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KushCo Holdings

Fiscal Fourth Quarter and Full Year 2020 Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the KushCo Holdings Fiscal Fourth Quarter and Full-year 2020 Earnings Conference Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. Please note this conference is being recorded.

I will now turn the conference over to your host, Mr. Najim Mostamand, KushCo's Director of Investor Relations. Mr. Mostamand you may begin.

Najim Mostamand

All right. Thank you, Operator. Good afternoon, and welcome to the KushCo Holdings fiscal fourth quarter and full-year 2020 earnings conference call.

A replay of this call will be archived on the investor relations section of the KushCo Holdings website, ir.kushco.com.

Before we begin, please let me remind you that during the course of this conference call management may make forward-looking statements. These forward-looking statements are based on current expectations that are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. These risks are outlined in the Risk Factor section of our SEC Filings, any forward-looking statements should be considered in light of these factors. Please also note as a Safe Harbor, any outlook we present is as of today and management does not undertake any obligation to revise any forward-looking statements in the future.

With me on the call today are our Co-founder, Chairman and CEO, Nick Kovacevich, and our CFO Stephen Christoffersen.

With that, I would now like to hand the call over to Nick, Nick?

Nick Kovacevich

Thanks, Najim, and thank you all for attending our fiscal fourth quarter and full-year 2020 earnings call.

As we previewed in our preliminary earnings release last month, Q4 was arguably one of the most pivotal quarters in KushCo's entire 10-year history. As we onboarded several new high profile customers, we returned to growth. We executed many of the initiatives in our strategic plan while achieving our first quarter of positive Adjusted EBITDA and cash flow from operations in more than three years. I could not be more proud of our KushCo family who came together during a difficult fiscal year, putting maximum effort to turn this business around and to put us in a much stronger position than we have arguably ever been, one in which we truly have more control of our own destiny.

From rightsizing our cost structure, streamlining our inventory, and consolidating our warehouses to refocusing on our core customers, tightening our credit standards, and improving our collections activity we are thrilled to have delivered on the initiatives we said we were going to deliver on giving us a solid foundation to continue growing our business profitably moving forward. We realized there's still a lot of work to be done to drive more significant long-term returns for our shareholders, but we are encouraged with the substantial progress we have made thus far, especially when you consider the challenging journey we underwent in Fiscal '20, starting with the illicit market vape crisis and culminating with the ongoing COVID-19 pandemic.

So, with that, let's turn to Slide 5 of the supplemental earnings slides, which can be found on the financial results page of our IR website @ir.kushco.com. Starting with revenue. We finished out the fiscal year on a high note, generating $26.5 million, which represented 19% growth compared to Q3 and represents a better result than the improved guidance we gave last month of between $25.5 and $26 million.

We believe our top-line trends have stabilized, which combined with our right-sized cost structure should result in a more sustainable business model going forward. The main driver for the growth of this quarter was largely an increase in sales to our top customers, leading MSOs, LPs, and brands that we have worked really hard these past two years to develop deep relationships with. These top customers are continuing to enter new markets and solidify their positions in existing markets. Their growth has been demonstrating our thesis, that the industry will continue to see consolidation with this select group of operators reaping the lion's share of the benefits of the industry's next stage of growth.

It also validates our strategy to align even deeper with these customers, which should help us unlock high-quality profitable growth for hopefully many more quarters and years to come as we are still in the very early innings of our industry's expansion. In fact, one very prominent example of this happened earlier this fall, as one of our large MSO customers acquired a smaller former customer when they were expanding into a new market. Now that smaller former customer who is becoming part of this MSO will likely go back to buying from KushCo because of the volume that we do with the parent company. The moral of this example is that it's better to be aligned with the larger operators since they will be the acquirers, rather than scrambling to try to secure all of the smaller operators who are likely to end up being consolidated down the road.

Now, to continue with the growth drivers for this quarter, part of the increase in revenue was also due to a reversal of some stringent regulatory and travel restrictions we saw in Q2 and Q3 in markets like Massachusetts and Michigan, as a result of COVID-19. Some of these impacted markets as we'll cover in Slide 7 are still taking some time to rebound, but we're encouraged to see once again, our growth being driven by a variety of markets and not isolated to one or two. Again, validating our strategy to align with the leading operators who have a large footprint in multiple states.

While we are pleased with the growth we experienced in this quarter, we remind everyone that because of our strategic shift to focus on the larger customers, we expect our revenue to continue to be lumpy quarter-to-quarter. This is due to the fact that we are now anchored to a more concentrated group of larger customers who have longer sales cycles and who are not going to order the same amount every single quarter. The good news is that we have a nice reoccurring business in this pipeline with these leading operators, and as we align ourselves even deeper with their businesses, we'll be in a position to continue expanding and growing alongside them.

Now, moving on to gross margins. On a GAAP basis, we returned to 25% plus gross margins achieving 26%, demonstrating that the restructuring charges we took in Fiscal Q2 and Q3 to align with the leading operators, right-size our business, and discontinued non-essential inventory are now largely behind us. Q4 also represented the sixth consecutive quarter of 20 plus percent non-GAAP gross margins as we achieved 29% non-GAAP. Both the strong GAAP and non-GAAP gross margins were driven by a reduction in excess and obsolete inventory charges and an improvement in our landed product costs. Once again, we continue to drive meaningful cost reductions as well, which resulted in a cash SG&A of $7.3 million for Fiscal Q4. This is an impressive achievement in any environment, but considering how quickly we were able to right-size our cost structure, and more importantly, still drive growth, this speaks to the operating leverage we are now gaining in our business.

