GrowGeneration Corp.

Third Quarter 2020 Earnings

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PRESENTATION

Operator

At this time, I'd like to welcome everyone to the GrowGeneration Corp. Third Quarter 2020 Earnings Call.

All lines have been placed on mute to prevent any background noise.

After the speaker's remarks, there will be a question-and-answer session. If you'd like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you'd like to withdraw your question, please press star, followed by two. Thank you.

Mr. Michael Salaman, you may begin your conference.

Michael Salaman:

Thank you. Good morning. My name is Michael Salaman, Co-founder and President of GrowGeneration. At this time, I would like to welcome everyone to the GrowGeneration Third Quarter 2020 Earnings Conference Call.

With me this morning is Darren Lampert, our CEO and Co-founder; Monty Lamirato, our CFO; and Tony Sullivan, our Chief Operating Officer. We will all be participants on our call this morning. After our CEO, CFO, and COO's remarks, there will be a question-and-answer session.

As always, we expect to make forward-looking statements this morning, but I want to caution you that our actual results could differ materially from what we say here. Investors should familiarize themselves with the full range of risk factors that could impact our results. 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 I'd also remind everyone that today's call is being recorded and an archived version of our call will be available on our website later today. Let's begin the call.

In the third quarter, GrowGeneration continued to further its leadership position in the hydroponics and garden supply industry. We recorded our eleventh consecutive quarter of record revenues, and we achieved record Adjusted EBITDA and net income for the quarter ended September 30, 2020. Today, we have 31 locations and recently announced the signing of an asset purchase agreement with the nation's third largest chain of hydroponic garden centers, The GrowBiz.

In anticipation of legalization passing on October 12, we added our eleventh state with our purchase of hydroponics depot located in Phoenix, Arizona. In addition, with New Jersey approving adult use cannabis, GrowGen anticipates opening a location in the Garden State in the spring of 2021. With the four new states that passed adult use legalization, there are now 15 states, or approximately one third of the country, where consumers can purchase cannabis for recreational purposes. We continue to build out our supply chain in mature markets and open new GrowGen garden centers in these new emerging states.

The third quarter saw all sales channels come together and perform extremely well. Our total sales were up 153% with commercial sales up 188%, and e-commerce sales up 112% versus the same quarter last year. We successfully launched our website now located at growgeneration.com. That is the focal point of our omni-channel and multi sales channel strategy. Our private label products are in full production and we feel very confident that we will achieve our goal of 10% of all sales in 2021 coming from our line of private label products.

With approximately $50 million of capital on our balance sheet today, we've expanded our institutional ownership to over 50%. Our Company is executing additional acquisitions, securing leases for several new store openings to continue to fuel our growth. GrowGen's business model is working well as we continue to scale the business with a relentless focus on execution discipline.

I will now turn the call over to Darren Lampert, our CEO and Co-founder, who'll present our third quarter 2020 financial results. Darren?

Darren Lampert:

Thank you, Michael.

Good morning, and welcome to our third quarter 2020 earnings call.

Before I begin my prepared remarks, I would like to thank each and every one of our staff and customers for their hard work, dedication, and loyalty. As we continue to monitor the COVID-19 outbreak, GrowGen is considered an essential supplier to the agricultural industry, supplying the nutrients and nourishments required to feed their plants.

Accordingly, all our 31 garden centers remain open during this difficult time. We have procedures in place to ensure our customers and employees stay safe. All of us at GrowGeneration remain committed to the safety and wellbeing of our customers and employees. We're excited to report another quarter of record financial results and operating performance by our Company.

As we continue to outpace our guidance, we are increasing Fiscal Year 2020 revenue guidance to $185 million to $190 million, increasing Adjusted EBITDA guidance for 2020 to $19 million to $20 million. We have set 2020 full year GAAP pre-tax net income guidance to $9 million to $11 million. Revenue guidance for full year 2021 is $280 million to $300 million, and full year Adjusted EBITDA 2021 is $34 million to $36 million.

The Company’s third quarter 2020 record financial results reflect our continued focus on revenue growth and Adjusted EBITDA expansion. The third quarter of 2020 was the Company’s eleventh consecutive quarter of record revenue growth.

Our continued ability to attract the best of breed hydroponic garden centers is again evidenced by the recent signing of our asset purchase agreement with The GrowBiz that we planned to close before the end of the year. The GrowBiz adds an additional five garden centers in California and Oregon to the GrowGen portfolio as the nation's third largest hydroponic chain. The GrowBiz business is operating in an annual revenue run rate in excess of $50 million.

Founded in 2010 by Ross and Ryan Haley, The GrowBiz team of 60 grow professionals brings tremendous experience and commercial relationships to GrowGen. Ross Haley, the former CEO of Hawthorne Gardening Company, a division of Scott's MiracleGro, will be joining Bob Nardelli, the former CEO of Home Depot, on GrowGen's Advisory Board and will be contributing to the Company in his role as Senior Strategic Advisor.

