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Verano Holdings Corp. (VRNO.CA)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good morning. My name is Abby, and I will be your conference operator today. At this time, I would like to welcome everyone to the Verano Holdings Corporation Second Quarter 2023 Earnings Conference Call. Today's conference is being recorded and all lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. And I will now turn the conference over to Julianna Paterra, Vice President of Investor Relations. You may begin.

Julianna Florence Paterra

Vice President-Investor Relations, Verano Holdings Corp.

Thank you and good morning, everyone. Welcome to Verano's second quarter and 2023 earnings conference call. I am joined today by George Archos, Chief Executive Officer and Founder; Brett Summerer, Chief Financial Officer; Darren Weiss, President; and Aaron Miles, Chief Investment Officer. During this call, we will discuss our business outlook and make forward-looking statements within the meaning of applicable US and Canadian Securities Laws, which based on management's current assumptions and expectations. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance and achievements of the business or developments in the company's industry to differ materially from those implied by such forward-looking statements. Actual events or results could differ considerably due to risks and uncertainties mentioned in our filings on EDGAR and SEDAR, including our financial statement for the quarter ended June 30, 2023.

In addition, throughout today's discussion, we'll refer to non-GAAP financial measures that do not have any standardized meaning prescribed by GAAP. Management believes non-GAAP results are useful to enhance the understanding of the company's ongoing performance, that these are supplemental to and should not be considered in isolations from or as a substitute for GAAP financial measures. These non-GAAP measures are defined in our earnings press release and available on our website at investors.verano.com, which also includes the reconciliation of these measures to the most comparable GAAP financial measures. Lastly, all currency is in US dollars unless otherwise noted.

George, please take it away.

George Archos

Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

Good morning and thank you for joining our second quarter 2023 earnings call. Today marked another quarter of progress for Verano, in which we achieved record revenue, generating 3% sequential top line growth and 31% adjusted EBITDA margin. Our results continued to exceed our internal expectations, which speaks to the strength of our strategy of positioning ourselves to capitalize on new adult use market, designing and deploying a comprehensive brand and product innovation blueprint, and building the business to continue to deliver near- and long-term value in the current environment. In light of this strong performance, I am proud to announce that we are raising the lower end of our 2023 free cash flow guidance to $65 million to $75 million, up from $50 million to $75 million.

Today, I'll speak to the quarter in more detail before passing it to Brett for a review of the financials. I'll then close by covering the many positive catalyst we see ahead driving Verano forward.

The second quarter was marked by relative pricing stability in retail and wholesale versus the first quarter. While some markets such as Pennsylvania and Ohio continue to experience some pressure, we were very pleased to see that on average across our portfolio, prices seemed to have mostly stabilized. As usual, we plan to continue avoiding irrational pricing strategies and will work to maintain responsible levels, which reflect a balance between appropriately responding to market dynamics to remain competitive and maintaining profitability. This story played out in Illinois across both the retail and wholesale. Though wholesale revenue was down 10% year-over-year, our data shows that double-digit pricing impact in the market outpaced this decline. Although we made market adjustments to mitigate pricing misalignment, we were successful in avoiding the significant discounting that seemed to ripple across the state.

Retail revenue was only down 7% year-over-year, despite dispensary count growth in the state, which by our measure is up about 20% in 2023 alone. On the CPG side of the business, I am excited to report that we have been growing wholesale market share the last few months, which we believe reflect the success of our brand strategy.

Looking at Florida, sales for the quarter were roughly flat year-over-year, and we are pleased with these results as we have been able to stay out of the aggressive discounting occurring in the state. We will continue to sell product at prices which reflect the quality of our brands in conjunction with leveraging our tiered value offerings to broaden our reach and expand wallet share. We have maintained our market share of over 10% in the second quarter, measured by ounces sold, similar to that of the first quarter. Given that we are priced above the state average and the state only reports market share in volume, we believe our true market share in terms of revenue in the state is in fact much higher than 10%.