As a reminder, we had $15.3 million in cash SG&A for Fiscal Q1 and we've been able to reduce that now by more than 50% to the $7.3 million we just reported in this quarter, which is also right in line with our previously reported guidance of $6.5 and $7.5 million for cash SG&A.

But perhaps the most impressive accomplishment this quarter was our achievement of Adjusted EBITDA for the first time in more than three years. Not only did we generate stronger, positive Adjusted EBITDA than we previously guided to last month, but more importantly, we feel great that we were able to deliver on the commitment to achieving profitability that we made at the start of Fiscal Year '20.

During the five years from 2014 to 2019, KushCo was one of the fastest-growing companies in our industry, more than doubling revenue each and every Fiscal Year from roughly $4 million in Fiscal 2014 to roughly $150 million in Fiscal 2019. Investors were seeking growth and we delivered it in abundance. But when the illicit vape market crisis hit at the beginning of our Fiscal Year, last September, we saw some of the investor sentiment quickly changing to favor profitability overgrowth. We headed this message, and we were one of the first and perhaps the quickest in our industry to adjust and right-size our business.

Then, unfortunately, the world got hit with the COVID-19 pandemic, and while many companies, unfortunately, could not make it, we persevered, we made the difficult changes early and fast, and we operated with the mindset that there would not be another single dollar of outside capital to support us. That mentality and our efforts these last nine months have culminated in a turnaround story that we're truly proud of. Let's not forget at the start of Fiscal 20, we guided to achieving positive Adjusted EBITDA in the second half of the Fiscal Year. This was before we faced the illicit vape market crisis, the credit crunch that ensued, and of course, COVID-19 the fact that we were still able to meet and exceed that profitability goal after all that has happened is truly remarkable. This would not have been possible without the heroic efforts from our entire staff, the continued commitment from our valued customers, and of course the ongoing support from our shareholders.

Lastly, I wanted to quickly touch on our cash flow generation in Q4. That is correct. We actually generated positive cash flow from operations this quarter for the first time in more than three years, a special thanks goes to Stephen Christoffersen and his team for tightening the belt and executing a comprehensive cost-cutting program in just the first few months on the job as our new CFO. This was an incredible accomplishment to not only right-size the business through tighter spending, a leaner workforce, and a smaller warehouse footprint, but to also improve our collections and dramatically reduce our cash conversion cycle.

Overall, we could not be more pleased with how the quarter turned out, reflecting months of hard work that turned the ship around. Now, we really feel like the wind is at our sales, especially with some of the market and election-related catalysts that are around the corner, which I will touch on briefly later in this call.

But before I do that, let's take a brief look at Slide 6, where we break out our sales by our Top 100 customers versus the rest of our customer base. Sales to these elite Top 100 customers were up 26% sequentially. Due to these customers continuing to expand and grow our traction and cross-selling deeper to these customers and also due to some of the regulatory restrictions and headwinds we saw in Q2 and Q3 beginning to reverse and provide a bit of a tailwind.

Next, we'll look at Slide 7, where we break out our sales by geographic market. As you can see, we experienced growth in virtually all of our major markets in Q4 with the exception of Nevada, which is still rebounding to pre-pandemic levels following the reversal of some regulatory restrictions there, as well as Canada, which was largely a function of order lumpiness. Although we did secure a half a million-dollar custom packaging order from a large LP, and we also won the disposable vape business of one of our large existing LP customers as well.

Looking elsewhere, there were some positive call-outs for this quarter, perhaps the most notable was California, which for the last couple of quarters saw sequential declines in sales due in part to the implementation of our strategic plan, which led to us tightening our credit terms and being more selective with customers in this market. But we experienced growth in California for the first time in four quarters leading us to believe that we finally bought them in that state and that we have the upside now as more MSOs are strategically increasing their presence in California and as more municipalities are approving cannabis retail stores in order to bring in much-needed tax revenue that can help address the budget deficit problems created by COVID-19.

Moving out of the Midwest and East coast. We continue to see outsized growth, sorry, outsides growth in these limited license states, that possess significant barriers to entry and more attractive supply-demand dynamics. In Massachusetts for example, we experienced a strong rebound in activity following the reversal of some of the aforementioned regulatory restrictions that impacted the state in the early months of the pandemic. Michigan also had a strong rebound in Q4 following what was stricter than usual shelter in place orders, which impacted sales at the consumer level and eventually impacted sales at the brand level and ultimately sales for KushCo. In supply constraint, Illinois, we had a record quarter in that market as we worked closely with our top MSO customers to sell more vape and packaging products, while we also secured a new, large private MSO, that has a great presence in Illinois.

Last but not least, our sales to medical markets continued to trend higher and balance out some of the historical high exposure we've had to California. This just goes to show our prudent decision to tightening up the types of customers we want to do business within a challenging California market, while simultaneously working more closely with the top MSOs who are well-positioned and expanding aggressively into the limited license markets, including some of the more promising states such as Arizona, New Jersey, New York, Pennsylvania, Florida, Maryland, and Ohio, virtually all of which saw robust sequential growth for us in our sales for Q4, and are also looking increasingly likely to approve adult-use rec cannabis in the very near future.

Next, I'd like to dive into Slide 8, which shows our product mix by category. First, starting with vape, we experienced a strong rebound in this category driven by growth in our top 100 customer bucket as I mentioned earlier, however, at a more micro level, we're seeing strong data that suggests vape sales on an absolute level have rebounded to the pre illicit market vape crisis levels, largely due to new markets opening up, but also due to many consumers switching to safer and regulated options on the legal market, even if those products come at a premium because of course, they do value their health above all else, especially during these COVID-19 times. These factors along with our current customers penetrating new and existing markets further, especially with some of our new innovative vape solutions should continue to help drive our vape sales higher.

