4Front Ventures

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Josh Rosen, Chief Executive Officer

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CONFERENCE CALL PARTICIPANTS

Pat Sullivan, Eight Capital

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Doug Cooper, Beacon Securities

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PRESENTATION

Operator:

Greetings, and welcome to the 4Front Ventures Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Whit Richardson, VP of Public and Investor Relations for 4Front Ventures. Thank you, you may begin.

Whit Richardson:

Thank you, Michelle. Welcome everybody to 4Front Ventures earnings call for the third quarter of 2019 ending September 30. The Company released its financial results for the quarter on November 29. On today's call, I'm joined by CEO Josh Rosen, Kris Krane, President of 4Front and Mission, it's retail division, and Brad Kotansky, 4Front's Chief Financial Officer.

Before we begin, I'm obligated to remind everyone that during the course of this conference call, Management may be making some forward-looking statements which are based on current expectations and are subject to a number of risks and uncertainties that may cause actual results to differ materially from expectations. These risks are outlined in the Risk Factors section of our filings and our disclosure materials. Any forward-looking statements should be considered in light of these factors. Please also note as a Safe Harbor, any outlook we present is as of today and Management does not undertake any obligation to revise any forward-looking statements in the future.

With that out of the way, I'd like to now hand the call over to CEO, Josh Rosen.

Josh Rosen:

All right, thanks Whit. I want to start by offering an outline of this morning's call. I'm going to get started with a business update, including an overview of our accomplishments in the first four months of the combined Company. We'll be highlighting the incredible effort of our team to complete our integration with Cannex and then overview our plans for accelerating growth in 2020. Then, I will discuss our perspective on our growth opportunities in the more restrictive capital market environment that we currently find ourselves in, as well as introduce more formal financial guidance. Then, our CFO, Brad Kotansky is going to provide details on our financial performance and greater visibility on our cash planning and capital allocation. He's also going to provide an update on our wellness brand, Pure Ratios, which he's been instrumental in integrating and supporting. After Brad, I'll add a few more comments before giving the line to our President, Kris Krane. Kris is going to provide his lens on the industry regulatory environment before we wrap up with questions.

Starting with our business update, our team remains laser focused on controlling what we can control. In that regard, I couldn't be prouder of what we've been able to accomplish over the first four months as a merged Company. We are operating as three business units supported by a corporate parent, those being Brightleaf, which is our cultivation and processing business, this is run by the former Cannex team; Mission, as we outlined, that's our retail business; and then Pure Ratios, our wellness brand. Each has been streamlined for empowerment at the division and location level while supported by our corporate infrastructure at 4Front for finance, HR, and communication. We're rapidly growing business, so we will continue to evolve, but our integration is effectively complete.

An initial focus for us was the optimization of cultivation and manufacturing capabilities in Massachusetts. This was one of the fundamental reasons for merging with Cannex, the power of replicating battle tested, low-cost cultivation and manufacturing capabilities that had been honed in Washington State. Post-merger, a top priority for us was proof of concept; that is, proving that these best practices can be replicated outside of Washington, and the early results in Massachusetts have been fantastic. The first harvest in Massachusetts, we've seen strong yield improvements in Georgetown and then initial yields in our Worcester facility. We've also introduced the first Cannex brands to the State of Massachusetts and we continue to work on preparations for rec approval in Massachusetts.

We also have construction moving swiftly in Commerce, California and preparations to go live late in the first quarter in our 190,000 square foot manufacturing center. More on this specifically later.

Pure Ratios is making tangible progress, something Brad will give more of an update on in his remarks, and then we continue to make preparations to go live for rec in Illinois and Michigan as we enter 2020. This includes working to finalize the second retail location in Illinois.

Switching from operations to the capital markets, although one wouldn't know it by stock prices, we believe the fundamental industry picture is as compelling as it's ever been. As Chris will get into, the country and the world continue to march towards legalizations. Along those lines, our investment thesis has remained constant and I believe is aligned with the core of our major investors that we regularly speak with. We're building a great company to be best prepared for U.S. legalization and the introduction of U.S. institutional capital that's still on the sidelines today.

