

# ANNUAL REPORT | 2022



**HYDROFARM®**

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**Hydrofarm is a leading branded hydroponics company with a manufacturing and distribution platform serving the Controlled Environment Agriculture (“CEA”) market.**

## MISSION

Enabling growers, farmers and cultivators to achieve higher yields and greater quality, consistency, efficiency and sustainability at their farms

## VISION

Bringing innovative solutions, preferred brands and gold standard service to the growing CEA market

## FEATURED BRANDS | 2022





## LETTER FROM THE CHAIRMAN AND CEO



*William Toler*  
Chairman and CEO

Dear Shareholders:

2022 was a challenging year for our industry and Hydrofarm. However, the decisive actions we took during the year position us well to improve in 2023 and beyond.

We made tremendous strides in 2022 with our restructuring initiative, which includes consolidation of our product portfolio, eliminating more than 40 brands and 1,100 SKUs, representing approximately 20% of brands and 33% of SKUs. We have also begun to right-size our manufacturing and supply chain footprint by closing a nutrient manufacturing facility in Canada and subleasing space in our distribution centers. We also reduced headcount which helped lower our employee compensation costs in the second half of 2022 compared to the first half. We aggressively reduced our working capital and have begun to further expand our sales efforts into non-cannabis channels, including controlled environment agriculture food and floral as well as lawn and garden. We expect our restructuring initiative and related actions will result in efficiencies and cost savings that will benefit us in 2023 and years to come. Collectively, these actions set us up to become a leaner, more nimble, more diverse and importantly, more profitable business.

In 2023 we have begun to see positive signals both internally and from several industry metrics. Our sales levels have been stabilizing, and while no single data source captures a complete view of demand in the cannabis industry, we are encouraged that data points demonstrate that U.S. cannabis dispensary average inventory in 2023 is below 2022 levels. In addition, U.S. cannabis prices have been stabilizing in many markets as U.S. cannabis dispensary sales unit volume has continued to grow. As we remain focused on positioning Hydrofarm for success when we emerge from this period of industry softness, we plan to reduce inventory and generate positive cash flow from operations and free cash flows<sup>1</sup> in 2023.

The U.S. is the largest consumer economy in the world, and yet a large portion of the population is just beginning to experience the improved access to cannabis, reduced stigma, and higher quality branded products that come from legalized medical and adult-use programs. If broader cannabis legalization occurs, we would expect more reliable and trackable consumption patterns, making our business stronger and more predictable.

*continued*

<sup>1</sup> Free cash flow is a non-GAAP measure. For more information on the adjustments and additional reconciliations of non-GAAP measures to the most directly comparable GAAP financial measures, see our press release titled "Hydrofarm Holdings Group Announces Fourth Quarter and Full Year 2022 Results" dated March 9, 2023 on our website at <https://investors.hydrofarm.com/news-events/press-releases>.



### *Letter from the Chairman and CEO, continued*

In summary, we are excited about the outlook for our business. We believe that the actions we have taken to right-size our business and our liquidity position have well positioned us for growth. We have a strong record of double-digit compound annual revenue growth despite some periods of softness, and my view on the long-term prospects for our industry and for Hydrofarm is stronger than ever. Our team has proven to be incredibly resilient and is focused on executing our strategy to position Hydrofarm for higher margins and future growth. I look forward to the growth opportunity ahead, as our disciplined approach to working capital and restructuring actions initiated in 2022 have put us in a solid position in 2023 and beyond.

