

## 4Front Ventures (US OTCQX: FFNTF: \$1.03): Favorable Growth Outlook intact Despite Near-term Headwinds

Last night, 4Front reported Q3/21 pro-forma earnings results of \$33.1M in revenues and \$7.5M adjusted EBITDA. Pro-forma results for the quarter came in below our estimates of \$41M/\$10.6M on a greater than anticipated drag from the delayed opening of 4Front's new Commerce, CA production facility and the Brookline, MA dispensary. Both had been expected to open in the early summer however in the quarter 4Front got only a month of dispensary contributions and nothing from the production business as the facility did not open until October. We expect California production to quickly be a meaningful contributor for 4Front given the scale of the operation (170K sq. feet), the established distribution relationship with Nabis, a leading distributor in the state, and management's proven track record as a low-cost producer of branded cannabis products. Furthermore, we note that bulk flower pricing declines in California make 4Front's production business a higher margin opportunity as production is ramped. Input prices have declined by as much as 30-40% in recent months while manufactured product prices have stayed steadier as manufactured products slowly take back share from flower.

We reduce our estimates to reflect the Q3 miss and management commentary that full year results will fall below guidance (\$170M to \$180M in revenues and \$40M to \$50M in adjusted EBITDA). We expect some headwinds to linger into 1H/22 as 4Front ramps the new California operation and brings on the acquired Massachusetts cultivation and production business. Never-the-less even after our estimates cut, we forecast strong top-line growth and margin expansion in 2022 and beyond. We continue to expect 2023 to be the year that growth initiatives truly come into play. Our rating remains Buy and our price target at \$2.00.

### Long term Growth Opportunity Remains Favorable

As highlighted in a recent note on 2023 valuations in US cannabis, we believe 4Front has one of the more attractive longer-term growth opportunities of any MSO based on existing core operations. In addition to California, 4Front has a looming acquisition of an operational 55K sq. feet cultivation and production facility in Massachusetts and is in the process of building out its "Big Daddy" cultivation project in Illinois (phase one to be 250K). The facility will be complete in late 2022. The Massachusetts acquisition is expected to close by early 2022 and be accretive to 2022 EBITDA. We also expect additional expansion of the facility is forthcoming allowing 4Front to get to the state's permitted 100K sq. feet canopy.

We are confident that both the Massachusetts cultivation expansion and the Illinois buildout can drive significant revenue growth while aligning with 4Front's proven core competencies of low cost production and wholesale operations. Given anticipated favorable pricing dynamics in both states, we expect the expanded capacity will translate to meaningful profitable growth for 4Front with product being sold through wholesale channels and owned dispensaries.

Our 2022 forecasts for 4Front represent ~35% of the company's longer-term targets within existing markets (revenues: \$650M and adjusted EBITDA at \$250M). While not yet publishing estimates, we are confident that 2023 will make up much of that difference in large part on contributions from Massachusetts and Illinois wholesale operations. Beyond these announced expansions, we expect growth to come from continued execution in core markets and anticipate additional acquisitions could be coming in both core and expansion markets. In particular within existing markets, we expect a focus will be on additional cultivation assets in Massachusetts and possibly retail assets in Illinois.

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### 4Front Ventures

**Rating: Buy**

**Price Target: \$2**

### Investment Highlights

- Q3 earnings miss on later than anticipated opening of CA production facility and delayed rollout of new MA dispensary.
- Management no longer expects '21 guidance is attainable.
- CA flower pricing declines a benefit for production business.
- 2022 and long-term growth outlook unchanged. True growth opportunity comes into play in '23 in our view.
- Looming acquisition closure in MA and Chicago cultivation facility buildout to present sizable growth opportunities in attractive wholesale markets.
- Expect additional tuck in acquisitions in coming months.
- Believe a takeout candidate by large MSO.

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## Potential Consolidation Target

Management continues to discuss consolidation in US cannabis. In the near term, we expect 4Front to seek out additional assets in core markets for acquisition while longer term we believe the company is positioned for a potential takeout by a larger MSO. As we have discussed, large scale M&A has become more common place in US cannabis in recent months and we believe consolidation of even larger operators like 4Front is likely given the strong capital position of the largest MSOs and because the lack of near term federal legislation blocks otherwise rapid multi-state expansion. Furthermore, as an additional motivant, for the largest MSOs we continue to believe that large scale plug and play acquisitions are the only reasonable path to excite investors in the short term and enhance valuations from the currently depressed levels.

We are confident that 4Front is an attractive candidate for any well-run operator to consider given its footprint in large and growing markets (CA, IL, MA, MI and WA) and proven cultivation/production expertise. We believe likely acquisition partners for 4Front would likely include large MSOs with overlapping geographic footprint or plans for expansion in these states along with a proven track record of either branded products development or retail operations. For investors, any consolidation would likely offer significant upside from current levels.

## We revise our estimates and reiterate our price target

- Pro-forma Revenues: Q4/21E from \$55M to \$38M; 2021E from \$162.2M to \$137.3M; 2022E from \$252M to \$241.2M.
- Pro-forma Adjusted EBITDA: Q3/21E from \$16.7M to \$8.9M; 2021E from \$40.1M to \$29.2M; 2022E from \$101.2M to \$82.3M

Price target: Our \$2 price target represents an EV/EBITDA multiple of 18.7x 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
<b>Revenue</b>	<b>31.8</b>	<b>34.4</b>	<b>33.1</b>	<b>38.0</b>	<b>137.3</b>	<b>49.2</b>	<b>58.2</b>	<b>67.8</b>	<b>66.0</b>	<b>241.2</b>
Gross Profit	19.1	21.7	21.2	24.3	86.2	31.0	36.7	42.7	42.2	152.6
Sales & Marketing	9.6	9.0	9.0	10.0	37.6	11.3	11.4	11.6	11.4	45.7
G&A	4.3	4.2	4.3	5.0	17.8	6.0	6.0	6.3	6.3	24.6
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	15.7	17.4	65.0	19.7	19.8	20.4	20.2	80.1
Income from operations	2.8	6.1	5.5	6.9	21.2	11.3	16.9	22.3	22.0	72.6
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	(0.2)	1.2	(1.1)	11.3	16.9	22.3	22.0	72.6
Taxes	2.0	2.0	2.0	2.0	8.0	2.0	2.0	2.0	2.0	8.0
Net Income	(4.4)	(1.6)	(2.2)	(0.8)	(9.1)	9.3	14.9	20.3	20.0	64.6
EPS	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	0.0	0.0	0.0	0.0	0.1
Shares	523.2	525.8	528.4	531.1	527.1	533.7	536.4	539.1	541.8	537.7
<b>Adjusted EBITDA</b>	<b>4.8</b>	<b>8.1</b>	<b>7.5</b>	<b>8.9</b>	<b>29.2</b>	<b>13.7</b>	<b>19.3</b>	<b>24.8</b>	<b>24.5</b>	<b>82.3</b>
<u>% Revenues</u>										
Gross Margin	60%	63%	64%	64%	63%	63%	63%	63%	64%	63%
Net Income	-14%	-5%	-7%	-2%	-7%	19%	26%	30%	30%	27%
Adjusted EBITDA	15%	23%	23%	23%	21%	28%	33%	37%	37%	34%
<u>Growth Rates</u>										
Revenues										
Y/Y	108%	-40%	4%	10%	139%	55%	69%	105%	74%	76%
Q/Q	108%	8%	-4%	15%		29%	18%	16%	-3%	

Source: Company Reports, Viridian Capital Estimates

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			Count	Percent
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