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 June 30, 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 are 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 entered 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. The transfer of the license is subject to regulatory approval. Please see Note 5 of the financial statements for a full description of the transaction.

Management Changes

Effective May 16, 2023, Amit Patel resigned as a director and the Chair of the Audit Committee of the Company.

Effective July 31, 2023, Keith Adams resigned as Chief Financial Officer of the Company. Effective August 4, 2023, Nicole Frederick has been named Interim Chief financial Officer.

Non-Binding Term Sheet for Extension of Senior Secured Debt

In July 2023, the Company entered into a definitive agreement with the Company's senior secured lender, LI Lending, LLC ("Lender") to extend the maturity date, reduce the interest payable, and expand the third-party financings allowed under the December 17, 2020 Amended and Restated Loan and Security Agreement ("Loan") between 4Front and Lender on terms and conditions set out in the Term Sheet. The Lender will extend the maturity date of the Loan to May 1, 2026, reduce the interest payable to 12.0% per year, payable monthly, and allow for in excess of $30.0 million additional senior secured financing.

The Company shall pay an extension fee of $0.52 million payable in cash on May 1, 2024. In addition, the Company shall issue warrants equal to 33% of the loan balance, or approximately $17.06 million, wherein each warrant shall be exercisable into one Subordinate Voting Share of the Company at an exercise price not less than $0.17 through May 1, 2026. Refer to Note 16 of the financial statements for further information.

Modification of Lease Agreement

On July 7, 2023, the Company amended its lease agreement for the cultivation and production facility in Matteson, Illinois to apply a portion of the security deposit to pay one-half of the monthly base rent for the four month period through November 30, 2023; to defer payment of the $2.2 million increase in security deposit to be funded as draws on the tenant improvement allowance through November 30, 2023; and to make pro rata payments of such deferred payments equal to 1/12 of the aggregate amount, concurrently with monthly base rent installments, for the twelve month period commencing January 1, 2024.

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 June 30, 2023 Compared With Three Months Ended June 30, 2022

The following table sets forth our results of operations for the three months ended June 30, 2023 and 2022:

	For the Three Months Ended June 30,		Change	
	2023	2022	$	%
Revenue from Sale of Goods	$ 27,696	$ 25,488	$ 2,208	9 %
Real Estate Income	3,000	2,951	49	2 %
Total Revenues	30,696	28,439	2,257	8 %
Cost of Goods Sold	(21,100)	(16,123)	(4,977)	31 %
Gross Profit	9,596	12,316	(2,720)	22 %
Total Operating Expense	15,378	16,462	(1,084)	(7) %
Loss from Operations	(5,782)	(4,146)	(1,636)	39 %
Total Other Income (Expense), net	(3,731)	642	(4,373)	(681) %
Net Loss Before Income Taxes	(9,513)	(3,504)	(6,009)	171 %
Income Tax Expense	(1,951)	(3,042)	1,091	36 %
Net Loss	**$ (11,464)**	**$ (6,546)**	**$ (4,918)**	**75 %**

Revenue from Sale of Goods

Revenue from sale of goods for the three months ended June 30, 2023 was $27.7 million, an increase of $2.2 million or 9% compared to the three months ended June 30, 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 June 30, 2023 was $3.0 million, which remained materially consistent compared to the $3.0 million recognized for the three months ended June 30, 2022.

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

	For the Three Months Ended June 30,		Change	
	2023	2022	$	%
THC Cannabis	$ 30,433	$ 28,195	$ 2,238	8%
CBD Wellness	263	244	19	8%
Total Net Revenues	**$ 30,696**	**$ 28,439**	**$ 2,257**	**8%**

Net revenues for the THC cannabis segment were $30.4 million for the three months ended June 30, 2023, an increase of $2.2 million or 8%, compared to the three months ended June 30, 2022. The increase was primarily attributable to the implementation of a new discounting structure resulting in decreased discounts coupled with increased pricing in the Massachusetts market year over year.

Net revenues for the CBD wellness segment were materially consistent for the three months ended June 30, 2023 and 2022.

Cost of Goods Sold

Cost of goods sold for the three months ended June 30, 2023 was $21.1 million, an increase of $5.0 million or 31% compared to $16.1 million for the three months ended June 30, 2022. This increase is primarily attributable to a fully operational California plant with a high fixed cost structure.

