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Presentation

Operator

Good day, and welcome to Cresco Labs' Third Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the call over to Megan Kulick, Senior Vice President of Investor Relations for Cresco Labs. Please go ahead.

Megan Kulick

Thank you. Good morning, and welcome to Cresco Labs' Third Quarter 2023 Earnings Conference Call. On today's call, we have Chief Executive Officer and Co-Founder, Charles Bachtell; Chief Financial Officer, Dennis Olis; and Chief Commercial Officer, Greg Butler, who will be available for the Q&A.

Prior to this call, we issued our third quarter earnings press release, which has been filed on SEDAR and is available on our Investor Relations website. These preliminary results for the third quarter of 2023 are provided prior to completion of all internal and external reviews and therefore, are subject to adjustment until the filing of the company's quarterly financial statements. We plan to file our corresponding financial statements and MD&A for the quarter ended September 30, 2023, on SEDAR and EDGAR later today.

Certain statements made on today's call may contain forward-looking information within the meaning of the applicable Canadian securities legislation as well as within the meaning of the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995. These forward-looking statements may include estimates, projections, goals, forecasts or assumptions that are based on current expectations and are not representative of historical facts or information. Such forward-looking statements represent the company's beliefs regarding future events, plans or objectives, which are inherently uncertain and subject to a number of risks and uncertainties that may cause the company's actual results or performance to differ materially from such forward-looking statements, including economic conditions and changes in applicable regulations.

Additional information regarding the material factors and assumptions forming the basis of our forward-looking statements and risk factors can be found in our earnings press release and in Cresco Labs' filings on SEDAR and with the Securities and Exchange Commission. Cresco Labs does not undertake any duty to publicly announce the results of any revisions to any of its forward-looking statements or to update or supplement any information provided on today's call. Please note that all financial information on today's call is presented in U.S. dollars, and all interim financial information is unaudited.

In addition, during today's conference call, Cresco Labs will refer to certain non-GAAP financial measures such as adjusted EBITDA, adjusted gross profit and adjusted gross margin, which do not have any standardized meaning prescribed by GAAP. Please refer to our earnings press release for the calculation of these measures and a reconciliation to the most directly comparable measures calculated and presented in accordance with GAAP. These non-GAAP financial measures should not be considered superior to, as a substitute for, or as alternative to, and should only be considered in conjunction with the GAAP financial measures presented in our financial statements.

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

Charles Bachtell
Co-Founder, CEO & Director

Good morning, everyone, and thank you for joining us on the call today. I'm pleased to share our Q3 results, which reflect our focus and execution against the things that will make Cresco Labs the strongest company possible, winning within our core markets and with our core stores, core brands and core products. As mentioned at the start of the year, by making 2023 the Year-of-the-Core, we would create strength and value via growth of the bottom line. The resulting margin and profitability gains enable us to

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succeed in the current industry dynamics, prepare us for the growth catalyst existing within our current state footprint and allow us to capitalize on future opportunities as they continue to avail themselves.

The results discussed today are the product of our incredible Cresco Labs team. I want to extend a very large thank you to the team for their thoughtful and disciplined execution of our Year-of-the-Core. To better illustrate the impact of this year's strategic plan, I'll be comparing several of this quarter's financial metrics to our Q1 results. On roughly the same revenue base, our Q3 results reflect the value and leverage created by prioritizing our core.

Kicking us off, in Q3, we generated $191 million of revenue, while off slightly from Q1. We saw retail growth and strong performance in our core markets offset the purposeful attrition from strategically divested and rationalized assets year-to-date. We generated adjusted gross profit of $96 million and adjusted gross margin of 51%, an almost 500 basis points increase from Q1. With adjusted SG&A expenses of $57 million in Q3, we reduced this number $10 million from Q1 by unlocking efficiencies and leverage throughout the business. Adjusted EBITDA in Q3 came in at $49 million and 26% of revenue. This is $20 million and over 1,000 basis points higher than our adjusted EBITDA from Q1. And finally, our operating cash flow of $41 million in the quarter is up $37 million from Q1. Again, all of these metrics on roughly the same revenue base.