Turning to Connecticut, its adult use market remains steady, with our Meriden location continuing to perform at about 2.5 times sales versus the prior-year period. From a macro perspective, we estimate that our house of brands holds over 40% market share in the state. We recently opened our first social equity joint venture location to adult use consumers in Norwich, and look forward to opening our remaining five locations over the remainder of the year and beyond.

Unfortunately, many states have launched programs that, although often well-intentioned, have made it extremely difficult for social equity entrepreneurs to create and maintain viable businesses by isolating them without access to capital. Connecticut programs, however, promote local equity business by allowing companies like Verano to steer our industry equities and contribute financially in a space that is starved for capital. We commend the state of Connecticut for structuring its social equity in a way that set entrepreneurs up for success.

Our business in Maryland is also performing well after seamlessly transitioning to its adult use program on July 1. The initial results have been in line with our expectations, which we attribute to the advanced modeling capabilities we developed from our extensive operating experience and history transitioning medical to adult use market. So far, our dispensaries are posting a similar adult use bump in top line to what we've seen in Connecticut, with retail sales trending slightly upwards each week. But still in its early days, we'll be watching this new adult use market closely as it matures.

And moving to New Jersey. The market remains a strong performer with our net wholesale revenue up nearly 50% in the second quarter versus the prior-year period. Relatedly, according to BDSA, our overall market share remained strong at over 21%, the largest in the state with our namesake Verano brand commanding the number one position as well. We launched Savvy in the tail end of the quarter, which we believe contributed to our market share growth, and speaks to the brand power within our strategically developed house of brands.

This success in New Jersey is a fantastic example of our data-driven brand strategy in action. We thoughtfully evaluate consumer data and demand in order to develop and deploy new brands, launching in individual market only once supported by the data. Last year, we launched our value tier in most markets, while purposely delaying its launch in New Jersey as the premium brand continued to dominate. This spring, we began to see a slight change in consumer patterns in New Jersey. Anticipating that these market dynamics will continue, we proactively launched our value tier in June. We continued to value innovation and brand development, and will work to serve consumer needs as preferences evolve. Holistically, we leverage our sophisticated operations and advanced automation to remain ahead of the curve and enable rapid speed to market. Our operations continue to improve upon their best-in-class baseline.

On the wholesale side, units per head count increased 60% in the first half of 2023 versus the prior-year period, and grams harvested per plant has increased 15% year-to-date. On the retail side, we've increased transaction per head count by 26% in the first half of 2023 versus the prior-year period. While we believe we are the top operators in the space, we maintain our ethos of continuous improvement, constantly searching for additional efficiencies.

And now, I will turn it over to Brett for a detailed review of the financials.

Brett Summerer

Chief Financial Officer, Verano Holdings Corp.

Thanks, George. This is another record quarter for Verano. As previously mentioned, the quarter exceeded our internal projections, largely due to price stabilization and continued strength from certain markets. Second quarter 2023 revenue was $234 million, up 5% compared to the second quarter last year, driven primarily by strength in

New Jersey and Connecticut, slightly offset by retail declines in Pennsylvania and Arizona. Sequentially, revenue was up 3%, driven by increased wholesale in New Jersey, in part due to Savvy's recent launch in the state.

On a gross revenue basis, excluding intersegment eliminations, 68% was derived from the retail side of the business and 32% from the wholesale business. Gross profit for the quarter was $115 million or 49% of revenue. On an adjusted basis, generally excluding depreciation, amortization and stock-based compensation, this is 58%, just slightly above the prior year quarter with increased vertical mix and reduced cultivating costs such as packaging, offsetting increased discounting and eight days of inventory reduction. We continue to expect adjusted gross margin exclusive of inventory movement to remain around 50%. Our vertical mix or Verano sell through remains high at 47% for the quarter, excluding Florida, Arkansas, and Michigan, as we do not wholesale in those markets. We anticipate our vertical mix remaining in the mid- to high-40s.

