4Front Ventures Corp.

FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2022

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investors should read the following discussion in conjunction with the unaudited financial statements and notes thereto included under Part 1, Item 1 of this Quarterly Report on Form 10-Q. In addition, investors should refer to our audited consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

Disclosure Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking information about the Company that is intended to be covered by the safe harbor for "forward-looking statements" provided by the Private Securities Litigation Reform Act of 1955. Forward-looking statements are statements that are not historical facts. Words such as "guidance," "expect," "will," "may," “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “suggests,” “potential” and similar expressions are intended to identify forward-looking statements. There statements include information regarding our plans, strategies, and expectations of future financial performance and prospects. Forward-looking statements are not guarantees of performance. These statements are based upon the current beliefs and expectations of our management and are subject to significant risk and uncertainties that could cause actual results to differ materiality from those expressed in, or implied or projected by, the forward-looking information and statements. Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot assure investors that the expectations will prove to be correct. Among the factors that could cause actual results to differ materially from the expectations are acts of war or terrorism and the impact on the social and economic conditions in the United States, the effects of the COVID pandemic, and changes in the legalization of marijuana across the United States. More information on factors that could cause actual results to differ materially from those anticipated is included from time to time in our reports filed with the Securities and Exchange Commissions, including our Annual Report on Form 10-K for the year ended December 31, 2021. New risk factors emerge over time and it is not possible to predict all such risk factors, or to assess the impact such risk factors have on the business. We undertake no obligation to update publicly any forward-looking statements whether as a result of new information, future events or otherwise, except as required by law.

Overview

4Front Ventures Corp. has two primary operating segments: THC Cannabis and CBD Wellness. With regard to its THC Cannabis segment, as of September 30, 2022, the Company operates six dispensaries in Massachusetts, Illinois, and Michigan, primarily under the “MISSION” brand name and nine production and cultivation facilities in Massachusetts, Illinois and California.

The Company's six "MISSION" branded dispensaries are located in Brookline, MA, Georgetown, MA, Worcester, MA, South Shore (Chicago), IL, Calumet City, IL, and Ann Arbor, MI. The Georgetown, MA and Worcester, MA locations are co-located with the Company's cultivation facilities in those towns.

4Front operations are structured in key geographic locations across the United States to scale operations efficiently and position the company for future growth opportunities as cannabis legalization efforts continue across the U.S. and federally. Management intends to continue scaling operations in Illinois, Massachusetts, and California to increase its market share. The Company has made significant investments in manufacturing facilities in each of these locations. The Company acquired a new cultivation facility in Holliston, MA in the New England Cannabis Corporation ("NECC") acquisition (**Note 5**) in January 2022 which doubled the Company's cultivation footprint in the Massachusetts market. During 2022, the Company has also ramped up production at its Commerce facility which opened in January and is already selling into more than 200 retailers in the state. In additions to scaling and driving operational effectiveness, the Company will also focus on developing trusted brand products to grow revenue, build customer loyalty and market share.

The Company's nine production and cultivation assets differ by state. In Massachusetts, the Company operates an indoor cultivation facility in Worcester, MA (~4k square feet of flowering canopy), an indoor cultivation and production facility in Holliston, MA (~15k square feet of flowering canopy), and an indoor cultivation and production facility in Georgetown, MA (~10k square feet of flowering canopy). In Illinois, the Company operates an indoor cultivation and production facility in Elk Grove, IL (~9k square feet of flowering canopy). Finally, in California the Company operates a production facility in Commerce, CA (~170k square feet of production and manufacturing space), a greenhouse cultivation facility in Monterrey County, CA (~80k square feet), and outdoor, hoophouse and nursery cultivation facilities in Watsonville, CA (totaling ~240k square feet).

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.

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.

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.

Recent Developments

Asset Acquisition of Bloom Farms

On August 19, 2022, the Company completed an asset acquisition of certain assets of Bloom Farms. Please see Note 5 of the financial statements for a full description of the asset acquisition transaction.

