

4Front Ventures (US OTCQX: FFNTF: \$1.09): Q4/20 Strength; Confident in Long-term Growth Outlook

April 7, 2021

4Front reported proforma Q4/20 earnings results of \$25M in revenues and a \$5.9M adjusted EBITDA. Results for the quarter exceeded our estimates of \$22.4M/\$3.6M. Meanwhile, management reiterated 2021 guidance of between \$170M and \$180M in revenues and \$40M to \$50M in adjusted EBITDA. We remain confident that 4Front can hit and even exceed these targets given a strong start to the year (inclusive of a nice stimulus boost in Q1) and our expectation for accelerating growth from the opening of a Brookline, MA dispensary and the California production facility in Q2.

We continue to view 4Front as one of the best positioned operators in cannabis for growth and margin expansion through the buildout of existing assets in key markets. This is different than most other leading operators which require new licenses and acquisitions to hit growth targets. 4Front's execution is now primarily within management's control. Furthermore, we are confident that growth in 2021 is only the beginning for 4Front with looming opportunities coming in 2022 and beyond as the company scales its California operation and with the "Big Daddy" Illinois cultivation and production facility coming online. Longer term, we believe 4Front's targeted revenues and adjusted EBITDA of \$650M and \$250M respectively are very much in play. Our estimates are unchanged for now and we reiterate our Buy rating and \$2.00 price target.

Q4/20 outperformance; maintains full year guidance

Q4/20 results exceeded our estimates on both revenues and adjusted EBITDA. Revenue outperformance reflected strong sales at new recreational dispensaries in Massachusetts and Illinois as well as continued steady growth in Washington with the company's core wholesale operations. Meanwhile, the adjusted EBITDA outperformance included lower than expected OPEX spending as management continue to cut costs where possible. Looking ahead, with management reiterating 2021 guidance we leave our estimates unchanged for now however we believe an upward revision could be forthcoming given a strong Q1/21. While management did not give specific color on Q1/21 results, the company did record quarterly revenues in the quarter. We believe sales at the company's Calumet, IL dispensary exceeded expectations and we expect 4Front like many other operators benefitted from a boost in sales from stimulus payments.

Looking beyond Q1/21, we continue to expect strong second half growth with the opening of the company's Brookline, MA (adjacent to Boston) dispensary and the California production facility representing significant incremental growth drivers. Additionally, 2021 will see a full year of recreational sales from 4Front's other two Massachusetts dispensaries which opened in 2H/20 and the company's two Illinois stores (Chicago store was closed throughout the summer due to protest related damage and Calumet store opened near Indiana border in December). In terms of profitability we continue to expect margin expansion as the year progresses with 4Front benefiting from opex leverage and a greater proportion of revenues from vertically integrated sales (in IL and MA).

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4Front Ventures
Rating: Buy
Price Target: \$2

Investment Highlights

- Q4/20 outperformance with proforma results. Maintains full year 2021 guidance.
- Anticipate 2H/21 strength on opening of 3rd MA rec dispensary and CA production facility.
- Continue to expect 2021 to be just the beginning of growth with CA ramping and IL production facility coming online.
- Capitalized for additional growth opportunities.

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Illinois Capacity Expansion underway

Last month, 4Front announced plans to buildout its long-discussed “Big Daddy” cultivation facility in Illinois. In collaboration with Innovative Industrial Properties (IIPR), 4Front will develop a 558K sq. foot cultivation and production facility. IIPR will acquire the land for \$6.5M and fund the \$45m buildout of phase one of the facility (258K sq. feet). For its part, 4Front will lease the facility from IIPR through a twenty-year lease agreement with ten years of extension potential.

The phase one buildout will give 4Front roughly 65K sq. feet of cultivation (vs. current footprint of 9K today) and 70K of manufacturing space. The expanded production capabilities will allow 4Front to sell a greater proportion of house brands at its two Illinois dispensaries while also becoming a wholesaler in the state. The phase one buildout is expected to commence within the next few months and be completed in late 2022. 4Front is licensed for up to 210K sq. ft of flowering canopy in Illinois (one of only 20 full license holders) so the expanded production capabilities from phase one are likely just the beginning of expansion initiatives. Based on attractive pricing dynamics in the state and 4Front’s expertise as a leading low-cost producer, we believe the Illinois facility will quickly become a top asset in the industry. Management has stated that a fully built-out facility would can generate between \$300M and \$350M in revenues with the phase one expansion providing roughly \$100M worth of sellable product for use in either wholesale operations or to become more so vertically integrated in the state.

New Jersey could present an expansion opportunity

As we previously mentioned, 4Front, applied for a vertically integrated license in New Jersey in 2019. A lawsuit regarding that process involving other operators resulted in that license application as well as those of other operators to remain in limbo since with the state halting the issuance of any new licenses. A February ruling by the New Jersey supreme court removed the stay on new licenses and again 4Front’s application is to be reviewed. We expect a resolution to the licensing process to come within the next month or two.

Prior to becoming an operator, itself, 4Front was a consultant to early cannabis operators helping them obtain licenses. The company was successful in obtaining sixty licenses across numerous states, so it is safe to assume that 4Front’s New Jersey application was viable.

