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

The following discussion of the financial condition and results of operations of MariMed Inc. should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2021, which was filed with the U.S. Securities and Exchange Commission ("SEC") on March 16, 2022.

Overview

We are a multi-state operator in the United States cannabis industry. We develop, operate, manage, and optimize over 300,000 square feet of state-of-the-art, regulatory-compliant facilities for the cultivation, production and dispensing of medicinal and recreational cannabis. We also license our proprietary brands of cannabis and hemp-infused products, along with other top brands, in several domestic markets and overseas.

Our common stock commenced trading on the Canadian Securities Exchange effective July 12, 2022, under the ticker symbol MRMD, and continues to trade on the OTCQX under the same symbol.

On April 27, 2022 (the "Kind Acquisition Date"), we acquired Kind Therapeutics USA ("Kind"), our former client in Maryland that holds licenses for the cultivation, production, and dispensing of medical cannabis (the "Kind Acquisition"). The financial results of Kind are included in our condensed consolidated financial statements for the period subsequent to the Kind Acquisition Date.

On May 5, 2022, we completed the acquisition of 100% of the equity ownership of Green Growth Group Inc. ("Green Growth"), an entity that holds a craft cultivation and production cannabis license in the state of Illinois (the "Green Growth Acquisition").

During the balance of 2022 and into 2023, we are focused on continuing to execute our strategic growth plan, with priority on activities that include the following:

- Continuing to consolidate the cannabis business that we have developed and manage.
- Expanding revenue, assets, and our footprint in the states in which we operate:
  - In Massachusetts, we intend to open two additional dispensaries and significantly expand the capacity and capability of our manufacturing facility.
  - In Delaware, we intend to develop an additional 40,000 square feet of cultivation and production capacity at our facility in Milford.
  - In Maryland, we intend to expand our manufacturing facility by 40,000 square feet and open a dispensary in Annapolis.
  - In Illinois, we recently closed on the acquisition of an Illinois craft cannabis license which will enable us to be vertically integrated and add cultivation, manufacturing, and distribution to our four existing retail cannabis operations in Illinois. Under Illinois cannabis laws, we have the potential to add six additional dispensaries, for a total of ten.
- Expanding into other legal states through mergers and acquisitions and by filing new applications in states where new licensing opportunities are available.
- Increasing revenues by producing and distributing our award-winning brands to qualified strategic partners or by acquiring production and distribution licenses.

Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience, knowledge of current conditions and believes of what could occur in the future given available information. If actual results differ significantly from management's estimates and projections, there could be a material effect on our condensed consolidated financial statements. We consider the following accounting policies to be both those most important to the portrayal of our financial condition and those that require the most subjective judgment: accounts receivable, the valuation of inventory, estimated useful lives and depreciation and amortization of property and equipment and intangible assets, accounting for acquisitions and business combinations, loss contingencies and reserves, stock-based compensation, and accounting for income taxes.

Accounts Receivable

We provide credit to our clients in the form of payment terms. We limit our credit risk by performing credit evaluations of our clients and maintaining a reserve, as applicable, for potential credit losses. Such evaluations are judgmental in nature and include a review of the client's outstanding balances with consideration toward such client's historical collection experience, as well as prevailing economic and market conditions and other factors. Accordingly, the actual amounts collected could differ from expected amounts and require that we record additional reserves.

Inventory

The net realizable value of inventories represents the estimated selling price for inventories in the ordinary course of business, less all estimated costs of completion and costs necessary to make the sale. The determination of net realizable value requires significant judgment, including consideration of factors such as shrinkage, the aging of and future demand for inventory, expected future selling price, what we expect to realize by selling the inventory and the contractual arrangements with customers. Reserves for excess and obsolete inventory are based upon quantities on hand, project volumes from demand forecasts and net realizable value. The estimates are judgmental in nature and are made at a point in time, using available information, expected business plans and expected market conditions. As a result, the actual amount received on sale could differ from the estimated value of inventory. Periodic reviews are performed on the inventory balance. The impact of any changes in inventory reserves is reflected in cost of goods sold.

Estimated Useful Lives and Depreciation and Amortization of Property and Equipment and Intangible Assets

Depreciation and amortization of property and equipment and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

Acquisitions and Business Combinations

Classification of an acquisition as a business combination or an asset acquisition depends on whether the assets acquired constitute a business, which can be a complex judgment. Whether an acquisition is classified as a business combination or asset acquisition can have a significant impact on how we record the transaction.