Our industry thesis rests upon our belief that execution with a focus on low-cost production and supply chain management should result in the creation of significant shareholder value, and we're focused on providing industry leadership particularly when it comes to driving efficient quality production. We don't prioritize brands to the degree that many others do during this immature supply chain cycle of the industry.

For those that have been following us for a while, you likely recall our Risk versus Monopoly analogy, which I'm happy to see is starting to be repeated by others in this space. We haven't viewed this as a game of Monopoly or pure land grab, we have been more deliberate about building our platform. In many ways, we at 4Front zigged while the industry zagged. We merged with the best low-cost producer of cannabis products that we could find in Cannex and, more specifically, a team that's developed multiple highly efficient cannabis facilities that have demonstrated performance at scale. We did this instead of acquiring greater and greater amounts of total addressable market that often requires significant amounts of new capital and bandwidth. We went to a less attractive end market because we believe the capabilities are most important to success.

While the stock price under pressure is not something we'd prefer, we believe the increased discipline across the industry plays to our strengths and is what we're built for. We're a growth company and the current environment is one where the rational approach is to roll up your sleeves and optimize spending. We're not planning layoffs or big spending cuts. We didn't over-extend to begin with, but as realists we have adjusted our near-term spending plans, and we will get into some of those specifics. The reality is the cost of capital has become more expensive and while we remain confident in our access to capital, as noted in our press release, we think it's in our shareholders best interest to take an even more measured approach to spending in the current environment.

I want to quickly refresh on our four pillars, the first one being battle-tested operating capabilities. This is our foundation and, as noted, a key part of our industry thesis. It's worth a quick reminder as to how this manifests in the State of Washington. In an investment environment that has shifted to viewing things as half empty as opposed to half full, it's easy to forget that our team built an operation that earns health returns in a highly competitive price environment. Yes, you can make money in this industry even when prices are a fraction of what they are in supply-constrained markets. We're not building 4Front on hope but on experience and battle scars, and we believe we have de-risked execution to stand up new facilities as well as improve existing facilities.

It would be hard to overstate how important I think this de-risking is when you look at how much capital is needed to support new cultivation and manufacturing supply. I'd argue much of what's been constructed has been constructed relatively poorly, often from inexperience, particularly when it comes to scale. We're seeing how these capabilities play out in Massachusetts, as I referenced, and also in our California go-to-market planning when contrasted with the price points we've seen produced in Washington. I'll have more on this coming. Just over a month ago, we also shared some of the early yield data in Massachusetts, and the one anecdote I'd add is we've just seen those numbers get better as time has gone one.

The second pillar is our committed and aligned leadership team. The skin in the game from our team is real and we are in this to drive value by building a great business, not just a great story or fancy brands but a cash flow and sustainable business. While I can't speak directly to the intentions of our leadership around incremental stock purchases, I can tell you I've received a lot of inquiries about when our executive blackout period comes to an end.

Our third pillar is our strategic asset base. This ties into our Risk versus Monopoly analogy. We are well positioned in a few key states implementing adult use legalization. As we optimize our near-term planning, a couple of states in particular allow us to demonstrate meaningful progress without needing large amounts of incremental capital. For us, that's Massachusetts and California as the near term priorities, enabling us to retain significant optionality should the cost of capital become less constraining to expand within our existing footprint, and we remain particularly excited about Illinois and then Michigan.

Our fourth pillar is our commitment to being a magnet for talent, which I'm going to save to discuss in greater detail for another call. Suffice it to say we are making progress on this front, but it's much less tangible.

Turning to the reality of the capital markets, the current environment today, in many ways I view this as a good discipline for our industry. It's quickly slowing down some of the excesses in the market (inaudible) ramifications for all players. For us, the focus turns to getting to cash flow positive in 2020 with a demonstration of the battle-tested operating capabilities in second, third and fourth markets. We believe this is achievable by the second half of 2020, that being the cash flow inflection. After spending more time on the road with our Washington-based ops team, I can't wait to have more tangible data points to share with our stakeholders as these capabilities manifest in additional operations. It's the culmination of making this all very real.