We look forward to working with Ross, not only continuing his legacy at The GrowBiz, but also working with Ross on future acquisitions and other strategic initiatives.

Revenue grew 153% quarter-over-quarter to approximately $55 million for the third quarter versus $21.8 million in the same period last year. The nine months ended September 30, 2020, revenue was $131 million versus $54 million for the nine months ended September 30, 2019, an increase of 142%.

Adjusted EBITDA was $6.6 million for the third quarter compared to $2 million last year, an increase of 230%. Adjusted EBITDA for third quarter of 2020 was $0.14 per share basic. For the nine months 2020, Adjusted EBITDA was $0.32 per share basic.

Net income from store operations grew 156% to approximately $9.6 million for the third quarter compared to $3.8 million for the same period last year. For the nine months, income from operations grew 161% to $23 million from $8.6 million for the same period last year.

Same-store sales grew 73% in the third quarter when compared to the same period last year. For the nine months ending September 30, 2020, same-store sales grew 59% compared to the same period last year.

Growgeneration.com, the online business, is now generating $1 million per month, up 112% for the third quarter versus last year, and up 140% for nine months ending September 30, 2019 as compared to the same period last year. Our commercial division is projected to do in excess of $40 million in annual revenue for 2020, an added $13 million in revenue in the quarter. This represents 188% increase for the third quarter of 2020 versus third quarter of 2019, and a 200% increase for the nine months of 2020 versus 2019.

To highlight our market-by-market growth. Colorado was up 37% quarter-over-quarter, 27% for the nine months. California, plus 58%, plus 41% for the nine months. Michigan, plus 272%, up 288% for the nine months. Oklahoma, plus 288%, or 312% for the nine months.

Our commercial revenues for the nine months ended September 30, 2020 were $32.7 million. Our e-commerce revenues finished the first nine months of 2020 at $7.5 million.

We continue to focus on margin expansion strategies that include furthering the deployment of more private label products and driving more efficiencies at the purchasing level as we continue to scale and grow top line revenue. Our private label program is in full production and we plan to derive 10% of our revenue from our private label product offerings.

We are proud of the reduction in store operating costs that fell to just 9% of revenue, down 28% from 12.6% compared to the third quarter of 2019. Corporate payroll and G&A, excluding non-cash compensation and depreciation, declined 34% to 5.5% of revenue compared to 8.4% of revenue for the third quarter of 2019. We expect new acquisitions and new store openings to continue through the remainder of 2020 and into the first quarter of 2021 to continue to drive and help achieve our plan: 50 plus locations in 2021 across 15 states.

Following the state legalization roadmap, GrowGen acquired Phoenix, Arizona-based Hydroponic Depot, and is securing leases for New Jersey for a spring 2021 opening of GrowGen locations in the Garden State. The New Jersey locations will serve not only the emerging New Jersey market, but also the adjacent States of New York and Pennsylvania, as we believe both states will follow New Jersey's legalization path.

GrowGen has a tremendous team of essential employees who have made a commitment to our Company and customers, and I could not be any prouder. I am inspired by their efforts and dedication, for they have worked tirelessly to service our customers and communities.

I will now turn the call over to Tony Sullivan, our Chief Operating Officer, who'll brief everyone on our current COVID-19 risk mitigation procedures and key operational initiatives executed in the third quarter; and then to our CFO, Monty Lamirato, who'll provide more details on our third quarter of 2020 results. Tony?

Tony Sullivan:

Thank you, Darren.

We had another successful quarter with record financial results and we are very proud of our team's continued growth, execution, and performance, in the third quarter. As stated by Darren, our top priority has been and will be the safety of our team, their families, and our customers. Currently, all 31 of our locations are open and operating efficiently. We have been relentless and one step ahead with all safety protocols throughout this pandemic. We are classified as an essential business and supply chain for agriculture and medical sectors.

Every city, county, and state and federal COVID-19 mandate, we have been on top of, we monitor all the changes multiple times a day, and we communicate to our teams daily. We have deployed remote working environments for all non-essential store personnel, including at our SSC, E-Com, Commercial, IT, and Purchasing departments. COVID is a fluid ever-changing situation and we continue to manage, monitor, and communicate daily to maintain all communication, safety and cleaning protocols as we work towards our new normal business practices.

We are monitoring and have a significant cleaning and safety supplies in all of our locations. We will continue to stay one step ahead, operating with stricter protocols to keep our teams and our customers safe. We are also ready to implement our proven level one through five protocols, if or when necessary.

Let me give you a couple of updates on our key operating initiatives and accomplishments in the third quarter. We have developed a real estate and a two-year growth strategy that will strengthen our multi-channel supply chain and our state-by-state ownership.