COVID-19 Pandemic

In March 2020, the World Health Organization (“WHO”) declared COVID-19 a global pandemic, and the United States declared a national emergency with respect to COVID-19. Management continues to actively monitor the developments regarding the pandemic and the impact the pandemic could have on our business, results of operations, financial condition, and most importantly the health and safety of our workforce. Given the continued volatility of the COVID-19 pandemic and the global responses to curb its spread, we are not able to estimate the effects of the COVID-19 pandemic on our results of operations, financial condition, or liquidity for 2022. Any recovery from negative impacts to our business and related economic impact due to the COVID-19 pandemic may also be slowed or reversed by a number of factors, including the current widespread resurgence in COVID-19 infections attributable to the Omicron variant, combined with the seasonal flu. As such, we are unable to reasonably estimate the duration of the pandemic or fully ascertain its long-term impact to our business.

War in Ukraine

In February 2022, the Russian Federation and Belarus commenced a military action with the country of Ukraine. As a result of this action, various nations, including the United States, have instituted economic sanctions against the Russian Federation and Belarus. Further, the impact of this action and related sanctions on the world economy are not determinable as of the date of these financial statements. The specific impact on our financial condition, results of operations, and cash flows is also not determinable as of the date of these financial statements.

Critical Accounting Policies and use of Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). Critical accounting policies and estimates are identified and discussed in our Annual Report on Form 10-K for the year ended December 31, 2021, as filed with the SEC on April 18, 2022. Although we believe our estimates and judgments are reasonable, they are based upon information available at the time the judgment or estimate is made. Actual results may differ significantly from estimates under different assumptions or conditions.

Results of Operations

Three Months Ended September 30, 2022 Compared With Three Months Ended September 30, 2021

The following table sets forth our consolidated statement of operations for the three months ended September 30, 2022 and 2021, and the change between the two years ($ in thousands):

	For the Three Months Ended September 30,		Change	
	2022	2021	$	%
Revenue from Sale of Goods	$ 29,067	$ 23,126	$ 5,941	26%
Real Estate Income	3,407	2,815	592	21%
Total Revenues	32,474	25,941	6,533	25%
Cost of Goods Sold	(17,427)	(10,269)	(7,158)	70%
Gross profit	15,047	15,672	(625)	4%
Total Operating Expense	14,530	16,596	(2,066)	(12)%
Income (Loss) from Operations	517	(924)	1,441	156%
Total Other income (expense), net	(5,796)	871	(6,667)	(765)%
Net Loss Before Income Taxes	(5,279)	(53)	(5,226)	9860%
Income Tax Expense	(3,322)	(4,541)	1,219	27%
Net Loss	$ (8,601)	$ (4,594)	$ (4,007)	87%

The Company has been focused on optimizing its operations, leveraging the assets acquired through acquisitions and realizing added synergies from expanding the size of its overall business and further vertically integrating its operations to achieve profitability.

Revenue from sale of goods for the three months ended September 30, 2022 was $29.1 million, an increase of $5.9 million or 26% compared to the three months ended September 30, 2021. In Q3 2022, wholesale and retail revenue was 26% and 66% of total revenue, respectively, as compared to 1% and 83% in the same period in 2021. Real estate income was 12% and 16% for the three months ended September 30, 2022 and 2021, respectively.

Revenue from retail sales for the three months ended September 30, 2022 was $21.5 million, which is flat as compared to the three months ended September 30, 2021. Increases in Massachusetts retail revenue were tempered by softness in retail revenues in Illinois and Michigan as compared to the three months ended September 30, 2021.

Revenue from sale of wholesale goods for the three months ended September 30, 2022 was $7.8 million, an increase of $6.0 million or 395% compared to the three months ended September 30, 2021. The increase is primarily attributable to the addition of the California wholesale business, growth in Illinois, and strong wholesale performance in Massachusetts as our brands continue to resonate with consumers outside our own dispensaries.

Finally, the addition of the new Holliston, Massachusetts cultivation facility added in the NECC acquisition has positioned the Company to aggressively expand further into the Massachusetts wholesale market.

Real Estate Income

Real Estate Income (**Note 6)** from leasing cannabis production facilities for the three months ended September 30, 2022 was $3.4 million, an increase of $0.6 million or 21% as compared to the three months ended September 30, 2021. This increase in real estate income is attribute to new subleases of building space in Illinois and California.

Gross Profit

Gross profit is calculated as revenue less cost of goods sold (“COGS”). COGS includes the direct costs attributable to the cultivation, production, manufacturing and purchase of the products sold. These costs include the direct cost of labor, seeds, growing material, raw materials and packaging, as well as other indirect costs such as utilities and supplies used in the growing process, post-harvest costs, indirect labor for individuals involved in the growing, quality control and inventory processes as well as certain costs related to its facilities.