Based upon this focus on profitability and a thorough review of our projects, we have optimized our near term plans to focus on what we refer to as our base case, and this is what we are providing guidance around. You'll note the base case does include some incremental capital needs, specifically $30 million, and we continue to evaluate the optimum mix of debt, equity and real estate finance to both minimize dilution and maintain flexibility to become more aggressive should the cost of capital become more attractive. As of the end of November, we had approximately $13 million in available cash and loan commitments and I look forward to providing some updates on this shortly.

Our leadership team is aligned with shareholders and we care about dilution. As realists, I don't think now is the time to aggressively take dilution to support big capital projects. Our team, as well as our more modest footprint, serves us very well in this environment.

Turning to the base case guidance, for 2020 we're guiding to pro forma system-wide revenue of $140 million to $180 million with reported revenue of $100 million to $140 million, and then Adjusted EBITDA in 2020 of $10 million to $15 million, and again crossing into positive, cash flow positive Adjusted EBITDA in the second half of 2020—and the positive cash flow from operations, I would clarify. For 2021, pro forma system-wide revenues of $250 million to $300 million with reported revenue of $200 million to $250 million, and then Adjusted EBITDA guidance for 2021 of $45 million to $50 million.

I'm now going to hand the line over to Brad who will provide more details on our financial performance.

Brad Kotansky:

Thanks Josh. I'll quickly go through our reported numbers for Q3. System-wide pro forma revenue, a non-IFRS measure, was $16.9 million, an increase of more than 20% over the previous quarter's $14 million. IFRS reported revenue was $7.5 million. Adjusted EBITDA, a non-IFRS number, was a loss of $4.6 million. As Josh already mentioned, the Company ended the quarter with $12.4 million of cash and anticipates ending November with approximately $13 million in available cash and undrawn loan commitments.

As Josh already discussed, we believe two of our greatest strengths include our operational expertise and our deep rooted industry knowledge and relationships. These two strengths allow us to find and evaluate the best opportunities in the industry and then operate them effectively, even in the toughest of markets. In addition, we believe our third greatest strength is our financial discipline. Financial rigor is built into almost every process and decision we make. We analyze every aspect of our business to make sure all our capital allocation decisions meet our minimum hurdles and are reflective of the state of the capital markets as well as the overall business environment.

Let me give some examples to show you how we operate internally on a weekly, monthly and quarterly basis. Every department at the Company has its own operating budget that is put together by the group heads and approved by the Management Team. We have weekly cash forecast meetings to discuss how all our basis lines are performing relative to our forecasts. This allows us to catch any deviations from plan early and forces constant analysis on all our projects. Fiscal discipline is part of our process. We can scale up or down our capital projects almost on the turn of a dime We have monthly calls with our construction teams to make sure projects are coming in on time and on budget, and discuss the status of future state projects as well.

Now, why do I say this? If the capital markets remain constrained, we're ready. In fact, we're prepared even if the operating environment gets worse, because we're built on discipline. Equally as importantly, we are ready for when the operating environment does improve. The key for us is to be patient and put ourselves in the best position to take advantage of whatever situation we find ourselves in, in the future without taking the unnecessary risk.

I'm now going to switch over to Pure Ratios. We've spent the past several months working closely with the Pure Ratios team since the acquisition in June of this year and have been fully integrated with them for several months now. We are absolutely thrilled about the progress made so far, and I'll highlight a couple of important developments.

First, we've moved production of all products to two contract manufacturers. Previously most of the products were being manufactured in house. This will allow us to drastically reduce new product development time going forward from months to under one month for new products. It will also allow the business to scale to tens of millions of dollars of revenue per month, something that we were not capable of doing beforehand. The sales and marketing team has now been increased to 10 people to capture the demand that we are seeing.