In the area of omni-channel, as Michael had shared with you, our new website is up and running. We are currently testing BOPUS, pick pack and ship, and curbside pickup solutions, as we wrap up the final development and launch our new site.

In the area of private label, our newest product offerings are exceeding our expectations, and phase two expansion is well underway. In the area of SKU rationalization and new store plan-o-gram project, we have selected one of the top industry partners in the space. We anticipate significant learnings and data to improve our inventory turn and optimization of inventory and profits.

With our new brand, Reset and Refresh, we have started our rebrand strategy where we will rebrand, resign, and develop a consistent customer experience across our multi-channel sites and stores.

GrowGeneration West Lansing, we consolidated and relocated into a 15,000 square foot super garden center with outstanding results to date. GrowGeneration Grand Rapids, we completed the relocation and expansion into over a 22,000 square foot, super hydroponic garden center and a Midwest fulfillment center in early September.

On August 10, we closed our twenty-eighth location, Emerald City Garden, located in Concord, California, and it's doing fantastic. On October 12, we closed our twenty-ninth location, Hydroponic Depot, located in Phoenix, Arizona, the Company’s eleventh state. On October 20, we closed our thirtieth and thirty-first locations, with the acquisition of Big Green Tomato located in Battle Creek and Taylor, Michigan. On October 27, we signed the APA with The GrowBiz, the third largest chain of hydroponic garden centers in the U.S.

With that said, I will turn it over to Monty, our CFO, to review the financial highlights. Monty?

Monty Lamirato:

Thanks, Tony.

Net revenue for the three months ended September 30, 2020 was approximately $55 million compared to approximately $21.8 million, an increase of 153%. Same-stores contributed revenue of $33.4 million for the quarter ended September 30, 2020, compared to revenues of $19.2 million for the same period last year, a 73% increase.

Gross profit was approximately $14.6 million for the three months ended September 30, 2020, compared to approximately $6.5 million for the three months ended September 30, 2019, an increase of approximately $8.1 million or 124%. Gross profit as a percentage of revenues was 26.5% for the three months ended September 30, 2020, compared to 29.9% for the three months ended September 30, 2019. The decrease in the gross profit margin percentage is due to a greater percentage of our revenues coming from commercial and e-commerce revenues as a percentage of our overall revenues in the third quarter of 2020.

Commercial and e-commerce accounted for approximately 29.3% of our overall sales for the quarter ended September 30, 2020, compared to 27.3% for the quarter ended September 30, 2019, resulting in a margin reduction of approximately 1.3 basis points.

For the nine months ended September 30, 2020, the Company has maintained a consistent margin of 27% throughout all of 2020.

Operating expenses are comprised of store operations, which are primarily payroll, rent, and utilities, and corporate overhead. Operating costs were approximately $9.5 million for the three months ended September 30, 2020, and approximately $5.4 million for the three months ended September 30, 2019, an increase of approximately $4.1 million or 76%.

Store operating costs were $5 million for the three months ended September 30, 2020, compared to $2.7 million for the quarter ended September 30, 2019, an increase of 81%. Store operating costs as a percentage of sales were 9% for the three months ended September 30, 2020, compared to 12.6% for the three months ended September 30, 2019, a 28% reduction. Store operating costs were positively impacted by the opening of new and acquired stores throughout 2019 and 2020 that have lower operating costs to revenues due to their larger size and higher volume, and a 73% increase in same-store sales.

Corporate overhead, comprised of general and administrative costs, share-based compensation, depreciation and amortization and corporate salaries, was approximately $4.5 million for the three months ended September 30, 2020, compared to $2.6 million for the three months ended September 30, 2019. Corporate overhead was 8.2% of revenues for the three months ended September 30, 2020 and 12.1% for the three months ended September 30, 2019, a reduction of 32%.

Share-based compensation for the three months ended September 30, 2020 was $1 million compared to $553,000 for the three months ended September 30, 2019. Share-based compensation as a percentage of revenue decreased from 2.5% for the three months ended September 30, 2019 to 1.9% for the three months ended September 30, 2020.

Corporate salaries and related payroll costs as a percentage of revenues were 4% for the three months ended September 30, 2020, compared to 4.7% for the three months ended September 30, 2019.

General and administrative costs as a percentage of revenues were 1.6% for the three months ended September 30, 2020 and 3.7% for the three months ended September 30, 2019.

Depreciation and amortization was $443,000 or 0.8% of revenue for the three months ended September 30, 2020, compared to $247,000 for the three months ended September 30, 2019.

Adjusted net income for the three months ended September 30, 2020 was approximately $3.3 million, compared to net income of approximately $1 million for the three months ended September 30, 2019, a positive change of approximately $2.3 million. The increase in net income for the quarter ended September 30, 2020 was primarily due to revenues increasing 153% while store operating costs increased only 81%.