To summarize, our disciplined Year-of-the-Core strategic growth plan is resulting in outsized gains to our bottom line. We're leaner and more productive. By growing revenue from our core states to effectively balance strategic rationalizations, we've held revenue roughly flat while eliminating over $40 million in annualized operating costs. The resulting improved cash flows and operating leverage prepare us to effectively compete today, execute the upcoming growth catalysts to existing within our underlying business and to be opportunistic as new market opportunities present themselves going forward. Again, credit to our incredible team as we continue to lead this emerging industry forward while building the strongest and most valuable Cresco Labs possible.

Now I'm going to share an update on how we're executing on the 3 pillars of our 3-year strategic plan, which again includes ensuring we have the most strategic footprint, broadening our branded product leadership and driving retail productivity across a larger base. So number one, we're ensuring that we have the most strategic geographic footprint. Throughout this year, we've taken the tough but necessary steps to impartially evaluate each of our state's long-term cash flow potential. Again, we're doubling down on our strongest core markets and implementing targeted strategies to optimize or rationalize any areas of margin dilution in our footprint.

The core of our footprint is comprised of states where we have material share and generate significant cash flow, many with significant adult-use on laws ahead, namely Ohio, Florida and Pennsylvania. We continue to drive margin improvement in these states by investing in our processes, procedures, facilities and technologies. These focused efforts have led around a 200 basis point improvement in gross margin from our core compared to Q1 of 2023, even with the ongoing price compression in many of these markets.

Of course, margin improvements weren't limited to our core states. Over the last couple of quarters, we've scaled back and restructured our California operations, sold our subscale Maryland processing operation and subsequent to the quarter's end, we divested our remaining Arizona assets for approximately $7 million in cash. We're seeing the benefits of the targeted actions we're taking, and we'll continue to refine and improve, so that we're positioned to compete in today's challenging environment, while also planning for the future growth of our organization and industry.

Number two, we held our leadership position in branded wholesale products. As with any consumer products category, long-term value is created with brands, and we continue to build our industry-leading brand portfolio. When it comes to brand building, we excel at introducing smart innovations, creating consistent quality products and meeting the consumers where they are, demonstrated by the sustained strength of our House of Brands. We continue to lean into our core brands and products by making smart, cost-effective investments that drive long-term share growth and profitability.

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For BDSA, we have the #1 portfolio of both branded flower and branded concentrates in the industry as well as the #4 portfolio of branded vapes and branded edibles. And once again, in the markets of Illinois, Pennsylvania and Massachusetts, we continue to hold the #1 overall share position. I'd like to spotlight the work of our teams in Michigan and Florida, who drove meaningful share gains in 2 ultra competitive markets, thanks to their persistent focus on improving quality to further bolster our portfolio's reputation in each state. Time and again, we've proven our ability to compete without first-mover advantage in highly competitive markets. Combining this with our many #1 market share positions and brand-building expertise perfectly positions us to be a long-term winner in this developing cannabis CPG category.

And number three, we're building a highly productive retail portfolio in the most strategic states. Our retail platform continues to grow, thanks to our efficient internal processes, proprietary technology and unmatched customer experience with 70 total stores generating almost $120 million in revenue this quarter. We've proven our ability to grow and defend retail market share, and our platform is only getting stronger as we continue driving margin improvements. We're particularly proud of our continued success in Illinois, where we were able to outcompete and essentially hold our total market share even with 19 new competitive doors opening in the quarter, resulting in an index to fair share of nearly 1.9x, up from 1.7x in Q2. We saw similar results in Ohio, where our fair share reached almost 2x the average.

In Pennsylvania, we've opened 3 new doors this year, growing our absolute retail share by 140 basis points since Q1 and maintaining our above-average fair share. In Florida, we opened 12 new doors this year, bringing our total to 33 stores that continue to drive share gains in the state. We've established ourselves as a highly productive retailer with stores that consistently outperform fair share with continuously improving cost structures. The investments we've made in technology and processes are driving down costs and our targeted approach to marketing means every dollar spent is generating measurable ROI, plus our retail strategy is a competitive advantage that we can efficiently transfer and replicate. It will continue to pay dividends as regulations change, and we can respond quickly by adding new stores that follow a winning, well-tested blueprint.