We allocate the purchase price of acquired assets and companies to identifiable assets acquired and liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net amount of the acquisition date fair values of the assets acquired and the liabilities assumed and represents the expected future economic benefits from other assets acquired in the acquisition or business combination that are not individually identified and separately recognized. Significant judgments and assumptions are required in determining the fair value of assets acquired and liabilities assumed, particularly acquired intangible assets, which are principally based upon estimates of the future performance and cash flows expected from the acquired asset or business and applied discount rates. While we use our best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, our estimates and assumptions are inherently uncertain and subject to refinement. If different assumptions are used, it could materially impact the purchase price allocation and our financial position and results of operations. Any adjustments to assets acquired or liabilities assumed subsequent to the purchase price allocation period are included in operating results in the period in which the adjustments are determined. Intangible assets typically are comprised of trademarks and tradenames, licenses and customer relationships, and non-compete agreements.

Loss Contingencies and Reserves

We are subject to ongoing business risks arising in the ordinary course of business that affect the estimation process of the carrying value of asserts, the recording liabilities, and the possibility of various loss contingencies. An estimated loss contingency is accrued when it is probably that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. We regularly evaluate current information available to determine whether such amounts should be adjusted and record changes in estimates in the period they become know. We are subject to various legal claims. We reserve for legal contingencies and legal fees when the amounts are probable and estimable.

Stock-Based Compensation

Our stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized over the requisite service period, which is generally the vesting period. We use the Black-Scholes valuation model for estimating the fair value of stock options as of the date of grant. Determining the fair value of stock option awards at the grant date requires judgment regarding certain valuation assumptions, including the volatility of our stock price, expected term of the stock option, risk-free interest rate and expected dividends. Changes in such assumptions and estimates could result in different fair values and could therefore impact our earnings. Such changes, however, would not impact our cash flows.

Income Taxes

We use the asset and liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are recorded for the future tax consequences of differences between the tax basis and financial reporting basis of assets and liabilities, measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent our management concludes that it is more likely than not that the assets will not be realized. To assess the recoverability of any tax assets recorded on the balance sheet, we consider all available positive and negative evidence, including our past operating results, the existence of cumulative income in the most recent years, changes in the business in which we operate and our forecast of future taxable income. In determining future taxable income, we make assumptions, including the amount of state and federal pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage our businesses.

Results of Operations

Three and six months ended June 30, 2022 and 2021

Revenue

Our main sources of revenue are comprised of the following:

- Product sales (retail and wholesale) – direct sales of cannabis and cannabis-infused products primarily by our retail dispensaries and wholesale operations in Massachusetts, Illinois, and, as of the Kind Acquisition Date, Maryland. We recognize this revenue when products are delivered or at retail points-of-sale.

- Real estate rentals – rental income and additional rental fees generated from leasing of our state-of-the-art, regulatory compliant cannabis facilities to our cannabis-licensed clients. Rental income is generally a fixed amount per month that escalates over the respective lease terms, while additional rental fees are based on a percentage of tenant revenues that exceed specified amounts.

- Management fees – fees for providing our cannabis clients with comprehensive oversight of their cannabis cultivation, production and dispensary operations. These fees are based on a percentage of such clients' revenue and are recognized after services have been performed.

- Supply procurement – resale of cultivation and production resources, supplies and equipment that we have acquired from top national vendors at discounted prices to our clients and third parties within the cannabis industry. We recognize this revenue after the delivery and acceptance of goods by the purchaser.

- Licensing fees – revenue from the sale of our branded products, including Betty's Eddies and Kalm Fusion, and from the sublicensing or contracted brands, including Healer and Tikum Olam, to regulated dispensaries throughout the United States and Puerto Rico. We recognize this revenue when the products are delivered.

Our revenue for the three and six months ended June 30, 2022 and 2021 was comprised of the following (in thousands):

	Three months ended		Six months ended	
	June 30, 2022	June 30, 2021	June 30, 2022	June 30, 2021
Product revenue:				
Product sales - retail	$ 23,087	$ 20,552	$ 44,528	$ 35,776
Product sales - wholesale	7,958	8,178	14,020	13,903
Total product sales	31,045	28,730	58,548	49,679
Other revenue:				
Real estate rentals	846	1,862	2,433	3,671
Supply procurement	820	398	2,010	918
Management fees	81	981	834	1,877
Licensing fees	194	598	443	1,067
Total other revenue	1,941	3,839	5,720	7,533
Total revenue	$ 32,986	$ 32,569	$ 64,268	$ 57,212

Our total revenue increased slightly in the three months ended June 30, 2022 compared to the three months ended June 30, 2021. Our total product revenue increased $2.3 million, primarily attributable to higher retail dispensary cannabis sales in Illinois and the inclusion of Kind's sales in our results since the Kind Acquisition Date. These increases were partially offset by lower retail and wholesale sales in Massachusetts due to increased competition. The decrease in our other revenue was primarily attributable to rent and management fee reductions in connection with one of our customers and the Kind Acquisition, partially offset by higher supply procurement revenue primarily attributable to revenue generated from our cannabis clients in Delaware and Maryland.