Net income from store operations, which was approximately $9.6 million for the quarter ended September 30, 2020, compared to approximately $3.8 million for the quarter ended September 30, 2019, grew $5.8 million or 155%. Net income was also impacted by income tax expense, which was approximately $1.8 million for the three months ended September 30, 2020, compared to no income tax for the three months ended September 30, 2019.

In prior years, the Company was able to offset taxable income with net operating loss carry-forwards. Those carry-forwards were fully utilized this year and as such, we commenced recording a provision for income taxes.

Adjusted EBITDA was $6.6 million for the third quarter 2020, versus $2 million for the third quarter of 2019. The increase in Adjusted EBITDA year-over-year was due to an increase in net income of approximately $2.3 million, non-cash add-backs, primarily depreciation and share-based compensation, which were $1.5 million for the third quarter of 2020, versus $801,000 for the third quarter of 2019, and income taxes which were $1.8 million for the third quarter of 2020, compared to zero for the third quarter of 2019.

Adjusted EBITDA as a percentage of revenues was 12% for the third quarter 2020, compared to 9.1% for the third quarter of 2019. Adjusted EBITDA per share was $0.14 for the third quarter 2020, versus $0.06 for the third quarter 2019.

Working capital. As of September 30, 2020, we had working capital of approximately $83 million, compared to working capital of approximately $30.6 million as of December 31, 2019, an increase of approximately $52.4 million. The increase in working capital from December 31, 2019 to September 30, 2020 was primarily due to proceeds from public offering of common stock, resulting in net proceeds of $44.6 million, the exercise of warrants totaling approximately $1.1 million for the nine months ended September 30, 2020, and three, the increase in net cash provided by operations.

At September 30, 2020, we had cash and cash equivalents of approximately $55.3 million. Currently, we have no demands, commitments, or uncertainties that would reduce our current working capital.

Our core strategy continues to focus on expanding on geographic reach across the United States through organic growth and acquisitions.

I would like to now turn the call over to Darren for concluding remarks before the Q&A.

Darren Lampert:

Thank you, Monty.

GrowGeneration recorded its eleventh consecutive record quarter of increased revenue, and we achieved record earnings. We believe that our Company has tremendous growth and momentum built into the remainder of the year and into 2021. Our store acquisitions and new store openings continue to drive growth and we continue to deliver double-digit same-store sales results quarter-over-quarter. We plan to own and operate over 50 locations in 15 states during the year 2021. Today, we own and operate 31 locations - 36 if you include The GrowBiz.

GrowGeneration has built a national scalable supply chain for the agricultural and cannabis industry. Our leadership position is driven through our corporate mission statement, to be the largest chain of hydroponic garden centers in the United States. We continue to invest in our supply chain and technology, creating more efficiencies across all departments. Execution of our financial goals and guidance is evident with the third quarter of 2020 numbers we reported, with revenue up 153% quarter-over-quarter and Adjusted EBITDA earnings, $6.6 million or $0.14 a share.

We completed a $48 million institutional follow-on public offering led by Oppenheimer, which was over-subscribed three times. Our stock is now 50% institutionally owned. Our balance sheet is strong with approximately $50 million in cash, which allows us to continue to execute our internal growth initiatives while we continue to purchase the best of breed operations and open new GrowGeneration locations.

We've increased Fiscal Year 2020 revenue guidance to $185 million to $190 million, Adjusted EBITDA guidance for 2020 of $19 million to 20 million, and full year GAAP pre-tax net income guidance to $9 million to $11 million. Revenue guidance for full year 2021 is $280 million to $300 million, Adjusted EBITDA guidance for the full year 2021 is $34 million to $36 million. We look forward to continuing to provide guidance as need be, and we're excited to share our successes with our shareholders, our Management team, and partners.

Now, we will turn the call over for questions.

Operator:

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star, followed by one, on your touch tone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star, followed by two. If you're using a speaker phone, please lift your handset before pressing any keys. One moment for your first question.

Your first question comes from Brian Nagel with Oppenheimer. Please go ahead.

Brian Nagel:

Hi. Good morning. Congrats on the great quarter. Very nicely done.

Darren Lampert:

Thank you, Brian.

Brian Nagel:

My first question is a question I get a lot as we're talking to our clients on the GrowGen story. You once again lifted guidance here, so congratulations on that.

As we think, particularly with the 2021 guidance, can you give us some more sort of say color on the buildup of that revenue guidance? How you're thinking about potential acquisitions relative to that guidance comp store sales.

Darren Lampert:

Brian, I'll answer that for you.