The third quarter results are a direct reflection of the actions we've taken in the first half of the year to invest wisely in our core through smart innovation, brand building, productive retail infrastructure and to rationalize and exit margin-dilutive operations. The industry is evolving and consolidating, creating openings for companies with strong cash flow generation. A stronger, leaner Cresco Labs sets us up for continued growth from our core and to take advantage of the many capital-efficient opportunities for expansion that we see on the horizon.

With that, I'll turn it over to Dennis to provide more details on our Q3 performance.

Dennis M. Olis
Chief Financial Officer

Thank you, Charlie, and good morning, everyone. It's nice to see the hard work by the team executing our Year-of-the-Core initiatives lead directly to better margins, profitability and cash flow.

In the quarter, we generated $191 million in revenue. This was a modest decline from Q2 due to the expected lower wholesale revenue based on the actions we took to rationalize and optimize California and Maryland. Retail revenue grew by 2% as we opened 2 new stores and saw continued fair share improvement across the network. The actions that we took in the first half of the year have led to a 370 basis point sequential increase in adjusted gross margin and a nearly 500 basis point improvement since Q1.

Our Q3 adjusted gross margin was 50.5%. We have said many times over the past couple of quarters that our long-term goal is to achieve and maintain approximately 50% gross margins. But as we've said in the past, we do expect to see fluctuations from quarter-to-quarter due to the timing of cost and revenue mix.

Our cost savings initiatives go beyond COGS as well, targeting every area of the business. The team has made tremendous effort to drive additional profitability at every level of the company. Total adjusted SG&A declined to $57 million in Q3, a $10 million lower than Q1. That represents a $40 million annualized adjusted SG&A savings versus the first quarter. As a result of this focus on margins, cost and profitability,

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we generated $49 million of adjusted EBITDA, up approximately 21% sequentially and almost 70% since Q1. Our Q3 adjusted EBITDA margin was 26%, up over 1,000 basis points from Q1.

With cash generation being our #1 goal this year, we're thrilled with our progress so far. We closed the quarter with approximately $113 million of cash on hand. In the quarter, we generated $41 million in operating cash flow, a significant improvement from $21 million from Q1 and Q2 combined. This improvement in operating cash flow was a direct result of the improved margins in the quarter, combined with ongoing management of working capital. Year-to-date, we've generated $62 million in operating cash flow.

We spent $12 million in CapEx during Q3, bringing the total year-to-date to $51 million. Our CapEx investment has been focused on facility improvements and new store openings, both projects with short payback periods and high ROIs. Looking ahead to the fourth quarter, we expect total revenue to be down mid-single digits sequentially. While we will see retail gains from new stores in Florida and Pennsylvania, they will be offset by our decision to exit Arizona in the quarter as well as seasonal weakness in Q4 versus Q3.

We expect margins to be in line or slightly lower in Q4 given the lower revenue base. Absolute SG&A expense should move lower as we continue to create efficiencies and manage our corporate overhead. We are taking the tough steps across the organization to drive increased profitability and cash flow that will enable us to reinvest back into the business, allocating capital efficiently to create a stronger Cresco Labs. While we're pleased with our results this quarter, we'll continue to drive efficiencies and cash generation initiatives to create shareholder value throughout the balance of the year and beyond.

With that, I'll pass it back to Charlie.

Charles Bachtell
Co-Founder, CEO & Director

Last week's successful ballot measure made Ohio the 24th state to pass adult-use cannabis legislation. The implications of this event should not be marginalized. With Ohio, now over 50% of the U.S. population lives in a state where adult-use cannabis is legal. You had an off-year election in a swing state, produce voter turnout almost equal to 2022's midterm election and pass a cannabis legalization effort with 57% of the vote. More than ever, cannabis continues to break down the partisan barriers as U.S. voters are saying they want to create a responsible and regulated cannabis industry. And while the timing of federal reform has been unpredictable, we've reached a tipping point where change is inevitable. Until that change comes, we're improving every aspect of our business to best position ourselves for both today's environment and for the future.

