GrowGeneration Corp.

First Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

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Darren Lampert
GrowGeneration Corp. — Chief Executive Officer

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CONFERENCE CALL PARTICIPANTS

Alan Brochstein
420 Investor — Analyst

Aaron Grey
Alliance Global Partners — Analyst

Roger Duan
RF Lafferty & Co. — Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen. My name is Leonie, and I'll be your conference Operator today. At this time, I would like to welcome everyone to GrowGeneration Corp. first quarter 2019 earnings conference call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, followed by 2. Thank you.

I would like to turn the conference over to your host, Mr. Michael Salaman, President. Please go ahead.

Michael Salaman — Co-Founder & President, GrowGeneration Corp.

Thank you. Good afternoon. My name is Michael Salaman, Co-Founder and President of GrowGeneration Corp.

At this time, I would like to welcome everyone to the GrowGeneration First Quarter 2019 Earnings Call. With me is Darren Lampert, our CEO; and Monty Lamirato, our CFO, who will both be participants on our call this afternoon. After our CEO and CFO's remarks, there will be a question-and-answer session.

One bit of housekeeping related to our IR activities. Our shareholder meeting is scheduled for 3:00 p.m., May 16th at the law offices of Robinson+Cole in New York City.

With that, let's move forward on today's call.

As always, we expect to make forward-looking statements this afternoon. But I want to caution you that our actual results could differ materially from what we say here. Investors should familiarize themselves a full range of risk factors that could impact our results, and those are filed in our Form 10-K, which we filed with the Securities and Exchange Commission.

I'd also remind everyone that today's call is being recorded, and an archived version of the call will be available on our website later today.

Let's get things started.

For those of you who are newly being introduced to GrowGeneration, we're a publicly held company trading on the OTCQX exchange. We are the largest and fastest-growing chain of hydroponic garden centres selling directly to all types of cultivators and growers throughout North America. Our growth has been driven through same store sales and from an acquisition strategy, aggressively opening up new locations.

Since our inception, the Company has delivered year-over-year growth of over 100 percent selling thousands of specialty products and servicing tens of thousands of growers of all types. With hyper-growth comes infrastructure, which we've built across sales, purchasing, logistics, technology, and accounting. The Company now has the foundation to surpass $100 million of revenue profitably next year.

Today, we have five wholly owned subsidiaries that reflect the corporate initiatives and strategies of the Company for 2019 through 2020.

First subsidiary is GrowGeneration Canada Corp., which is a corporation that we formed to expand our operations into Canada, which we planned to do in 2019.

Second, GrowGeneration Management Corp. is securing large capital projects and build-outs, consisting of a team of 10 commercial experts.

Three, GrowGeneration Hemp Corp. is a dedicated division solely for developing a supply chain of agricultural products solely for hemp farms.

Fourth, GrowGen Distribution Corp. is developing and has developed proprietary products across all product categories to drive higher margins and generate sales into various vertical markets.

And lastly, advancing our e-commerce strategy through our recent acquisition of HeavyGardens.com. We are now adding e-commerce functionality to all of our locations, which we plan to have completed by the end of this year.

With that said, I will now turn the call over to Darren, who will present the financial results of our first quarter.

Darren?

Darren Lampert — Chief Executive Officer, GrowGeneration Corp.

Thank you, Michael. Good afternoon, and welcome to our first quarter 2019 earnings call.

We'd like to begin our call by thanking our shareholders, management, and employees for their continued support and belief in the mission Michael and I set forth five years ago, to build the largest national chain of hydroponic stores in the United States. With 21 locations in eight states, a rapidly expanding online superstore, HeavyGardens.com, today GrowGeneration is a leading marketer and distributor of nutrients, growing media, advanced indoor and greenhouse lighting, ventilation systems, and accessories for hydroponic gardening.

The Company's first quarter financial results were transformational. We improved the financial performance of the Company in all areas. I'm going to read this one more time because it's been five years, and this is such an important milestone for GrowGeneration and its staff.

The Company's first quarter financial results were transformational. We improved the financial performance of the Company in all areas. Revenue was up almost 200 percent year over year and almost 50 percent from fourth quarter 2018 over first quarter 2019.

Adjusted EBITDA was over $600,000 and a positive $0.02 per share. Our same store sales were up approximately 42 percent year over year, with margins increasing over 1 basis point. Year over year, the Company increased revenue by $2 million in California and Colorado, 1.5 million in Michigan and Oklahoma, and $500,000 in both Rhode Island and Nevada.

The newly acquired stores and our new store openings are all performing much better than expected. Our newly acquired e-commerce store, HeavyGardens, added almost $700,000 in new revenue.