SG&A expenses were $85 million for the quarter or 36% of revenue. On an adjusted basis, generally excluding depreciation, amortization, and stock-based compensation, this was 28% of revenue, about 2% higher versus the prior quarter due to bonus timing. On an adjusted basis versus the prior year, this was an improvement of 2% due to the rightsizing of our staffing levels. As communicated in previous quarters, we continue to expect adjusted SG&A to remain in the 26% to 28% range for the foreseeable future. We had a net loss for the quarter of $13 million and adjusted EBITDA of $72 million or 31% of revenue.

Turning to balance sheet and cash flows. We ended the quarter with $103 million in cash and cash equivalents. The acquisition consideration payable balance is nearly eliminated, with only $2 million outstanding after paying down over $12 million in the quarter. Cash flow from operations for the quarter was $24 million, even while decreasing our income taxes payable balance to $227 million. This marked our 10th quarter in a row of positive operating cash flow and third consecutive quarter of positive free cash flow. After spending $8 million in CapEx this quarter, we generated $16 million of free cash in the second quarter alone.

Looking ahead for CapEx, we still anticipate spending between $35 million and $50 million for the year. In addition, given we continue to meet or exceed our internal expectations for free cash flow after generating $24 million in the first six months and that we now have visibility into Maryland's adult use impact. We are confident in our raised free cash flow guidance of $65 million to $75 million. This would be largely free cash flow for the industry in 2023 and reiterate the strength of our balance sheet relative to our peers.

We look forward to providing future updates on our progress for free cash flow. But, for now, I'll pass it back to George.

George Archos

Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

Thank you, Brett. Turning our attention to legislative development, while a potential SAFE passage seems to be at the forefront of the headlines, we have many tangible wins that give Verano and the industry reasons to celebrate. So, far this year, Connecticut, New Jersey, and Illinois have decoupled the heavy 280E tax burden at the state level. This is a major victory given New Jersey and Illinois are within our top three retail revenue contributors, and those two states, along with Connecticut serve as our top three wholesale revenue contributor. Our groundwork at the state level has had tremendous success as we ensure we had a seat at the table in providing a first-hand perspective to legislators regarding the cannabis industry. Our team will continue their hard work and we are hopeful for further legislative and regulatory progress in states that have not yet followed suit.

Shifting to the Southeast region, in June, we were notified that Verano was to be awarded one of the five coveted vertical licenses for Alabama's new medical program. This likely would allow us to operate a cultivating and processing facility, along with five retail dispensaries. After the state commission discovered some inconsistencies in the tabulation, an independent third party was hired to review scoring. However, given that we had the top score by a comfortable margin above the other winners, we still expect to be among the five operators granted a vertical license. We hope to share an update on the Alabama license later this month.

Regarding M&A, while we continue to evaluate many opportunities, we remain extremely selective, particularly on valuation. As it stands today, we are biding our time as valuations continue to decline in the private market. In the meantime, we are happy with our portfolio and remain in no rush to make changes where we'll continue to explore synergistic fits.

In DC, we are pleased to see SAFE conversations continuing. We are actively involved with the ATACH organization and hold a board seat at the US Cannabis Council, both of which coordinate lobbying efforts at an industry level. With a rescheduling or de-scheduling decision still on the horizon, we will continue our involvement at the federal level to help push progress forward.

We ultimately anticipate that some form of federal action will create large changes for the industry, including the possibility of an uplisting to US exchanges. We have been emphasizing this for quarter, but bears repeating. We want to be prepared for any opportunities that benefit our shareholders. Our registration statement filed in the US and Canada both recently became effective. Though we are not currently conducting an offering, it provide us with greater efficiency in connection with any compelling momentum or opportunities in the future.

Despite uncertainties surrounding legislative outcome, we remain focused on scaling the business and developing our people. We prioritize promoting from within, building a robust infrastructure to ensure stability and continuity. We announced a slew of executive promotions in June, which highlights the deep bench of talent we've developed over the years and further positions us for the next stage of growth. Relatedly, we recently announced two additions to our board. We welcomed John Tipton, President of the Southern Region of Verano, and Charles Mueller, an independent director who brings deep tax experience from his over 36 years of experience at PepsiCo. We are thrilled to have their expertise on the board.