The long-term cannabis growth story remains unchanged. Cannabis is estimated to be a $100 billion market where only about 30% currently comes from state-regulated sales. As regulations change and consumers turn to the accessible, safety-focused, regulated legal market, Cresco Labs is doing what needs to be done to secure long-lasting industry leadership. Again, thank you to the Cresco team for your disciplined, focused, unmatched creative problem-solving skills and relentless pursuit of industry leadership.

In closing, we will continue leaning into our core by investing in our largest highest-margin markets while optimizing those markets that negatively impact margin, driving operating efficiencies throughout our entire organization and doing more with less, investing in brand and retail innovation to provide the consumer with the best cannabis experience possible and generating more free cash flow to strengthen our balance sheet.
With that, I'll open the call for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question today is from the line of Aaron Grey, Alliance Global Partners.

Aaron Thomas Grey
Alliance Global Partners, Research Division

Nice job with the margin improvement in the quarter. First question for me, I want to actually talk about sales. So you had guided for sales to be down high single digits in 2H versus 1H, based on some [background about math] it now implies that it will be down more in the mid single-digit based on 3Q and how 4Q seems to be coming up for you guys based on the guide. So can you speak to maybe what fared better than you might have expected in terms of the margins being down less, maybe pricing pressure not being as bad as you as expected. You guys holding on to your market share better than you had anticipated in some markets like Illinois. So any commentary in terms of sales now coming in 2H versus expectations when we last spoke in August would be helpful? Thanks.

Charles Bachtell
Co-Founder, CEO & Director

Good morning, Aaron. There's a lot that goes into producing the Q3 that we had. And as I said in the prepared remarks, like credit to the broad Cresco team for really committing to following through on the Year-of-the-Core initiatives. And so the results that you see in Q3 are a product of us being incredibly competitive in our core markets and maintaining and stabilizing and growing in all of those things from a performance perspective. And at the same time, it's the realization of a really diligent approach to cost management and also the optimization and rationalization of components of our business that have been headwinds from the margin perspective. So again, just I think an overall really well-executed quarter, phenomenal job by the team.

Aaron Thomas Grey
Alliance Global Partners, Research Division

Okay. Great. And second question for me. Just on the cost savings initiatives, really a nice job of lowering that $10 million since 1Q to [$57 million]. So could you just provide more color maybe where you've been driving some of those efficiencies? And then it sounds like you still have some more going forward. I think you said you expect SG&A to be a bit lower in 4Q. So how much more -- in fact, you think there's a cut. Obviously, you've done a lot of work for the first 9 months of the year. So any commentary on what's been driving it and expectations for further efficiencies that you might be able to drive out the business going forward?

Charles Bachtell
Co-Founder, CEO & Director

Sure. I'll start, and then Dennis will add some additional color. The -- some of this is also the product and recognizing in 2022 preparing to close a really large transformative transaction. That, of course, would require a lot of resources and bandwidth in certain areas of the business as we refocused for '23 to be the Year-of-the-Core presented itself with opportunities for us to get leaner and to create efficiencies in structural design and responsibilities, et cetera. And it also really has put us on a path to, I guess, living this way, right? When you make tough decisions and you make some strategic overhauls to structures and design, it also opens up your eyes to what else can be done. It's challenging. It's difficult. But again, the team has done a really great job of committing to this philosophy of the Year-of-the-Core.

Dennis M. Olis
Chief Financial Officer

Yes. Aaron, I'll just add a couple of things to what Charlie noted. There was a small piece of the improvement that we've seen from Q1 to Q3 related to some of the activities we did in some of the states

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to divest of some of our businesses. But the bulk of the savings really came from looking -- taking a hard look at our corporate expenses, looking at every dollar we're spending and really reevaluating if there's a more efficient way to do it. Some of the investments we've made in people and systems have enabled us to reap those benefits from a cost perspective.