Our commercial division added over 2.5 million in revenue from some of the largest, multistate operators in the country. GrowGeneration now services Harvest, TILT, iAnthus, and Cresco Labs, to name a few of our multistate operators.

Our strategies to increase margins are working, by purchasing in larger volume and buying more efficiently. With our significant top- and bottom-line growth, we were still able to reduce our operating expenses by 26 percent and our corporate overhead by over 100 percent as a percentage of our revenue. As our revenue continues to increase and corporate overhead stays relatively flat, we will continue to increase net income quarter over quarter.

With Q2 being our traditionally strongest quarter, revenue and net income are trending significantly higher than our first quarter numbers. We have a strong pipeline of new acquisition targets set to close in Q2.

The Company continues the process of up-listing the Company to a larger exchange.

We are increasing our guidance for 2019, revenue to 60 million to 65 million and adjusted EBITDA to 0.14 to $0.18 per share for 2019.

I'd like to go over a few of our first quarter 2019 financial highlights.

Adjusted EBITDA of 615,000 for Q1 2019 compared to adjusted EBITDA of negative 366,000 for Q1 2018. Net income of 229,000 for Q1 2019 compared to a net loss of 953,000 for Q1 2018.

Revenue of 13.1 million, up 8.7 million or 199 percent over Q1 2018 revenues of 4.4 million.

Same store sales were up 42 percent for Q1 2019 compared to Q1 2018.

Acquired stores in Denver, Colorado; Palm Springs, California; and Reno, Nevada and opened Tulsa, Oklahoma and Brewer, Maine locations in 2019. To date, all stores are performing better than expected.

Gross profit margin's percentage was 28.2 percent for Q1 2019 compared to 27.1 percent for Q1 2018.

Store operating costs as a percentage of revenue have declined 26 percent, from 20.4 percent for Q1 2018 to 15 percent for Q1 2019. Corporate overhead declined 107 percent, from 21.8 percent of revenue for Q1 2018 to 10.5 percent of revenue for Q1 2019.

The Company has 6.6 million in cash and cash equivalents at March 31, 2019. As of March 31, 2019, the Company had working capital of 17.4 million compared to working capital of 21.6 million at December 31, 2018.

With that, I'd like to turn the call over to Monty Lamirato, our CFO, who will present the financial results in more detail for our first quarter.

Monty Lamirato — Chief Financial Officer, GrowGeneration Corp.

Thanks, Darren. Some of these items Darren went over, but I'll give a little bit more detail.

So net revenue for the three months ended March 31, 2019, increased approximately 8.7 million or 199 percent to approximately 13.1 million compared to approximately 4.4 million for the three months ended March 31, 2018.

The increase in revenues in 2019 was primarily due to the addition of 14 new stores opened or acquired after January 1, 2018, and the new e-commerce site acquired in mid-September 2018. The 14 new stores and the new e-commerce website contributed 9.9 million in revenue for the quarter ended March 31, 2019.

Four new stores, which were opened at various times during the quarter ended March 31, 2018, contributed sales of 1.7 million during that quarter.

Same store sales were up 42 percent for Q1 2019 compared to Q1 2018.

Cost of goods sold for the three months ended March 31, 2019, increased approximately 6.2 million, or 195 percent to approximately 9.4 million as compared to approximately 3.2 million for the three months ended March 31, 2018. The increase in cost of goods sold was primarily due to that 199 percent increase in sales comparing the three months ended March 31, 2019, to the three months ended March 31, 2018.

Gross profit was approximately 3.7 million for the three months ended March 31, ‘19 compared to approximately 1.2 million for the three months ended March 31, 2018, an increase of approximately 2.5 million or 210 percent.

Gross profit as a percentage of sales was 28.2 percent for the three months ended March 31, 2019, compared to 27.1 percent for the three months ended March 31, 2018.

Store operating costs as a percentage of sales were 15 percent for the three months ended March 31, 2019, compared to 20.4 percent for the three months ended March 31, 2018, a 26 percent decline in store operating costs as a percentage of revenue. Store operating costs were positively impacted by the acquisition of new stores in 2018 and 2019, which have a lower percentage of operating cost to revenue due to their larger size and higher volume.

Corporate overhead was 10.5 percent of revenue for the three months ended March 31, 2019, and 21.8 percent for the three months ended March 31, 2018, representing a reduction as a percentage of revenue of 107 percent. Corporate overhead, excluding noncash depreciation, amortization, and share-based compensation, declined from 15.9 percent of revenues in Q1 2018 to 8.8 percent of revenues for Q1 2019.