Given the asset-light nature of Pure Ratios' business, the high margin profile and strong demand indicators, we are very excited about this business as we move into 2020. We look forward to sharing more of these details on the Company's progress early in the coming year.

Josh Rosen:

All right, thanks Brad. Thank you additionally for the implementation of—kind of taking that discipline to the next level for us internally.

I want to take a moment to provide a few anecdotes regarding California. It's a market I've grown increasingly excited about for us after admittedly pushing back on the Cannex team early on when it came to prioritizing California. I think it's easy to anecdotally think of California as a competitive market like Washington or Oregon. I now fully see the wisdom of pursuing this market with our capability set.

To set the stage, we're not planning on cultivating or growing in California but rather have prioritized a large-scale finished goods manufacturing facility in metro L.A. These post-harvest through packaging capabilities are what we believe we're the strongest in the industry at.

The first data point I'd share as one of the big challenges in California is the illicit often prices much less expensively than the regulated market. Anecdotally, we're hearing sometimes it's half the price to the customer. We think this represents a strong opportunity to bring more of the illicit market onto the regulated market with pricing leadership. It's more about taking share from the illicit market than it is about taking share from the competitors you'd naturally think of. We think our go-to-market strategy can accomplish this.

The second aspect of the California market that is particularly intriguing for us is the depth of the market, given its size, allows us to plan for greater automation, and we think the wholesale pricing of our brands in Washington would generally already put us in a price leadership position in California, sometimes comfortably so. This is what's been most exciting to me because it's dealing with real data in Washington and California.

Last, our marketing team won't love this part from me as this is not how we will articulate our brands to consumers, but it's how I like to explain our go-to-market strategy. We internally call it Better, Cheaper, and Better. In other words, we want consumers to have been told it's a better product but at a more attractive price, so it's an easy decision to make at the point of purchase. The first buy decision is easy, and then when they experience the product, they will come back to the Better part, so Better, Cheaper, and Better.

Another personal note for me, and that's my personal excitement around Pure Ratios, owing mostly to the incredible anecdotal feedback I continue to hear about the usefulness of their patch products in particular. I've come to note internally that we should be thinking of the patch as the killer app from a form factor standpoint, and I've seen the Pure Ratios team grow tremendously under CEO Chad Conner's leadership with a strong assist from the support of our CFO, Brad, who has provided them great assistance on the growth plan.

Then with that, I wanted to turn it over to Kris.

Kris Krane:

Good timing. Sorry, I'd just gotten booted off the call and they just allowed me back in, so sorry for the delay there.

Just wanted to give a quick update on what's happening in the regulatory environment nationally because it has a big impact on both our business as well as the industry at large. As many may know, one of the biggest things that has happened of late at the federal level was the passage of the Safe Banking Act in the House of Representatives just passed on September 25 by a vote of 321 to 103, which included all but one Democrat voting in favor and 50% of Republicans, which is particularly notable for its chances of passing the Senate. This now moves onto—now moves to the Senate Banking Committee where Chairman Crapo, a Republican from Idaho has indicated that he is likely to bring it to a vote but may do so with some changes, and in fact may even it be technically a different bill which would need to be reconciled in conference committee.

If it does pass, the Senate floor decision and whether or not it will be voted on, on the floor rests entirely with Mitch McConnell, who to date has not indicated his intentions one way or another. Our best hope is that he wants to provide a victory for Cory Gardner in his tight reelection for Senate in Colorado. We do know that McConnell would like to give Gardner a victory on cannabis if possible and this seems to be the lowest hanging fruit for him to do so, so we are cautiously optimistic about its chances of making it through the Senate. If Mitch McConnell calls the Safe Banking Act to the floor for a vote, we are quite confident that there are enough votes for it to pass. The timing of both the committee vote or a floor vote is very much uncertain, in particular due to the current impeachment proceedings happening in Congress.

Should this pass, the real world impact is a bit challenging to predict. It is unlikely that major financial institutions will jump into the space immediately, but it does likely open up smaller state-chartered and smaller banks to get into the industry and provide a full range of banking services to cannabis businesses, which obviously would be a major boost for ourselves as well as all businesses in the space.

