going to do – our goal as a wholesaler is to bring every week to every dispensary, every form factor in the market, and not a lot of people are going to be able to do that. I think there's four or five people in Illinois that can do that. There aren't that many operators. There's a tremendous opportunity for the existing scale operators, and scale is going to be the name of the game. And we're going to be there in Illinois. I think the same thing holds true in Massachusetts. It is a $2 billion retail market. We have a very de minimis share. We can get to a 5% market share, and it can absorb all our biomass and that is not that high a hurdle.

We think that smaller operators are going to be challenged in a more competitive environment and that works in the favor of any operator with the scale, with 55,000 feet of canopy like we have. So look, it's a more competitive environment. We think it works – as in every industry, it works to the favor of those with scale and with resources and with operational capabilities. And that's us as other MSOs. And we think it's a real opportunity for us to excel.

And also, I think in particularly in Mass, our biomass is extremely good right now and we have great biodiversity and we have great THC scores. We are adding additional – a lab and a kitchen, additional form factors. We think we're in great shape.

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

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Yes, I think – that last point, I think, is important too as well. We've only been selling flower form factors in Illinois. So the lab comes online in the first half. The kitchen comes online in the second half of the year. That will enable us to sell a more fulsome assortment to the market, which will definitely help.

Matthew Robert McGinley
Analyst, Needham & Co. LLC

Q

Okay, got it. My second question is on the cash flow from ops in the fourth quarter. Dan, you noted the tax payments that were a drag on that, but it looks like you also built a substantial amount of inventory. Can you give some insight on where that inventory build is occurring? Is that mostly in Illinois, Massachusetts, given the weaker trends? Or is that more about building for adult use in New Jersey? I think as – how should we think about your ability to generate cash flow from ops in the first half of the year, given your expectations that revenue and margins will be roughly flat?

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

A

Yeah. So the building – it's kind of across the board. We do have some inventory that is building in New Jersey ahead of adult use. But also given the weaker trends in Illinois and Massachusetts, there was a little bit of a build up there, more so weighted to the Mass side of things than the Illinois side of things. And so that's kind of the inventory build there. There was a use of working capital in the quarter. I'd say looking at the first half of the year with performance that we expect, no meaningful step-up either from the canopy expansions or New Jersey adult use sales. I think with this step-back in performance that move back or move to kind of operating cash flow generation in the first half of the year, I think we'll be in a much better place to revisit that in the second half with these canopy expansions coming online, which will come with higher margins, combined with that turn on of adult use sales in New Jersey.

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

A

Yeah. I mean, look, I mean, it's only about a $10 million inventory build in the quarter. In order to pursue our goal of all form factors to all dispensaries every week in our markets, we're going to need more inventory. We're not in an inventory build situation. We're running hand-to-mouth on a lot of form factors. Now are there – as we come online in Michigan and Mass, there's inventory build as we build sales, of course. But we're still in a kind of early-stage wholesale business where we're going to need more inventory to provide the market of full range of form factors and inventory to hit our goals.

Matthew Robert McGinley
Analyst, Needham & Co. LLC

Q

Great. Thank you.

Operator: Thank you. Next question will be from Kenric Tyghe at ATB Capital Markets. Please go ahead.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Thank you, and good evening. In your remarks, you called out your share gains being low despite the pricing and volume pressures in the state. Could you speak to in that context how important Ozone and Ozone's traction is? How important Simply Herb will be in terms of selling in that good gap as you referred to? And putting that all together, if we look to Ozone, Simply Herb, plus the sort of second half additional available cultivation, how would you expect to see your trends into – your market share and positioning at Illinois trends through 2022, Abner?

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

A

Yeah. I'm going to turn that over to Frank who's got some good answers for you.

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

A

I'm sorry, that was the Illinois market?

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Yes, that was. Thanks, Frank.

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

A

Yes. We're focused on building quality at each of those form factors. So as you look to producing more, you've got to produce more and better. And the Ozone brand has been perfectly positioned to hit the largest segment of the consumers. But more recently, we've been able to produce the highest quality Ozone reserve. That's getting on shelves more and now addressing again the largest growing segment of the population with 25% or more of the consumer with a value brand. So for us, this gets us to put our biomass into the proper segment and get it to the right consumer at the right price.