Next, I want to take a look at our Packaging, Paper, and Supplies bucket, which was roughly flat in Q4, despite meaningful progress on the custom packaging side of things. In a recent survey we conducted with our top customers, 80% of the respondents mentioned that 80% of their purchase from us over the next 12 months is likely to be custom products. As a result, we have been investing further in our customization capabilities and we will look to drive further innovation in our packaging position so that we can enhance our defensible moat, and we can continue to deliver value to our customers. We're looking to land large scale items for some of our big MSO customers, and when we do that, we look to build intellectual property around it, which then makes us very sticky and very defensible, given not only the complexity around the product but also the complexity of building something that is compliant with each market's differentiated regulations.

Next, let's look at our Energy and Natural Products bucket. We have been experiencing some positive traction with our new stainless steel tanks, which our customers are upgrading to in order to have a cleaner and more cost-effective vessel for their extraction process. Some customers have already jumped at the opportunity to have access to these superior vessels by signing long-term supply agreements with our energy division. We expect this trend to continue, as we believe we are the only company in the marketplace with this innovative offering today.

Lastly, I'll spend a quick moment to talk about our services. Our CBD division has been working behind the scenes on helping expand distribution for many of our client brands, and we look forward to providing some additional details on that front as appropriate. However, I wanted to quickly touch on some of the work we've been doing with our friends at XS Financial and furthering our partnership and collaborating on customer wins.

As a reminder, we entered into an equity swap transaction with XSF back in January. Given how complimentary our offerings are to each other, we thought this made a lot of sense. The partnership has been off to a great start these past nine months with both companies referring leads and working closely to convert customers over to each other's platform. We look forward to building on our momentum with more customer wins and synergistic collaboration in the near future, especially given the fact that there is a dearth of financing options for this industry, especially when it comes to financing one's equipment.

We will now turn to Slide 9, which highlights the main pillars of our strategic plan, as well as some noteworthy achievements and milestones. We know we have featured variations of the slide a lot, so we're going to just focus on a couple of the main points. Starting with focusing on our Top 100 customers, we have really reorganized and invested our salesforce to be able to maximize customer satisfaction, retention, and acquisition. We recently brought on a new sales director who is overseeing the Northeast and Canada, and also another new sales director who is overseeing the Southwest, both of whom have wasted no time in getting up to speed and going out, servicing our customers, and landing new accounts. Our sales team is more energized than ever to expand their current book of business, either through cross-selling or winning new customers, and we're making sure to invest the tools and resources needed to ensure their success in these efforts.

The early results have been really encouraging, as we are now securing several large new customers and we are working to secure supply agreements with many of our top existing customers. I am excited that with our recently enhanced financial position. We are now able to be more competitive and further incentivizing our large operators who are not currently customers of KushCo to be able to switch over some of their products into our ecosystem. Speaking of enhanced financial position, we are really pleased with how we have been able to right-size our footprint and workforce. Now that we are generating positive cash flow we are in a strong position to further enhance that cash flow because there's less capital needed to run the business, especially at these current levels.

In a way, the challenges of Fiscal '20 have been a blessing in disguise, forcing us to dig deep, to accelerate our plans, to become self-sufficient, and truly transform into a stronger organization that can sustainably scale and enhance market share. With our complete product and service ecosystem, our customer base, and our track record, we believe we are in a very enviable position.

With that, I'd like to turn the call over to Stephen who will walk us through our Q4 financial summary.

Stephen Christoffersen

Thanks, Nick. We are executing on all areas of our strategic plan and are now in a more sustainable and structurally sound business with a healthier balance sheet.

Turning to the financial summary beginning on Slide 11, which displays a snapshot of our income statement in Fiscal Q4 2020. Total net revenue decreased 44% year-over-year but increased 19% quarter-over-quarter to $26.5 million. The quarter-over-quarter increase, as Nick described earlier, was driven primarily by an increase in sales of our Top 100 customers. On a GAAP basis, gross profit for the fourth quarter increased sequentially to $6.8 million from the $2.4 million in Q3 2020. This represents a 26% GAAP gross margins for Q4.

As we mentioned on our last earnings call, GAAP gross profit in Fiscal Q3 was impacted by additional restructuring charges we took during the quarter for the right-size our business and better align it with our new strategic plan. Most of these charges being taken in Q2 and to a lesser extent in Q3, Q4 represented a much cleaner quarter from a financial reporting perspective. We feel good that gross margins have stabilized around this 25% plus mark and expect for us to continue generating margins at or above this benchmark given the efficiencies we've implemented in the business.

On a non-GAAP basis, excluding the impact of the China trade tariffs and restructuring charges, gross profit was approximately $6.9 million for 29% of revenue, which is an increase of 28% of the revenue that we generated in Q3 2020. For a complete reconciliation of GAAP to non-GAAP financials, please visit the reconciliation table at the end of this presentation or in our Fiscal Q4 earnings release. Sales, general, and administrative expense for Fiscal Q4 2020 were approximately $10.3 million which was down from the $12.7 million in the prior quarter and $20.8 million compared to Q4 a year ago. Cash SG&A, which excludes non-cash expenses, such as bad debt, stock-based compensation, depreciation, and amortization was $7.3 million, which was down over 50% from Q1 Fiscal '20.

The big drivers were among other things, headcount reductions, executive salary reductions, reduced consulting expenses, lower facilities costs, and lower travel and entertainment expenses. We were pleased that we were able to drive revenue growth under our reduced cost structure and are excited about the operating leverage of this business going forward.

