UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: March 31, 2022

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number 000-56075

4Front Ventures Corp.
(Exact name of registrant as specified in its charter)

British Columbia	**83-4168417**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

5060 N. 40th Street
Suite 120
Phoenix, Arizona 85018
(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (602) 633-3067

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on Which Registered
Class A Subordinate Voting Shares, no par value	FFNTF	OTCQX
	FFNT	CSE

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company” in Rule 12b-2 of the Exchange Act:

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☒
		Emerging growth company	☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of May 20, 2022, the registrant had 636,636,686 Class A subordinate voting shares outstanding.

4Front Ventures Corp.

FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2022

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.
4FRONT VENTURES CORP.
CONDENSED CONSOLIDATED INTERIM BALANCE SHEETS (unaudited)
As of March 31, 2022 and December 31, 2021
(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	March 31, 2022	December 31, 2021
ASSETS		
Current assets:		
Cash	$ 8,638	$ 22,581
Accounts receivable, net	2,742	1,946
Other receivables	1,802	289
Current portion of lease receivables	2,627	3,630
Inventory	25,910	20,087
Current portion of notes receivable	11	109
Prepaid expenses	2,079	2,232
Total current assets	43,809	50,874
Property, plant, and equipment, net	57,815	42,633
Lease receivables	7,543	6,748
Intangible assets, net	43,616	26,246
Goodwill	33,404	23,155
Right-of-use assets	99,395	100,519
Deposits	5,107	5,364
TOTAL ASSETS	$ 290,689	$ 255,539
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Current liabilities:		
Accounts payable	$ 5,110	$ 2,131
Accrued expenses and other current liabilities	7,596	9,411
Taxes payable	27,619	23,968
Derivative liability	2,202	3,502
Current portion of convertible notes	—	2,784
Current portion of lease liability	3,700	3,629
Current portion of notes payable and accrued interest	5,385	3,413
Total current liabilities	51,612	48,838
Convertible notes	14,920	14,641
Notes payable and accrued interest from related party	48,651	48,266
Long term notes payable	1,709	1,709
Long term accounts payable	1,200	1,200
Contingent consideration payable	2,393	2,393
Construction finance liability	16,000	—
Deferred tax liability	7,162	7,849
Lease liability	93,505	93,111
TOTAL LIABILITIES	237,152	218,007
SHAREHOLDERS' EQUITY		
Equity attributable to 4Front Ventures Corp.	294,981	274,120
Additional paid-in capital	53,235	52,197
Deficit	(294,756)	(288,857)
Non-controlling interest	77	72
TOTAL SHAREHOLDERS' EQUITY	53,537	37,532
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 290,689	$ 255,539

See accompanying notes to financial statements.

4FRONT VENTURES CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF OPERATIONS (unaudited)
For the Three Months Ended March 31, 2022 and 2021
(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	Three Months Ended March 31, 2022	2021
REVENUE		
Revenue from sale of goods	$ 23,083	$ 20,080
Real estate income	2,965	2,890
Total revenues	26,048	22,970
Cost of goods sold	(12,594)	(9,125)
Gross profit	13,454	13,845
OPERATING EXPENSES		
Selling and marketing expenses	5,166	5,157
General and administrative expenses	7,644	5,165
Depreciation and amortization	847	774
Equity based compensation	1,038	2,396
Total operating expenses	14,695	13,492
(Loss) Income from operations	(1,241)	353
Other income (expense)		
Interest income	2	3
Interest expense	(2,620)	(2,461)
Amortization of loan discount upon conversion of debt to equity	—	(2,915)
Change in fair value of derivative liability	1,300	(2,532)
Loss on lease termination	—	(879)
Other	103	—
Total other expense, net	(1,215)	(8,784)
Net loss before income taxes	(2,456)	(8,431)
Income tax expense	(3,438)	(2,653)
Net loss from continuing operations	(5,894)	(11,084)
Net loss	(5,894)	(11,084)
Net income attributable to non-controlling interest	5	5
Net loss attributable to shareholders	$ (5,899)	$ (11,089)
Basic and diluted loss per share	$ (0.01)	$ (0.02)
Weighted average number of shares outstanding, basic and diluted	619,113,389	558,997,571

See accompanying notes to condensed financial statements.

4FRONT VENTURES CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (unaudited)
For the Three Months Ended March 31, 2022 and 2021
(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	Share Capital						
	Shares	Amount	Additional Paid-In Capital	Deficit	Total 4Front Ventures Corp. Shareholders' Equity	Non-Controlling Interest	Total Shareholders' Equity
Balance, December 31, 2021	594,181,604	$274,120	$ 52,197	$(288,857)	$ 37,460	$ 72	$ 37,532
Shares issued for NECC pursuant to acquisition	28,571,428	17,689	—	—	17,689	—	17,689
Share-based compensation	—	—	1,038	—	1,038	—	1,038
Conversion of notes to equity	6,235,512	3,122	—	—	3,122	—	3,122
Shares issued with exercise of warrants	88,659	50	—	—	50	—	50
Net loss	—	—	—	(5,899)	(5,899)	5	(5,894)
Balance, March 31, 2022	629,077,203	$294,981	$ 53,235	$(294,756)	$ 53,460	$ 77	$ 53,537

	Share Capital						
	Shares	Amount	Additional Paid-In Capital	Deficit	Total 4Front Ventures Corp. Shareholders' Equity	Non-Controlling Interest	Total Shareholders' Equity
Balance, December 31, 2020	538,851,252	$250,583	$ 42,116	$(250,548)	$ 42,151	$ 52	$ 42,203
Shares issued for Pure Ratios earnout	473,491	161	—	—	161	—	161
Share-based compensation	—	—	2,396	—	2,396	—	2,396
Conversion of notes to equity	24,366,003	6,253	—	—	6,253	—	6,253
Shares issued with exercise of stock options	1,358,116	871	—	—	871	—	871
Shares issued with exercise of warrants	2,422,363	1,563	—	—	1,563	—	1,563
Return of treasury shares	(8,320)	—	—	—	—	—	—
Net loss	—	—	—	(11,089)	(11,089)	5	(11,084)
Balance, March 31, 2021	567,462,905	259,431	$ 44,512	$(261,637)	$ 42,306	$ 57	$ 42,363

See accompanying notes to condensed interim financial statements.

4FRONT VENTURES CORP.
CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS (unaudited)
For the Three Months Ended March 31, 2022 and 2021
(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	Three Months Ended March 31,	
	2022	2021
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (5,894)	$ (11,084)
Adjustments to reconcile net loss to net cash used by operating activities		
Depreciation and amortization	1,795	1,046
Equity based compensation	1,038	2,396
Change in fair value of derivative liability	(1,300)	2,532
Accretion of lease liability	1,513	612
Write-off of deposit	—	80
Write-off of fixed asset from terminated lease	—	799
Accretion of contingent consideration	—	124
Accretion of convertible debenture and interest	279	590
Accrued interest on notes payable	1,973	1,097
Interest accrued - lease receivable	208	—
Deferred taxes	(687)	632
Amortization of loan discount upon conversion of debt to equity	—	2,915
Changes in operating assets and liabilities	(1,293)	1,075
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(2,368)	2,814
CASH FLOWS FROM INVESTING ACTIVITIES		
Payment for NECC business combinations, net of cash acquired	(24,998)	—
Notes receivable repayments	98	63
Sale of dispensaries and interests in cannabis licenses	—	1,093
Purchases of property and equipment	(1,109)	(7,186)
NET CASH (USED IN) INVESTING ACTIVITIES	(26,009)	(6,030)
CASH FLOWS FROM FINANCING ACTIVITIES		
Notes payable received, net of costs	—	411
Proceeds from issuance of construction financing liability	16,000	—
Proceeds from the exercise of warrants	50	1,563
Proceeds from the exercise of stock options	—	871
Repayment of notes payable	(1,616)	(755)
NET CASH PROVIDED BY FINANCING ACTIVITIES	14,434	2,090
NET DECREASE IN CASH	(13,943)	(1,126)
CASH, BEGINNING OF QUARTER	22,581	18,932
CASH, END OF QUARTER	8,638	$ 17,806

See accompanying notes to condensed interim financial statements.