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

A

Yeah. I mean, look, just simply, I think most vapes in Illinois are $50 to $60. That's too high. I mean it's too high relative to other markets in the country. And as more biomass comes online, it makes sense to have a lower priced product. It's going to spur demand and allow other consumers to enter the market. Cresco, the largest player in the state, has done a great job on that with their High Supply. They've really started to open up that segment, and we think they're right and we want to come with a great product as well.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Appreciate it, Abner. And a quick pivot to New Jersey, if I could. Could you bridge the gap between a potential start, call it May 1 for sake of discussion, and your expectations of that ramp only in July? How do we think about that start to adult use and perhaps help us reconcile the gap in the step-up between when you see a contribution in New Jersey and when you expect to see that step-up as you referred to it, Abner? Just want to make sure we're understanding the potential progression of potential barriers.

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

A

Look, the operational aspects of our business have to be ready for us to be approved on March 24 and for the state to want to open 30 days later, so May 1. We have to be ready for that. Given the history of delays in the sector and the industry, we are projecting a July 1 start or June kind of start because that's just the way this industry has rolled. So that's the way we look at it.

In terms of the ramp-up, based on Illinois, you never know exactly when your store is going to be able to open and particularly the two additional stores. So we try to be conservative in terms of the ramp-up. But we're hopeful and encouraging New Jersey to open the doors on May 1. We're ready to go.

Kenric Tyghe
Analyst, ATB Capital Markets, Inc.

Q

Great. Thank you and good luck.

Operator: Thank you. [Operator Instructions] Next will be Russell Stanley at Beacon Securities.

Russell Stanley
Analyst, Beacon Securities Ltd.

Q

Hello, and thanks for taking my question. Just coming back to Illinois and given the competition you're seeing there in that ongoing legal battle around the retail licenses. And just again, a crystal ball question. But how are you thinking about how that battle will play out? What kind of resolution are you preparing for? And when do you think we might see new doors open for your wholesale business to sell into?

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

A

Well, look, we've hoped for a while that Illinois would issue the licenses without resolution of the legal problems, right? There's been a number of states, New Jersey, Maryland and others, that have issued the licenses and then based on the outcome of legal would issue more licenses or whatnot. Illinois has chosen not to do that. As a result, it's very hard to predict the legal framework. We're hoping for later this year, but we don't know.

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

Yeah, I mean, just to add to that. I think if you were to issue the licenses today, what's the quickest they get online reasonably with construction and permitting and licensing, 6 months, 8 months, 12 months. So the end of this year probably is as rosy as I think we can give. But let's also be clear, Illinois should issue those licenses to the social equity applicants that deserve it.

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

Also, I mean, the problem with the delays in Illinois is that all of these applicants pretty much lost their real estate, right? It's just gone on for so long that they've been unable to keep or afford the real estate that they – for many of them that they were originally planning to use for their stores. So that will also delay the opening when the licenses do get issued. It's unfortunate. Illinois is a great story, but the new stores are going to come.

Russell Stanley
Analyst, Beacon Securities Ltd.
Q

Okay. Thanks for the color.

Operator: Thank you. Last question will be from Ty Collin at Eight Capital. Please go ahead.

Ty Collin
Analyst, Eight Capital
Q

Hi, thanks for taking my question. I appreciate the commentary on New York at the top of the call today. I guess just assuming a favorable outcome in your case there, can you kind of help us think through the implications of being sort of months behind your competitors building out in that market while you wait for that litigation to settle? Thanks.

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

So look, I think that we're hopeful. We agreed to an expedited trial. We're hopeful that sometime this year we get resolution. We do acknowledge that the New York legal system moves at its own pace. And the sellers have a long history of litigious behavior, so you never know what kind of appeals they might pursue. But we think this is an open and shut case, and therefore summary judgment and quick result is a possible outcome.

In terms of being behind, we think we're in good shape. We can't disclose everything we're working on now, but we think we have a good opportunity to join adult use when it opens with substantial canopy through actions that we're doing. So we're very hopeful here that we're going to be able to be in a great position in New York despite the current litigation.

Ty Collin
Analyst, Eight Capital
Q

Okay. Thank you.

Operator: Thank you. This does conclude the question portion for today's call. I now would like to turn the conference over back to Rebecca Koar.

Rebecca Koar

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

All right. Well, thanks everyone for joining us today. We appreciate everyone's interest, and feel free to follow up with us if you have any other questions.

Operator: Thank you. 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.