Turning to the next item. On a GAAP basis, net loss for Fiscal Q4, 2020, was $7.3 million or negative $0.06 a share, it represents an improvement from the net loss of approximately $13.5 million or negative $0.11 per basic share in Q3 2020. On a non-GAAP basis, excluding the impact of certain nonrecurring charges, our net loss for the quarter was approximately $1.4 million or negative $0.01 per share, which represents an improvement of the negative $0.05 per share we reported in Q3 2020.

Last but not least, our Adjusted EBITDA for the quarter was positive $1 million compared to the negative $2.7 million in Q3 2020 and the negative $5.2 million in Q4 2019. A significant improvement in Adjusted EBITDA was largely driven by the cost-cutting initiatives and the streamline processes we described earlier.

You can see on Slide 12 that even though revenue was impacted by these market challenges, our Fiscal 2020 and our strategic decision to align deeper with the leading operators that our cost structure, Adjusted EBITDA continued to improve. In fact, we were able to demonstrate that even with lower revenues, we were able to generate higher Adjusted EBITDA, showcasing some operating leverage we're realizing from this leaner and more efficient business model. This positions us nicely to drive further profitable growth and EBITDA margin expansion as we leverage our lower cost structure, which is largely fixed in nature.

Turning now to Slide 13, which provides a snapshot of our balance sheet as of the end of Fiscal Q4. After written off several of our smaller delinquent accounts in Q2, and to a lesser extent in Q3, we have been generating much stronger collections activity due to some of the proactive measures we are taking help these customers, and in some cases, working with third parties to collect on accounts that are being a little more difficult.

We are encouraged by the current health of our receivables and believe we're aligned with solid financially strong customers that can pay their invoices on time, which has lowered our credit risk in general.

Moving on, our total inventory as of Q4 was approximately $28 million as compared to approximately $24 million at the end of Q3 and $43.8 million as of Q4 2019. We did have a slight uptick in inventory to support higher level of sales. Especially as we have added some notable customers over the past few months. Also, as we move closer to Chinese new year, this upcoming February, we will make sure that this level of inventory that we believe is sufficient, given the weeks that suppliers are shut down over the holidays. Overall, we are seeing inventory terms continuing to improve, our days of inventory outstanding continue to drop, and our overall inventory mix that are matching revenue mix, which is exactly where we want to be.

Our cash position once again, remained strong as we ended Q4 with $10.5 million and did not draw on a revolving credit line. In fact, we have not drawn on our credit facility since February demonstrating how efficient we've become in managing and allocating our capital while still growing the business. We went from a company that was burning cash to now generating cash all in the span of two quarters and are pleased with the over $0.5 million we generated from cash flow from operations in Q4. We believe we are in a strong financial and liquidity position to achieve our sales goals over the next couple of quarters.

Our cost structure has been right-sized and we can support a higher level of revenues with the same operations footprint and head counts that we currently have. Of course, if we do start to see some new states coming online, either for adult or medical use, and need to grow faster to keep pace with our customer's growth, then we will evaluate our capital needs at that time. However, for now, we are feeling good about our current liquidity.

It's also worth reminding everyone that we do have a $22 million note outstanding that is due at the end of April and we are currently evaluating our refinancing options. Given that we are now EBITDA positive and generating positive cash flow, we believe that the business is in a far better shape to handle this amount of debt going forward.

Overall, I could not be more excited that the business is firing on all cylinders and are really starting to generate the results that we know we can.

With that, I will turn it back to Nick.

Nick Kovacevich

All right, thanks, Stephen.

Now let's turn to Slide 15, which covers our outlook for Q1. Historically, Q1 has been our lightest quarter in terms of revenue. We expect some modest growth this quarter driven by securing new business and cross-selling deeper into our existing customer base. As I mentioned at the onset, we have been able to land some high profile accounts, which are going to be ramping up their custom projects in Fiscal Q1 and into the balance of Fiscal '21. From Q1, we expect to see a notable uptick in growth, which we anticipate will accelerate in the back half of Fiscal '21. Why? Because new states are legalizing and we have large customers that are really ramping up their cultivation and output while expanding into new markets and growing their footprint in existing markets.

Well, all of us are hoping to gain greater access to capital on the heels of what's looking to be a pivotal election for our entire industry. We're going to be focusing on leaning further into our top customers by cross-selling additional products and services by improving or extending credit terms to the most creditworthy customers in the marketplace, and by locking in supply agreements with a handful of these elite customers. We're also going to be focusing on adding new MSO and LP customers to our book. As it stands today, we are already doing some level of business with most of the major industry players out there, but there is room for us to expand the business that we're doing with these operators and we are going to be working hard to earn a bigger piece of the pie.

Now let's turn to the final slide of the presentation, Slide 16, where we will highlight our guidance for Fiscal '21. Starting at the top, we're guiding revenue for the fiscal year to be between $120 million and $150 million. With the increasing trend toward more consolidation, continued growth from our top customers, and a growing preference for customized solutions, we believe $120 million of high quality, high margin revenue is a very achievable base case. Of course, we're expecting a lot to happen next week. With that, we believe there's significant upside to our low end of $120 million, if, and when new states legalize and rollout adult recreational or medical programs, which could launch us to the higher end of our range up to $150 million. We're also guiding for Adjusted EBITDA to be between $5 and $7 million or EBITDA margins of between 3% and 6% for the fiscal year, which represents a substantial improvement to the negative $23.3 million we recorded in Fiscal '20.

Overall, we are thrilled to be able to achieve the milestones we did in Fiscal '20 to turn around the business and get us where we need to be. We have a lot of room left to grow. We believe that Fiscal '21 can be a major catalyst driven year for our industry as new states come online and we potentially set up some favorable legislation out of Congress that will open up our industry in terms of capital and consumer access. As one of the leading operators in the ancillary marketplace, providing solutions to MSOs, LPs, and top brands, we believe we are in a prime position to capture this next wave of growth, which should translate into stronger profitability, cash flow generation, and returns for our shareholders.