The other major piece of news coming out of the federal government is surrounding the MORE Act, or the Marijuana Opportunity and Reinvestment and Expungement Act. This act would effectively legalize cannabis federally and was recently passed out of the House Judiciary Committee on November 20 by a 24-10 vote. This bill would remove cannabis from the Controlled Substances Act and provide reinvestment into communities hit hardest by cannabis prohibition enforcement, effectively legalizing marijuana federally although with a likely implementation timeline that will take a few years. Whether or not this bill comes to a vote on the floor is up to Nancy Pelosi, who to date has not indicated whether she intends to call it one way or another. It is certain, though, that the impeachment proceedings will delay the process of any potential floor vote.

We do expect that if it is called for a vote, that it would pass on the House floor. It's important to note, however, that the MORE Act has virtually no chance in the Senate but it could provide pressure on the

Senate to take up the less comprehensive States Act, in which case you could see both go to a conference committee which would likely result in some sort of comprehensive cannabis reform somewhere in between the States Act and the MORE Act coming out of Congress sometime in 2020. We're certainly not predicting that this will happen but there is a path for it, which is more than we could have said just a few months ago.

All of this, what it's really doing is setting the stage for what federal legalization will ultimately look like, which could be seriously debated as early as 2021 depending on what happens in 2020, and particularly during the 2020 election.

The last thing I want to go over real quick is what's happening at the state level, because we think that this is going to be a major catalyst for reform at the federal level post-2020 election. While 2019 has been relatively quiet in terms of new states legalizing for adult use, 2020 is expected to be the busiest year that we've ever seen. In November 2020, we expect to see legalization on the ballot in more states than in any prior election. This likely includes major states like Florida, Ohio, Arizona and New Jersey, as well as in other states such as Montana, South Dakota, North Dakota, and possibly Missouri.

With Illinois becoming the first state to legalize via the legislature this year, a number of states are expected to seriously take up legalization efforts in 2020 through their legislatures. The most likely candidates to pass include New York, Connecticut, Rhode Island, Vermont and New Mexico, and we also expect serious efforts, although less likely to make it through next year, in New Hampshire, Minnesota, Maryland, and Delaware. There is a very real path to double the current number of states with legal marijuana, currently sitting at nine plus D.C., by the time we get to 2021, which we think would have a major impact on the industry as well as provide significant pressure on the federal government to move forward with meaningful—some sort of meaningful reform. What that looks like, I think will largely depend on what happens in the 2020 election.

With that, I'm going to turn it back over to Josh, and I'll be available for questions.

Josh Rosen:

All right, appreciate the update on that, Kris. Thanks.

Before taking questions, I just wanted to add one last thing on the investment side, and this isn't just for 4Front but really for the industry. It's simply a reminder that often investing when others aren't is what makes the greatest of opportunities. I personally have never been involved in anything with the structural impediment of federal law, but I think it's creating some unique investment opportunities and I'm an enthusiastic 4Front shareholder and love where we sit in the industry.

With that, I would be happy to take questions. Michelle?

Operator:

Thank you. We'll now be conducting a question-and-answer session. In the interests of time, we ask that you please limit yourself to one question and one follow-up. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for your questions.

Our first question comes from the line of Graeme Kreindler with Eight Capital. Please proceed with your question.

Pat Sullivan:

Hi, good morning everyone. This is actually Pat Sullivan on behalf of Graeme. I'm going to start with the guidance. You said that it's contingent upon raising the $30 million in capital and then you provided a little bit of high level detail on what you guys are looking for there. I guess, is there any more detail you can provide in terms of discussions you've had with potential investors, how far along in the road those discussions are?