Company continues to focus on eight markets and the new e-commerce site and with the growth opportunities that exist in each market. We continue to focus on new store acquisitions, proprietary products, and the continued development of our online and Amazon sales.

With regard to the balance sheet, as of December (sic) [March] 31, 2019, we had working capital of approximately 17.4 million compared to working capital of approximately 21.6 million as of December 31, 2018, a decrease of approximately 4.2 million.

The decrease in working capital from December 31, 2018, to March 31, 2019, was primarily due to, one, the use of cash in the acquisition of three new stores during the quarter ended March 31, 2019; and two, the application of a new accounting standard related to operating leases, which resulted in 1.2 million in current liabilities being added to the balance sheet.

At March 31, 2019, we had cash and cash equivalents of approximately 6.6 million. And as of the date of this filing, we believe that existing cash and cash equivalents are sufficient to fund existing operations for the next 12 months.

Darren, let me send the call back to you.

Darren Lampert

Thank you, Monty. GrowGeneration has built a supply chain with 21 locations in eight states. Today, GrowGeneration is the leading marketer and distributor of nutrients, growing media, advanced indoor and greenhouse lighting and ventilation systems, and accessories for hydroponic gardening.

Our company improved its financial performance significantly in the first quarter 2019 versus first quarter 2018. Revenues were up 200 percent, margin's up 1 point, adjusted EBITDA was a positive $0.02 per share, with operating expenses down 26 percent and corporate overhead down 107 percent as a percentage of revenue.

Second quarter's trending up, as it is our traditionally strongest quarter of the year. We service thousands of growers and several of the country's largest multistate operators.

The Company continues the process of up-listing to a larger exchange. We project strong growth and margin expansion in 2019. We're adjusting our guidance up for 2019 to 60 million to 65 million in revenue and 0.14 to $0.18 a share in adjusted EBITDA.

We look forward to sharing our continued successes with our shareholders, our management team, and partners.

Michael Salaman

We will now open the call up for questions, Operator.

Q&A

Operator

Thank you. Ladies and gentlemen, once again if you do have a question, please press *, followed by 1 on your touch-tone phone. If you're using a speakerphone, please lift your handset before pressing any keys. One moment, please, for your first question.

Your first question is from Alan Brochstein from 420 Investor. Alan, please go ahead.

Alan Brochstein — 420 Investor

Hey, guys. Congratulations. Very exciting to see the financials you shared this quarter.

Michael Salaman

Thank you.

Darren Lampert

Thank you, Alan.

Monty Lamirato

Thank you.

Alan Brochstein

I just had—first of all, I appreciate you guys sharing some of your clients. I think that's the first time I've heard that, and I heard TILT Holdings, Cresco, and iAnthus. I think you mentioned another one, if you could just—

Darren Lampert

Harvest.

Alan Brochstein

Harvest. Got it. Thank you. So one of the things I noticed was the inventory build, you guys used some cash. And I understand you believe you have enough cash to handle your current operations for the rest of the year, but clearly you guys have been in an M&A mode. Are you finding some other potential ways to raise cash besides selling equity? I've seen some of your peers tap into the debt markets, for instance. Are there any other forms of financing open to you guys at this point?

Michael Salaman

Yeah. Alan, we’re currently exploring all types of financial instruments to finance acquisitions. Currently we have enough capital, cash on our balance sheet to fund acquisitions that we’ll be doing over the next month or two. But once again, we’re always looking for additional types of funding for accretive acquisitions.

Alan Brochstein

Okay. And then my next question is—fantastic job in some of these new markets like Oklahoma and Michigan where you guys went from zero to something substantive, pretty much immediately. Now I’m just wondering if you could talk about these markets in terms of whether or not you’re seeing other competitors emerge? Or how big the runway could be in some of these new markets that you guys have entered?

Michael Salaman

The strategy of the Company, Alan, has been to be a first-mover. And we went into Oklahoma as the laws were passed, and they were very favourable laws pertaining to the number of licences that they’ve issued, which provides GrowGeneration with a nice, targeted list of growers and cultivators. And because of that, we’ve captured the market. And with our brand and our staff and our ability to service these commercial growers, we have customers coming to us. We do very little marketing in these markets, so it’s mainly word of mouth and providing a complete, one-stop shopping solution for those licensed commercial growers.

And we see that in the other markets as well. Michigan, we’ve entered into, and it’s another market that we see a lot of potential for 2019 growth. And we’re constantly identifying these emerging markets as the laws pass. GrowGeneration will be an early mover to put our operation in those markets, to provide a one-stop solution for these large commercial operators. And the strategy’s working.