With that, I'd like to turn the call over to the Operator for the Q&A session.

Operator

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. If you'd like to ask a question, you may press star, one, on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

Our first question comes from the line of Gerald Pascarelli with Cowen and Company. Please proceed with your question.

Gerald Pascarelli

Hey guys. I'm for Vivian today. Thanks very much for taking the questions.

Nick Kovacevich

No problem Pas, you can take your time.

Gerald Pascarelli

Sure thing. So Nick, California saw a healthy recovery and sequential growth for the quarter. It's our understanding that there could be disruption from the wildfires in particular in terms of the flower supply. And so, I guess my question is, have you guys seen any impacts to your business from the wildfires, either positive or negative, any color you could provide there would be helpful? Thank you.

Nick Kovacevich

Yes. First of all our thoughts and prayers go out to everybody affected by the wildfires and specifically cannabis businesses because some of these companies have really been hurt by the wildfires and so it's not a good situation. However, I think the impact to us should be minimal. I think this will keep prices of flower higher for longer, which the pricing in California's fairly robust when compared to other similar markets like Oregon and Washington. So, I think this will continue that trend with some of the supply coming offline due to the fires. Brands are still scrambling, right? They're trying to find product, they're trying to get product to market, but stores are still stocked.

So, unfortunately, when one brand falls out another one fills the place, and I don't expect any shortage of sales. And ideally, we're pretty spread out in California there's not a lot of concentration, so I don't think that we would have any specific impact on this because like I said, any impact negative is probably offset to the positive for another operator that does have supply.

Gerald Pascarelli

Got it. That's super helpful. My next question is just on revenues by state. Totally get that there could be incremental states coming online, based on what happens next week. But in your base case as you look forward to 2021, what states would you say you're most constructive on? Just kind of given what you're seeing in the marketplace and the momentum that you've seen exiting the year. Thanks.

Nick Kovacevich

Yes. So, with our strategic shift, we shifted more to focusing on customers versus markets. We are working with a lot of the leading MSOs and so we're kind of following their trend. We know that they're making investments in some of the more lucrative markets, which is fairly common knowledge markets like Florida being invested in Pennsylvania, Massachusetts, Illinois, and even some of the less-known medical markets like Maryland and Ohio. So, I think we expect our sales to kind of follow where those investments are being made by MSOs.

We do see some MSOs coming into California a little bit more. We know that MSOs are gearing up for legalization in New Jersey and Arizona. So, TBD on when those programs will actually get kicked off, but the rhetoric is very positive. We're hearing that New Jersey wants to accelerate and actually begin sales within weeks of legalizing next week, which is all about our foregoing conclusion that that will happen.

So, hopefully, things heat up, but we're not baking that in. What we're baking into our model is really our existing customers and the expectations that we're going to have from them as they continue to grow modeling in some of the newly acquired customers that we'll be ramping quickly with us as they're moving business over from other suppliers. Then a modest expectation about new customer acquisition but really a lot of it's just baked into the existing base and what we kind of have right within our line of sight.

Gerald Pascarelli

Makes sense. Thanks very much, Nick. I'll hop back into the queue.

Nick Kovacevich

Thank you.

Operator

Our next question comes from the line of Aaron Grey with Alliance Global Partners. Please proceed with your question.

Aaron Grey

Good evening, guys. Thanks for the questions and congrats on inflecting to profitability again. So, first question for me, I know you said it was more modest part of the future growth you're looking for in terms of incremental clients coming online, but I would just love to get some further color in terms of where you see the opportunities they're not—you've kind of narrowed the addressable market as you kind of look for better credit capabilities.

It's a more so kind of reaching out to some operators who aren't using as high-quality products as KushCo or someone who you might be able to provide better service to. Just want to get a better sense of what the sales pitch might be to as you approach some of these MSOs, LPs, or brands that aren't currently in your portfolio, or as you look to get a bigger piece of their business. Thanks.

Nick Kovacevich

Yes. So, great question. One of the key parts of our growth plan is going to be bringing hyper custom projects to market on the packaging product for some of these larger MSOs, specifically geared around the high volume product lines, so this would be like one-eighth of flower, that's kind of a standard product line that moves a lot of volume of vape cartridge package because we sell a lot of vape cartridges and we don't believe it or not, we don't have all the packaging business that those vapes end up in. Some folks we sell vape packaging and we don't have the vape pens that go into that packaging. So, that's really a simple way to look at cross-selling is every vape pen we sell we want to have a corresponding package, and we know that's a high volume concentrate lines.

So, we're working on a few projects right now, projects that have been in the works these are longer sales cycles. So, we began a project for one of the leading MSO on an eighth jar, we began that probably about six months ago. We're expected to expedite it and we're expected to get that into market probably at the start of our Q2 in December. So these are the—these are the lead times, they're longer, longer sales cycle. So, we have visibility, but we've got to be working on a lot of these projects behind the scenes, and then, where it pays off is a little bit down the road. So, that's in the works.

We also have an opportunity with some new MSOs that was given us an opportunity to provide some products for one of their product lines that's not their main product line. So, this would be something like tincture vials, for droppers or syringes, for oil or some bags maybe for edibles or flower. It's a small piece of business, but I think if we execute well and build that relationship, we're going to get the next opportunity. If we execute on that, then maybe they'll move something over that they're unsatisfied with the current provider. So, that's kind of the cycle on that front. You got to do a lot of this. So a lot of this is happening at once and we want to slowly build out from there and then we'll see the net effect of that show up really three or four quarters down the road. The fruit of those efforts will start to really show up in the numbers.