Note 1: NATURE OF OPERATIONS

4Front Ventures Corp. ("4Front" or the "Company") exists pursuant to the provisions of the British Columbia Corporations Act. On July 31, 2019, 4Front Holdings LLC ("Holdings") completed a Reverse Takeover Transaction ("RTO") with Cannex Capital Holdings Inc. ("Cannex") whereby Holdings acquired Cannex and the shareholders of Holdings became the controlling shareholders of the Company. Following the RTO, the Company's SVS are listed on the Canadian Securities Exchange ("CSE") under the ticker "FFNT" and are quoted on the OTC (OTCQX: FFNTF).

The Company has two primary operating segments: THC Cannabis and CBD Wellness. With regard to its THC Cannabis segment, as of March 31, 2022, the Company operates six dispensaries in Massachusetts, Illinois, and Michigan, primarily under the "MISSION" brand name. As of March 31, 2022, the Company operates three production facilities in Massachusetts, Illinois and California and produces the majority of products that are sold at its own Massachusetts, Illinois, and California dispensaries. Also, as part of its THC Cannabis segment, the Company leases real estate and sells equipment, supplies and intellectual property to cannabis producers in the state of Washington.

While marijuana is legal under the laws of several U.S. states (with varying restrictions), the United States Federal Controlled Substances Act classifies all "marijuana" as a Schedule I drug, whether for medical or recreational use. Under U.S. federal law, a Schedule I drug or substance has a high potential for abuse, no accepted medical use in the United States, and a lack of safety for the use of the drug under medical supervision.

The Company's CBD Wellness segment is focused upon its ownership and operation of its wholly owned subsidiary, Pure Ratios Holdings, Inc. ("Pure Ratios"), a CBD-focused wellness company in California, that sells non-THC products throughout the United States.

On January 28, 2022, the Company entered into an agreement and plan of merger (the "NECC Merger Agreement") with New England Cannabis Corporation, Inc., a Massachusetts Corporation ("NECC") and a wholly owned subsidiary of the Company entered into a membership interest purchase agreement (the "Everett Purchase Agreement," and together with the NECC Merger Agreement, the "NECC Merger Agreements") with Kenneth Stevens to purchase all of the membership interests of 29 Everett, LLC ("29 Everett"), a Massachusetts limited liability company. See Note 7 for further details on the NECC Merger Agreements and corresponding transactions under such agreements.

Management continues to evaluate the impact of the COVID-19 pandemic on the Company's industry and has concluded that while it is reasonably possible that the virus could have a negative effect on the Company's financial position and results of its operations the specific impact is not readily determinable as of the date of these consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The corporate office address of the Company is 5060 North 40th Street, Suite 120, Phoenix, Arizona, and the Company's registered office is 550 Burrard Street, Suite 2900, Vancouver, British Columbia.

Note 2: BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") applicable to interim financial information and with the rules and regulations of the United States Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed, or omitted, pursuant to such rules and regulations.

In the opinion of management, the unaudited interim financial statements include all adjustments necessary for the fair presentation of the results of the interim periods presented. All adjustments are of a normal recurring nature, except as otherwise noted below. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereto for the year ended December 31, 2021, included in the Company's Annual Report on Form 10-K, filed April 18, 2022, with the U.S. Securities and Exchange Commission, as well as the Company's Amendment to the Annual Report on Form 10-K, filed April 21, 2022, and on the System for Electronic Document Analysis and Retrieval in Canada (or SEDAR). The results of operations for the interim periods are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

There have been no changes to the Company's significant accounting policies as described in Note 2 of the Company's 2021 Annual Report on Form 10-K.

Principles of consolidation

The accompanying condensed consolidated interim financial statements include the accounts of the Company and all entities in which the Company either has a controlling voting interest or is the primary beneficiary of a variable interest entity. All intercompany accounts and transactions have been eliminated on consolidation. The financial results of NECC are included in the condensed consolidated financial statements beginning on January 28, 2022, the merger closing date.

The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

Note 3: SIGNIFICANT ACCOUNTING POLICIES

(a) Critical accounting estimates and judgments

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of the Company's condensed consolidated interim financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. The significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those described in the latest annual consolidated financial statements.

We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

(b) Recent Accounting Pronouncements

Recently Adopted

i. In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes", which is intended to simplify various aspects related to accounting for income taxes. ASU 2019-12 removes certain exceptions to the general principles in Topic 740 and also clarifies and amends existing guidance to improve consistent application. ASU 2019-12 was effective for the Company beginning January 1, 2021. Adoption of this standard did not materially impact the Company's consolidated financial position, results of operations or cash flows.

ii. In August 2020, the FASB issued ASU 2020-06, "Debt - Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging - Contracts in Entity's Own Equity (Subtopic 815-40)". ASU 2020-06 simplifies the accounting for certain financial instruments with characteristics of liabilities and equity, including convertible instruments and contracts on an entity's own equity. ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. Adoption of this standard did not materially impact the Company's consolidated financial position, results of operations or cash flows.

iii. In May 2021, the FASB issued ASU 2021-04, "Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options (Subtopic 815-40)". ASU 2021-04 clarifies and reduces diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified written call options (for example, warrants) that remain equity classified after modification or exchange. ASU 2021-04 is effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. Adoption of this standard did not materially impact the Company's consolidated financial position, results of operations or cash flows.

Accounting Pronouncements Not Yet Adopted

i. In October 2021, the FASB issued ASU 2021-08, "Business Combinations - Accounting for Contract Assets and Contract Liabilities (Topic 805)". The amendments in this update address diversity and inconsistency related to the recognition and measurement of contract assets and contract liabilities acquired in a business combination by requiring that an acquirer recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606, Revenue from Contracts with Customers. ASU 2021-08 is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. The Company does not expect the adoption of this ASU to have a material impact on the Company's financial statements.

Note 4: INVENTORY

The Company's inventories include the following as of March 31, 2022 and December 31, 2021:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	March 31, 2022	December 31, 2021
Raw Materials - unharvested cannabis	$ 4,409	$ 2,164
Raw materials CBD and ingredients	37	36
Work in process - flower and extract	11,325	7,780
Finished goods - cultivation supplies	2,351	1,734
Finished goods - packaged products	7,788	8,373
Total	$ 25,910	$ 20,087

Note 5: PROPERTY, PLANT, AND EQUIPMENT

Property, plant and equipment and related depreciation are summarized in the table below:

	March 31, 2022	December 31, 2021
Land	$ 774	$ —
Buildings & improvements	13,509	1,483
Construction in process	218	63
Furniture, equipment & other	16,841	13,425
Leasehold improvements	35,514	35,538
Total	$ 66,856	$ 50,509
Less: accumulated depreciation	(9,041)	(7,876)
Total property, plant, and equipment, net	$ 57,815	$ 42,633

On January 28, 2022, in conjunction with a business combination with NECC, the Company acquired property, plant, and equipment totaling $15,238 (Note 7). The Company subsequently sold the property, plant, and equipment to a third-party and leased back the equipment from the third-party. As discussed in Note 9, the Company recognized this fact pattern as a failed sale-leaseback transaction, whereby the Company recognized the fixed assets on the balance sheet of NECC and established a construction finance liability for rental payments made as part of the lease agreement.

Approximately $33,000 of property and equipment is secured by LI Lending as collateral on the LI Lending note (Note 9). There were no significant contractual commitments for future capital expenditures as of March 31, 2022 and December 31, 2021.