Darren Lampert

Yeah. Alan, I think—this is Darren—I think a good way to look at GrowGeneration, we will be a first-mover in all new markets and certainly a consolidator in more mature markets. And what you're seeing right now in our first quarter numbers is the resurgence of the Colorado and California markets, and you're also seeing new markets opening up to GrowGeneration, where we are a first-mover. So you're really seeing the perfect storm.

You're seeing consolidation in a lot of the mature markets that we're leading right now. So you're certainly seeing a lot of the smaller companies that can't handle the large MSOs and the large cultivators closing their doors. And you're seeing the larger, more well-funded companies starting to take over in some of these more mature markets.

And you're also seeing within a 45-day lead period, we have a team over at GrowGen that can open a store anywhere in the country and do it right and get it stocked right. And through our experiences in our eight states right now, we're getting much more efficient in opening stores in new states.

Alan Brochstein

Great. And then, when I saw you guys in Miami in January, you were very excited about the hemp opportunity, and I'm sure that's playing out. But can you just share a little bit with us about your progress in that vertical?

Michael Salaman

Did you say hemp?

Alan Brochstein

Hemp.

Michael Salaman

Hemp. Yeah. We formed our division, and we're defining—I mean, there's complementary products that we already stock that would work for the hemp market, but we're also learning there's large agricultural machinery and other products that we're investigating to put into a portfolio. And the goal is to create a supply chain, like we've done on the cannabis side and do the same thing for the hemp market.

Alan, we certainly believe that the farming and the cultivation and the acreage that today is about 75,000, based on our data, is only going to get larger. And GrowGeneration is so well positioned to take its knowledge of the plant and also its ability to create a supply just-in-time channel for cultivators and farms.

We just want to get the product right, and we're doing the work right now. We're putting our program together, and it's something that will be available on a very turnkey basis, like we have on the cannabis space, in the next month or so. So it's something that's a work in progress, and we are extremely excited about the accretive revenue that that vertical market can bring to the Company.

Alan Brochstein

Great. So just to be clear, all the success you just had in Q1 didn't even include much of anything from hemp. Right?

Michael Salaman

Very, very little, and we've started to fulfill some of the Kentucky-based farms and the farms in North Carolina and some in the Colorado market, but very, very small as a percentage of our overall business.

Alan Brochstein

Okay. I'll jump back in the queue. Thank you for taking my questions.

Darren Lampert

Thank you, Al.

Michael Salaman

Thank you, Al.

Operator

Thank you. Your next question is from Aaron Grey from Alliance Global Partners. Aaron, please go ahead.

Aaron Grey — Alliance Global Partners

Thanks for the question, and congrats on the quarter, guys.

Darren Lampert

Thanks, Aaron.

Michael Salaman

Thank you.

Aaron Grey

So quickly, just on the top line raised guidance. Can you talk about which states kind of came in ahead of expectations there? I know Oklahoma did very well. So I guess, what drove that outperformance for you guys to raise that top line? And was it both part of 1Q and then also what you're expecting going forward? Or is the embedded kind of raise in guidance more just the upside that you saw in 1Q?

Darren Lampert

Well, it was a little of both, Aaron. We're seeing strong performance in all our stores. It's not only just one state. We're seeing the resurgence of some of our old, more mature states that we're in, California and Colorado, and also Rhode Island.

But we're also—we purchased three stores in Michigan a year ago that we're seeing tremendous growth in. We bought a three-store operation that was doing about 3.5 million. Those stores are on a 6.5 million to 7 million run rate right now.

And we're seeing tremendous, tremendous growth in our Oklahoma markets, in new stores that we've opened. So I mean, we're seeing growth everywhere. We're seeing our old stores starting to work, we're seeing our new stores starting to work, and we're also seeing our online store starting to gain some traction.

So it was basically, the first quarter was strong straight around. We saw no weakness within the quarter at all. And we're going into our seasonally strongest second quarter right now. Our first month sales are tracking wonderfully, and we're into May right now. So everything seems to be firing on all cylinders right now.

Michael Salaman

The one other thing that I would add, Aaron, is that our commercial division, which is a fairly new division that the Company formed this year, is really starting to get its legs under itself. We now have 10 individuals that all they do is work to obtain commercial accounts, the large multistate operators; they're dedicated managers for those accounts. And that side of the business is growing, and we see that side of the business certainly continuing to grow and support the operation at the store level.

Our e-commerce business is growing. That's another part of the business that we didn't have last year. And that's a nice-to-have, and it's certainly part of the long-term strategy of enabling our customers to not only come into one of the locations, which they love to do, by the way. They love to talk to one of our professional growers, but they also would like the convenience of accessing their orders online and being able to pick it up or have it delivered. So that technology is being evolved from our acquisition that we made that's going to be embedded as part of our optionality for our customers.