We are watching the license review process carefully as the opportunity could become significant for 4Front. As applications are reviewed, 4Front is likely to have as good a shot as any operator to receive licenses which could be valuable given the dearth of existing operators in the state and the significant forecasted growth with the kick-off of recreational sales in the near term. The license in question would permit 4Front the ability to open a medical dispensary and a cultivation footprint up to 30K sq. feet. As has occurred in most markets, upon the state’s flip to rec, existing medical license holders will likely be given early mover advantages toward the receipt of rec licenses. If 4Front receives a license but chooses not to buildout the assets, the company could sell the license for a likely premium price. New Jersey exposure is very sought after amongst the leading MSOs.

Dry powder remains for further growth initiatives

4Front generated positive cash from operations in Q4/20 and has been a positive cash generator since summer 2020. 4Front ended Q4/20 with roughly \$19M in cash (with ~\$9M earmarked for the California facility). We expect the company to generate ~\$21M in cash this year despite first half investment to open the new Massachusetts dispensary and the California production facility.

4Front’s cash position leaves management with ample dry powder to complete small to medium scale expansion initiatives that might come available in the near term while we note that IIPR could again be a source of non-dilutive financing to support more aggressive additional expansion initiatives moving forward. The IIPR agreement is 4Front’s second in the past three months (completed \$33M sale lease back in December). In the near term, we would expect the most likely significant expansion initiatives for 4Front would be to build out the company’s Massachusetts cultivation footprint further to launch a wholesale business in the state (currently 15K sq. ft of canopy but licensed for 100K) or for further scaling of Michigan and California operations.

We reiterate our estimates and price target

- Revenues: Q1/21E remains \$31.8M; 2021E remains \$170M; 2022E remains \$252M.
- Adjusted EBITDA: Q1/21E remains \$3.6M; 2021E remains \$44.9M; 2022E remains \$101M.

Our \$2.00 price target reflects an EV/Sales multiple of 6.1x our 2022 estimate and EV/EBITDA of 15.1x.

FY Income Statement (\$M)

	2021					2022				
	Q1 '21E Mar-21	Q2 '21E Jun-21	Q3 '21E Sep-21	Q4 '21E Dec-21	2021 Dec-21	Q1 '22E Mar-22	Q2 '22E Jun-22	Q3 '22E Sep-22	Q4 '22E Dec-22	2022 Dec-22
Revenue	31.8	42.8	47.9	47.5	170.0	53.2	67.2	67.3	64.0	251.7
Gross Profit	19.1	26.5	30.2	29.9	105.7	33.5	43.3	44.0	42.1	163.0
						20%	16%	16%	17%	17%
Sales & Marketing	9.6	10.0	11.0	11.0	41.6	10.8	10.9	10.9	10.9	43.5
G&A	4.3	4.3	4.5	4.5	17.6	4.5	4.6	4.6	4.6	18.3
Depreciation	0.9	0.9	0.9	0.9	3.6	0.9	0.9	1.0	1.0	3.8
Stock based Comp	1.5	1.5	1.5	1.5	6.0	1.5	1.5	1.5	1.5	6.0
Opex	16.3	16.7	17.9	17.9	68.8	17.7	17.9	18.0	18.0	71.6
Income from operations	2.8	9.8	12.3	12.0	36.9	15.9	25.4	26.0	24.1	91.4
Total Other Income	(5.2)	(5.7)	(5.7)	(5.7)	(22.3)	0.0	0.0	0.0	0.0	0.0
Pre-tax Income	(2.4)	4.1	6.6	6.3	14.6	15.9	25.4	26.0	24.1	91.4
Taxes	2.0	2.0	2.0	2.0	8.0	2.0	2.0	2.0	2.0	8.0
Discontinued Operations										
NCI										
Net Income	(4.4)	2.1	4.6	4.3	6.6	13.9	23.4	24.0	22.1	83.4
EPS	(0.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Shares	523.2	525.8	528.4	531.1	527.1	533.7	536.4	539.1	541.8	537.7
Adjusted EBITDA	4.8	11.8	14.3	14.0	44.9	18.2	27.8	28.5	26.6	101.2
<u>% Revenues</u>										
Gross Margin	60%	62%	63%	63%	62%	63%	65%	65%	66%	65%
Sales & Marketing	30%	23%	23%	23%	24%	20%	16%	16%	17%	17%
G&A	14%	10%	9%	9%	10%	8%	7%	7%	7%	7%
Tax Rate	-83%	48%	30%	32%	55%	13%	8%	8%	8%	9%
Opex	51%	39%	37%	38%	40%	33%	27%	27%	28%	28%
Operating Income	9%	23%	26%	25%	22%	30%	38%	39%	38%	36%
Net Income	-14%	5%	10%	9%	4%	26%	35%	36%	35%	33%
Adjusted EBITDA	15%	28%	30%	29%	26%	34%	41%	42%	42%	40%
<u>Growth Rates</u>										
<u>Revenues</u>										
Y/Y	108%	-25%	51%	11%	196%	67%	57%	41%	35%	48%
Q/Q	108%	35%	12%	-1%		12%	26%	0%	-5%	

Source: Company Reports, Viridian Capital Estimates

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			Count	Percent
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Not Rated (NR)	0	0%	0	0%

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