Josh Rosen:

Yes, this is Josh responding here. I think broadly speaking, our confidence here is relatively high. When you think of the right way to come at this, I guess first our relationships in the capital markets are deep. We have a strong core shareholder base that's quite supportive, much of it going back to the very early days with us, and then from that vantage point we also ourselves have lots of skin in the game right alongside our shareholders, and not just paper wealth here but hard capital invested. I think if you look at the last debt deal as just an example of maybe our more patient approach to capital but trying to make sure we get the right terms as operative to both the confidence as well as our focus.

Then I think probably the third point I'd make related to this, and you noted it, is we really optimized the amount of money that we're raising. We really dialed it back to a modest amount because we're sensitive to the cost of capital, and we recognize the uncertainty that the current environment creates. It's why we decided to give a specific number. We're very confident in our ability to source the right capital for our business and I really look forward to providing an update pretty soon, but for probably fairly obvious reasons I can't get real specific on it.

Pat Sullivan:

Okay, understood. If I can get a follow-up in here, just continuing with the guidance, I was just wondering what other critical path assumptions are embedded in reaching those numbers? Are you assuming any other markets that you participate in, like Arizona, Maryland or PA convert to rec, or how soon does that assume adult use approvals are received in Massachusetts?

Josh Rosen:

Great questions. I actually think there are a few variables that come into play relative to achieving the guidance, and we've really stress tested and tried to make sure it was achievable based upon probably three main drivers that I'll get into here, but not all of them have to go our way in order for us to reach the guidance. Really, it does tie back to what you just noted. One is the timing of Massachusetts rec. We are working our tails off to get that over the hump. It's been a frustrating process thus far to say the least. We believe we've got a situation where we're what I'd define as close to imminent, but that's been the case for a little while, so that's one of the variables. Frankly, I think when Mass turns rec, it's a fairly predictable stream from there in terms of what the performance looks like.

The other two that have a little bit more variability potential where we could outperform guidance in terms of why we set it where we set it, would be the performance in California as well as performance with Pure Ratios as being a little bit less involved in supply constrained markets and more, in the case of California, finishing the project and getting it turned on, which is progressing quite nicely at this juncture, and then in the case of Pure Ratios, it's really pushing forward, as Brad referenced. We've done a nice job of building the supply chain in order to support scale, and now it's really the sales and marketing engine that's being enhanced and put resources behind, so we're really excited about where that sits.

When it comes to what I'd call the other states and any assumptions, we've got no additional assumptions around recreational passing and/or really much navigation. I mean, the three that I just referenced from a growth standpoint are the biggest contributors, mixed with what I'd call Illinois rec which has passed. We get some meaningful growth there, but it's off a smaller base, and so kind of the big three followed by Illinois would be the way that I would articulate the growth in 2020.

Pat Sullivan:

Okay, great. Thank you. I'll get back in queue.

Operator:

Thank you. Our next question comes from the line of Neal Gilmer with Haywood Securities. Please proceed with your question.

Neal Gilmer:

Yes, thanks. I'll probably continue on, on the guidance side of things. I think that's what topical. Maybe to ask a different way, when from your perspective are you assuming you have the $30 million to make sure that you can achieve that guidance? Is there some sort of point of time, I don't know whether you're comfortable giving it, say, March or next year or whatever the timeframe is, saying that this is what we've baked into our assumptions, we get the capital by this particular point in time in order to make sure that we reach the guidance that you've put out.

Josh Rosen:

From a financial modeling standpoint, the simple answer is first quarter of next year, but what I would say, and Brad articulated this, we've got some levers to pull that can let us optimize around that accordingly, and so I'd kind of leave it at that. You might have seen the press release this morning, we are planning to divest our economic interest in Arkansas, just a non-core state for us at this juncture, and so there are things like that, that can extend the runway beyond and so we're pretty comfortable with where we sit right at this moment. As I said, the goal is obviously to avoid having a gun to our head. We're realists about these things.

Neal Gilmer:

Yes, and in your prepared remarks, as my follow-up I guess, you highlighted Massachusetts and California as your current key areas of focus, followed by Illinois and Michigan. Obviously it's a quickly changing landscape across the U.S. From your perspective, what would you have to see in Illinois and Michigan to have those move a little bit forward, or anything like that, that might sort of change? I know that you're constantly evaluating your deployment of capital.