Depreciation of property, plant and equipment is computed using the straight-line method over the asset's estimated useful life. The Company does not depreciate land, which has an indefinite useful life. Depreciation expense for the for the three months ended March 31, 2022 and 2021 was $1,165 and $463, respectively, of which $948 and $325, respectively, is included in cost of goods sold.

Note 6: INTANGIBLE ASSETS AND GOODWILL

Intangible Assets

Intangible assets are recorded at cost less accumulated amortization and impairment losses. Intangible assets acquired in a business combination are measured at fair value at the acquisition date. Amortization of definite life intangibles is recognized on a straight-line basis over their estimated useful lives. The estimated useful lives, residual values, and amortization methods are reviewed at each year end, and any changes in estimates are accounted for prospectively.

Intangible assets and related amortization are summarized in the table below:

	Licenses	Customer Relationships	Non-Competition Agreements	Know-How	Total
Balance, December 31, 2020	$20,146	$ 1,668	$ 43	$ 6,933	$28,790
Amortization expense	—	(580)	(43)	(1,921)	(2,544)
Balance, December 31, 2021	$20,146	$ 1,088	$ —	$ 5,012	$26,246
NECC merger and 29 Everett acquisition (Note 7)	18,000	—	—	—	18,000
Amortization expense	—	(145)		(485)	(630)
Balance, March 31, 2022	$38,146	$ 943	$ —	$ 4,527	$43,616

Goodwill

Balance, December 31, 2020	**$23,155**
Balance, December 31, 2021	**$23,155**
NECC merger and 29 Everett acquisition (Note 7)	10,249
Balance, March 31, 2022	**$33,404**

Impairment of Intangible Assets and Goodwill

On an annual basis, the Company assesses the Company's reporting units ("RUs") for indicators of impairment or when facts or circumstances suggest that it is more likely than not that the carrying amount may exceed fair value. For the purpose of impairment testing, goodwill is allocated to the Company's RUs to which it relates.

Goodwill was not tested for impairment during the three months ended March 31, 2022.

Three Months Ended March 31, 2021

On January 28, 2022, the Company entered into the NECC Merger Agreements with NECC and 29 Everett for total consideration of $44,689. As part of the purchase price allocation of the acquisition and merger, the Company recognized $18,000 of acquired licenses and $10,249 of goodwill based on the consideration transferred and fair value of assets acquired. For further details on the acquisition and purchase price allocation, see Note 7.

Year Ended December 31, 2021

In 2021, management assessed indicators of impairment and concluded the below for the respective RUs:

Retail, Production and Ancillary Cannabis Reporting Units

Management did not identify any significant negative triggering events that would suggest it is more likely than not that impairment exists. Therefore, further analysis is not required for these RUs.

Pure Ratios RU

As of March 31, 2022 and December 31, 2021, the accumulated impairment is $13,400, which is due to goodwill impairment of the entire outstanding balance of goodwill on the Pure Ratios segment for the year ended December 31, 2020. As a result, the segment does not have a balance of goodwill or intangible assets remaining as of December 31, 2021.

Note 7: ACQUISITIONS AND BUSINESS COMBINATIONS

On January 28, 2022, the Company entered into the merger agreement (the "NECC Merger") with NECC, Kenneth V. Stevens ("Mr. Stevens"), who is the sole owner of all of the issued and outstanding capital stock of NECC, and 4Front NECC Acquisition Co., a Massachusetts corporation (the "NECC Merger Sub"). At the effective time of the merger, the Company (i) paid Mr. Stevens cash in the amount of $9,000,000, and (ii) issued Mr. Stevens 28,571,428 Class A Subordinate Voting shares of the Company (the "SVS").

In connection with the consummation of the NECC Merger on January 28, 2022, Mission Partners RE, LLC, a Delaware limited liability company wholly owned by the Company ("Mission Partners RE"), and Mr. Stevens entered into the first amendment to that certain membership interest purchase agreement (the "Everett Purchase Agreement"). Pursuant to the Everett Purchase Agreement, the Company (through Mission Partners RE) completed its acquisition of 100% of the issued and outstanding membership interests of 29 Everett Street LLC, a Massachusetts limited liability company (the "Everett LLC"), which was solely held by Mr. Stevens and which owns certain real property that is currently leased to and used by NECC. The Company (i) paid Mr. Stevens cash in the amount of $16,000,000, and (ii) issued Mr. Stevens a promissory note in the initial principal amount of $2,000,000, which will bear interest at an annual rate of ten percent (10%) and will mature on the six-month anniversary of January 28, 2022. The Merger and Purchase Agreement were recorded as one transaction (collectively, referred to as the "NECC Acquisitions"), as the entities were commonly owned by the same individual and the purchase of Everett LLC was contingent on the Merger with NECC.

The NECC Merger was accounted for as a business combination in accordance with ASC 805. The Company has determined preliminary fair values of the assets acquired and liabilities assumed in the NECC Merger. These values are subject to change as the Company completes its determination of the fair value of assets acquired and liabilities assumed. Upon acquisition of NECC and Everett LLC on January 28, 2022, the Company consolidated the operations of Everett LLC into NECC.

The Company entered into the NECC Merger in order to acquire cannabis licenses, as well as property and equipment held by NECC to increase the Company's presence in Massachusetts and the northeastern United States. As part of the NECC Merger, the Company incurred $596,000 in transaction costs, which were expensed as incurred.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

The following tables presents the preliminary purchase price allocation for the NECC Merger:

Cash consideration	$25,000
Seller note	2,000
Equity consideration - common stock	17,689
Total Purchase Price	$44,689

Description	**Fair value**
Assets acquired:	
Cash	$ 2
Inventory	2,000
Property, plant, and equipment	15,238
Intangible asset- licenses	18,000
Total assets acquired	$ 35,240
Liabilities assumed:	
Accounts payable	800
Total liabilities assumed	$ 800
Estimated fair value of net assets acquired	$ 34,440
Estimated Goodwill	$ 10,249

Goodwill and Intangible Assets

Goodwill is represented by the future potential for the generation of positive cash flows and future relationships associated with the Company's operations. While NECC had yet to generate revenues as of the date of the Merger, the Company identified that the inputs of the business were in place to begin generating revenue during fiscal year 2022. The Company adjusts provisional goodwill balance when new information is obtained regarding the valuation of acquired assets and liabilities during a one-year measurement period from the date of acquisition in accordance with ASC 805-10. The Company has determined that the goodwill recognized in the above acquisition is not deductible for tax purposes.

The intangible assets acquired by the Company consist of cannabis licenses for operations. Utilizing alike licenses as a benchmark, the Company determined that the licenses acquired are indefinite lived assets.

Unaudited Pro Forma Results

The following unaudited pro forma financial information presents the results of operations of the Company and NECC for the three months ended March 31, 2022 and 2021, as if the acquisition had occurred as of the beginning of the first period presented instead of on January 28, 2022. The pro forma information does not necessarily reflect the results of operations that would have occurred had the entities been a single company during those periods.

The unaudited pro forma financial information for the Company and NECC is as follows:

	For the For the Three Months Ended March 31,			
	2022		**2021**	
	Reported	**Proforma**	**Reported**	**Proforma**
Revenues	$26,048	$26,048	$ 22,970	$ 22,970
(Loss) income from operations	(1,241)	(1,241)	353	344
Net loss	$ (5,894)	$ (5,609)	$(11,084)	$(11,093)
Basic and diluted earning (loss) per share	$ (0.01)	$ (0.02)	$ (0.02)	$ (0.02)

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

Note 8: LEASES

The Company has operating leases for its facilities where the Company conducts its operations. These leases have remaining lease terms ranging from 1.25 years to 19.43 years.