In addition to market fluctuations, cannabis costs are affected by various state regulations that limit the sourcing and procurement of cannabis products. The change in regulatory environments may create fluctuations in gross profit over comparative periods.

Gross profit for the three months ended September 30, 2022 was $15.0 million or 46% of revenue compared to $15.7 million or 60% of revenue for the three months ended September 30, 2021. The decrease in gross profit percentage of 14% is primarily due to decreased pricing across the Company's markets. The decrease in gross profit margin has been mitigated by increases in retail sell-through of the Company owned produced products primarily in Illinois and Massachusetts. Improvements in flower yields and quality led to increases in revenue, market share, and gross margin in Massachusetts for the three months ended September 30, 2022. In late Q3 2022, the Illinois has experienced similar improvements in flower yields and quality.

Total Operating Expenses

Operating expenses consist of selling and marketing expenses, general and administrative expenses, depreciation and amortization, transaction and restructuring expenses, and equity based compensation expense. Total operating expenses for the three months ended September 30, 2022 were $14.5 million, a decrease of $2.1 million or 12%, as compared to the three months ended September 30, 2021. This decrease is primarily driven by a decrease in equity based compensation expense of $1.7 million as a result of a number of terminations of individuals who held stock options resulting in lower compensation expense.

Total Other Income (Expense), net

Other Income (Expense) consists primarily of interest income, interest expense, change in fair value of derivative liability, and loss on litigation settlement. Total Other Income (Expense) for the three months ended September 30, 2022 was ($5.8) million, as compared to $0.9 million for the three months ended September 30, 2021. This is primarily driven by a decrease in other income attributable to an increase in interest expense of $1.6 million and a decrease in the change in fair value liability of $2.9 million. The increase in interest expense is attributable to the $16 million of incremental debt added to finance the NECC acquisition (**Note 5)**, which resulted in an increase of $0.4 million in interest expense and increased interest incurred related to the promissory notes used to finance the Island and NECC acquisitions. During the three months ended September 30, 2021, the Company recorded a $3.3 million gain on the fair value of its derivative liability.

Nine Months Ended September 30, 2022 Compared With Nine Months Ended September 30, 2021

The following table sets forth our consolidated statement of operations for the nine months ended September 30, 2022 and 2021, and the change between the two years ($ in thousands):

	For the Nine Months Ended September 30,		Change	
	2022	2021	$	%
Revenue from Sale of Goods	$ 77,638	$ 67,658	$ 9,980	15 %
Real Estate Income	9,323	8,374	949	11 %
Total Revenues	86,961	76,032	10,929	14 %
Cost of Goods Sold	(46,144)	(30,210)	(15,934)	53 %
Gross profit	40,817	45,822	(5,005)	11 %
Total Operating Expense	45,640	45,725	(85)	— %
Income (Loss) from Operations	(4,823)	97	(4,920)	5072 %
Total Other income (expense), net	(6,416)	(11,448)	5,032	44 %
Net Loss Before Income Taxes	(11,239)	(11,351)	112	1 %
Income Tax Expense	(9,802)	(10,545)	743	7 %
Net Loss	$ (21,041)	$ (21,896)	$ 855	4 %

Revenue from sale of goods for the nine months ended September 30, 2022 was $77.6 million, an increase of $10.0 million or 15% compared to the nine months ended September 30, 2021. Wholesale revenue was 18 % and 5% for the nine months ended September 30, 2022 and 2021, respectively. Retail revenue was 71% and 84% for the nine months ended September 30, 2022 and 2021, respectively. Real estate income was 11% for the nine months ended September 30, 2022 and 2021.

Revenue from retail sales for the nine months ended September 30, 2022 was $61.8 million, an decrease of $1.8 million or 3% compared to the same period in 2021. Increases in Massachusetts retail revenue were offset by softness in retail revenues in Illinois and Michigan.

Revenue from sale of wholesale goods for the nine months ended September 30, 2022 was $15.9 million, an increase of $11.8 million or 238% compared to the same period in 2021. The increase is primarily attributable to the addition of the CA wholesale business in January 2022, coupled with Illinois and Massachusetts strong wholesale performance as our brands continue to resonate with consumers outside our own dispensaries. Finally, the addition of the new cultivation facility added in Massachusetts from the NECC acquisition has positioned the Company to aggressively expand further into the Massachusetts wholesale market.