Our total revenue increased 12.3% in the six months ended June 30, 2022 compared to the six months ended June 30, 2021. Our total product revenue increased $8.9 million, or 17.9%, primarily attributable to higher retail dispensary cannabis sales in Illinois and the inclusion of Kind's sales in our results since the Kind Acquisition Date. Similar to our quarter-over-quarter results described above, the decrease in our other revenue was primarily attributable to rent and management fee reductions in connection with one of our customers and the Kind Acquisition, partially offset by higher supply procurement revenue primarily attributable to revenue generated from our cannabis clients in Delaware and Maryland.

Cost of Revenue, Gross Profit and Gross Margin

Our cost of revenue represents the direct costs associated with the generation of our revenue, including licensing, packaging, supply procurement, manufacturing, supplies, depreciation, amortization of acquired intangible assets, and other product-related costs.

Our cost of revenue, gross profit and gross margin for the three and six months ended June 30, 2022 and 2021 were as follows (in thousands, except percentages):

			Increase (decrease) from prior year	
	2022	2021	$	%
Three months ended June 30,				
Cost of revenue	$ 17,981	$ 13,163	$ 4,818	36.6%
Gross profit	$ 15,005	$ 19,406	$ (4,401)	(22.7)%
Gross margin	45.5%	59.6%		
Six months ended June 30,				
Cost of revenue	$ 32,287	$ 24,620	$ 7,667	31.1%
Gross profit	$ 31,981	$ 32,592	$ (611)	(1.9)%
Gross margin	49.8%	57.0%		

Our cost of revenue increased in both the three and six months ended June 30, 2022 compared to the three and six months ended June 30, 2021. These higher costs resulted in lower gross margins in both current year periods compared to the same prior year periods. Our higher cost of revenue in the current year periods compared to the same prior year periods was primarily attributable to higher manufacturing, employee-related and supply procurement costs aggregating $4.4 million and $8.9 million, respectively, in the three and six months ended June 30, 2022. These higher costs were primarily attributable to continuing supply chain issues and associated higher shipping costs, coupled with higher employee-related costs principally due to our increased headcount in connection with our recent acquisitions and in-process expansions. These increases in cost and resulting decreases in gross profit resulted in lower gross margins in both current year periods.

Operating Expenses

Our operating expenses are comprised of personnel, marketing and promotion, general and administrative, acquisition-related and other, and bad debt expenses. Our operating expenses for the three and six months ended June 30, 2022 and 2021 were as follows (in thousands, except percentages):

			Increase (decrease) from prior year	
	2022	2021	$	%
Three months ended June 30,				
Personnel	$ 3,382	$ 2,058	$ 1,324	64.3%
Marketing and promotion	809	270	539	199.6%
General and administrative	5,565	4,282	1,283	30.0%
Acquisition-related and other	754	-	754	100.0%
Bad debt	-	794	(794)	(100.0%)
	$ 10,510	$ 7,404	$ 3,106	42.0%
Six months ended June 30,				
Personnel	$ 6,424	$ 3,785	$ 2,639	69.7%
Marketing and promotion	1,452	495	957	193.3%
General and administrative	11,793	7,453	4,340	58.2%
Acquisition-related and other	754	-	754	100.0%
Bad debt	14	1,819	(1,805)	(99.2%)
	$ 20,437	$ 13,552	$ 6,885	50.8%

The increase in our personnel expenses in both the three and six months ended June 30, 2022 compared to the three and six months ended June 30, 2021 was primarily due to the hiring of additional staff to support higher levels of projected revenue from existing operations as well as from the Kind Acquisition. Personnel costs increased to approximately 10% of revenue in both current year periods, compared to approximately 6% of revenue in the same prior year periods.

The increase in our marketing and promotion expenses in both the three and six months ended June 30, 2022 compared to the three and six months ended June 30, 2021 was primarily attributable to our focused efforts to upgrade our marketing initiatives and personnel in order to expand branding and distribution of our licensed products. Marketing and promotion costs increased to approximately 2% of revenue in both current year periods, compared to less than 1% of revenue in the same prior year periods.