Josh Rosen:

Yes, I think it's actually quite simple. Illinois particularly is the state we're very excited about. Illinois is capital constrained on our side relative to just achieving what we want to achieve in 2020 and really demonstrating performance. We believe our degrees of freedom will increase with the demonstration of that performance, and while I think the early advantages in the marketplace are real, one of the things that our battle-tested operating capabilities bring us is perfectly—I guess we are perfectly confident going in as a second or third mover in markets and still adding tremendous value and driving tremendous volume, and so while—you know, if we were in a better capital markets environment, we would be pressing more aggressively in Illinois to expand, that's probably the first project that we would come back to should the capital markets improve in terms of adding more capacity in that market. But for now, we'll optimize what we have and we'll still do really well in that market.

Neal Gilmer:

That's great. Thanks very much.

Operator:

Thank you. Our next question comes from the line of Russell Stanley with Beacon Securities. Please proceed with your question.

Doug Cooper:

Hey Josh, it's actually Doug Cooper. Can you give us a bit more color on the actual quarter and the $16.3 million—excuse me, $16.9 million of systems sales, how much was from Washington and the old Northwest Cannabis, and maybe can you just give us an update on what the margin profile looked like there and maybe their market share?

Josh Rosen:

Yes, certainly. In broad strokes, we've continued to grow in Washington, albeit relatively slowly and relatively stable. I think the team there was excited because we got our first minor price increases in ages in a market that's been under tremendous price pressure over the last few years, so we have seen that stabilization and a little bit of growth finally. Up until a few months ago, it was volume gained while pricing declined—actually, probably the last several months more of pricing stability finally, but we are beginning to see a little bit of price, not anything we're—I would say we're meaningfully enhancing what the normalized margins would look like, but still a really good progress data point in the marketplace.

At a high level, I think it's easy to—it would be right to point at just over half of the system-wide revenue that would have been reported in the third quarter, a little bit greater than $9 million in revenue, and then from a margin profile standpoint it's been pretty steady, and we tend to think of it as—you know, we've got a normalized number, given the structure, we tend to think of it as a 20%-plus EBITDA margin business and that's just continued to hold true.

Then on the market share side, I think some of you that track data, you probably are aware of this, the Washington data up until maybe a year, year and a half ago was pretty clean and pretty easy to track relative to market share. That's really not the case anymore, and so we don't have the real time market share data we would have had previously, but I think we've generally—you know, Northwest Cannabis Solutions has generally been growing relatively in line with the market, so I think the high single digit market share still holds true.

Doug Cooper:

Okay, so roughly—let's just call it $40 million run rate, just for round figures. In your guidance for 2021, is it pretty much flat for Washington in those numbers?

Josh Rosen:

That is accurate.

Doug Cooper:

Okay, with the bulk of the rest coming from Massachusetts and California?

Josh Rosen:

The bulk, correct. I would say—remember I mentioned three. We also are going to see off of a pretty small base of, we think, some pretty significant growth at Pure Ratios.

Doug Cooper:

Yes, I just sort of group them in with California.

Josh Rosen:

Fair enough.

Doug Cooper:

Then Illinois, just to be clear, Illinois in terms of your guidance, going rec legal rollout, you mentioned maybe you're a bit capital constrained there, so what is your expectation for Illinois in your guidance?

Josh Rosen:

We're not going not get that granular with specific numbers. What I would say if we were ranking on relative growth, it's probably not terribly far behind where Pure Ratios sits, kind of number three and number four behind Massachusetts, California. We get a meaningful pick-up with the retail operation, the ability to open a second retail operation. Where the capital constraints really come into play is we do have approximately 5,000 square feet of revenue producing flower canopy that we're just in the process of optimizing. Similar to what you heard in terms of taking the battle-tested operating capabilities from Washington to Massachusetts, we're doing the same in Illinois only in a smaller footprint, and so the capital constraints really come into play in preventing us from aggressively expanding upon that footprint.