Real Estate Income

Real Estate Income from leasing cannabis production facilities for the nine months ended September 30, 2022 was $9.3 million, an increase of $0.9 million or 11% compared to the $8.4 million recognized for the nine months ended September 30, 2021. In 2022, the increase in real estate income is attribute to new subleases of building space in Illinois and California.

Gross Profit

Gross profit for the for the nine months ended September 30, 2022 was $40.8 million or 47% of revenue compared to $45.8 million or 60% of revenue for the nine months ended September 30, 2021. The decrease in gross profit percentage of 13% is primarily due to decreased pricing across the Company's wholesale and retail markets. The decrease has also been mitigated by increases in retail sell-through of the Company owned produced products primarily in Illinois and Massachusetts. Additionally, improvements in flower yields and quality led to an increases in revenue, market share and gross margin in Massachusetts for the nine months ended September 30, 2022. Late in Q3 2022, the Illinois cultivation facility experienced similar improvements in yields and quality.

Total Operating Expenses

Operating expenses consist of selling and marketing expenses, general and administrative expenses, depreciation and amortization, transaction and restructuring expenses, and equity based compensation expense. Total operating expenses for the nine months ended September 30, 2022 were flat at $45.6 million as compared to the same period in 2021.

Total Other Income (Expense), net

Other Income (Expense) consists primarily of interest income, interest expense, change in fair value of derivative liability, amortization of loan discount, and loss on litigation settlement. Total Other Income (Expense) for the nine months ended September 30, 2022 was ($6.4) million, as compared to ($11.4) million for the nine months ended September 30, 2021. As part of the 2022, contingent consideration from the OM acquisition, the Company determined it was no longer probable the milestones would be reached. This resulted in a $2.4 million gain on the contingent consideration to be recognized. During the nine months ended September 30, 2021, there was a loss on a lease termination of $1.2 million and a debt to equity conversion that resulted in a loss of $2.9 million. There were no similar losses recorded in the comparable 2022 period.

Non-GAAP Financial and Performance Measures

In addition to providing financial measurements based on GAAP, we provide additional financial metrics that are not prepared in accordance with GAAP. Management uses non-GAAP financial measure, in addition to GAAP financial measures, to understand and compare operating results across accounting periods, for financial and operational decision making, for planning and forecasting purposes and to evaluate the Company's financial performance. Management uses the non-GAAP measurement of adjusted EBITDA, which we believe reflects our ongoing business in a manner that allows for meaningful comparisons and analysis of trends in the business, as it facilitates comparing financial results across accounting periods. We also believe that this non-GAAP financial measure enables investors to evaluate the Company's operating results and future prospects in the same manner as management. This non-GAAP financial measures may also exclude expenses and gains that may be unusual in nature, infrequent or not reflective of the Company's ongoing operating results. As there are no standardized methods of calculating non-GAAP measures, our methods may differ from those used by others, and accordingly, the use of these measures may not be directly comparable to similarly titled measures used by others. Accordingly, non-GAAP measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

Adjusted EBITDA

Adjusted EBITDA is a financial measure that is not calculated in accordance with U.S. GAAP. Management believes that because adjusted EBITDA excludes (a) certain non-cash expenses (such as depreciation, amortization and stock-based compensation) and (b) expenses that are not reflective of the Company's core operating results over time (such as restructuring costs, litigation or dispute settlement charges or gains, and transaction-related costs), this measure provides investors with additional useful information to measure the Company's financial performance, particularly with respect to changes in performance from period to period. The Company's management uses adjusted EBITDA (a) as a measure of operating performance, (b) for planning and forecasting in future periods, and (c) in communications with the Company's board of directors concerning the Company's financial performance. The Company's presentation of adjusted EBITDA is not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation and should not be used by investors as a substitute or alternative to net loss or any measure of financial performance calculated and presented in accordance with U.S. GAAP. Instead, management believes adjusted EBITDA should be used to supplement the Company's financial measures derived in accordance with U.S. GAAP to provide a more complete understanding of the trends affecting the business.

Although adjusted EBITDA is frequently used by investors and securities analysts in their evaluations of companies, adjusted EBITDA has limitations as an analytical tool, and investors should not consider it in isolation or as a substitute for, or more meaningful than, amounts determined in accordance with U.S. GAAP. Some of the limitations to using non-GAAP measures as an analytical tool are (a) they do not reflect the Company's interest income and expense, or the requirements necessary to service interest or principal payments on the Company's debt, (b) they do not reflect future requirements for capital expenditures or contractual commitments, and (c) although depreciation and amortization charges are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and non-GAAP measures do not reflect any cash requirements for such replacements.