First and foremost, there is a pandemic and COVID is in full force right now. Like each quarter during COVID, we're very, very conservative with guidance. When we look to the emerging markets, it's six months to a year conservatively to get states organized, to get business up and running. Certainly, when looking at new markets, that's going to be a latter part of 2021. On the new store openings in emerging markets, we're forecasting very little sales in those new markets. Certainly, we will see how they unfold during the year.

Right now, same-store sales this year have been up 59% year-to-date; last year, mid-to-high thirties. We certainly do not expect that to continue, but as of now, we certainly don't know when they're going to start slowing down. Our stores are getting more mature in states that were in. We're starting to see tremendous efficiencies in our purchases. When looking at purchases from GrowGen, you're usually looking at least six months to start gathering efficiencies in the new stores that we're purchasing. You'll see tremendous growth the following year from GrowGen on those stores.

Right now, we have about $35 million out of our $55 million in sales that are coming through same-store sales and you'll see the rest of our stores, they're starting to come on next year into same-store sales calculations. Really what you're looking at right now is a combination of growth within our current stores for next year, new acquisitions, and new store openings. It's a combination of all three.

Like anything else, Brian, we do update guidance on a quarterly basis, dependent upon what we're seeing in the industry, and it's still our contention that the industry is in such an early growth state that is really challenging during these times to really forecast and forecast properly. When you're looking at forecasting from GrowGen, it's still our position and understanding that these are the low parts, and when we guide, we certainly do feel that we will beat quarters right now with the growth in this industry.

Brian Nagel:

That's very helpful, Darren. Thank you. Then just one really quick follow-up, again, relative to the guidance, but so I guess we're now, call it several weeks into the fourth quarter.

Any comment on how the business has performed during the fourth quarter relative to what we saw in results for Q3?

Darren Lampert:

Yes. Our fourth quarter is tracking well a month and a half into the quarter. We're seeing no issues, no slowdowns as of today. Customarily, our fourth quarter usually is our slowest quarter of the year. We're certainly seeing no slow down as of today.

Brian Nagel:

Congrats again. Thank you.

Darren Lampert:

Thank you, Brian.

Operator:

Your next question comes from Eric Des Lauriers with Craig Hallum Capital Group. Please go ahead.

Eric Des Lauriers:

All right. Thank you and congrats on—you had another strong quarter and impressive guidance. Great execution, guys. Maybe a bit of a follow-up on that first question there, just on M&A versus greenfield openings. Obviously, unit growth is a vital component of your strategy.

Can you help us understand how you guys think of M&A versus greenfield openings, basically the buy versus build decision? What drives those decisions for you guys? What are the differences in economics in those two?

Darren Lampert:

Eric, I'll take that and then I'm going to send it over to Tony to finish up the question. We've been pretty consistent though. We purchase in emerging—we purchase stores in mature markets or markets that, again, are up running and have consistent numbers to it. Markets like California, markets like

Michigan, Colorado, Oregon and we open stores in new emerging markets; Oklahoma was an emerging market for us.

You'll see us opening stores in New Jersey, in Illinois, Massachusetts, and states of that nature, hopefully, Pennsylvania, New York. Our unit economics, we're buying anywhere from two to five times EBITDA, halftime sales. Opening stores right now, I think we've gotten through the unit economics. It's usually costing us anywhere from $0.25 million to $0.5 million to greenfield a store plus inventory depending upon the size of the store and it is really dependent upon how much inventory is stocked in those stores.

Next year, and as of now, right now, we have a very full acquisition pipeline that will continue into the beginning of next year, and then you'll probably see GrowGen shift into new store openings, into new emerging markets in New Jersey, hopefully, Pennsylvania, New York. You'll see us probably greenfielding stores in Illinois and Missouri, and again, still waiting, like anything else, the elections have been very important and just starting to wait to see how they shake out in the future.

Eric Des Lauriers:

Okay, great. That's very helpful. Then as a bit of a follow-up to that one, for the stores that you do acquire, can you help us understand how you guys think about cash versus stock? What's your ideal mix? Why is that, and how might that change going forward?

Darren Lampert:

The mix has been pretty constant through the five years that we've been in business. We usually pay cash for inventory and we're very resilient in certainly inventory counting with obsolete and slow-moving inventories. Then we split the goodwill, usually between stock and cash. It's usually a 50/50 split in most transactions we're doing.

The reason for that is we want the prior owners of these stores to share in the successes of GrowGen. We think it keeps them much focused, so the larger transactions you're usually seeing, again, a 50% stock component to it. Some of the smaller transactions, the immaterial transactions to GrowGen, you may see an all-cash deal from time to time.

Eric Des Lauriers:

All right, great. That's helpful. Congrats again, guys, and good luck going forward.

Darren Lampert:

Thank you, Eric.

Operator:

Your next question comes from Andrew Carter with Stifel. Please go ahead.

Andrew Carter:

Hi. Thanks. Good morning.