So I think it's really—as Darren said—it's a combination of everything: consolidation, expansion, growth. And GrowGeneration has scaled its business where it can now attract these large multistate operators, which are very challenging to manage on a national level and a regional level, and they're coming to us because we're performing and we're executing. And we see that continuing.

Aaron Grey

All right. Great. And yeah, I just want to dig a little bit deeper on kind of those MSO relationships where you've made a lot of progress. Just what stage would you say you are in that effort to kind of penetrate those large players? And has that been evolving kind of faster than you think? I think you've just kind of touched on it before, but.

And also, within working with those players that you talked about earlier, I guess, what level are you working with them? Do you kind of first start within one state and then hope to kind of expand and be a provider for them in multiple states? Or, I guess, can you just talk about kind of how that kind of evolves in terms of the relationships you have with the current MSOs you're working with? And also, as the ones you have—

Darren Lampert

Yeah. Yes—

Aaron Grey

—come on board?

Darren Lampert

Yeah. It works exactly the way you described it. It starts in a region and then it—we start to get our experience working with the MSOs in a market, and then we expand into a second and tertiary markets. All the companies that we mentioned were in multiple locations. So within those MSOs, there's continued growth, organic growth, because all these MSOs are in multiple locations. Most of them are in 8, 9, 10 different locations.

Right now, the Company with the MSO business is in a handful within those individual organizations. So as we continue to service the individual grows within their portfolio, we're expanding organically through an MSO strategy because they have multiple cultivation facilities. And it's working. It's certainly working for the Company.

Aaron Grey

All right. Great. That's all I have on my end. Best of luck.

Darren Lampert

Thank you.

Michael Salaman

Thank you, Aaron.

Monty Lamirato

Thank you.

Operator

Thank you. Ladies and gentlemen, as a reminder should you have a question, please press *, followed by 1.

Your next question is from Roger Duan from RF Lafferty & Co. Roger, please go ahead.

Roger Duan — RF Lafferty & Co.

Hi, Darren. Hi, Michael. Congrats on the quarter.

Darren Lampert

Thank you, Roger.

Michael Salaman

Thank you, Roger.

Roger Duan

Hey. So just quick … a couple of quick questions. First of all, can you talk a little bit about your private label business and how is it progressing? Sort of, is it what contributed to your margin expansion for this quarter? And where do you think this is going, this particular segment is going going forward?

Michael Salaman

Roger, the private label business, which was based on the acquisition that we made of about 18 different trademarks and we picked up some inventory, it's just now starting to benefit the Company from a margin perspective. It just recently within the last 30 days we've moved product into the stores. And that, in combination with our buying power, our ability to buy more direct and get better deals, is what's driving our margin strategy and our margin increase.

In addition, the Company's working to develop intellectual property around different types of products that will be private labelled and owned. And that's something that's been in a work in process that has yet to come into the market, but we are developing different products that will have IP attached to it.

Roger Duan

Right. So are those private label products in all the states right now? Or is it still in the like sort of the regional test run—

Michael Salaman

They're still being developed. They're not in the market as of today.

Roger Duan

Okay. Okay. No problem. So second, as you talk about your multistate … your relationship with multistate operators, will it—as they usually have bigger purchasing powers, will it be a problem for you guys in terms of they sort of pressure down the price for the product they're buying? And how will it impact your margin as their percentage of—as their purchase becomes bigger as a percentage of your revenue, if that makes sense?

Darren Lampert

Roger, again, our margins are going up, not down right now. So we're seeing—

Roger Duan

Yep.

Darren Lampert

—no pressure from the MSOs on—

Roger Duan

Mm-hmm.

Darren Lampert

—on a margin standpoint. We look at GrowGen, again, we have 21 stores and an online store. So what you're seeing is a blend of margins, which starts at the bottom with the MSOs and goes straight up to the individual customers that are growing lettuce and tomatoes.

So right now, our margins have never been stronger. I think our first quarter was our strongest margin quarter, and we're seeing it continuing into the second quarter.

Roger Duan

Okay. Great. I think that's it for me. Thanks.

Darren Lampert

Thank you, Roger.

Operator

Thank you. There are no further questions at this time. Please proceed.

Michael Salaman

Well, we wanted to thank everyone for taking the time today. And we appreciate our shareholders, our management team, and we're excited to talk about our second quarter shortly.

Everyone, have a great afternoon, and thank you.

Darren Lampert

Thank you.

Operator

Ladies and gentlemen, this concludes your conference call today. We thank you for participating and ask that you please disconnect your lines.