Adjusted EBITDA is defined by the Company as earnings before interest, taxes, depreciation and amortization, accretion, share-based compensation expense, legal settlement, change in value of derivative liability, foreign exchange gain (loss), loss on lease termination, loss on litigation, other non-cash expenses, and one-time charges related to acquisition costs, financing-related costs, extraordinary pre-opening expenses and non-recurring expenses.

We consider these measures to be an important indicator of the financial strength and performance of our business. The following table reconciles adjusted EBITDA to its closest GAAP measure. For comparative purposes, certain prior year amounts have been reclassified to conform to the current year presentation.

For the nine months ended September 30, 2022 and 2021, adjusted EBITDA consisted of the following:

Nine months ended September 30,	**2022**	**2021**
Net loss (GAAP)	$ (21,041)	$ (21,896)
Interest income	(8)	(13)
Interest expense	15,072	7,894
Amortization of loan discount upon conversion of debt to equity	—	2,915
Income tax expense	9,802	10,545
Depreciation and amortization	6,844	3,668
Accretion of lease liability	11,440	—
Equity based compensation	2,290	7,978
Change in contingent consideration payable	(2,393)	—
Change in value of derivative liability	(3,494)	(502)
Acquisition, transaction, and other one-time costs	3,876	4,854
Non-cash inventory adjustment	1,600	—
Non-cash lease amortization	3,258	2,203
Loss on litigation settlement	250	—
Loss on lease termination	—	1,210
Adjusted EBITDA (Non-GAAP)	$ 27,496	$ 20,891

For the three months ended September 30, 2022 and 2021, adjusted EBITDA consisted of the following:

Three months ended September 30,	**2022**	**2021**
Net loss (GAAP)	$ (8,601)	$ (4,594)
Interest income	(6)	(2)
Interest expense	5,798	2,532
Amortization of loan discount upon conversion of debt to equity	—	—
Income tax expense	3,322	4,541
Depreciation and amortization	2,155	1,502
Accretion of lease liability	4,040	—
Equity based compensation	862	2,603
Change in contingent consideration payable	—	—
Change in value of derivative liability	(420)	(3,345)
Commerce facility pre-opening expense	—	2,035
Acquisition, transaction, and other one-time costs	866	1,800
Non-cash lease amortization	1,045	438
Loss on litigation settlement	250	—
Adjusted EBITDA (Non-GAAP)	$ 9,311	$ 7,510

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, net loss. There are a number of limitations related to the use of adjusted EBITDA as compared to net loss, the closest comparable GAAP measure. Adjusted EBITDA excludes:

- Interest income and expense
- Current income tax expense
- Depreciation and amortization expense
- Accretion expense related to a periodic update of the present value of a liability
- Equity based compensation expense, which has been, and will continue to be for the foreseeable future, a significant recurring expense in our business and an important part of our compensation strategy
- Legal settlements
- Non-cash change in fair value of derivative liability
- Acquisition, transaction, and other expenses (income), which vary significantly by transaction and are excluded to evaluate ongoing operating results

Liquidity and Capital Resources

As of September 30, 2022 and December 31, 2021, we had total current liabilities of $69.1 million and $48.8 million, respectively, and current assets of $51.1 million and $50.9 million, respectively, to meet our current obligations. As of September 30, 2022, we had a working deficit of $18.0 million, compared to working capital of $2.0 million, as of December 31, 2021. The decrease of $20.0 million is driven primarily by a decrease in cash and increases in accounts payable and taxes payable, partially offset by increases in accounts receivable, other receivables, and inventory, and decreases in accrued expenses and other current liabilities, derivative liability, and current portion of convertible notes.

The Company is an early-stage growth company. It is generating cash from sales and is deploying its capital reserves to acquire and develop assets capable of producing additional revenues and earnings over both the immediate and near term. Capital reserves are being utilized for capital expenditures and improvements in existing facilities, product development and marketing, as well as customer, supplier and investor and industry relations.

Historically, the Company has raised capital as needed however there is no guarantee the Company will be able to continue to raise funds in the same manor it has historically.