All real estate leases are recorded on the balance sheet. Equipment and other non-real estate leases with an initial term of twelve months or less are not recorded on the balance sheet. Lease agreements for some locations provide for rent escalations and renewal options. Many leases include one or more options to renew the lease at the end of the initial term. The Company considered renewals in its right-of-use assets and operating lease liabilities. Certain real estate leases require payment for taxes, insurance and maintenance which are considered non-lease components. The Company accounts for real estate leases and the related fixed non-lease components together as a single component.

The Company determines if an arrangement is a lease at inception. The Company must consider whether the contract conveys the right to control the use of an identified asset. Certain arrangements require significant judgment to determine if an asset is specified in the contract and if the Company directs how and for what purpose the asset is used during the term of the contract.

There are no material residual guarantees associated with any of the Company's leases, and there are no significant restrictions or covenants included in the Company's lease agreements. Certain leases include variable payments related to common area maintenance and property taxes, which are billed by the landlord, as is customary with these types of charges for office space.

The Company's lease agreements occasionally provide an implicit borrowing rate. When implicit borrowing rates are provided, the Company utilizes these implicit borrowing rates to calculate right-of-use assets and liabilities at the end of each reporting period. The Company may enter into leases that do not provide an implicit borrowing rate. When an implicit borrowing rate is not provided, the Company uses a benchmark approach to derive an appropriate imputed discount rate. The Company will benchmark itself against other companies of similar credit ratings and comparable quality and derive an imputed rate, which was used in a portfolio approach to discount its lease liabilities.

For the three months ended March 31, 2022 and 2021 the Company recorded $4,822 and $4,872 in operating lease expense, respectively.

(a) The Company as a Lessee

The following table summarizes the Company's operating leases:

	Classification - Consolidated Balance Sheet	March 31, 2022	December 31, 2021
Assets			
Operating lease assets	Operating Lease Assets	$ 99,395	$ 100,519
Liabilities			
Current			
Operating	Current portion of operating lease liabilities	3,700	3,629
Noncurrent			
Operating	Operating lease liabilities	93,505	93,111
Total lease liabilities		$ 97,205	$ 96,740

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

The components of lease expense are included in cost of goods sold, general and administrative expenses, and selling and marketing expenses, based on the underlying use of the right-of-use asset.

Maturities of lease liabilities for third-party operating leases as of March 31, 2022 were as follows:

Three months ending March 31, 2022	Operating Leases
2022	$ 11,091
2023	15,433
2024	15,859
2025	16,213
2026	16,594
2027	16,603
2028 and Thereafter	227,684
Total undiscounted cash flows	$ 319,477
Less discounting	(222,272)
Total lease payments	$ 97,205

The Company has right-of-use assets and lease liabilities for leased real estate for dispensaries, cultivation and production facilities and office space. The incremental borrowing rate used for leases for 2022 was 10.25 - 18% and was 10.25 - 18% for 2021.

(b) The Company as a Lessor:

The Company leases a building in Elma, Washington that is subleased by the Company to a third party. This sublease is classified as a finance lease with a long term lease receivable balance of $7,543 and a short term lease receivable balance of $2,627 as of March 31, 2022 compared to a long term lease receivable balance of $6,748 and a short term lease receivable balance of $3,630 as of December 31, 2021. This lease generated $692 of the $2,965 and $791 of the $2,890 in real estate income for the three months ended March 31, 2022 and 2021, respectively.

The Company owned buildings in Olympia, Washington that were leased to a third party. This lease was classified as a finance lease. On December 17, 2020, the Company sold the Olympia building and other assets as part of a sale and leaseback transaction and this lease was cancelled. The Company applied ASC 842 to a new sublease to the same third party and classified the new sublease as an operating lease. The lease receivable was sold to the purchaser of the assets as part of the sale and leaseback transaction. This lease generated $2,273 of the $2,965 and $2,099 of the $2,890 in real estate income for the three months ended March 31, 2022 and 2021, respectively.

The following table summarizes changes in the Company’s lease receivables:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	March 31, 2022	December 31, 2021
Balance, beginning of the year	$ 10,378	$ 11,045
Interest	692	2,783
Lease payments received	(900)	(3,450)
Balance, end of the period	$ 10,170	$ 10,378
Less current portion	(2,627)	(3,630)
Long-term lease receivables	$ 7,543	$ 6,748

Future minimum lease payments receivable (principal and interest) on the leases are as follows:

	Operating Leases
2022	$ 2,730
2023	1,575
2024	—
2025	—
Thereafter	—
Total minimum lease payments	4,305
Effect of discounting	(667)
Present value of minimum lease payments	3,638
Present value of residual value of leased property	6,532
Total lease receivable	10,170
Current portion lease receivable	(2,627)
Long-term lease receivable	$ 7,543

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

Note 9: NOTES PAYABLE AND CONVERTIBLE NOTES

The Company's notes payable and convertible notes are as follows:

	LI Lending, LLC	May 2020 Convertible Notes	May 2020 Convertible Notes (Swap)	October 2021 Convertible Note	Other Loans	Total
Balance, December 31, 2020	$ 45,362	$ 2,855	$ 11,867	$ —	$ 6,931	$ 67,015
Loans advanced, net	—	—	—	14,376	930	15,306
Loan payments	(4,671)	—	—	—	(1,079)	(5,750)
Converted to equity	—	(5,852)	(11,867)	—	—	(17,719)
Accrued interest	7,575	2,997	—	265	1,124	11,961
Balance, December 31, 2021	$ 48,266	$ —	$ —	$ 14,641	$ 7,906	$ 70,813
Loans advanced, net	—	—	—	—	2,000	2,000
Loan payments	(1,506)	—	—	—	(110)	(1,616)
Converted to equity	—	—	—	—	(2,784)	(2,784)
Accrued interest	1,891	—	—	279	82	2,252
Balance, March 31, 2022	$ 48,651	$ —	$ —	$ 14,920	$ 7,094	$ 70,665
Less current portion	—	—	—	—	(5,385)	(5,385)
Long-term portion	$ 48,651	$ —	$ —	$ 14,920	$ 1,709	$ 65,280

Convertible Notes

On May 14, 2020, the Company issued $5,827 in convertible notes to existing investors in the Company. The notes pay interest of 5% per annum and have a maturity date of February 28, 2022. The notes can be converted into SVS of the Company for $0.25 per share at any time at the option of the holder. The Company can require mandatory conversion at any time that the Company's stock price remains above $0.50 for 45 consecutive days. In 2021, the Company enacted the mandatory conversion feature and converted the May 2020 Convertible Note balance to subordinate voting shares.

As part of issuing the convertible notes, the investors were given the right to exchange stock in the Company into separate convertible notes (swap notes). In total 29,448,468 shares with a value of $13,661 were exchanged for $13,661 in convertible notes. These notes were effective May 28, 2020, have a maturity date of May 28, 2025, and can be converted into Class A Subordinate Voting Shares of the Company for $0.46 per share at any time at the option of the holder. The notes pay no interest if the Company's annual revenue is greater than $15,000, and 3% annually otherwise. The Company can require mandatory conversion at any time that the Company's stock price remains above $0.92 for 45 consecutive days. In 2021, the Company exercised the mandatory conversion feature and converted the May 2020 Convertible Note (Swap) balance to subordinate voting shares.

On October 6, 2021, the Company entered into a convertible promissory note purchase agreement for $15,000, less issuance costs of $624, resulting in net proceeds of $14,376. The notes pay interest of 6% per annum and have a maturity date of October 6, 2024. The notes can be converted into SVS of the Company for $1.03 per share at any time at the option of the holder. As of March 31, 2022, no payments have been made for this loan.

