

4Front Ventures (US OTCQX: FFNTF: \$1.11): Attractive Growth Outlook In-Tact; Meaningful Acquisition News Looms

August 17, 2021

4Front reported lower than expected Q2/21 results with proforma revenues and adjusted EBITDA of \$34.4M/\$7.5M coming in below our estimates of \$42.8M/\$11.8M. The full year outlook though remains intact with guidance of \$170M to \$180M in revenues and adjusted EBITDA in the range of \$40M to \$50M maintained despite delayed openings of 4Front's Brookline, MA dispensary (Greater Boston) and the California production facility. We expected each to open in early July with the dispensary now set to open this week and the production facility coming online in the next few weeks. We are confident that each will be a meaningful contributor to an anticipated 2H ramp in results, particularly in Q4. In fact, we now believe the California facility will be a more significant contributor in the second half than previously expected due to 4Front's distribution relationship with Nabis (a leading CA distributor servicing >750 dispensaries) and on favorable flower pricing dynamics in the state. Lower bulk California flower pricing allows 4Front to buy distillate cheaper and generate higher margins with finished concentrates products sold. Meanwhile, we believe strong demand at 4Front's Illinois dispensaries this summer offsets lost contributions from new assets. We adjust our estimates to meet the low end of guidance while noting that any further issue with the openings in Brookline or California will challenge our '21 outlook.

Long-term Growth Outlook In Tact

Despite the Q2 miss and 2021 questions, we remain positive on 4Front and maintain our Buy rating and \$2 price target based on the company's attractive growth opportunity. During the investor call, management highlighted the upcoming ground breaking on 4Front's Illinois cultivation project (initial phase will be a 250K cultivation and production facility to open in early '23 and enabling 4Front to be the preeminent wholesaler in the state), a potential license receipt in New Jersey and a non-dilutive capital commitment from Navy Capital to finance a proposed accretive acquisition. We believe each of these initiatives can be meaningful and in the case of the acquisition and New Jersey license be incremental to 4Front's long term targets of roughly \$650M in annual revenues and \$250M adjusted EBITDA to be derived from core markets.

Meaningful Acquisition News Looms

While not providing specifics on the potential acquisition, management highlighted plans to acquire an accretive asset which will meaningfully boost the company's position within an existing core market. In our view, this acquisition is likely a cultivation facility in Massachusetts permitting 4Front to quickly expand to the full 100K sq. feet of flower canopy and once again to be a wholesaler in the state. We would be positive on any transaction of this nature as it would align with 4Front's core competencies of being a low-cost producer of cannabis and capitalize on the favorable pricing dynamics that we expect to persist in Massachusetts. We will be closely monitoring any news related to a transaction.

Along with the planned acquisition, management also discussed the potential of partnering with a larger MSO in the space longer term. As previously stated, we believe consolidation of even larger operators like 4Front will become a trend in the near term given the strong capital position of the largest MSOs and because the lack of near term federal legislation blocks otherwise quick expansion. We believe the company would be a viable candidate for any well-run operator to consider given its attractive footprint and cultivation/production expertise. For investors, any consolidation would likely offer significant upside from current levels.

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4Front Ventures

Rating: Buy

Price Target: \$2.00

Investment Highlights

- Q2/21 miss vs. our estimates.
- Full year guidance maintained. Guidance calls for sharp 2H ramp led by CA production facility and Brookline, MA dispensary openings.
- Long term growth opportunity remains favorable.
- Construction on Illinois cultivation facility underway.
- Looming meaningful acquisition news with financing in place.
- Partnership with larger MSO on the table.

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Maintain full year estimates and price target

- Pro-forma Revenues: Q3/21 from \$47.9M to \$50.8M; 2021E remains \$170M; 2022E remains \$252M..
- Pro-forma Adjusted EBITDA: Q3/21 from \$14.3M to \$15.6M; 2021E remains \$44.5M; 2022E remains \$101M.

Our \$2 price target reflects an EV/EBITDA multiple of 15.1x our 2022 estimate.

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	34.4	50.8	53.0	170.0	53.2	67.2	67.3	64.0	251.7
Gross Profit	19.1	21.7	31.5	32.9	105.1	33.5	43.3	44.0	42.1	163.0
Sales & Marketing	9.6	9.0	11.0	11.8	41.4	10.8	10.9	10.9	10.9	43.5
G&A	4.3	4.2	4.5	4.6	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	15.6	17.9	18.8	68.6	17.7	17.9	18.0	18.0	71.6
Income from operations	2.8	6.1	13.6	14.1	36.5	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)	0.4	7.9	8.4	14.2	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)	(1.6)	5.9	6.4	6.2	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	8.1	15.6	16.1	44.5	18.2	27.8	28.5	26.6	101.2
<u>% Revenues</u>										
Gross Margin	60%	63%	62%	62%	62%	63%	65%	65%	66%	65%
Sales & Marketing	30%	26%	22%	22%	24%	20%	16%	16%	17%	17%
G&A	14%	12%	9%	9%	10%	8%	7%	7%	7%	7%
Tax Rate	-83%	520%	25%	24%	56%	13%	8%	8%	8%	9%
Opex	51%	45%	35%	35%	40%	33%	27%	27%	28%	28%
Operating Income	9%	18%	27%	27%	21%	30%	38%	39%	38%	36%
Net Income	-14%	-5%	12%	12%	4%	26%	35%	36%	35%	33%
Adjusted EBITDA	15%	23%	31%	30%	26%	34%	41%	42%	42%	40%
<u>Growth Rates</u>										
Revenues										
Y/Y	108%	-40%	60%	54%	196%	67%	95%	32%	21%	48%
Q/Q	108%	8%	48%	4%		0%	26%	0%	-5%	

Source: Company Reports, Viridian Capital Estimates

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			Count	Percent
Buy (Buy)	9	100%	0	0%
Hold (Hold)	0	0%	0	0%
Sell (Sell)	0	0%	0	0%
Not Rated (NR)	0	0%	0	0%

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