Lastly, with $24 million of free cash flow generated to-date in 2023, we were progressing nicely towards our updated free cash flow guidance of $65 million to $75 million. While margins are still core to our business, our focus has evolved to emphasize free cash flow. We anticipate delivering strongest free cash flow in the industry in 2023, given current industry guidance and all while managing our balance sheet and obligations appropriately. We have so much possibility ahead of us and I believe this is only the tip of the iceberg of what we will accomplish. We have laid the right groundwork and have set the stage to take advantage of further progress and new opportunity. We see a long runway of growth and are excited about continuing to execute on our strategy.

Operator, please open the lines for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we will take our first question from Aaron Grey with Alliance Global Partners. Your line is open.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

Hi. Good morning. Thank you for the questions and congrats on the strong quarter. So, first question for me, just want to talk a little bit more specifically about the driver of you raising the lower end of the free cash flow guidance. You talked about pricing being better than you had expected with some stabilization and you also avoided some of the discounting. So, was that really the primary reason why you have to raise the lower end? And just could you clarify whether or not any of the added state 280Es, did that have an impact on this year and have an impact of you also raising the lower end of the free cash flow guidance? So, just any incremental color on what gave the confidence to raise lower end would be helpful. Thank you.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. So, it's a combination of factors, I think. The first and foremost, as you know, we put together our projections for the beginning of the year. And so far we delivered against our internal projections at or above where we – what we had expected. And that gives us confidence in our long-term outlook for free cash this year. And that's kind of the biggest driver. But if you think about the different components, it absolutely helps that, New Jersey and Illinois had their 280E rollback. It's not a huge driver of our guidance, but it is one of the factors. I think the other real reason that we have this free cash flow and the strength that we have is, as we've been talking about for the last few quarters, we're working on our inventory. We've been very successful in delivering the inventory reductions we've been talking about. So, that also give us confidence in our ability to deliver the free cash number this year.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

Okay, great. Thank you. I appreciate that. Second question for me, just wanted to turn specifically to Florida. So, I know that's one territory you've always stayed away from some of the promotional activity that a lot of players do participate in the marketplace. Just curious now, just what's your take in terms of whether or not that's going to maintain or worsen through the remainder of the year and even potentially into 2024? And would there be anything that might make you change your stance or are you comfortable maintaining kind of the position you've had in terms of staying away from the promotional activity and just kind of growing more so on the quality and higher price points there? Thank you.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Hey, good morning, Aaron. Thanks for the question. I mean, for us, it's status quo. We're going to continue to look at everything across our business, every single state, including Florida, and we'll make decisions accordingly. For us, staying out of the discounting game has been very important to our success, and we'll probably continue to do so. That being said, holidays are coming up. We might take an opportunity to do something there for our patients and consumers in Florida, but other than that, it's business as usual.

Aaron Grey
Analyst, A.G.P. / Alliance Global Partners Corp.

Q

All right. Great. Thanks very much for the questions, and I'll jump back in the queue.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Thanks.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Thank you.

Operator: We will take our next question from Scott Fortune with ROTH MKM. Your line is open.

Scott Fortune
Analyst, ROTH MKM

Q

Yeah. Good morning and congrats on the cash flow there. Real quick, just want to follow up on the inventory levels, improving cost efficiencies and overall that's helping the margins here. But where are you at the inventories level? I know you wanted to get down to 90 days. You kind of step us through on your inventory time management here to maintain the gross margins at these current levels kind of looking forward here?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. So, initially, when we're looking at targeting inventory, we are coming in around that 90-day mark from an internal perspective. However, I think last quarter we talked about, it's more of a range of in the – kind of 90 to 100. This quarter we got to 109 days. And I think that's – I'm actually pretty comfortable with where that is. We're still going to do some things, incremental improvements, that sort of thing. But I think all the big moves are out of there. And I think being right around 100 is probably the right level for our company, at least for now. And we kind of see where everything falls out, especially when you think about we have the Maryland AU and whatnot. We don't want to be too restrictive in what we're doing in terms of managing that inventory.