Cash Flows

Net Cash (Used in) Provided by Operations

Net cash used in operating activities was $2.0 million for the nine months ended September 30, 2022, a decrease of $5.9 million as compared to $4.0 million of net cash provided by operating activities for the nine months ended September 30, 2021. The decrease is primarily attributable to increases in working capital and the overall scaling of the Company's California operation.

Net Cash Used in Investing Activities

Net cash used in investing activities was $27.0 million for the nine months ended September 30, 2022, an increase of $14.2 million as compared to $12.7 million of cash used in investing activities for the nine months ended September 30, 2021. The increase can be attributed to the $24.5 million in cash used to complete the NECC acquisition, partially offset by a reduction in purchases of property and equipment to $2.5 million for the nine months ended September 30, 2022 as compared to $14.0 million spent on property and equipment during the nine months ended September 30, 2021.

Net Cash Provided by (Used in) Financing Activities

Net cash provided by financing activities was $11.7 million for the nine months ended September 30, 2022, an increase of $13.3 million as compared to $1.7 million of cash used in financing activities for the nine months ended September 30, 2021. The increase is attributed to proceeds from the construction finance liability of $16.0 million associated with the NECC acquisition and a $3 million promissory note purchase during the nine months ended September 30, 2022. This was partially offset by repayments of notes payable during the nine months ended September 30, 2022 of $5.9 million and compared to $3.5 million paid in the comparable 2021 period. Refer to **Note 7** for additional discussion.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

We review new accounting standards as issued. Although some of these accounting standards issued or effective after the end of our previous fiscal year may be applicable to the Company, we have not identified any standards that we believe merit further discussion. We do not expect the adoption of any recently issued accounting pronouncements to have a significant impact on our financial position, results of operations, or cash flows.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, the Company is not required to provide information required by this Item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, our management has carried out an evaluation, with the participation and under the supervision of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2022. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating and implementing possible controls and procedures.

Material Weaknesses

A material weakness is a deficiency, or a combination of deficiencies, within the meaning of Public Company Accounting Oversight Board (“PCAOB”) Auditing Standard AS 2201, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

Material Weaknesses in Internal Control

The Company did not fully design and implement effective control activities based on the criteria established in the COSO framework. The Company has identified deficiencies that constitute a material weakness, either individually or in the aggregate. This material weakness is attributable to the following factors:

- We did not have sufficient accounting staff resources to timely perform closing and audit-related procedures.
- We did not have effective controls over the review procedures for balance sheet account reconciliations and manual journal entries.
- We did not have documented evidence of review procedures and did not have sufficient segregation of duties within our accounting function.

Due to the existence of the above material weakness, management, including the CEO and CFO, has concluded our internal control over financial reporting was not effective as of September 30, 2022. This material weakness creates a possibility that a material misstatement to the consolidated financial statements will not be prevented or detected on a timely basis.

Management conducted its evaluation of disclosure controls and procedures under the supervision of our CEO and CFO. Based upon, and as of the date of, this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded our disclosure controls and procedures may not be effective as of September 30, 2022 due to the material weaknesses listed above.

Remediation of Material Weaknesses in Internal Control over Financial Reporting

The Company continues to strengthen our internal control over financial reporting and is committed to ensuring that such controls are designed and operating effectively. The Company is implementing process and control improvements to address the above material weakness as follows:

- The Company will assess sufficient resources, both in accounting staff and related technology, needed to timely perform closing and audit-related procedures and align identified resources.
- The Company will assess controls needed to effectively review procedures for balance sheet account reconciliations and manual journal entries and implement identified controls.
- The Company will assess review procedures to have sufficient segregation of duties within our accounting function, then standardize and document such procedures for evidence of review.

The material weakness in the Company’s internal control over financial reporting will not be considered remediated until the remediated controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. The Company is working to have the material weaknesses remediated as soon as possible. However, there is no assurance that the remediation will be fully effective. As described above, the material weakness has not been fully remediated as of the filing date of this Form 10-Q. If these remediation efforts do not prove effective and control deficiencies and material weaknesses persist or occur in the future, the accuracy and timing of the Company’s financial reporting may be materially and adversely affected.