As we look to Q4, there are still some things that we're actively looking at. I think the decline you'll see from Q3 to Q4 will be less than what you saw from Q2 to Q3. But we're going to continue to examine every dollar we spend and look for every opportunity to run the business more efficiently at corporate and in the field.

Operator

Our next question today is from the line of Frederico Gomes of ATB Investments.

Frederico Yokota Choucair Gomes
ATB Capital Markets Inc., Research Division

My first question is just on your capital allocation plans, given the strong cash generation this quarter. How do you look at the options between the leveraging or investing for further growth? And I know that you mentioned that you're going to be opportunistic in terms of new market opportunities. So if you could expand on what are you looking for in new markets or a potential target and how the M&A pipeline looking like?

Charles Bachtell
Co-Founder, CEO & Director

Sure. This is Charlie. I'll start. Is it -- again, great operational cash flow production in the quarter. It's a trend, right, that we want to continue. So as we continue leaning into this area and creating more with less, it's going to -- you're going to see us allocate capital to the things that continue to move us in this direction that help increase efficiencies, that help us reduce costs and improve margins as we move forward that make us more competitive, especially in our core markets.

As it relates to growth opportunities that already exist in our footprint, there will be some investment, as you see, Ohio recently passing an adult-use law and Pennsylvania and Florida to be expected in the coming year-ish. So we have opportunities to make investments in the footprint that are going to have great ROI. And as we look at opportunities in other areas of the industry markets et cetera, we have a very disciplined eye at this point in how we want to move into those markets. We've had opportunities to move into them before for various reasons.

The position that we find ourselves in right now is a very strong position. We can see how these markets unfold. We're seeing trends already developed in states like New Jersey and Maryland that will make us a more effective and more efficient acquirer should we choose to move into those states, then the opportunity would have presented itself over the last 18 months to 24 months.

Frederico Yokota Choucair Gomes
ATB Capital Markets Inc., Research Division

And then my second question is just looking at your portfolio of branded products, your good, better, best approach. And just thinking about the broader competitive environment, are you seeing any need to discount certain segments more than the others? And just any general color you could provide on discounting and the overall, I guess, surrounding market dynamics that you're seeing out there?

Charles Bachtell
Co-Founder, CEO & Director

Greg will start us off on this one.

Gregory Butler
Chief Transformation Officer

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Sure. Look, I think we're very pleased with how our brands performed this quarter, as we talked before, we still lead a market position either in the market position or within top 5 across all categories. I think from a branded products perspective, our view is we want to continue to grow and defend our share positions. We'll do that through innovation. We think there's some nearing innovations that we can continue to do, bring whether it's flavors or new formats in the markets. But from a general kind of business perspective, our view is we've got brands that we know consumers love. We're seeing that as they vote for our brands with their sales. And to what Dennis mentioned before, it's just about driving efficiency on the back end of those brands to really help drive margin, so that we can flex with price as we have to, but really just focus on delighting our customers and driving better margins off our brands.

Frederico Yokota Choucair Gomes
ATB Capital Markets Inc., Research Division

Perfect. Congrats on the great margin expansion this quarter.

Operator

Our next question today is from the line of Ty Collin of Eight Capital.

Ty Collin
Eight Capital, Research Division

Charlie, maybe for my first one, and you're obviously very dialed into everything going on in D.C. So I'm just wondering if you could update us on your thoughts around rescheduling at this point, how you're handicapping the likelihood of that going through? And what time frame you think is realistic?

Charles Bachtell
Co-Founder, CEO & Director

Yes, sure. Always have to caveat the things that involve government decisions and actions, but nothing has changed as it relates to the rescheduling. Once the HHS announcement or recommendation came out, nothing that we've heard or seen has changed the expectations on how that process is going to move forward and what the end result of it is going to be. From a timing perspective, again, there's flexibility in timing but all indications and what we're hearing and seeing from other reports on it is by the end of the year, it's sort of the expectation around the end of the year is the expectation on a DEA announcement. There is a process that has to happen before it becomes effective. That's just the recommendation from DEA. But feeling optimistic about the rescheduling. As I mentioned, I think, on our last quarter, there's a difference between legislation and administrative action and administrative action like a rescheduling is somewhat more insulated from the complexities and risks associated with legislation. So we feel good about it.