Not to beat a dead horse, but I do want to ask, relative to your previous guidance if you include the incremental M&A, it is well below what you had for outstanding for 2021, and I get that's a fluid mix of acquisitions, new store openings, etc., but as you're looking at that updated range for 2021, is that more of just an organic number, what you can do with the business in hand now versus no incremental M&A, more conservative store openings? Can you help us understand how you're thinking about that?

Darren Lampert:

Once again, it's a combination. It certainly includes acquisitions that will be going on throughout the year. Also, new store openings, and certainly same-store sales included in there. Once again, new industry, it takes us six months to really get the stores up and running that we're purchasing, takes us three to four months to build stores out. Right now, it's just so early in the game. I mean, we're still in November; 2021 is a long way away so right now, this is our best estimate for 2021. As I said earlier, we will adjust guidance as we see fit, if we're seeing business is stronger going out throughout the first quarter.

Andrew Carter:

Got it, thanks. The second part is part of your guidance is you did upgrade your Adjusted EBITDA margin expectations for next year, so I want to understand the puts and takes there. We have the private label program, margin accretive, consumer e-commerce will be a drag going forward, but also growing scale benefits (inaudible) investment. Kind of help us understand the change there and your expectations for the stronger profit performance in the out years. Thanks.

Darren Lampert:

Monty, would you like to take that? Monty, are you there?

Monty Lamirato:

Sorry, I was on mute.

One of the things we're seeing is tremendous leverage on all of our operating costs, from store operating costs to corporate overhead. A greater percentage of our dollars are hitting the bottom line in terms of an Adjusted EBITDA number, and so even though margins have been consistent at 26%, 27% - basically the 27% level - we're getting tremendous leverage from all the other costs and therefore dropping more dollars to the bottom line.

Andrew Carter:

Thanks, I'll pass it on.

Operator:

Andrew, do you have a follow-up?

Andrew Carter:

No, thanks. I'll pass it on

Operator:

Your next question comes from Glenn Mattson with Ladenburg Thalman. Please go ahead.

Glenn Mattson:

Hi. Thanks for taking the question and nice results on the quarter. Good to see that you're opening a store in New Jersey. I'm curious, obviously, New Jersey is not a huge market yet for cultivation, likely it will be down the road, but Pennsylvania clearly is, and I know you've been serving the Pennsylvania market from the Rhode Island store, I believe.

I guess I'm curious if you see a bigger pickup in Pennsylvania next year that you're able to service from the New Jersey store, or if you're already capturing a lot of share in Pennsylvania as it stands today?

Darren Lampert:

Michael, can you take that, please?

Michael Salaman:

Yes, I'll take that.

Glenn, basically the strategy—I mean, right now, we are servicing Pennsylvania customers, so the strategy for next year is to put a fulfillment center, a hub which will be a larger GrowGeneration garden center in the South Jersey area, which will not only service the emerging New Jersey market but also allow us to really service the tri-state area. It will put us closer to the customers that we're already working with in the Pennsylvania market.

We certainly believe Pennsylvania and New York are going to follow the lead of New Jersey, so we're looking at really the whole tri-state area as a supply center for GrowGen. Right now, we're looking at New Jersey, but we certainly see, as legalization unfolds, multiple stores between New York, New Jersey, and Pennsylvania; but starting in the spring, we'll have a super hydroponic garden center, 30,000, 40,000 square feet, that gives us the ability to service our current customers and any new customers that are obtaining licenses in both the New Jersey and Pennsylvania markets.

Glenn Mattson:

Great. Thanks. You're in 12 states now with Arizona, so you've contemplated 15 states by next year—I'm sorry, 11 states is Arizona; 12, I guess, will be New Jersey. What other markets are you contemplating for 2021?

Darren Lampert:

We're looking at Ohio, we're looking at Massachusetts; believe it or not, Montana, which has passed legalization. We're also expanding our footprint in California. We're looking at New York and Pennsylvania. Certainly, we're keeping our eye on those markets. Going deeper in Southern California; Florida, we think, is going to start moving more towards an adult-use market. So we're looking at the entire landscape.

As we've mentioned earlier, we follow—really what's nice is that we're able to follow the roadmap of legalization and be relatively predictive as these states go from medical to adult, and our ability to open up a new location. Once we locate a facility, we can have a new GrowGen facility up and running and operating within 90 days, so we're very nimble.

We're certainly continuing to look at the best of breed of stores that exist. We still believe there's another good 50 to 100 stores out there that are potential acquisitions in multiple markets for GrowGen.

Glenn Mattson:

A question on the margins quick. It makes a ton of sense, obviously, that commercial has lower gross margins than the brick-and-mortar standard, but can you give us a sense of how much difference there is between online gross margin versus the retail store gross margin?