Inherent Limitations on Effectiveness of Controls

Management recognizes that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud or error, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in Internal Control over Financial Reporting

The Company has begun implementing changes to strengthen the Company's internal controls, including the hiring of a permanent CFO and Director of External Reporting, evaluating systems that could aid in improving controls, and implementing month end close procedures that include monthly flux analysis, gross margin analysis and performing balance sheet reconciliations.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings[1]

On January 26, 2022, Savills, Inc. sued the Company in the U.S. District Court for the Southern District of New York. That lawsuit alleged that the Company had 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 claimed damages of approximately $19.4 million in connection with its claim that it obtained benefits for the Company allegedly valued at over $129.0 million. The Company denied these allegations, denied the Company had obtained such benefits, disputed Savills' characterization of the facts, and denied liability. The Company filed a counterclaim against Savills alleging breach of contract by Savills. On August 3, 2022, the parties reached a confidential settlement in principle and agreed to dismissal of all claims, which was finalized on September 12, 2022 and required the Company to pay $0.25 million in five monthly installments beginning in October 2022. In addition to this initial payment, there is a portion of the settlement that is contingent on future tax savings. As of September 30, 2022, this additional contingent amount is not reasonably estimable.

Apart from the foregoing and ongoing legal proceedings, from time to time, we may be subject to various other legal proceedings and claims that are routine and incidental to our business. Although some of the legal proceedings set forth herein may result in adverse decisions or settlements, management believes that the final disposition of such matters will not have a material adverse effect on our business, financial position, results of operations or cash flows.

Item 1A. Risk Factors

As a "smaller reporting company" as defined by Item 10 of Regulation S-K, we are not required to provide information required by this Item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On January 14, 2022, pursuant to a settlement agreement to settle an unsecured promissory note with an outstanding balance of $3.2 million at December 31, 2021, the Company issued 6,235,512 SVS to LJM Investment Group.

On January 28, 2022, pursuant to an agreement and plan of merger whereby New England Cannabis Corporation, Inc., a Massachusetts corporation ("NECC") became a wholly owned subsidiary of the Company, the Company issued 28,571,428 SVS, with a deemed value of $1.05 per share, or a total estimated valuation of $9 million to Mr. Kenneth V. Stevens, the sole owner of all of the issued and outstanding capital stock of NECC.

On April 25, 2022, pursuant to an agreement and plan of merger whereby Island Global Holdings, Inc., a California corporation ("Island") became a wholly owned subsidiary of the Company, the Company issued an aggregate of 8,783,716 SVS and warrants to purchase 2,999,975 SVS at a price of $1.00 per SVS to certain shareholders and debt holders of Island.

On August 19, 2022, the Company issued 3,750,000 SVS, was a deemed value of $0.56 per share, or a total estimated valuation of $2.1 million for the asset acquisition of certain assets of Bloom Farms.

The foregoing transactions did not involve any underwriters, any underwriting discounts or commissions, or any public offering. We believe the offers, sales, and issuances of the above securities were exempt from registration under the Exchange Act (including Regulation D promulgated thereunder) by virtue of Section 4(a)(2) of the Securities Act, because the issuance of securities to the recipients did not involve a public offering. The recipients of

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[1]

the securities in each of these transactions represented their intentions to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof, and appropriate legends were placed upon the stock certificates issued in these transactions. All recipients had adequate access, through their relationships with us or otherwise, to information about us. The issuances of these securities were made without any general solicitation or advertising.

The Company did not repurchase any shares during the reporting period.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

The Company advanced its annual shareholder meeting from December to June, and held its annual shareholder meeting on June 22, 2022.

Item 6. Exhibits

Exhibit Number	Exhibit Description	Form	Filing Date	Exhibit Number	Filed Herewith
31.1	Certification of the Chief Executive Officer (Principal Executive Officer) pursuant to Rule 13a-14(a) of the Securities Exchange Act				x
31.2	Certification of the Chief Financial Officer (Principal Financial Officer) pursuant to Rule 13a-14(a) of the Securities Exchange Act				x
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) Under the Securities Exchange Act of 1934 and Section 1350 of Chapter 60 of Title 18 of the United States Code *				x
101.INS	XBRL Instance Document				
101.SCH	XBRL Taxonomy Extension Schema Document				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)				

\+ Indicates management contract or compensatory plan.

* This certification is being furnished solely to accompany this Quarterly Report pursuant to 18 U.S.C. Section 1350, and it is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

4FRONT VENTURES CORP.

Date: November 14, 2022

By: /s/ Leo Gontmakher

Leo Gontmakher
Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 14, 2022

By: /s/ Keith Adams

Keith Adams
Chief Financial Officer
(Principal Financial Officer)