Ty Collin
Eight Capital, Research Division

Great. Great. Appreciate your thoughts on that. And for my follow-up, just wondering if you could provide a little more detail around the operating cash flow generation this quarter as we're waiting for the full financials to hit, assuming there was some movement in working capital or tax payables in there. So just wondering if you could comment on that. And specifically, curious if there was any change to your policy around paying the 280E taxes, which a number of your peers have announced this quarter?

Charles Bachtell
Co-Founder, CEO & Director

Dennis will handle that one.

Dennis M. Olis
Chief Financial Officer

Thanks, Ty. I'll start with the second part of that question first. There was no change to our policy on how we're handling 280E from a tax perspective. We will be making -- we did make tax payments in Q4, so it

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didn't really affect our Q3 results to pay off the balance -- the majority of the 2022 federal taxes. But we continue to pay our taxes as they're due according to the current IRS law. So no change to our policy on that.

As far as the operating cash flow in the quarter, it was about a $42 million improvement in working capital in the quarter. A lot of that comes from -- one of the things I'm really proud of, and we've talked about it in the past, we continue to see our inventory levels drop. This time last year, we were sitting with an inventory balance of about $155 million or so. We've worked that down this quarter, we ended with about $115 million of inventory on hand. So we're really pleased with that, the aging of that inventory and so forth. So that puts us in a good position.

And we're proactively managing our AP and AR. So feel good about where we're at with operating cash flow. We will have a little bit of an impact in Q4 as we did make the tax payment that I noted earlier. But again, I feel that we're on the right track. All the actions we've taken from a cost standpoint, both from an SG&A and as well as from cost of goods sold, we're going to continue to see the benefits of that through our cash generation and operating cash flow for the foreseeable future.

Operator

Our next question today is from the line of Luke Hannan of Canaccord.

Luke Hannan
Canaccord Genuity Corp., Research Division

I appreciate the commentary so far on your thoughts on capital allocation. Dennis, maybe this one is for you. I think you talked about you're seeing some shorter payback periods on the projects that you're choosing to invest in now, whether that's automation within your production facilities or in the new stores that you're rolling out. Can you give us a sense of where those payback periods are now and maybe how that's evolved over the course of the last year or 2 or since you've initially rolled out new store builds in your core markets, how that's evolved over time?

Dennis M. Olis
Chief Financial Officer

Yes, thanks for the question, Luke. So if you look back at some of our investments we've made going back a year or 2, a lot of those were investments we were making in some of our cultivation facilities, building them out. We made quite a bit of investments earlier -- late last year and early this year, in building out our New York facility in Ellenville. So those are going to be larger investments, but also have a longer payback period.

What you're seeing more recently is we're making investments in our facilities, whether it's with lighting or automation to improve our productivity and efficiencies in our cultivation and manufacturing facilities. So those have a relatively short payback period once you install new lighting, for example, in a cultivation site. Also, we've made -- we've seen quite a bit of growth in our stores, retail stores, whether it's in Florida. We've added a number of stores in Pennsylvania. And again, those stores have relatively short payback periods in the 12 months or less time frame. So, again, it's where we're making those investments that have shortened the -- one is, it's reduced the size of the investment. But two, it's also reduced the payback period of the ROI.

Luke Hannan
Canaccord Genuity Corp., Research Division

Got it. And then my follow-up here is just -- I don't know if you can share this. But can you give us a sense of, overall, what we should be expecting as far as those onetime cash costs going forward? I think it was about $8 million this quarter. Should we expect that to lower in magnitude going forward? And how soon should we be able to see the operating cash flow that converges closer to the true underlying cash flow generation potential of the business and we have those onetime cash costs sort of roll off?