Gross Profit

Gross profit for the three months ended June 30, 2023 was $9.6 million, or 31% of revenue, compared to $12.3 million, or 43% of revenue, for the three months ended June 30, 2022. The decrease in gross profit percentage of 12% was primarily due to increase in cost of goods sold in California as described above coupled with price compression in the Illinois market.

Total Operating Expenses

Operating expenses consist of selling and marketing expenses, general and administrative expenses, depreciation and amortization, equity based compensation expense, and transaction related expenses. Total operating expenses for the three months ended June 30, 2023 was $15.4 million, a decrease of $1.1 million or 7%, as compared to the three months ended June 30, 2022. The decrease was primarily attributed to declines in transaction related expenses as a result of decreased acquisition activity as compared to 2022.

Total Other Income (Expense), net

Other income (expense) consists primarily of interest expense, change in fair value of derivative liability, gain on contingent consideration payable, and other expense. Total other expense for the three months ended June 30, 2023 was $3.7 million, as compared to other income of $0.6 million for the three months ended June 30, 2022. The decrease of $4.4 million was primarily due to a change in fair value of derivative liability of $1.8 million in the prior year versus none in the current period as the derivative liability expired in November 2022. In addition, the Company recognized a gain on contingent consideration payable of $2.4 million for the three months ended June 30, 2022 versus none in the current year.

Net Loss

Net loss for the three months ended June 30, 2023 was $11.5 million, compared to $6.5 million for the three months ended June 30, 2022. The increase in net loss for the three months ended June 30, 2023 was primarily attributable to the decline in gross profit as described above.

Six Months Ended June 30, 2023 Compared With Six Months Ended June 30, 2022

The following table sets forth our results of operations for the six months ended June 30, 2023 and 2022:

	For the Six Months Ended June 30,		Change	
	2023	2022	$	%
Revenue from Sale of Goods	$ 55,066	$ 48,571	$ 6,495	13 %
Real Estate Income	6,006	5,916	90	2 %
Total Revenues	61,072	54,487	6,585	12 %
Cost of Goods Sold	(40,488)	(28,717)	(11,771)	41 %
Gross Profit	20,584	25,770	(5,186)	20 %
Total Operating Expense	32,162	31,110	1,052	3 %
Loss from Operations	(11,578)	(5,340)	(6,238)	117 %
Total Other Expense, net	(6,261)	(620)	(5,641)	(910) %
Net Loss Before Income Taxes	(17,839)	(5,960)	(11,879)	199 %
Income Tax Expense	(5,017)	(6,480)	1,463	23 %
Net Loss	**$ (22,856)**	**$ (12,440)**	**$ (10,416)**	**84 %**

Revenue from Sale of Goods

Revenue from sale of goods for the six months ended June 30, 2023 was $55.1 million, an increase of $6.5 million or 13% compared to the six months ended June 30, 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 six months ended June 30, 2023 was $6.0 million, which remained materially consistent compared to the $5.9 million recognized for the six months ended June 30, 2022.

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

	For the Six Months Ended June 30,		Change	
	2023	2022	$	%
THC Cannabis	$ 60,593	$ 53,978	$ 6,615	12%
CBD Wellness	479	509	(30)	6%
Total Net Revenues	**$ 61,072**	**$ 54,487**	**$ 6,585**	**12%**

Net revenues for the THC cannabis segment were $60.6 million for the six months ended June 30, 2023, an increase of $6.6 million or 12%, compared to the six months ended June 30, 2022. The increase was primarily attributed to a maturing wholesale market in Massachusetts and price structure reevaluations resulting in increased revenue of $3.4M period over period. California contributed approximately $4M in additional revenue as a result of the facility being fully operational in 2023 as compared to the same period in 2022. These increases were offset by declines in revenue in Illinois operations driven by price compression.

Net revenues for the CBD wellness segment were materially consistent for the six months ended June 30, 2023 and 2022.

Cost of Goods Sold

Cost of goods sold for the six months ended June 30, 2023 was $40.5 million, an increase of $11.8 million or 41% compared to $28.7 million for the six months ended June 30, 2022. Due to the economic environment as well as cannabis market and regulations in the first half 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 six months ended June 30, 2023 was $20.6 million, or 34% of revenue, compared to $25.8 million, or 47% of revenue, for the six months ended June 30, 2022. The decrease in gross profit percentage of 13% was primarily due to the 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 six months ended June 30, 2023.