Then, we're going to get growth from our existing customers. The big MSOs that buy vape pens from us. Q1 for us is an interesting period. As we mentioned, it's typically a softer period for us, it's less selling days in our Q4. Also, historically we've done a lot of business in markets like Colorado, where it's considered mud season. So tourism is down, obviously, all bets are off with COVID, but, that's just been the typical case with Q1.

But in general, we expect our large MSOs to order more vape pens from us every six months than they did the six months prior of when those orders actually hit, could be a little lumpy, but they're growing and they're growing on their main categories and their main categories are usually going to include flower and vape. So, if we can win the flower packaging, we can win the vape business, we can win the vape packaging, that's going to be the anchor to keep growing, and then we want to compliment that with additional lines of business and selling energy products like ethanol and butane. So we're, it's a—it's a slower, more methodical approach, but it adds up really big over time, and these lines of product are very sticky.

Again, if you're developing a hyper custom jar, the example I always use, let's say there's an emerging soda industry and a brand like Coca-Cola comes to you and wants you to design a proprietary jar and you are a bottle of right, a 12-ounce bottle and you do, and then that brand ends up being Coca-Cola and scaling globally, you're going to sell a lot of bottles, right? We want to be that partner for these MSOs as they're just really still at the early stage of their life cycle even though many of them are crossing over 100 million-plus per quarter still very early and the upside is huge.

Aaron Grey

Thanks for that color. That's super helpful. Second question for me just on gross margins, next to CBD enhancement again this quarter up to 29%. I'm curious because I did see vape come up to about nearly

70%, as a mix of sales historically vape has been not one of the higher-margin categories. So, curious to seeing the dynamics there because mix went up in vape and you still saw the increase in gross margins, and then how they think about gross margins going forward, considering you're looking to build out customized packaging along with what looks to be nice margins now on vape too? Just have us think about the gross margin profile over a Fiscal Year 2021. Thank you.

Nick Kovacevich

Yes. I mean, we feel really good about our gross margins. We feel like there's still a little further efficiencies and cost-cutting that we can do, which some of that gets loaded into cogs. We're also working now with more scale with a lot of our key factories and so we can get pricing down. The flip side of that is we're working with larger MSOs and we're very aggressive. So, we need to sell all of our products suite, as you mentioned, vape typically has had a lower margin. We want to balance that out with sales of packaging, specifically hyper custom packaging, and also with sales of our energy products. We intend to do that.

We've got an internal goal to get vape below 50% by the end of the fiscal year, and so we're pushing toward that. But the good news is the vape margin is healthier, which is why you're seeing the margins up even with a quarter where we were not necessarily pleased with the mix shift being so heavy over to vape. We do expect that to drop down here in Q1.

But why is the margin up with vape? Well, a couple of reasons, number one, the 29% that you quoted was the non-GAAP. We're backing up the tariffs, the tariff pass-through and we thought it was going to be temporary, it's last quite a while, but, I think the general consensus is that the tariff experiments that's been going on with China, maybe coming to an end here shortly.

We know that the election next week, we'll either, re-elect president Trump who will now have leveraged to finalize the trade deal with China, or currently, the polls are favoring Biden who will likely have a much more lax policy with China. So we do expect the trade wars or the trade tariffs to fall off here at some point. That's how we get those extra two or three points of margin that you're seeing there in the non-GAAP.

Then, we've mentioned this in the calls in the past, CCELL who the parent company is more recently did a huge IPO in Hong Kong, the company is worth over $20 billion. They raised a billion dollars of cash. They were already working on innovation, they've got 400 engineers at the company, that innovation pipeline is going to accelerate, they're going to bring new products to market, and we help launch all their products here in the U.S., and those products, the new innovative products, the new pod systems that we've been selling, which are showing up in the Q4 numbers, those products typically have a higher margin. So, that's one reason why even though with the percentage skewed to vape, you're also seeing healthy margins.

Then where our margins go long-term look, there's a lot of factors at play here. We're just focused on being great at what we do. As we do that, we think that the margin enhances, we like being in the high 20s, we still think we can get over 30%, but we're modeling our fiscal year, kind of right around the range that we've been coming in at. So, we don't want to get too ahead of the curve, but we are optimistic about the margins long-term.

Aaron Grey

All right, great. Thanks for that detail. I'll jump back in the queue.

Nick Kovacevich

Thanks, Aaron.

Operator

Our next question comes from the line of Owen Bennett with Jefferies. Please proceed with your question.

Owen Bennett

Afternoon, gents. So far so good. Just a couple of questions for me, first or both related to guidance. So on the top end of '21 guidance, you mentioned that the flex, certain states coming online I was just wondering how many more states you're factoring into that assumption? Then on the election, just curious if the Democrats were to take the Senate and chances of something like the more that's happening in 21 increases, assuming you can get access to capital, would you want to be spending money ahead of that, or would you prefer to wait until we actually saw the legislative changes come into place? Thank you.

Nick Kovacevich

Yes. Great questions. So, the first question on what we're making into the guidance, we kind of look at let's put the guidance at the mid-point, right, $135 million. I think we look at the lower side of the range of $120 to $135, not factoring in any new additional markets. Where we look at the higher side of that range, $135 to $150, that would factor in maybe a little bit of boost from New Jersey, potentially Arizona, potentially Montana, but it's more likely that New Jersey will be the main driver. They seem more motivated to getting this thing live quicker. So, that's kind of how we're looking at it and it's certainly not an exact science. We recognize it's tough to forecast in this industry because it's very dynamic. But that's how we're kind of looking at that guidance range.