The increase in our general and administrative expenses in the three months ended June 30, 2022 compared to the three months ended June 30, 2021 was primarily attributable to $1.3 million of higher stock-based compensation, $0.3 million of higher depreciation and $0.2 million of higher facility-related expenses. These increases were partially offset by $0.5 million of lower professional fees. The increase in the six months ended June 30, 2022 compared to the six months ended June 30, 2021 was primarily attributable to $3.4 million of higher stock-based compensation, a $0.5 million increase in depreciation expense and an increase of $0.3 million in facility-related expenses. General and administrative expenses increased to 16.9% and 18.3% of revenue in the three and six months ended June 30, 2022, respectively, compared to approximately 13% of revenue in both the three and six months ended June 30, 2021.

Acquisition-related and other expenses include those expenses related to acquisitions and other significant transactions that we would otherwise not have incurred, and include professional and services fees, such as legal, audit, consulting, paying agent and other fees. We recorded $0.8 million of acquisition-related and other expenses in both the three and six months ended June 30, 2022, primarily related to the Kind Acquisition and the recent listing of our common stock on the Canadian Securities Exchange. We did not record any acquisition-related and other expenses in the three and six months ended June 30, 2021.

We did not record bad debt expense in the three months ended June 30, 2022, and such expense was nominal in the six months then ended, compared to $0.8 million and $1.8 million in the three and six months ended June 30, 2021, respectively. These decreases are due to the higher reserve balances that were required in 2021 for aged trade receivable balances.

<u>Interest and Other (Expense) Income, Net</u>

Interest expense primarily relates to interest on mortgages and notes payable. Interest income primarily relates to interest receivable in connection with our notes receivable. Other (expense) income, net, includes gains (losses) on changes in the fair value of our investments, and other investment-related income (expense).

Our net interest expense decreased in both the three and six months ended June 30, 2022 compared to the same prior year periods, reflecting our lower debt levels in the current year periods. Our net other expense was $0.7 million and $0.4 million in the three months ended June 30, 2022 and 2021, respectively, and was primarily comprised of losses from the changes in the fair value of our investments. The three months ended June 30, 2021 also included a nominal loss on the extinguishment of debt.

We recorded net other income of $0.3 million in the six months ended June 30, 2022 and net other expense of $0.4 million in the six months ended June 30, 2021. The current year amount is comprised of $1.0 million of non-cash income from an investment, partially offset by a $0.7 million loss from the change in fair value of our investments. The prior year amount is comprised of a $0.4 million loss from the change in fair value of our investments and a nominal loss on the extinguishment of debt.

<u>Income Tax Provision</u>

We recorded income tax provisions of $5.4 million and $5.0 million in the six months ended June 30, 2022 and 2021, respectively.

Liquidity and Capital Resources

We had cash and cash equivalents of $7.9 million and $29.7 million at June 30, 2022 and December 31, 2021, respectively. In addition to the discussions below of our cash flows from operating, investing, and financing activities included here, please also see our discussion of non-GAAP Adjusted EBITDA in the section "Non-GAAP Measurement" below, which discusses an additional financial measure not defined by GAAP which our management also uses to measure our liquidity.

Cash Flows from Operating Activities

Our primary sources of cash from operating activities are from sales to customers in our dispensaries and cash collections from our wholesale customers. We expect cash flows from operating activities to be affected by increases and decreases in sales volumes and timing of collections, and by purchases of inventory and shipment of our products. Our primary uses of cash for operating activities are for personnel costs, purchases of packaging and other materials required for the production and sale of our products, and income taxes.

Our operating activities provided $2.0 million and $17.6 million of cash in the six months ended June 30, 2022 and 2021, respectively. The change in cash from operating activities in the current year period compared to the prior year was primarily attributable to $11.9 million of cash utilized to pay income taxes in the current year period, compared to $0.4 million in the same prior year period, coupled with higher costs and operating expenses arising as we continue to increase and expand our sales activities, facilities and footprint both in the states where we currently operate and into other states.

Cash Flows from Investing Activities

Our investing activities used $20.9 million and $8.5 million of cash in the six months ended June 30, 2022 and 2021, respectively. The increase in cash usage in the current year period was primarily attributable to $12.7 million of aggregate cash consideration paid for the Kind Acquisition and Green Growth Acquisition in April 2022 and May 2022, respectively.