But, yeah, again, it's been very good for us. I think the big wins from a cash perspective have been put on our balance sheet at this point. There's some probably stuff in the noise, but I think we're pretty good where we are and I think we can deliver our cash flow without any incremental, significant reductions in inventory.

Scott Fortune
Analyst, ROTH MKM

Q

Appreciate the color there. Thanks. And then just kind of a follow-up update on New Jersey, kind of how you guys are viewing the store cadence there. Can it provide you with more wholesale opportunities? Are you starting to see any pricing pressure in New Jersey? I know you just introduced the value side of things, but just kind of a little more color on New Jersey holding the prices there and the margins in New Jersey with – in terms of new wholesaling opportunities coming on board. Just the cadence there, that would be helpful. Thanks.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Good morning, Scott. This is George. New Jersey has been fairly stable. We're excited about the new stores coming online. They've been in various areas throughout the state. We're continuing to wholesale there. Our wholesale business is very strong and we feel it's going to be viable for many years to come. We don't see many actionable cultivation facilities coming online in the state. We've been one of the top wholesalers there, and I think that's going to continue.

Scott Fortune
Analyst, ROTH MKM

Q

Great. Thanks for the color.

Operator: And we will take our next question from Chad Britnell with Needham & Company. Your line is open.

Chad Britnell
Analyst, Needham & Co. LLC

Q

Thanks. Good morning. Just wanted to touch on the free cash flow guidance again. Is the range you provided contingent upon using deferred tax payments as a source of cash in the back half of the year or do you think that the updated range is achievable while further paying down that tax balance like we saw in the first half?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Yeah, absolutely. So, first of all, I'd like to point out our current tax balance due is $227 million relative to prior quarters. It's down about $20 million. We're in the $240 million range to kind of towards the end or $250 million range towards the end of the year. Last year, we've continued to pay that down a little bit more aggressively than we have in the past, although we're not going beyond our current guidance of about 18 months give or take. All of the free cash flow that we've been talking about today includes the payment of the full 2021 tax burden that we have and follows the guidance again that we have in the – for the 18 months. So, to answer your question, yes, we plan to deliver that without anything unnatural in taxes. And we still plan to pay plenty of taxes between the year without destroying our free cash.

Chad Britnell
Analyst, Needham & Co. LLC

Q

Great. Thank you. And just a follow up on the inventory. Can you quantify the inventory reduction impact on gross margin in the quarter? And then I know you've said you're sort of switching out target to 100 days up from the 90 days. But can you maybe talk about how you think that impact will look in the remainder of 2023?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. So, in the quarter, we did about $9 million worth of inventory reduction. So, if we didn't have that in our gross margin, it would be in that 34% to 36%, 35%, I guess 35% range. I'm sorry, EBITDA margin would be 35%. Then our gross margin would be what, 63%, I think. So, that's where we'd be. I apologize. What was your second question?

Chad Britnell
Analyst, Needham & Co. LLC

Q

Just how that impact looks in the remainder of the year on gross margin as you approach the 100-day target?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.
A

Yeah. So, again, I think we have been targeting, I think the key initiatives that we took to get to, what we had laid out originally as target has kind of been behind this. So, I do think there's some, again, moving around the median, but there's not any big major lifts or anything around that, that we have ahead of us. And with the adult use in Maryland and whatnot, we might even see some lift to inventory. But to answer your question, I don't expect inventory to be a huge driver of our profitability for the next six months. So, at least, there's not a current plan for it. So, you'll see a couple of million here and there, but what I'm expecting to see, like the $9 million we saw this quarter, the $8 million we saw [ph] in the (00:25:30) quarter.

Chad Britnell
Analyst, Needham & Co. LLC
Q

Great. Thank you.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.
A

Yeah.

Operator: And we will take our next question from Russell Stanley with Beacon Securities. Your line is open.