LI Lending LLC

On May 10, 2019, the Company entered into a loan agreement with LI Lending LLC, a related party, for $50,000. LI Lending LLC is related because an officer of the Company is a part-owner of LI Lending LLC. As of March 31, 2022, the Company had drawn $45,000 on the loan in two amounts, an initial $35,000 and a final $10,000, both bearing a 10.25% and 12.25% interest rate, respectively. The outstanding balance as of March 31, 2022 is $49,027, less debt discount of $376, for a net balance of $48,651. See Note 13 for further discussion of this related party transaction.

In April 2020, the loan was amended. In exchange for consent to allow the sale of the Pennsylvania and Maryland assets and the release of related collateral, the Company agreed to make prepayments of principal to LI Lending LLC in the amount of $250 per month for an eight-month period beginning on May 1, 2020. The $2,000 prepayment was applied to the initial $35,000 amount, decreasing the balance to $33,000. Additionally, the Company agreed to pay an increased interest rate of 12.25% on the final $10,000 of the loan until such time as this amount has been paid down, with the initial $33,000 amount continuing to be subject to the original 10.25% interest rate.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

In December 2020, the loan was amended to allow for the release of collateral for the sale and leaseback transactions described in Note 8 above, which was entered into with Innovative Industrial Properties, Inc. ("IIPR"). The amendment increased both interest rates by 2.5% on the loan amounts but allowed the payments resulting from the incremental interest to be deferred until January 1, 2022. The Company elected to defer payment, and the additional 2.5% interest is accrued each month and added to the balance of the loan. The Company was required to make interest-only payments monthly of 10.25% on the initial $33,000 and 12.25% on the final $10,000 of the loan until January 1, 2022 when the interest rates of 12.75% for the initial $33,000 and 14.75% for the final $10,000 took effect for the remaining term.

The loan matures on May 10, 2024. An exit fee of 20% of the principal balance will be due as principal is repaid. Accrued interest expense of $1,891 includes a loan discount accretion expense of $125 for the three months ended March 31, 2022. On January 1, 2022, the Company began making the required principal payments in addition to the interest payments for this loan. As of March 31, 2022, the Company has made $1,506 in payments on this loan.

Other

Outstanding as of March 31, 2022 were other payables totaling $7,094 which include notes issued as part of the acquisitions of Healthy Pharms, NECC, and Arkansas entities as follows:

Other

Subsidiary	**Terms**	**March 31, 2022**	**December 31, 2021**
Healthy Pharms Inc.	Unsecured convertible note, due November 18, 2021 at 12% per annum	$ —	$ 2,784
Healthy Pharms Inc.	Unsecured promissory note at $0.50 per share due December 18, 2022 at 10% per annum (1)	3,294	3,213
NECC	Promissory note due July 28, 2022 at 10% per annum	2,000	—
Arkansas Entities	Unsecured Promissory note, monthly interest payments at 14% per annum	1,709	1,709
Equipment Loans	Secured by equipment, monthly payments beginning in 2021 at 15% per annum	—	49
Other	Various	91	151
Total Notes Payable and Convertible Notes		$ 7,094	$ 7,906

1

(1) In November 2021, the unsecured promissory note was modified to be due and payable in full on or before December 18, 2022. The Company concluded the extension resulted in a debt modification under *ASC 470*.

Future minimum payments on the notes payable and convertible debt are as follows:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	March 31, 2022
2022	$ 6,935
2023	143
2024	65,280
2025	—
2026	—
Thereafter	—
Total minimum payments	72,358
Effect of discounting	(1,693)
Present value of minimum payments	70,665
Less current portion	(5,385)
Long-term portion	$ 65,280

Construction Finance Liability

On January 28, 2022, a wholly owned subsidiary of the Company acquired property at 29 Everett in conjunction with the NECC Merger (see Note 7 for further details on the transaction). Concurrently, effective January 28, 2022, the Company sold a portion of the property it had acquired in the acquisition for $16,000, less security deposits withheld of $403, which was the cost to the Company. In connection with the sale of the property at 29 Everett, the Company agreed to lease the location back for cultivation, effective on January 28, 2022. The details of the lease included three purchase options that the Company can exercise, in which the Company has the ability to repurchase the property on either the second, fourth, or sixth anniversary of the lease agreement. As the Company plans to exercise one of the three purchase options available, per guidance prescribed in ASC 842, this transaction was determined to be a finance lease. Under this guidance, lease arrangements where assets are sold and leased back, whereby the agreement is classified as a finance lease, does not meet the definition of a sale because control is never transferred to the buyer-lessor. As a result, the transaction was treated as a failed sale-leaseback financing arrangement. On January 28, 2022, the Company recorded a construction finance liability for the proceeds received from the sale to recognize a liability resulting from the failed sale-leaseback transaction.

The initial term of the agreement is 20 years, with two options to extend the term for five years each. The initial monthly rent payment is equal to $140 for the first year of the agreement, with 3% annual increases over the life of the agreement. As of March 31, 2022, the total finance liability associated with this transaction is $16,000.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

Note 10: SHARE CAPITAL AND EQUITY

The Company has authorized an unlimited number of Class A Subordinate Voting Shares (“SVS”) and Class C Multiple Voting Shares (“MVS”), all with no par value. In December 2020, the shareholders of the Company passed a resolution to permit the Company to convert all Class B Subordinate Voting Shares (“PVS”) shares into Class A shares and cancel the Class B PVS equity class, which occurred in 2020.

All share classes are included within share capital in the consolidated statements of stockholders’ equity on an as-converted basis. Each share class is entitled to notice of and to attend at any meeting of the shareholders, except a meeting of which only holders of another particular class of shares will have the right to vote. All share classes are entitled to receive dividends, as and when declared by the Company, on an as-converted basis, and no dividends will be declared by the Company on any individual class unless the Company simultaneously declares or pays dividends on all share classes. No subdivision or consolidation of any share class shall be made without simultaneously subdividing or consolidating all share classes in the same manner.

Voting shares activity for the periods presented is summarized as follows:

	Class A Subordinate Voting Shares	Class C Multiple Voting Shares	Total
Balance, December 31, 2020	537,575,044	1,276,208	538,851,252
Share capital issuances	55,330,352	—	55,330,352
Balance, December 31, 2021	592,905,396	1,276,208	594,181,604
Share capital issuances	34,895,599	—	34,895,599
Balance, March 31, 2022	627,800,995	1,276,208	629,077,203

Class A Subordinate Voting Shares

Holders of Class A Subordinate Voting Shares are entitled to one vote in respect of each SVS.

Class C Multiple Voting Shares

Holders of Class C Multiple Voting Shares are entitled to 800 votes in respect of each MVS. One MVS can convert to one SVS but are not convertible until the later of the date that (i) the aggregate number of PVS and MVS held by the Initial Holders (being the MVS holders on their initial issuance) are reduced to a number which is less than 50% of the aggregate number of PVS and MVS held by the Initial Holders on the date of completion of the Business Combination with Cannex, and (ii) 3 years following the date of the business combination with Cannex.

Series	Shares outstanding as of March 31, 2022	As converted to SVS Shares
Class A – Subordinate Voting Shares	627,800,995	627,800,995
Class C – Multiple Voting Shares	1,276,208	1,276,208
	629,077,203	629,077,203

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

On November 23, 2020, the Company closed a brokered private placement and issued 24,644,500 Units at a price of C$0.70 per Unit. Each Unit is comprised of one subordinate voting share of the Company and one-half of a subordinate voting share purchase warrant. Each whole warrant entitles the holder to purchase one subordinate voting share for a period of two years from the date of issuance at an exercise price of C$0.90 per subordinate voting share. Net proceeds from this transaction were $11,557 net of share issuance costs of $690.

Because of the Canadian dollar denominated exercise price, these warrants do not qualify to be classified within equity and are therefore classified as derivative liabilities at fair value with changes being reported through the statement of operations. On November 23, 2020, the warrants were valued using the Black Scholes option pricing model at $4,229 using the following assumptions: Share Price: C$0.94; Exercise Price: C$0.90; Expected Life: 2 years; Annualized Volatility: 87.73%; Dividend yield: 0.00%; Discount Rate: 0.16%; C$ Exchange Rate:1.31.