Dennis M. Olis
Chief Financial Officer

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Yes. What you saw in this quarter was there was a couple of million dollars of severance payments related to some of the reduction in force that we've had in the first couple of quarters that severance has kind of rolled out. That will continue a little bit into Q4. And again, as we continue to manage our cost structure effectively, you may see that will continue for a couple of quarters yet as we defer that cost over a number of quarters. Some of the legal costs that we incurred and deal costs that we incurred in Q2 and Q3 really relate to the Columbia Care transaction. So those costs will go away. So bottom line is, I would expect those costs to decrease over time. But again, as we continue to look at cleaning up our cost structure and running this business as effectively as we can, you will see some fluctuations from quarter-to-quarter on the amount of onetime charges we have. But overall, I would expect them to decrease over time.

Operator

[Operator Instructions] And our next question today is from the line of Scott Fortune of Roth MKM.

Scott Thomas Fortune
ROTH MKM Partners, LLC, Research Division

Congrats to continue to execute on the margin improvement leaning in. That said, can you provide a little bit of color on the CapEx and your kind of intentions looking out? I know you mentioned Florida, Pennsylvania, and Ohio as potential builds a little bit. But can I focus on kind of the store growth? I know you opened 13 in the first half and we saw 2 new stores come on third quarter in Florida, but just kind of more of a little bit of expectation for the store growth and production facilities as far as CapEx is concerned. And just kind of following on what was kind of a level for CapEx maintenance kind of moving forward as we look into '24 here?

Dennis M. Olis
Chief Financial Officer

Yes. Thanks, Scott. This is Dennis. I'll start that one. So again, from a store standpoint, we did open 2 more stores in this quarter. We expect to open -- we have one more store in PA that will open, I think, in early '24. From a CapEx perspective, in Q4, we will see a very small mid single-digit CapEx expense in the quarter. We've been talking about managing that over the course of the year. You've seen that come down, again, the first half being driven by the expansion in New York.

As we look at the next year, we haven't given any specific guidance, but we do expect our total CapEx expenditures to come down from our current year. This year we'll end in the mid $50 million range. As we look forward into next year, we do expect that to come down. And again, focusing on short-term ROI paybacks to improve our efficiencies and operations and additional store openings that -- the 1 store of PA and additional stores in Florida as well.

Scott Thomas Fortune
ROTH MKM Partners, LLC, Research Division

Got it. And just kind of focusing on Florida, obviously, you've opened up a number of stores there. I think you have total of 33 now. How do you look -- obviously, Florida, in the fourth quarter, you see a lot of promotional, a lot of discounting. Is that a big part of the potential kind of 4Q number here on the top line? And how is Florida as far as kind of the margins, the profitability for that state versus kind of some of the other as you like on core states in the side and the opportunity to expand or improve in Florida, just kind of focus on Florida going forward here.

Dennis M. Olis
Chief Financial Officer

Yes, Scott, I'll start that, and then I'll pass it over to Greg. From a margin perspective, we don't give margins at a state-by-state level, but the margins in Florida are good. The fact that you've got a vertically integrated operation in Florida allows you to capture some of the margin that you would otherwise pass along to some independents or third parties. So from a margin profile, we're pleased with what we've seen in Florida, and I think we'll continue to see some growth opportunities. Greg, do you want to add on...

Gregory Butler

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Chief Transformation Officer

Yes. The only thing I'd add to this is you're absolutely correct. Pricing in Florida from Q2 to Q3 has been tough, just different weekends, different price promotions. We don't expect that to change drastically, at least we're not planning it to change drastically as we look to Q4. What I would say for the team out there, they have done just a phenomenal job of bringing more product line, getting more out of our facility in Florida, which has helped us ensure that we've got the best assortment across our stores. And we feel good that in Q4, we're going to continue to see the benefits of that work as we go into the quarter and then also in the next year as well, where we're -- if you remind like we have a pretty small share today, and we only see opportunities for us to continue to grow as we rounded our assortment and just get more out of the facility. So we're really pleased with our Florida results and excited for what next quarter brings.

Operator

And our final question today is from the line of Matt McGinley of Needham.