Then the second part of the question was—what was that Stephen?

Stephen Christoffersen

How aggressive we want to be with…

Nick Kovacevich

Yes, with the capital. So look, I think right now it's looking pretty good in terms of the Senate changing hands. I think that's what most of the models are showing. We know that there's record voter turnout at this stage in the election, which if that continues, probably favors the Democrats. If they do get control of the Senate, Schumer has pretty much said this is going to be a key area of focus. Can we trust politicians and what they say? No, but it does feel good that he's talking about it at this stage, and it seems like there is a focus of this—of the democratic party to move some legislation. So, that's great. It will certainly open up capital.

I don't think we will look at this as an opportunity for Kush to raise capital and spend money to grow, but really more of an opportunity for players in the industry to access capital, and we know that there's going to be a lot of groups trying to come into the industry once they get that line of sight to federal legality, they're going to want to ramp up. We know that the folks that are already expanding and growing are going to be able to accelerate that growth. And then we're going to kind of play it on the backside with taking that effect and seeing increased volume in the market, increased demand for our product, and then making sure we have enough capital to support that demand.

We feel great about the capital that we have to execute on our current plan and hit the guidance that we just put out. But, if there creates a scenario where there's now a rush into the market, people really want to spend ahead of that, and then that does translate to more sales for KushCo, and we've got the opportunity to exceed the guidance that we put out and we need capital to be able to support that, yes, of course, we would consider it at that point.

Owen Bennett

Okay, perfect. Thanks very much, guys.

Nick Kovacevich

All right. Thanks, Owen.

Operator

Our next question comes from the line of Scott Fortune with ROTH Capital Partners. Please proceed with your question.

Scott Fortune

Good afternoon, and thanks for taking the questions. Kind of a follow-up, great job on growing the MSO part of this. But as you mentioned, and we think we're hearing here in California, more of these cities are looking to access or add retail sales for that. Are you seeing improvement and bigger opportunity to re-engage with the smaller operators outside the MSOs? Or, is it still too early a little bit with these operators and the balance sheets? Kind of step us through as you see the trends in the quarter on that segment of the business moving forward here.

Nick Kovacevich

Yes, great question. A lot of people focus on the macro and certainly no bigger macro than federal legalization, and then most people go down and look at okay, New Jersey and Arizona and new states coming online, New York, right talking about it. But to your point, something that's going to really move the needle in the near term is down at the local level. We know California has still only 700 to 800 retail stores, liquor has 28,000. I don't expect cannabis to be there in the next five years, but they're certainly going to get somewhere in between where they are today and where liquor is today. So, how's that going to happen? It's going to happen with local municipalities allowing retail, something they haven't traditionally done in many cities throughout California. Orange County is a good microcosm, it's our headquarters.

As we said before, Santa Ana is the only city in Orange County that is allowed retail. We now know that Stanton is going through the application process. It's on the docket at the Fullerton city council meeting. Costa Mesa is now considering retail, even Anaheim is talking about retail. Disney is typically had the influence there, but Disney is not bringing in a lot of money for Anaheim right now. So, people are changing their tune, that's happening across the board. I mean, that's a great thing for companies in California, it's ultimately going to be a great thing for us as well.

We're not going to rush in terms of taking a lot of risk at this stage. Our hands are pretty full. We have limited resources now we've really cut back on our resources and we have to allocate those resources to the highest ROI, and right now we're seeing that with MSOs and we're seeing that with LPs, and leading brands. There are some leading brands that we represent in California and we put a lot of effort behind them, but we're going to pick our spots when it comes to up and coming smaller brands. We certainly are going to pick our spots. We can—we make exceptions, we extend credit, we extend resources, and folks are buying cash too. When the market heats up, more people are going to need our stuff and they're going to be willing to pay for it, especially if their financing options improve.

So, we think it is ultimately a positive trend, but something that we're not going to rush and overextend ourselves to try to capitalize on at this early stage. But, more so pick our spots, ride the horses that we do have, and kind of let this market continue to mature and develop and let those winners separate more. Once they've clearly defined as winners, then we can invest more time, more resources, and more credits into those accounts.

Scott Fortune

Okay. No, I appreciate that color. Shifting up North down here in the states, obviously, we see strong demand, consumer demand moving away from the listed side the states more legalization, the cities like you just talked to them moving forward in potential federal legalization, but kind of what's your Canadian expectations over 2021? We know it's been about consumer access and they're starting to get more stores up there, it's still oversupply pricing environment makes it tough, but what's your sense that kind of starts to move the—you said you're working out your Canadian LPs to drive growth there, but what's your sense of moving Canada forward going into 2021 here?

Nick Kovacevich

Yes, so we have some really good anchor clients in Canada. Now, some of the largest LPs. We want to be doing more with those customers. We have robust product lines with them today, but we can expand that, and instead of one or two product lines, end up with four or five product lines. So, there's certainly room for growth. We're also onboarding some new LP clients as well, some smaller ones that end one case the newer one that just popped up. But, we think that Canada is going to be fairly steady and growing for us. We think that obviously there's some challenges in the market as you mentioned with the retail access with pricing sort of coming down, we are seeing more of a focus on cost control and that is actually presenting an opportunity because as we shared before, we were not as strong in Canada when it came to flower packaging, and now folks are looking to kind of find a lower cost vessel for their flower so that they can effectively compete with the competitive market that's developing up there.

So, we are getting new looks, but with those cheaper options, you've got to move a lot of volume to move the needle. So we're not—we're not expecting anything too crazy from Canada, as we said here with our numbers for Q4. We don't really read it into the depth that we had there because we think that was just timing, but we feel very good about kind of our base level there, call it around $2 million a quarter. We think we can grow that. But, we're not going to project anything like 100% year-over-year growth in that market.