On March 31, 2022, the warrants were revalued using the Black Scholes option pricing model, using the following assumptions: Share Price: C$1.00; Expected Life: 0.65 years; Annualized Volatility: 70.96%; Dividend yield: 0%; Discount Rate: 1.06%; C$ Exchange Rate: 1.28. The decrease in the value of the derivative liability of $1,300 is reflected in the statement of operations as a $1,300 gain on the change in fair value of the derivative liability.

Note 11: WARRANTS

As of March 31, 2022, there were share purchase warrants outstanding to purchase up to 26,103,578 SVS shares:

Series	Number of warrants	Weight-average exercise price
Balance, December 31, 2021	26,192,237	$ 0.75
Issued	—	—
Exercised	(88,659)	0.56
Balance, March 31, 2022	26,103,578	$ 0.75

As of March 31, 2022, the Company has the following warrants outstanding and exercisable:

Warrants Outstanding	Exercise Price	Expiry Date
10,403,150	C$ 0.90	November 23, 2022
209,426	C$ 0.70	November 23, 2022
12,135,922	0.82	December 17, 2022
2,230,080	0.67	January 29, 2023
625,000	C$ 0.80	October 6, 2024
500,000	C$ 0.80	October 6, 2025
26,103,578		

Note 12: SHARE-BASED COMPENSATION

The Company adopted two equity incentive plans where the Company may grant Class A stock options. Under the terms of the plans, the maximum number of stock options which may be granted are a total of 10% of the number of shares outstanding assuming conversion of all shares to SVS. The exercise price for stock options issued under the plans will be set by the compensation committee of the board of directors but will not be less than 100% of the fair market value of the Company’s shares on the grant date. Stock options have a maximum term of 10 years from the date of grant. Stock options vest at the discretion of the Board.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

As of March 31, 2022, the Company had the following options outstanding and exercisable on an as-converted basis:

Grant Date	Strike Price in CAD$	Outstanding Options	Exercisable Options	Life Remaining (years)
July 31, 2019	0.10	6,245,840	6,245,840	2.47
July 31, 2019	1.00	7,783,332	7,783,332	0.70
July 31, 2019	1.00	1,166,667	1,166,667	1.52
July 31, 2019	1.50	508,333	508,333	2.20
July 31, 2019	1.50	800,000	800,000	2.21
August 22, 2019	0.80	5,237,720	4,126,609	2.40
August 22, 2019	1.00	6,150,000	4,894,444	2.40
November 1, 2019	0.80	1,200,000	900,000	2.59
February 3, 2020	0.80	375,000	145,833	2.85
June 8, 2020	0.80	25,000	10,417	3.19
July 31, 2020	0.80	1,200,000	1,141,667	3.34
September 15, 2020	0.86	7,315,860	7,315,860	3.46
October 2, 2020	0.77	3,000,000	3,000,000	3.51
November 24, 2020	0.94	1,675,000	1,675,000	3.65
December 2, 2020	1.11	2,900,000	2,900,000	3.68
December 21, 2020	1.06	1,200,000	500,000	3.73
March 18, 2021	1.63	6,650,000	3,325,000	3.97
April 2, 2021	1.36	200,000	133,333	4.01
April 21, 2021	1.58	175,000	116,667	4.06
June 23, 2021	1.56	450,000	300,000	4.23
November 11, 2021	1.33	25,000	6,250	4.62
January 25, 2022	0.89	1,100,000	99,306	4.82
February 1, 2022	0.84	100,000	8,056	4.84
February 17, 2022	0.85	100,000	5,833	4.89
March 1, 2022	1.09	200,000	8,333	4.92
		55,782,752	47,116,780	2.79

Stock option activity is summarized as follows:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	Number of Options	Weighted Average Price CAD$	Weighted Average Years
Balance December 31, 2020	50,427,065	0.84	3.72
Granted	7,900,000	1.62	5.00
Exercised	(2,737,326)	1.04	—
Forfeited/ Expired	(1,306,987)	0.43	—
Balance December 31, 2021	54,282,752	0.94	2.97
Granted	1,500,000	0.91	5.00
Exercised	—	—	—
Forfeited/ Expired	—	—	—
Balance March 31, 2022	55,782,752	0.94	2.79

During the three months ended March 31, 2022 and 2021, the Company recognized share-based compensation of $1,038 and $2,396, respectively.

In determining the amount of equity-based compensation during the year, the Company used the Black-Scholes option pricing model to establish fair value of options granted during the year with the following key assumptions:

	2022	2021
Risk-Free Interest Rate	2.42%	0.87%
Expected Life (years)	5.00	5.00
Expected Annualized Volatility	71.30%	86.20%
Expected Dividend Yield	—	—

Note 13: RELATED PARTIES

Related party transactions

LI Lending LLC

Linchpin Investors LLC ("Linchpin"), a subsidiary of the Company, and LI Lending LLC ("LI Lending") entered into a Construction Loan Agreement dated May 10, 2019, as amended, whereby Linchpin received an up-to $45 million loan from LI Lending of which $48,300 was outstanding as of December 31, 2021. Mr. Gontmakher, the CEO of the Company, and Roman Tkachenko, a director of the Company, each hold a 14.28% ownership interest in LI Lending. Additionally, Mr. Tkachenko is a managing member of LI Lending. LI Lending has advanced the Company a real estate improvement/development loan of $50,000 under that certain Construction Loan Agreement to be used for the acquisition and development of real estate to be used for cannabis operations. The loan matures in May 2024 and bears interest at 10.25%, payable monthly in cash. Upon maturity, an exit fee of $9 million is payable, for a total payable at maturity of $54 million. $49,027 of the loan advanced includes the notes payable and accrued interest less debt discount of $376 that was outstanding as of March 31, 2022. Of the $49,027 outstanding at March 31, 2022, $1,891 represents interest accrued through March 31, 2022. See Note 9 for details on the outstanding note payable.

Pure Ratios

Leonid Gontmakher, Chief Executive Officer of the Company, holds an interest in an entity related to iWolf Management, LLC, an online marketing company serving the online CBD market which provided online marketing services during 2020 and 2019 for the Company's Pure Ratios division. Pure Ratios paid $313 for the three months ended March 31, 2021 to this vendor for management fees, pass through marketing costs and customer service. Pure Ratios did not make any such payments during the three months ended March 31, 2022.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

Note 14: CONTINGENCIES

(a) Cannabis Industry

Cannabis is still considered a Schedule 1 substance under the Controlled Substance Act. As such, there is an inherent risk related to the federal government's position on cannabis; additionally, the risk exists, due to the Company's business in cannabis, that third party service providers could suspend or withdraw services and as well as the risk that regulatory bodies could impose certain restrictions on the issuer's ability to operate in the U.S.; however, the Company has deemed it not reasonable to estimate a potential liability related to the possible enforcement of laws against the medical cannabis industry.

(b) Contingent consideration payable

As part of the acquisition of Om of Medicine, LLC and Cannex's prior acquisition of Pure Ratios, the Company is subject to contingent consideration payable to the sellers. The fair value of the contingent consideration, which is based on specific revenue levels achieved over a 2-3-year period, is as follows:

	Om of Medicine
Balance, December 31, 2021	$ 2,393
Balance, March 31, 2022	2,393
Less: current portion	—
Long-term portion	$ 2,393

The contingent consideration payable is measured at fair value based on unobservable inputs and is considered a Level 3 financial instrument. The determination of the fair value of these liabilities is primarily driven by the Company's expectations of the respective subsidiaries achieving certain milestones. The expected milestones were assigned probabilities and the expected related cash flows were discounted to derive the fair value of the contingent consideration. The remaining balance of contingent consideration as of March 31, 2022 is $2,393, all of which is a long-term contingent consideration. The contingent consideration payment is due in full in April 2023.