Russell Stanley
Analyst, Beacon Securities Ltd.
Q

Good morning, and thanks for taking my question. So, just on the decoupling from 280E, just wondering if you can provide any granularity or any color as to or quantify the impact of those three markets on cash flow on an annualized basis. Just a rough idea as to how much of a benefit you're seeing there. And maybe secondarily, other markets that you see that could follow the same path?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.
A

Sure. I mean, your guess is as good as mine in terms of the markets that follows the same path, although we're seeing the same news articles, et cetera. So, we'll just have to see how those play out. But in terms of the amount of – impact to our cash flow and to our balance sheet, if you think about the reduction, as I mentioned before, we're down from about $250 million to about $225 million. The state portion is a healthy portion, but not all of that. And that's essentially a direct result of the 280E rollbacks that we saw in Illinois and New Jersey. So, yeah, it's high single-digit, low double-digit sort of savings.

Russell Stanley
Analyst, Beacon Securities Ltd.
Q

Great. Thanks on that. And just a follow up on Illinois, just wondering what your latest view is. We're now into August. Just curious as to how many stores you think we might exit the year [indiscernible] (00:26:55) in terms of, supporting more doors for your wholesale business there?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.
A

Hey, good morning, Russ. We'll see. I mean, they continue to open up slowly, but surely. And maybe we end the year around 20 stores or so.

Russell Stanley
Analyst, Beacon Securities Ltd.

Q

That's great. Thanks for the color. I'll get back in the queue.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Thank you.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Thank you.

Operator: And we will take our next question from Andrew Semple with Echelon Capital Markets. Your line is open.

Andrew Semple
Analyst, Echelon Capital Markets

Q

Good morning, and congrats on the quarter. First question here would be on the early days of the Maryland adult use market. Just would like to get your sense of how supply conditions are in the state. First of all, at your own stores, whether you're keeping those well-stocked and have ample capacity for wholesale and whether you're seeing good availability of third-party brands where you decide to bring those into your store?

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Yeah. So, I would just say our initial reactions to the Maryland market are actually very much in line with what we had internally projected. We had probably given some – what we have, given some color in the past on how – what we thought about that market versus other ones such as New Jersey, we did think it would be a little bit less of an impact and it played out the way we expected. But still very, very favorable. We're very happy with where they're at.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Yes, supply to our stores have been very good. Vertical integration there is a key component to our business. We continue wholesaling to all parties within that state's. It's been a legacy state for us. So, it's been a very nice lift, and we're excited for Maryland. It's been a very strong market for us for many, many years, and seeing this switch over to AUs have been great. We also recently just moved our Towson store, which has been a much better location, doing extremely well for us. So, very good launch for the midyear.

Andrew Semple
Analyst, Echelon Capital Markets

Q

Great. Glad to hear. My follow-up question would just be on the operating costs. You managed to keep that fairly flat for several quarters. But we did see that increase in Q2. Was there anything maybe a little bit more temporary in there, first of all? And second of all, are you seeing any sort of impact of the inflationary pressures and tight labor market on operating expenses? Just wondering, how we should be thinking about this moving forward.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Yeah. So, we did have a couple onetime items in this quarter when you look at last – this quarter versus last quarter. The bonuses that we had for the company are on a larger base with higher merits – obviously as a result of our merit. And also our bonus payout in the first quarter was below target, what we had laid out last year. So, the combination of those two factors is why we have this kind of step up. I'd say the majority of the step up quarter-over-quarter. In terms of the outlook, I do think the guidance that we've provided in the past, somewhere between 26% and 28% on an adjusted basis, is still where we plan to come in. And there's no major reasons why we don't expect that to continue.

Andrew Semple
Analyst, Echelon Capital Markets

Q

Great. That's all for me. Thank you for taking my questions.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Thank you.

Operator: [Operator Instructions] And we will take our next question from Yewon Kang with Canaccord Genuity. Your line is open.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Hi, this is Yewon Kang on for Matt Bottomley. Thanks for the question. I just wanted to touch on Maryland just a little bit. I know it's been only about a month since they launched the adult use program and you guys obviously penetrate the market on day 1 of launch with four incumbent medical dispensaries that you guys had. So, I guess could you comment on the initial demand levels seen at those stores on the retail level and any kind of ramp up that's been presented within the past few weeks?