Scott Fortune

Got it. Thanks. I'll jump back in the queue.

Nick Kovacevich

Thanks, Scott.

Operator

As a reminder, ladies and gentlemen, it is star, one to ask a question. Our next question comes from the line of Alan Brochstein with New Cannabis Ventures. Please proceed with your question.

Alan Brochstein

Hey guys, congrats on the quarter. I just have a quick one because I was going to ask about California and I appreciated your response. My question is just back to the potential uplisting to the Nasdaq, is that still something that's possible in a—what would it take for you guys to be able to do that? Is it just giving the share price to a certain level? Are there any other outstanding issues that you can say?

Nick Kovacevich

Alan, great to hear from you, and thank you for tuning in and all the support you've always given us. So we appreciate it even through the downturn. In terms of the uplist, it's no secret that we've been working on uplisting to Nasdaq for quite some time. Unfortunately, a lot of things have changed over the last year. So, we're adjusting to that. We're still focused on uplisting. We do believe we will be able to uplist. As you mentioned, right now there is a discrepancy between the minimum listing price and our current share price. Hopefully, that changes tomorrow. By the way, the minimum is $2.

So again, hopefully, that will change tomorrow, but we can't control that. There are other ways to obviously move the share price up as we need. But that would be something done at the last stage. So, we're not at that stage, unfortunately, we can't comment on the stage that we're at. But we can say that we do believe we will be listed at some point down the road. It's something that we're working on and it's something that remains as a potential catalyst for the stock, if, and when that does happen.

Alan Brochstein

As a follow-up, there's some specs out there, and obviously merging into a spec would be a way to get on the Nasdaq as well. Is that even possible?

Nick Kovacevich

Well, I think—I think if we didn't feel like we could do it organically, we would more seriously consider an alternative like that. That is something we could consider at some point, but we feel that's premature because we do believe we can vouch on our own, and it's not like those deals come together overnight, there's a lot of work involved there. Also, a lot of dilution involved and quite frankly, I think we've been in the penalty box because of the dilution that we've had over the last year. We appreciate our shareholders that have stuck with us, and so we're mindful of that.

We're looking to minimize dilution across the board. We feel like we're finally in a position as a business to be able to control that, to be able to control our own destiny. So look, we want to be listed. We want to be on Nasdaq. It's certainly a big goal of ours. But the most important thing right now is executing on our business, producing profits. We've got it to $8, $5 to $7 million of EBITDA for this next fiscal year. I think if we can hit that or exceed that we're in phenomenal shape. What will happen with the exchange will happen when it happens, that's the mindset we have to have, we have to be focused. We're delivering a lot of value to our customers and we were very pleased to put out a customer survey right at the end of our fiscal year with our top 10 customers really high remarks, 8, 9, 10 out of 10 on all the critical things that we were asking.

So, we're thrilled to have the confidence of some of the largest MSOs in the world that rely on us for their supply chain, and we are going to deliver on execution to be able to support them. Everything else is behind that. But certainly listing on Nasdaq is a goal of ours and I think we could do it organically or else we would explore other routes.

Alan Brochstein

All right, sounds great. Good luck in the year ahead, Nick. Thank you.

Nick Kovacevich

Thank you, Alan.

Operator

There are no further questions in the queue. I'd like to turn it back to Mr. Kovacevich for closing remarks.

Nick Kovacevich

All right. Thank you, everyone. We appreciate the great questions. Thanks for tuning in. There's a lot of news going on right now, and I'm sure there's a lot of places you could be, I appreciate you tuning in to our call and hearing our update. This is an exciting time, not only for KushCo but the entire industry. We are a few days away from the general election, a historic election on all fronts, especially when you think about cannabis. I mentioned on the last call, that 2020 could be the biggest year, not only for KushCo in a sense of us achieving positive Adjusted EBITDA and cash flow from operations, which we did, but also for the industry as residents of five states are voting on adult and medical use legalization right now and through Tuesday.

On top of that, there are key Senate races in many states that could play a big role in how our industry supports this next stage of growth through increased market access and sources of capital. All of this has significant implications for our industry, making it imperative that we get out there and vote, no matter which side of the political aisle you stand, there is no denying how critical this year is for cannabis, legalization, awareness, and acceptance.

We all have a part to play in pushing this industry forward and next week is a perfect opportunity to play that part through your voting. I also would like to remind everyone that here at KushCo we gave our entire Company, November 3rd, a full paid day off so that they can not only vote but volunteer at the polls if they're inclined to do so. We encourage other companies to do the same, if you haven't already, especially if you're a business that's benefiting from the legalization of cannabis and progression of cannabis.

It has become a bit of a cliche to say, but in our industry has truly reached an inflection point. Nobody knows if we're going into 2.0 or 3.0 or 4.0, but we know that this is an inflection point. Twenty-twenty one is shaping up to be a better year from a state legalization and market expansion perspective, and if we can make our voices heard in circles, forums, and booths, that really matter, who knows what new heights this industry can reach in coming months.

I'll end by saying thank you as always for continuing to follow the KushCo story and enduring the challenging times we have faced in Fiscal 2020.

Overall, it's not how you start the race that matters, but it's how you finish it. After all, we went through and accomplished this year, I would say that we finished off the race in the best way imaginable, setting us up nicely for Fiscal 2021 and the industry catalysts that are around the corner.

So again, thank you all for listening. We look forward to updating you on our next earnings call. Take care, stay safe, everyone, and go vote.

Operator

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.