OM of Medicine: The contingent consideration payable is determined as the amount in excess of gross sales of $3,400 (for fiscal 2021) and $3,500 (2022) to a maximum payable of $6,900. There was no activity related to contingent considerations for the three months ended March 31, 2022.

(c) Legal Matters

From time to time, the Company may be involved in certain disputes arising in the ordinary course of business. Such disputes, taken in the aggregate, are not expected to have a material adverse effect on the Company. There are also no proceedings in which any of the Company's directors, officers, or affiliates is an adverse party or has a material interest adverse to the Company's interest.

On August 5, 2019, Richard Hernandez and Commerce Citizens Against Marijuana Corruption (the "Complainants") filed a complaint (Superior Court of California Case No. 19ST-CV-27029) and writ of mandamus against the City of Commerce, California and certain of its officials alleging procedural errors committed by the City in relation to certain development agreements granted to 22 cannabis operators allowing such operators to operate various cannabis businesses in the City of Commerce. Cannex Holdings (California), Inc., a wholly owned subsidiary of the Company, is one such operator that was named as a Real Party in Interest in the case, and as such, engaged counsel to defend its interests relating to the claims brought against the City of Commerce, California. On April 15, 2021, the court in the matter ruled on a demurrer where certain of the Complainants' claims were dismissed. Additionally, a writ of mandamus hearing (subject to an application for continuance being sought on August 17, 2021) was scheduled for September 30, 2021. If the Complainants' remaining claims were upheld (including through appeals), the City of Commerce could have been required to reissue the "ordinances", "Development Agreements" or other applicable license rights to the current license holders. While the City of Commerce stated in no uncertain terms that it would act immediately to ensure/restore fully licensed status of any of the affected operators, there could be no assurances that such relicensing would be successful or if successful would not result in a significant disruption of operations for the operators. As a result, the Company entered into a confidential settlement with Complainants on or around September 22, 2021 and the matter was dismissed with prejudice as to the Company.

In December 2021, the Company settled a dispute with an undisclosed defendant. As part of the settlement, the Company recorded a gain on the settlement of $3,768.

On January 26, 2022, Savills, Inc. sued the Company in the U.S. District Court for the Southern District of New York. That lawsuit alleges that the Company has breached an alleged agreement with Savills under which the Company was allegedly required to pay Savills a percentage of savings realized under certain incentive programs offered in some jurisdictions, which Savills would assist the Company in obtaining. Savills claims damages of approximately $19,000 in connection with its claim that it obtained benefits for the Company allegedly valued at over $129,000. The Company denies these allegations, denies the Company has obtained such benefits, disputes Savills' characterization of the facts, and denies liability. The Company has filed a counterclaim against Savills alleging breach of contract by Savills.

Note 15: FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

ASC 820, Fair Value Measurements, provides guidance on the development and disclosure of fair value measurements. The Company follows this authoritative guidance for fair value measurements, which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles in the United States of America, and expands disclosures about fair value measurements. The guidance requires fair value measurements be classified and disclosed in one of the following three categories:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities;
Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
Level 3 Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Fair value measurements discussed herein are based upon certain market assumptions and pertinent information available to management as of and during the periods ended March 31, 2022 and December 31, 2021. The fair value of the Company's cash, accounts receivable, other receivables, accounts payable and accrued expenses approximates carrying value due to their short-term nature. The Company's notes receivable, lease receivables, contingent consideration payable, derivative liabilities, convertible notes payable, construction finance liability, and notes payable approximate fair value due to the instruments bearing market rates of interest or their short-term nature. As the interest rates utilized to calculate these instruments approximates market value interest rates, the carrying amounts of the instruments approximate fair value, which are primarily based on Level 1 inputs. The fair value of stock options granted were estimated based on a Black-Scholes model during the periods ended March 31, 2022 and December 31, 2021. The estimated fair value of the derivative liabilities, which represent embedded put included in the convertible notes payable, represent Level 3 measurements.

The following table details the fair value measurements within the fair value hierarchy of the Company's financial instruments, which includes the Level 3 liabilities:

	Fair value at March 31, 2022			
	Total	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Derivative liability	$2,202	$ —	$ —	$2,202
Total liabilities	$2,202	$ —	$ —	$2,202

	Fair value at December 31, 2021			
	Total	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Derivative liability	$3,502	$ —	$ —	$3,502
Total liabilities	$3,502	$ —	$ —	$3,502

The table below provides a summary of the changes in fair value of the derivative liabilities measured on a recurring basis using significant unobservable inputs (Level 3):

	For the Three Months Ended March 31,	
	2022	**2021**
Derivative liability:		
Balance, beginning of period	$ 3,502	$ 5,807
(Gain) loss on fair value of derivative liability	(1,300)	2,532
Balance, end of period	$ 2,202	$ 8,339

There were no transfers between fair value levels for the three months ended March 31, 2022 and 2021.

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

(a) Financial Risk Management

The Company is exposed in varying degrees to a variety of financial instruments related risks. The Board mitigates these risks by assessing, monitoring and approving the Company's risk management processes.

(b) Credit Risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash, lease receivables, other receivables, and notes receivable. The Company's maximum credit risk exposure is equivalent to the carrying value of these instruments.

The risk exposure is limited to the carrying amounts at the statement of financial position date. The risk to cash deposits is mitigated by holding these instruments with regulated financial institutions. Lease receivables, notes receivables and other receivables credit risk arises from the possibility that principal and interest due may become uncollectible. The Company mitigates this risk by managing and monitoring the underlying business relationships.

The Company maintains cash with federally insured financial institutions. As of December 31, 2021, the Company exceeded federally insured limits by approximately $10,866. The Company did not exceed any federally insured limits at any of its financial institutions for the three months ended March 31, 2022. The Company has historically not experienced any losses in such accounts. As of March 31, 2022, the Company held approximately $29 in cash in a Canadian account that is denominated in C$.

As of March 31, 2022 and December 31, 2021, the maximum credit exposure related to the carrying amounts of accounts receivable, other receivables, notes receivable and lease receivables was $14,725 and $12,722, respectively.

(c) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with financial liabilities. The Company manages liquidity risk through the management of its capital structure. The Company's approach to managing liquidity is to raise sufficient capital to settle obligations and liabilities when due.

The Company has the following gross contractual obligations as of March 31, 2022, which are expected to be payable in the following respective periods:

	Less than 1 year	1 to 3 years	3 to 5 years	Greater than 5 years	Total
Accounts payable and accrued liabilities	$ 12,706	$ 1,200	$ —	$ —	$ 13,906
Convertible notes, notes payable and accrued interest	5,385	65,280	—	—	70,665
Contingent consideration payable	—	2,393	—	—	2,393
Construction finance liability	—	16,000	—	—	$ 16,000
Total	$ 18,091	$ 84,873	$ —	$ —	$102,964

(d) Interest Rate Risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

(e) Foreign Exchange Risk

The Company is exposed to exchange rate fluctuations between United States and Canadian dollars. The Company's share price is denominated in Canadian dollars. If the Canadian dollar declines against the United States dollar, the United States dollar amounts available to fund the Company through the exercise of stock options or warrants will be less. The Company also has bank accounts with balances of $29 in Canadian dollars. The value of these bank balances if converted to U.S. dollars will fluctuate. While the Company maintains a head office in Canada where it incurs expenses primarily denominated in Canadian dollars, such expenses are a small portion of overall expenses incurred by the Company. The Company does not have a practice of trading derivatives and does not engage in "natural hedging" for funds held in Canada.