Matthew Robert McGinley
Needham & Company, LLC, Research Division

I think you said that retail sales were up about 2% quarter-over-quarter, which would imply that wholesale was down around 12% or around $10 million sequentially. How much of that sequential decline in wholesale is from the divested assets or from states that you're now less focused on like California compared to decline in your wholesale program in core states like Illinois, Pennsylvania and Massachusetts? And then into the outlook for a mid single-digit decline of revenue in the fourth quarter, does that assume a decline like you saw this quarter in wholesale? Or are you seeing a little bit more stabilization there?

Charles Bachtell
Co-Founder, CEO & Director

Thanks, Matt. This is Charlie. I'll start, and I think Greg and Dennis will have some to contribute. But yes, I think you're right, like if you look at California, it was responsible for a portion of that, the divested assets from earlier in the year, of course, but all part of the plan. And then I would also add increased verticalization also as a component of transition from wholesale sales to recognizing some of that same sales across our own footprint or our own retail shelf. Greg, additional color?

Gregory Butler
Chief Transformation Officer

And the only thing I'd add to that is what -- we're seeing both in our stores and I think across the market is unit volume and trip volume continues to grow, which is really encouraging just from the consumer side of this, which is showing that consumers are both entering stores and buying bigger sized products in stores as well. Obviously, the revenue declines associated across the industry for most of our core markets are due to price compression. We don't see that changing too much in Q4 or the first half of next year, which is why, as Dennis mentioned, like our focus is how do we drive unit costs down, so that we can get whole margins through that period.

From an overall business perspective, a couple of big trends that we're watching. One is just MSO allocation of own shelf. That obviously was an impact to us for Q3. As many retailers were prioritizing their own brands on their own shelves. And then the second thing, particularly in Q4 that we're watching is with independent pricing actions. Some of the independent stores that are open, I think as we look at the market might start to struggle, you might see that cause some price as they're liquidating their unit sales, which could put some compression on the wholesale market, and as we get into Q4 [we'll be] watching for Q1. But overall, from a just total retail and our wholesale brand perspective, unit volumes up, trips are growing. It's a price compression reality we're all facing right now. And through innovation and cost programs, we hope to drive increased margins as we continue to get into 2024.

Charles Bachtell
Co-Founder, CEO & Director

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And the last thing I would add to that, Matt, too, is if you look at the divestiture of Maryland, that's 100% wholesale, it's all we had in that market. And then also in California, the rationalization in California, we're only on the wholesale side in California.

Matthew Robert McGinley
Needham & Company, LLC, Research Division

So it sounds like most of that decline was driven by core markets and not California and Maryland, correct?

Gregory Butler
Chief Transformation Officer

It's about 50-50. Half the decline in wholesale was attributed to California and Maryland and the other was core business.

Matthew Robert McGinley
Needham & Company, LLC, Research Division

Okay. And then on the gross margin side, I think you said that about 200 basis points of that improvement you saw was from, I think, Ohio, Florida and Pennsylvania. What drove -- I guess, what was the underlying driver of that? Was that just less discounting in those states? Or is that just the overall production efficiency gains as you were talking about and now you have a cleaner inventory position. And I guess how much of a margin benefit did you have from that decline in revenue from California and Maryland?

Dennis M. Olis
Chief Financial Officer

So absolutely, California and Maryland, which were states that we made those strategic decisions to change our model on our footprint. Those decisions were made because of the fact that they were dilutive to the overall margin of the business. So that definitely contributed to the improvement that you saw from Q2 to Q3.

The other thing you have to remember is a lot of the actions that we took across our business in Q1 and Q2 as they relate to manufacturing, we capitalize those costs, and we then expense them as a product ship. So there's always a delay from when you take an action and when you actually see it flow through the P&L. So what you saw in Q3 was a culmination of some of the activities that we had done to reduce our cost actions that we took in the first half of the year that are starting to pay dividends in the second half of the year.

Operator
Thank you, and this will bring us to the end of the Cresco Labs third quarter 2023 earnings conference call. Thank you to everyone for joining us today. You may now disconnect your lines.

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