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, 2022.

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, 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, 2022. 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. ("4Front", the "Company", "we" or "our") has two primary operating segments: THC Cannabis and CBD Wellness. With regard to its THC Cannabis segment, the Company operates six dispensaries and seven production and cultivation facilities in Massachusetts, Illinois, Michigan, and California as of March 31, 2023. 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 Company's seven cultivation and production assets differ by state as detailed in our Annual Report on Form 10-K for the year ended December 31, 2022.

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 and Massachusetts to increase its market share. The Company has made significant investments in manufacturing facilities in each of these locations. In January 2022, the Company acquired a new cultivation facility in Holliston, MA in the New England Cannabis Corporation ("NECC") acquisition, which doubled the Company's cultivation footprint in the Massachusetts market. The Company has continued to expand it's footprint in the Illinois market with the development of the Matteson facility which is currently in progress. Additionally, the company ended into an agreement to purchase a cannabis license to enable the Company to open an additional dispensary in the state of Illinois. In addition 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.

As part of its THC Cannabis segment, the Company also 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 Euphoria, LLC

On March 27, 2023, the Company entered into a Membership Interest Purchase Agreement to acquire 100% of the issued and outstanding equity interests in Euphoria, LLC which holds a conditional adult use dispensary license in the state of Illinois. Please see Note 5 of the financial statements for a full description of the transaction.

Management Changes

Effective March 14, 2023, the Board of Directors appointed Kristopher Krane as an interim member of the Board. Mr. Krane has continued to serve as a strategic advisor to the Company since stepping down as 4Front Cofounder and President of Mission Dispensaries after more than a decade with the business.

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, 2022, as filed with the SEC on March 30, 2023. 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 March 31, 2023 Compared With Three Months Ended March 31, 2022

The following table sets forth our results of operations for the three months ended March 31, 2023 and 2022:

	For the Three Months Ended March 31,		Change	
	2023	**2022**	**$**	**%**
Revenue from Sale of Goods	$ 27,370	$ 23,083	$ 4,287	19 %
Real Estate Income	3,006	2,965	41	1 %
Total Revenues	30,376	26,048	4,328	17 %
Cost of Goods Sold	(19,388)	(12,594)	(6,794)	54 %
Gross Profit	10,988	13,454	(2,466)	18 %
Total Operating Expense	16,784	14,648	2,136	15 %
Loss from Operations	(5,796)	(1,194)	(4,602)	385 %
Total Other Expense, net	(2,530)	(1,262)	(1,268)	(101) %
Net Loss Before Income Taxes	(8,326)	(2,456)	(5,870)	239 %
Income Tax Expense	(3,066)	(3,438)	372	11 %
Net Loss	**$ (11,392)**	**$ (5,894)**	**$ (5,498)**	**93 %**

Revenue from Sale of Goods

Revenue from sale of goods for the three months ended March 31, 2023 was $27.4 million, an increase of $4.3 million or 19% compared to the three months ended March 31, 2022. Refer to the segment discussion below for specific revenue drivers quarter over quarter.

Real Estate Income

Real estate income from leasing cannabis production facilities for the three months ended March 31, 2023 was $3.0 million, which remained materially consistent compared to the $3.0 million recognized for the three months ended March 31, 2022.

Revenue in the reportable segments from which we operate is as follows:

	For the Three Months Ended March 31,		Change	
	2023	**2022**	**$**	**%**
THC Cannabis	$ 30,160	$ 25,783	$ 4,377	17%
CBD Wellness	216	265	(49)	18%
Total Net Revenues	**$ 30,376**	**$ 26,048**	**$ 4,328**	**17%**

Net revenues for the THC cannabis segment were $30.2 million for the three months ended March 31, 2023, an increase of $4.4 million or 17%, compared to the three months ended March 31, 2022. The increase was due to increased production at the Company's manufacturing facility in Commerce, CA resulting in increased sales of $3.6 million coupled with increased revenue of $2.4 million in the Massachusetts market offset by declines in revenue in Illinois operations driven by price compression.

Net revenues for the CBD wellness segment were materially consistent for the three months ended March 31, 2023 and 2022.

Cost of Goods Sold

Cost of goods sold for the three months ended March 31, 2023 was $19.4 million, an increase of $6.8 million or 54% compared to $12.6 million for the three months ended March 31, 2022. Due to the economic environment as well as cannabis market and regulations in the first quarter of 2023, the Company has experienced an increase in the direct cost of labor and materials, indirect costs such as utilities and supplies used in the growing process, and indirect labor costs for individuals involved in the growing, quality control and inventory processes, as well as certain facility costs.

Gross Profit

Gross profit for the three months ended March 31, 2023 was $11.0 million, or 36% of revenue, compared to $13.5 million, or 52% of revenue, for the three months ended March 31, 2022. The decrease in gross profit percentage of 15% was primarily due to increase in cost of goods sold as described above coupled with pricing compression across the Company's markets which has been mitigated by increases in retail sell-through of the Company-owned produced products in Massachusetts. Improvements in flower yields and quality led to increases in revenue, market share, and gross margin in Massachusetts for the three months ended March 31, 2023. In fiscal first quarter of 2023, the Company’s wholesale segment, an inherently lower margin business, represented a larger percentage of revenue as compared to prior period, adding to the overall decline in gross margin.