(f) Other Price Risk

Price risk is the risk of variability in fair value due to movements in equity or market prices. The Company is subject to risk of prices to its products due to competitive or regulatory pressures.

Note 16: SEGMENT INFORMATION

Reportable Segments

Operating segments are components of the Company that combine similar business activities, with activities grouped to facilitate the evaluation of business units and allocation of resources by the Company's board of directors and management. As of March 31, 2022, the Company had two reportable segments:

- THC Cannabis – Production and cultivation of THC cannabis, manufacturing and distribution of cannabis products to own dispensaries and third-party retail customers, ancillary services supporting wholesale operations, and retail sales direct to end consumers
- CBD Wellness – Pure Ratios which encompasses the production and sale of CBD products to third-party customers

The results of each segment are regularly reviewed by the Company's Chief Executive Officer, who is the Company's chief operating decision maker, to assess the performance of the segment and make decisions regarding the allocation of resources. The Company's chief operating decision maker uses revenue and net loss as measure of segment performance. There are no intersegment sales or transfers. All revenues are derived from customers domiciled in the United States and all assets are located in the United States.

The below table presents revenues by type for the three months ended March 31, 2022 and 2021:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	Three Months Ended March 31, 2022	Three Months Ended March 31, 2021
Net Revenues		
THC Cannabis	$ 25,783	$ 22,148
CBD Wellness	265	822
Corporate	—	—
Total Net Revenues	26,048	22,970
Depreciation and Amortization		
THC Cannabis	847	756
CBD Wellness	—	16
Corporate	—	2
Total Depreciation and amortization	847	774
Net (Income) Loss		
THC Cannabis	256	2,838
CBD Wellness	(15)	3
Corporate	5,658	8,247
Total Net Loss	$ 5,899	$ 11,089

Assets	March 31, 2022	December 31, 2021
THC Cannabis	$ 286,461	$ 238,933
CBD Wellness	725	805
Corporate	3,503	15,801
Total Assets	**$ 290,689**	**$ 255,539**

On January 28, 2022, the Company acquired assets and liabilities from NECC and 29 Everett in conjunction with the NECC Merger Agreements. As part of the acquisition, the Company acquired $18,000 in intangible assets related to the licenses acquired from NECC, and recognized goodwill of $10,249 as part of the purchase price consideration. The Company also consolidated revenues and net loss from NECC from the acquisition date of January 28, 2022 through the period end date of March 31, 2022. For further details on the acquisition of NECC and 29 Everett, see Note 7. The Company concluded that as of the date of acquisition, that NECC would be recognized under the THC Cannabis segment as part of segment reporting.

Goodwill assigned to the THC Cannabis segment as of March 31, 2022 and December 31, 2021 was $33,404 and $23,155, respectively. Intangible assets, net assigned to the THC Cannabis segment as of March 31, 2022 and December 31, 2021 were $43,616 and $26,246, respectively.

The Company did not have any Goodwill or intangible assets assigned to the CBD Wellness segment as of March 31, 2022 and December 31, 2021.

Note 17: SUPPLEMENTARY CASH FLOW INFORMATION

Changes in non-cash working capital:

(Amounts expressed in thousands of U.S. dollars except for share and per share data)

	March 31, 2022	March 31, 2021
Changes in operating assets and liabilities		
Accounts receivable and other receivables	$ (2,309)	$ 100
Inventory	(3,823)	(934)
Prepaid expenses	153	(830)
Deposits	257	(460)
Accounts payable and accrued liabilities	778	1,393
Taxes payable	3,651	1,806
	$ (1,293)	$ 1,075

Supplemental disclosure of non-cash investing and financing activities:

	March 31, 2022	March 31, 2021
Exchange of convertible debt to equity	$ 3,122	$ —
Change in right-of-use assets and lease liabilities	$ 77	$ —
Issuance of equity for NECC pursuant to acquisition	$ 17,689	$ —
Property, plant, and equipment acquired through NECC acquisition	$ 15,238	$ —
Issuance of notes payable in through NECC acquisition	$ 2,000	$ —
Inventory acquired through NECC acquisition	$ 2,000	$ —

- Cash paid for interest for the three months ended March 31, 2022 and 2021 was $1,569 and $818, respectively.
- Cash paid for income taxes for the three months ended March 31, 2022 and 2021 was $1,110 and $224, respectively.

Note 18: INCOME TAXES

The following table summarizes the Company's income tax expense:

	For the Three Months Ended March 31,	
	2022	2021
Net loss before income taxes	$ (2,456)	$ (8,431)
Income tax expense	(3,438)	(2,653)

The Company has computed its provision for income taxes under the discrete method which treats the year-to-date period as if it were the annual period and determines the income tax expense or benefit on that basis. The discrete method is applied when application of the estimated annual effective tax rate is impractical because it is not possible to reliably estimate the annual effective tax rate. The Company believes the use of this discrete method is more appropriate than the annual effective tax rate method due to the early growth stage of the business. At this time, there is a high degree of uncertainty in estimating the Company's annual pre-tax income and significant non-deductible expenses so the Company cannot reliably estimate the annual effective tax rate.

Internal Revenue Code ("IRC") Section 280E denies, at the U.S. federal level, deductions, and credits attributable to a trade or business trafficking in controlled substances. Because the Company is subject to IRC Section 280E, the Company has computed its U.S. tax based on gross receipts less cost of goods sold. The tax provisions for the three months ended March 31, 2022 and 2021, have been prepared based on the assumption that cost of goods sold is a valid expense for income tax purposes.

The federal statute of limitation remains open for the 2018 tax year to the present. The state income tax returns generally remain open for the 2017 tax year through the present. Net operating losses arising prior to these years are also open to examination if and when utilized.

Note 19: SUBSEQUENT EVENTS

On March 30, 2022, the Company entered into an agreement and plan of merger (the “Island Merger Agreement”) by and among the Company, Island Merger Sub, Inc., a Delaware corporation and wholly owned subsidiary of the Company (“Island Merger Sub”); Island Global Holdings, Inc., a California corporation (“Island”); and Navy Capital SR LLC, a Delaware limited liability company (“Navy”, and together with the Company, Island Merger Sub, and Island, the “Island Parties”). Pursuant to the terms and conditions of the Merger Agreement, Island Merger Sub will be merged with and into Island, with Island surviving the merger and continuing its corporate existence as a wholly owned subsidiary of the Company (the “Island Merger”). The Island Merger Agreement was effective as of April 13, 2022 (the “Effective Date”).

On the Effective Date, the Island Parties consummated the Island Merger, pursuant to the terms and conditions of the Island Merger Agreement, as amended. However, due to administrative and technical issues at the California Office of the Secretary of State, the Island Parties did not receive the certificate of merger evidencing the closing of the Island Merger as of the Effective Date until April 25, 2022. At the Effective Date, pursuant to the terms and conditions of the Island Merger Agreement, as amended, the Company issued to certain shareholders and debtholders of Island an aggregate of: (i) 8,783,716 Class A Subordinated Voting Shares of the Company (the “SVS”); (ii) 6% 54-month, subordinated promissory notes (the “Island Merger Notes”) in the aggregate principal amount of $6,500,000; and (iii) warrants to purchase 2,999,975 SVS at a price of $1.00 per SVS (the “Warrants”, and together with the SVS and Island Merger Notes, the “Island Merger Consideration”).

On April 22, 2022, the Parties entered into the first amendment to the Island Merger Agreement to replace the requirement that certain noteholders fund a letter of credit to Island of up to $1,000,000. In lieu of funding a line of credit, the noteholders agreed to pay the full $1,000,000 in cash to Island on or prior to the closing of the transactions contemplated by the Island Merger Agreement.

The Company is in the process of assessing the fair values of the acquired tangible assets and any intangible assets and liabilities for these acquisitions, and thus, have not presented purchase price allocations as of the date of this filing.