Darren Lampert:

Monty, you want to take that

Monty Lamirato:

Yes. There's about a six-point difference between the online and commercial and brick-and-mortar. That's why you see the combined margin where it is. Once again, depending on the percentage of e-commerce and commercial relative to total revenues, it has an impact on the margin.

Glenn Mattson:

Okay, great.

Darren Lampert:

Hey, Glenn, last thing, just so you know, we do believe that in 2021, we should see a point, point and a half bump in margins based upon our private label offerings that we will be rolling out through the year.

Glenn Mattson:

Okay. Thanks, Darren, and good quarter. Thanks again.

Darren Lampert:

Thank you.

Operator:

Your next question comes from Aaron Gray with Alliance Global. Please go ahead.

Aaron Gray:

Hi, guys. Congrats on the quarter and thanks for the questions.

First of all, for me, it's kind of on commercial business. We saw real nice sequential growth from $9 million to $13 million. Can you just talk about some updates there and your relationship that you're having with the MSOs, and how that's been building out as that's becoming more and more of an important part of your revenue and growth that you guys, especially as those start to become the consolidators within the overall cannabis space? Thanks.

Darren Lampert:

Michael, can you take that, please?

Michael Salaman:

Yes, I'll take that.

Aaron, as we've mentioned, the Company has a multi-sales strategy where we're obtaining customers from walk-ins that are coming into any one of our 31 locations; through our e-commerce site that today gets over 150,000 unique visitors that are coming. We get leads for commercial business through our website, and then the dedicated commercial division that is made up of commercial account managers, customer service reps, quoters, we have a very white glove customer service approach when we're dealing with the MSOs. That approach has created a customer base on the commercial side.

Right now, we're servicing over a thousand commercial customers. Quarter-over-quarter, we were able to pick up an additional 240 new licensed commercial customers, and the reflection is that our revenue has gone up. Right now, we're well ahead of our projections. We did $13.2 million for the quarter. For the nine months, we're over $32.7 million. We've actually adjusted our internal numbers, which we mentioned we'll do over $40 million of commercial business. I believe the attraction to GrowGen is our ability to service the customized solutions, to deliver just in time, to provide a high level of customer service, which is challenging when you're dealing with the multi-state operators.

Our ability to execute at that level, whether it's a single-state operator, Aaron, or a multi-state operator, each customer is treated the same way, and it's the execution of the commercial team that continues to excel. We certainly believe with the combination of the commercial team, which is a very strong team coming out of GrowBiz, with the commercial division that GrowGen has built, you're going to see commercial revenues skyrocket in 2021.

Aaron Gray:

Thanks for that color. That's super helpful. Kind of tagging on to that, one thing I think that's very unique about you guys versus some of the other players and players on cannabis, is your ability to operate and do well in various regulatory environments. Take Oklahoma, an unlimited licensed market that has been tremendous for you guys.

Just curious, now that we have some new states coming online; Arizona, we can kind of see how regulations are going to look; New Jersey, we're still kind of pending; just wanted to know, in terms of lemonade in unlicensed markets, I know you guys are able to operate well in both, but is there one that you guys prefer versus the other in terms of how you look at new regulations and licensing opportunities as new states come about? Thank you.

Michael Salaman:

Darren, do you want to take that?

Darren Lampert:

You can take that, Michael.

Michael Salaman:

Yes. Aaron, our revenue certainly tracks to the number of licenses that are being issued. Oklahoma has over 5,000 licenses so our position—GrowGeneration is a proponent of an open market, a green economy, multiple licenses, and we're starting to see that certainly in talking to some of the insiders within New Jersey and certainly following what's happening in Illinois.

We believe that social equality, entrepreneurship, taxation, real estate, value increasing with idle warehouses that will be converted into beautiful cultivation facilities; we believe that that is going to be the future of the economy on a state-by-state basis. GrowGen's business trends and tracks, the more licenses, the more business, so we are certainly well-positioned to take advantage, whether it's a state like Oklahoma where today we have four locations to manage those 5,000 licenses.

Or Arizona. Right now, we've put our first location which we're actually going to be consolidating into a 30,000 square foot facility in Phoenix anticipating the growth. We believe that these states, the new states, and certainly the mature states, where there already are thousands of licenses, GrowGen will be in those markets, servicing those customers, and continuing to execute our plan.

Aaron Gray:

Thanks for that color and congrats on the quarter. I'll pass it on.

Darren Lampert:

Thank you, Aaron.

Operator:

Your next question comes from Mark Smith with Lake Street Capital Markets. Please go ahead.

Mark Smith:

Hi. Good morning, guys.

First one from me, just looking at the guidance, is it safe to assume that the GrowBiz acquisition is built into the guidance?

Monty Lamirato:

GrowBiz - it is built into the guidance, Mark.