Doug Cooper:

What do you think that capital requirement would be if money was not an object? What would you need to optimize the assets in Illinois?

Josh Rosen:

Well, we've had some interesting conversations on that internally (phon) recently. What I will say, and this really comes back to the confidence around how we've de-risked what I'd call the really expensive part of this industry, which is develop—building the infrastructure around cultivation and manufacturing capacity, particularly cultivation, and so one of the things we're evaluating in Illinois currently is how to optimize under the 210,000 square foot flower canopy limits that are in place per license in Illinois, so that's actually led to some creative conversations around how big of a project we could ultimately do relative to our efficiencies in that state.

So, what I would say is, it's speculative at this point, but the underlying point around that is it really could scale up or down depending on availability and the marketplace. From a capability standpoint, we think we could execute a really large project in Illinois, a little bit larger than what our existing building would handle, for instance.

Doug Cooper:

Okay. My final question, prior to the issuance of this guidance, you had, I guess, more general target, a three-year target of $200 million of EBITDA. Can you just walk us through how that—where you're at with that target?

Josh Rosen:

Yes, I think from a license standpoint, what we've articulated previously still holds true even with the announcement this morning around Arkansas, that was not a material contributor. I think the way I've described it in the past is the licenses in hand would get us about three-quarters of the way there. I still feel that to be true. I think broadly speaking, stating the obvious, we would need access to—what I would call the cost of capital to come down for us to feel comfortable when taking on the scope to get to those numbers, but it's still very much in mind relative to how we're building the Company and what we're playing for in the industry. We think the opportunities are there, we think we've got the platform to go pursue the opportunities, and I'll leave it at that.

Doug Cooper:

Okay, thanks guys.

Operator:

Thank you. Our next question comes from the line of Robert Petrie with Jennison Associates. Please proceed with your question.

Robert Petrie:

Good morning guys, thanks a lot. I have a question on Pure Ratios. You guys really haven't highlighted that business previously, and it sounds like you're pretty excited about the potential, so I was wondering if you could just put—expand a little bit more on the potential of that business, maybe what the revenue potential might be in your mind. Thanks.

Josh Rosen:

Yes, certainly. I mean, I think it's probably two pronged. One, we did, and Brad referenced kind of his deeper dive into the operations and the strategy of Pure Ratios. We had great appreciation for the efficacy of the product set there and went in and, over the course of probably five or six months now, have really helped support the outsourcing, the manufacturing order support scale that was one of the bigger constraints we saw in the business. For those familiar with CCG companies more broadly, the access to a supply chain that can scale with you from a growth standpoint is vitally important, and they were a company that, as Brad referenced, was self manufacturing. Really, before you turn on the sales engine, you want to make sure you can supply, and so we've really spent the initial—I'd say the initial emphasis there, building that platform out so that we can grow. The anecdotal feedback really across the board continues to be incredibly positive around the patch as well as some of the newer products that they've launched, and for lack of a better description, we remain really excited. Really, I think as we move through 2020, I think we'll provide a lot more tangible details as it relates to the business itself.

Robert Petrie:

Okay, thanks a lot.

Operator:

Thank you. Once again as a reminder, if you would like to ask a question, please press star, one on your telephone keypad. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for more questions.

There are no further questions at this time. I'd like to turn the call back over to Mr. Rosen for any closing remarks.

Josh Rosen:

All right, thank you Michelle. In closing, I really wanted to thank our existing shareholders. Clearly when we formed the new 4Front through the merger with Cannex and entered the public markets, we weren't hoping for this. We weren't planning on the Department of Justice costing us significant legal sums and months of delays in order to step into this type of public market environment, with the close being pushed back into the late summer. But what I would say is I've received tremendous encouragement from our shareholder base and I'm really excited about what's on our plate. We've been working toward this for a while and I look forward to future updates.

To end, I think it's probably worth noting that the transcription of this conference call will be available online on our website, and I think it also might get filed, so with that, thanks very much.

Operator:

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.