Cash Flows from Financing Activities

Our financing activities used $2.9 million of cash in the six months ended June 30, 2022 and provided $5.3 million of cash in the six months ended June 30, 2021. We paid $2.0 million of cash to redeem the outstanding minority interests in one of our majority-owned subsidiaries in June 2022 and made $0.6 million of aggregate principal payments on our outstanding mortgages and notes payable.

On August 4, 2022, we entered into a Second Amendment to the Purchase Agreement with Hadron pursuant to which, inter alia, (a) Hadron's obligation to provide any further funding to the Company and the Company's obligation to issue any further securities to Hadron was terminated, (b) Hadron's right to appointment a designee to the Company's board of directors was eliminated, and (c) certain covenants restricting the Company's incurrence of new indebtedness were eliminated.

Based on our current expectations, we believe our current cash and future funding opportunities will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next twelve months. The rate at which we consume cash is dependent on the cash needs of our future operations, including our contractual obligations at June 30, 2022, primarily comprised of our outstanding mortgages and promissory notes, as well as our operating leases. Our mortgage and promissory note obligations totaled approximately $23 million at June 30, 2022, with payments aggregating approximately $1 million in the remainder of 2022, $3 million in 2023, $2 million in 2024, $2 million in 2025, $1 million in 2026 and $14 million thereafter. Our operating lease obligations totaled approximately $9 million at June 30, 2022, with payments aggregating approximately $571,000 in the remainder of 2022, $1 million in each of the years 2023 through 2026, and $3 million thereafter. We anticipate devoting substantial capital resources to continue our efforts to execute our strategic growth plan as described above.

Non-GAAP Measurement

In addition to the financial information reflected in this report, which is prepared in accordance with generally accepted accounting principles in the United States ("GAAP"), we are providing a non-GAAP financial measurement of profitability – *Adjusted EBITDA* – as a supplement to the preceding discussion of our financial results.

Management defines Adjusted EBITDA as net income, determined in accordance with GAAP, excluding the following:

- interest income and interest expense;
- income tax provision;
- depreciation and amortization of property and equipment;
- amortization of acquired intangible assets;
- impairments or write-downs of acquired intangible assets;
- stock-based compensation;
- acquisition-related and other;
- legal settlements;
- other income (expense), net; and
- discontinued operations.

Management believes that Adjusted EBITDA is a useful measure to assess our performance and liquidity, as it provides meaningful operating results by excluding the effects of expenses that are not reflective of our operating business performance. In addition, our management uses Adjusted EBITDA to understand and compare operating results across accounting periods, and for financial and operational decision-making. The presentation of Adjusted EBITDA is not intended to be considered in isolation or as a substitute for the financial information prepared in accordance with GAAP.

Management believes that investors and analysts benefit from considering Adjusted EBITDA in assessing our financial results and our ongoing business, as it allows for meaningful comparisons and analysis of trends in the business. Adjusted EBITDA is used by many investors and analysts themselves, along with other metrics, to compare financial results across accounting periods and to those of peer companies.

As there are no standardized methods of calculating non-GAAP measurements, our calculations may differ from those used by analysts, investors, and other companies, even those within the cannabis industry, and therefore may not be directly comparable to similarly titled measures used by others.

Reconciliation of Net Income to Adjusted EBITDA (a Non-GAAP Measurement)

The table below reconciles Net income to Adjusted EBITDA for the three and six months ended June 30, 2022 and 2021 (in thousands):

	Three months ended		Six months ended	
	June 30, 2022	June 30, 2021	June 30, 2022	June 30, 2021
GAAP net income	$ 1,896	$ 7,589	$ 6,137	$ 11,899
Interest expense, net	122	229	272	1,707
Income tax provision	1,750	3,813	5,410	5,017
Depreciation and amortization of property and equipment	850	501	1,552	963
Amortization of acquired intangible assets	285	169	425	346
EBITDA (earnings before interest, taxes, depreciation and amortization)	4,903	12,301	13,796	19,932
Stock-based compensation	2,553	1,244	5,024	1,600
Acquisition-related and other	754	-	754	-
Other expense (income), net	727	371	(275)	417
Adjusted EBITDA	$ 8,937	$ 13,916	$ 19,299	$ 21,949

Off-Balance Sheet Arrangements

We have no 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, revenue, expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Inflation

In the opinion of management, inflation has not had a material effect on our financial condition or results of operations.

Seasonality

In the opinion of management, our financial condition and results of its operations are not materially impacted by seasonal sales.