Total Operating Expenses

Operating expenses consist of selling and marketing expenses, general and administrative expenses, depreciation and amortization, equity based compensation expense, and transaction related expenses. Total operating expenses for the six months ended June 30, 2023 was $32.2 million, an increase of $1.1 million or 3%, as compared to the six months ended June 30, 2022. This increase was primarily due to an increase in distribution expense in California and increased 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 Expense, net

Other expense consists primarily of interest expense, change in fair value of derivative liability, and gain on contingent consideration payable. Total other expense for the six months ended June 30, 2023 was $6.3 million, as compared to $0.6 million for the six months ended June 30, 2022. The decrease of $5.6 million was primarily due to a change in fair value of derivative liability of $3.1 million in the prior year versus none in the current period as the derivative liability expired in November 2022. In addition, the Company recognized a gain on contingent consideration payable of $2.4 million for the six months ended June 30, 2022 versus none in the current year.

Net Loss

Net loss for the six months ended June 30, 2023 was $22.9 million, compared to $12.4 million for the six months ended June 30, 2022. The increase in net loss for the six months ended June 30, 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 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 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 as 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 and six months ended June 30, 2023 and 2022:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2023	2022	2023	2022
Net loss before NCI (GAAP)	$ (11,464)	$ (6,546)	$ (22,856)	$ (12,440)
Interest income	(7)	—	(21)	(2)
Interest expense	3,075	3,418	6,271	6,038
Income tax expense	1,951	3,042	5,017	6,480
Depreciation and amortization	2,487	2,894	4,878	4,689
EBITDA	**$ (3,958)**	**$ 2,808**	**$ (6,711)**	**$ 4,765**
Share-based compensation	214	390	1,234	1,428
Change in fair value of derivative liability	—	(1,774)	—	(3,074)
Change in fair value of contingent consideration	—	(2,393)	—	(2,393)
Loss on litigation settlement	—	—	3	—
Sale leaseback related interest expense and non-cash operating lease amortization	1,477	1,487	2,952	2,876
Facility start-up costs/under-absorbed overhead costs	2,948	1,942	5,920	3,854
Acquisition, transaction, and other non-cash costs	1,306	3,520	2,104	5,940
Adjusted EBITDA (Non-GAAP)	**$ 1,987**	**$ 5,980**	**$ 5,502**	**$ 13,396**

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 share-based compensation expense;
- Non-cash changes in fair value of derivative liability and contingent consideration;
- Loss recognized on litigation settlements;
- Sale leaseback related interest expense and non-cash operating lease amortization;
- Facility start-up costs and under-absorbed overhead costs; 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 June 30, 2023 and December 31, 2022, we had total current liabilities of $81.2 million and $77.5 million, respectively, and current assets of $47.4 million and $53.3 million, respectively, to meet our current obligations. As of June 30, 2023 and December 31, 2022, we had a working capital deficit of $33.8 million compared to $24.2 million. The decline in working capital of $9.6 million was driven primarily by a decrease in cash. Refer to the cash flow section below for specific drivers.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 $4.2 million for the six months ended June 30, 2023, which is materially consistent compared to $2.9 million for the six months ended June 30, 2022.

Net Cash Used in Investing Activities

Net cash used in investing activities was $0.7 million for the six months ended June 30, 2023, a decrease of $26.0 million as compared to $26.7 million for the six months ended June 30, 2022. The decrease was primarily attributable to the financing of the NECC acquisition in 2022. In the period ended June 30, 2023, there were no comparable acquisitions.

Net Cash (Used in) Provided by Financing Activities

Net cash used in financing activities was $4.9 million for six months ended June 30, 2023, a decrease of $17.9 million as compared to $13.0 million of cash provided by financing activities for the six months ended June 30, 2022. The decrease was primarily attributable to the non-recurring nature of the proceeds from the construction finance liability of $16.0 million associated with the NECC acquisition during the six months ended June 30, 2022. This was partially offset by repayments of notes payable during the six months ended June 30, 2023 of $4.9 million compared to $2.7 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.