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. So, from a initial day-over-day, week-over-week sort of launch, and when we saw the adult use, we had really, really good outstanding result, and we saw a lot of people coming in and driving up our sales. We don't obviously talk about what we expect over time, but we did see it cool off a little bit after the first couple of days, which always happens. But we're pretty consistent. We're happy with where it's kind of going in. Right now, it's about a 2.5 times lift that we're seeing out there in the market.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Great. Thanks. And just to follow up on that, I just wanted to touch on Pennsylvania as well. I know the competition on the retail level has been fierce for some time now within that market. But I guess are you guys seeing any signs of price stabilization in the market there and what do you think needs to happen in Pennsylvania, in order for growth to be resumed in that state?

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Sure. So, we're seeing, pricing pressure continuing to fall often everywhere in the country, including Pennsylvania. Actually, our sales in Pennsylvania are continuing to flat to up. It's because of our products and our unique position in the market. We're happy with Pennsylvania. Obviously, it'd be better if the prices were higher. But it's not unique in that regard. It's just more visible, I think than certain other ones just because of the history that it had.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Great. Thanks for the color.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

We also [indiscernible] (00:32:11) in there. So, we're pretty excited about Pennsylvania. Great store locations. We can continue to open in prime areas. Our wholesale business is strong there and we think that AU happens within the next two years, which will be extremely exciting not only for our company, but for others, and we have a very positive outlook for PA.

Yewon Kang
Analyst, Canaccord Genuity Corp.

Q

Great. Thank you.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

A

Thank you.

Operator: And we will take our next question from Frederico Gomes with ATB Capital Markets. Your line is open.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Hi, morning. Thanks for taking my questions. First question is just on the amount of free cash flow you expect to generate this year. Just considering that, I'm just curious how you look at capital allocation and the different options you have, be it investing for growth, reducing debt, or even buybacks at this point in that context. Thank you.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. So, we always look at everything. Whenever we have excess cash, we look at the best return for that cash in any given base, at any given day and in any given basis. The way we think about it generally, we do look at M&A transactions. We have a number of things that are always in the – on the burner there and looking at different things. And obviously, cash is king in that regard. So, we want to make sure we have a little bit of a war chest.

In addition to that, obviously, we have a good opportunity ahead of us to pay down either our taxes or our debt with Chicago Atlantic. Both of those carry a double-digit interest rate, and we're happy to reduce some of that. Even though we have – we're great friends of Chicago Atlantic. And then I think we do have optionality in terms of stock buybacks, that sort of thing. But it's just another one of those things we have to look at with the return overall for all investors and is that the right decision in the long-term so. But, again, everything – all options are on the table.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Thank you. And then on your production efficiencies, so you mentioned some data about cultivation costs being lowered and you continue to get that in your footprint. But I'm curious, if you expect that sort of same pace of gains to continue through the year? Are there any low-hanging fruits here in specific markets you might be working on in terms of lowering your cultivation cost and how that might offset price compression in some of those markets? Thank you.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Sure. I think we're – it's hard to see right now because of the inventory movements, but our gross margins are actually steadily improving quarter-over-quarter-over-quarter. So, we're pretty happy with where we are, and I think the trajectory is fine. We have made some key major decisions in terms of reducing our footprints, certain closures and/or reductions in capacity just to make sure that we're matching our output to level the market demand. But, nothing major still on radar. It's just more about continuing to tighten the screws as we go forward.

Frederico Gomes
Analyst, ATB Capital Markets, Inc.

Q

Thank you. I'll hop back in the queue.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

A

Thank you.

Operator: And ladies and gentlemen, we have no further questions at this time. So, I will now turn the call back to Mr. George Archos for closing remarks.

George Archos
Co-Founder, Chairman & Chief Executive Officer, Verano Holdings Corp.

Thank you, everyone, for joining and we'll see you next quarter. Everyone, have a great day.

Brett Summerer
Chief Financial Officer, Verano Holdings Corp.

Thank you.

Operator: Ladies and gentlemen, this concludes today's conference call, and we thank you for your participation. You may now disconnect.