Total Operating Expenses

Operating expenses consist of selling and marketing expenses, general and administrative expenses, depreciation and amortization, and equity based compensation expense. Total operating expenses for the three months ended March 31, 2023 was $16.8 million, an increase of $2.1 million or 15%, as compared to the three months ended March 31, 2022. This increase was primarily due to an increase in selling and marketing expenses as a result of increased marketing efforts related to the expansion of its brand and products portfolio resulting from the launch of new products and expansion of the Island and Bloom brands across company operations.

Total Other Income (Expense), net

Other income (expense) consists primarily of interest expense, change in fair value of derivative liability, loss on litigation settlement, and other income. Total other expense for the three months ended March 31, 2023 was $2.5 million, as compared to $1.3 million for the three months ended March 31, 2022. The increase of $1.3 million was primarily due to an increase in interest expense as a result of the promissory notes related to the NECC and Island acquisitions during fiscal year 2022, in addition to a $1.3 million gain on change in fair value of derivative liability in 2022 which did not reoccur in the current period.

Net Loss

Net loss for the three months ended March 31, 2023 was $11.4 million, compared to $5.9 million for the three months ended March 31, 2022. The increase in net loss for the three months ended March 31, 2023 was primarily due to the decline in gross profit and other factors described above.

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 measures, 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), it represents a clearer picture of what the Company's operations could be doing. Adjusted EBITDA is defined by the Company is detailed below. 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 are 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 income 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. For comparative purposes, certain prior year amounts have been reclassified to conform to the current year presentation.

The following table reconciles Net Loss to Adjusted EBITDA for the three months ended March 31, 2023 and 2022:

	For the Three Months Ended March 31,	
	2023	2022
Net loss before NCI (GAAP)	$ (11,392)	$ (5,894)
Interest income	(14)	(2)
Interest expense	3,196	2,620
Income tax expense	3,066	3,438
Depreciation and amortization	2,391	1,795
EBITDA (Non-GAAP)	**$ (2,753)**	**$ 1,957**
Equity based compensation	1,020	1,038
Change in fair value of derivative liability	—	(1,300)
Loss on litigation settlement	3	—
Sale leaseback related interest expense and non-cash operating lease amortization	1,475	1,389
Operating lease expense in IL facility build-out phase	2,972	1,912
Acquisition, transaction, and other non-cash costs	798	2,421
Adjusted EBITDA (Non-GAAP)	**$ 3,515**	**$ 7,417**

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, as defined by the Company, excludes from Net Loss:

- Interest income and expense;
- Current income tax expense;
- Non-cash depreciation and amortization expense;
- Non-cash equity based compensation expense;
- Non-cash changes in fair value of derivative liability;
- Loss recognized on litigation settlements;
- Sale leaseback related interest expense and non-cash operating lease amortization;
- Operating lease expense incurred at non-operational facilities during construction build-out phase; and
- Acquisition, transaction, and other non-cash costs, which vary significantly by transactions and are excluded to evaluate ongoing operating results.

Liquidity and Capital Resources

As of March 31, 2023 and December 31, 2022, we had total current liabilities of $75.0 million and $77.5 million, respectively, and current assets of $46.1 million and $53.3 million, respectively, to meet our current obligations. As of March 31, 2023 and December 31, 2022, we had a working capital deficit of $29.0 million compared to $24.2 million. The decline in working capital of $4.8 million was driven primarily by a decrease in cash and an increase in accounts receivable and inventory due to the Company's expanded operations resulting from the mergers and acquisitions completed during fiscal year 2022, offset by a decrease in accrued expenses. The conditions described above raise substantial doubt with respect to the Company’s ability to meet its obligations for at least one year from the issuance of these consolidated financial statements, and therefore, to continue as a going concern.

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 Operations

Net cash used in operating activities was $6.9 million for the three months ended March 31, 2023, an increase of $4.5 million as compared to $2.4 million of net cash used in operating activities for the three months ended March 31, 2022. The increase in spend was primarily attributable to the overall scaling of the Company's California and Illinois operations.

Net Cash Used in Investing Activities

Net cash used in investing activities was $0.4 million for the three months ended March 31, 2023, a decrease of $25.6 million as compared to $26.0 million of cash used in investing activities for the three months ended March 31, 2022. The decrease was primarily attributable to the $25.0 million cash paid for the NECC acquisition during the three months ended March 31, 2022 versus $0.3 million cash paid for the Euphoria transaction in the current period.

Net Cash (Used in) Provided by Financing Activities

Net cash used in financing activities was $3.3 million for the three months ended March 31, 2023, a decrease of $17.7 million as compared to $14.4 million of cash provided by financing activities for the three months ended March 31, 2022. The decrease was primarily attributable to proceeds from the construction finance liability of $16.0 million associated with the NECC acquisition during the three months ended March 31, 2022. This was partially offset by repayments of notes payable during the three months ended March 31, 2023 of $3.3 million and compared to $1.6 million paid in the prior 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 March 31, 2023. 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.

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

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2023 that have materially affected, or that are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

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 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 March 31, 2023, 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

None.

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 will hold its annual shareholder meeting on June 29, 2023.