Mark Smith:

Excellent. Then just want to follow up on commercial business. The growth there is certainly fantastic. Walk us through how this GrowBiz acquisition impacts commercial, how they trend towards commercial versus your business today.

Darren Lampert:

Michael?

Michael Salaman:

Yes. They're very strong, and certainly, it's a five-store chain, four locations in California, Northern California, one up in Oregon. They have a very talented Executive that has created a very substantial commercial business. This transaction for the Company, not only does it accretively add $50 million of revenue going into 2021 but the personnel that we're picking up and the division that they have in terms of their commercial business, which is a significant part of their overall revenue, is going to be completely integrated into GrowGeneration’s management for our commercial division.

When you start to look at it, and they're more concentrated out West, we have a lot of concentration back East. They have some of the larger MSOs so as we integrate, the pie gets a lot bigger. It was a big part of the strategic nature of why we identified, not only are they the third largest hydroponic chain in America, but they bring tremendous experience.

Ross Haley has been in this business for 15, 20 years, has tremendous outreach within the cultivation community. We're certainly going to leverage that relationship. He built a wonderful company, so it will be completely integrated within our commercial division.

Mark Smith:

Excellent. Last one from me, just kind of housekeeping: tax rate was a little bit higher here during this quarter. Any guidance you can give us on maybe what we should expect for tax rate going forward?

Darren Lampert:

Monty, can you take that, please?

Monty Lamirato:

Sure. The tax rate is a combination, obviously, of not only the federal but the state tax rate. Also, one of the things to consider in the tax accrual is that's a GAAP number, not necessarily the amount of income taxes that are due. When you're reversing timing differences and things like that, the tax accrual is a combination of reversal of those timing differences and the actual amounts that you will be paying to the State and the Federal Government. It is a slightly higher rate this quarter. You have some non-deductible expenses, some related to share-based compensation, and so that has an impact on the taxable income for which the tax rate is applied.

Mark Smith:

Okay. That's helpful. Thank you, guys.

Darren Lampert:

Thank you.

Operator:

Your final question comes from Scott Fortune with Roth Capital Partners. Please go ahead.

Scott Fortune:

Good morning and congrats for your consistent execution over the last six years, not just quarter-over-quarter, but you've done a great job of driving revenue growth here.

I want to focus on the margin side a little bit, and private label, touch base more on those initiatives. We've seen a lot of potential upside on the margins on leveraging the operating side and those efficiencies, but you said, Darren, I think one- to two-point bump up potentially on the private label. Just step us through the private label initiatives looking into 2021 and percentage of revenue kind of targeting towards that end of 2021 here.

Darren Lampert:

Right now, Scott, we're targeting approximately 10% of our business next year will come from private label brands. We're seeing right now in the industry, and really from initial launches of our private label, we're seeing margins upward of 50% on private label products. If you factor that in at 10%, it'll come out somewhere, in the one to two-point range. Again, we're pretty confident with our private label products, and we've spent a lot of time this year certainly testing products and curating products and starting to put them out into the markets as we speak and using, certainly, some of our shelf space for our private label brands and our end caps.

Michael Salaman:

Scott, just to add...

Scott Fortune:

I appreciate—go ahead.

Michael Salaman:

Just to add to what Darren said, and I think, and Tony, certainly, I think you have some commentary here.

Selection. GrowGeneration, the position that we've taken in the market is to provide all the brands that the growers are seeking and provide them a complete selection of products so it becomes a turnkey solution. We really believe that we provide an experience between the Grow professionals that we've hired that operate at the store level, to the customer service, solving problems. Every one of our growers has... (audio interference)

Scott Fortune:

Hello?

Darren Lampert:

I wonder if Michael fell off. I'm not sure.

Operator:

I'm still seeing Michael connected. Michael, maybe did you mute yourself?

Tony Sullivan:

Hi, guys. This is Tony. I'll wrap that up with the private label piece.

As you guys know, we are wanting to offer the best selection, best service, best solutions. We want to offer quality products at the right price to our customers, and as we work forward with the private label, we've already tested multiple strategic categories. As we go into 2021, we are going to put together that offering that will allow us to have the best of breed on the brand side, as well as on the private label side. We're very confident in what we've already tested, and we're very confident in hitting that 10% of total sales in 2021.

Scott Fortune:

Thanks. I appreciate the color. Congrats again,

Operator:

Mr. Lampert, there are no further questions at this time. Please proceed

Darren Lampert:

Yes, I'd like to sum up, guys. I just want to wish everyone a happy Thanksgiving. Stay safe during these trying times, and we wish everyone a happy Holiday Season that's coming up. Our staff at GrowGen has never been more focused, and we appreciate each and every one of you. We certainly pray for everyone's safety and health during these trying times.

Thank you so much, and we look forward to sharing our many accomplishments and successes with you in the future. Thank you.

Operator:

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