Sincerely,  
William Toler

Chairman and Chief Executive Officer

### *Cautionary Note Regarding Forward-Looking Statements*

Statements contained in this annual report, other than statements of historical fact, which address activities, events and developments that Hydrofarm Holdings Group, Inc. (the "Company") expects or anticipates will or may occur in the future, including, but not limited to, information regarding the future economic performance and financial condition of the Company, the plans and objectives of the Company's management, and the Company's assumptions regarding such performance and plans are "forward-looking statements" within the meaning of the U.S. federal securities laws that are subject to risks and uncertainties. These forward-looking statements generally can be identified as statements that include phrases such as "guidance," "outlook," "projected," "believe," "target," "predict," "estimate," "forecast," "strategy," "may," "goal," "expect," "anticipate," "intend," "plan," "foresee," "likely," "will," "should" or other similar words or phrases. Actual results could differ materially from the forward-looking information in this release due to a variety of factors, including, but not limited to: The market in which we operate has been substantially adversely impacted by industry conditions, including oversupply and decreasing prices of the products the Company's end customers sell, which, in turn, has materially adversely impacted the Company's sales and other results of operations and which may continue to do so in the future; If industry conditions worsen or are sustained for a lengthy period, we could be forced to take additional impairment charges and/or inventory and accounts receivable reserves, which could be substantial, and, ultimately, we may face liquidity challenges; Although equity financing may be available, the current stock prices are at depressed levels and any such financing would be dilutive; The ongoing COVID-19 pandemic could have a material adverse effect on the Company's business, results of operation, financial condition and/or cash flows; Interruptions in the Company's supply chain, whether due to COVID-19 or otherwise could adversely impact expected sales growth and operations; The highly competitive nature of the Company's markets could adversely affect its ability to maintain or grow revenues; Certain of the Company's products may be purchased for use in new or emerging industries or segments, including the cannabis industry, and/or be subject to varying, inconsistent, and rapidly changing laws, regulations, administrative and enforcement approaches, and consumer perceptions and, among other things, such laws, regulations, approaches and perceptions may adversely impact the market for the Company's products; The market for the Company's products has been impacted by conditions impacting its customers, including related crop prices and other factors impacting growers; Compliance with environmental and other public health regulations or changes in such regulations or regulatory enforcement priorities could increase the Company's costs of doing business or limit the Company's ability to market all of its products; Damage to the Company's reputation or the reputation of its products or products it markets on behalf of third parties could have an adverse effect on its business; If the Company is unable to effectively execute its e-commerce business, its reputation and operating results may be harmed; The Company's operations may be impaired if its information technology systems fail to perform adequately or if it is the subject of a data breach or cyber-attack; The Company may not be able to adequately protect its intellectual property and other proprietary rights that are material to the Company's business; Acquisitions, other strategic alliances and investments could result in operating and integration difficulties, dilution and other harmful consequences that may adversely impact the Company's business and results of operations. Additional detailed information concerning a number of the important factors that could cause actual results to differ materially from the forward-looking information contained in this release is readily available in the Company's annual, quarterly and other reports. The Company disclaims any obligation to update developments of these risk factors or to announce publicly any revision to any of the forward-looking statements contained in this release, or to make corrections to reflect future events or developments.



FORM 10-K | 2022



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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

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(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2022

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-39773

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**Hydrofarm Holdings Group, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**81-4895761**

(I.R.S. Employer  
Identification Number)

**1510 Main Street  
Shoemakersville, Pennsylvania 19555  
(707) 765-9990**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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**Securities registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$0.0001 par value per share	HYFM	The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements.

Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant’s executive officers during the relevant recovery period pursuant to §240.10D-1(b).  Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):  
Yes  No

The aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price of a share of common stock on June 30, 2022, as reported by The Nasdaq Global Select Market on such date was \$148 million. As of March 1, 2023, the registrant had 45,258,497 shares of common stock, \$0.0001 par value per share, outstanding.

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#### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for its 2023 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K to the extent stated herein. Such Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the registrant’s fiscal year ended December 31, 2022.



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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained in this Annual Report on Form 10-K other than statements of historical fact, including statements concerning our business strategy and plans, future operating results and financial position, as well as our objectives and expectations for our future operations, are forward-looking statements.

In some cases, you can identify forward-looking statements by such terminology as “believe,” “may,” “will,” “potentially,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan,” “expect” and similar expressions that convey uncertainty of future events or outcomes, although not all forward-looking statements contain these words. Forward-looking statements include, but are not limited to, statements about:

- industry conditions, including oversupply and decreasing prices of our customers' products which, in turn, has materially adversely impacted our sales and other results of operations and which may continue to do so in the future;
- the potential for future charges associated with the impairment of our long-lived assets, inventory allowances and purchase commitment losses, and accounts receivable reserves;
- our liquidity;
- potential dilution that may result from equity financings while our stock prices are depressed;
- general economic and financial conditions, specifically in the United States and Canada;
- the conditions impacting our customers, including related crop prices and other factors impacting growers;
- the adverse effects of public health epidemics, including the ongoing COVID-19 outbreak, on our business, results of operations and financial condition;
- interruptions in the supply chain;
- federal and state legislation and regulations pertaining to the use and cultivation of cannabis in the United States and Canada;
- public perceptions and acceptance of cannabis use;
- fluctuations in the price of various crops and other factors affecting growers;
- the results of our recent acquisitions and strategic alliances;
- our long-term non-cancellable leases under which many of our facilities operate, and our ability to renew or terminate our leases;
- our reliance on, and relationships with, a limited base of key suppliers for certain products;
- our ability to keep pace with technological advances;
- our ability to execute our e-commerce business;
- the costs of being a public company;
- our ability to successfully identify appropriate acquisition targets, successfully acquire identified targets or successfully integrate the business of acquired companies;
- the success of our marketing activities;
- a disruption or breach of our information technology systems or cyber-attack;
- our current level of indebtedness;
- our dependence on third parties;
- any change to our reputation or to the reputation of our products;
- the performance of third parties on which we depend;
- the fluctuation in the prices of the products we distribute;
- competitive industry pressures;
- the consolidation of our industry;



- compliance with environmental, health and safety laws;
- our ability to protect and defend against litigation, including claims related to intellectual property and proprietary rights;
- product shortages and relationships with key suppliers;
- our ability to attract key employees;
- the volatility of the price of our common stock;
- the marketability of our common stock; and
- other risks and uncertainties, including those listed in “Risk Factors.”

We have based these forward-looking statements largely on our current expectations and described future events and trends that we believe may affect our business, financial condition, results of operations, prospects, and financial needs. These forward-looking statements speak only as of the date of this Annual Report on Form 10-K and are subject to a number of risks, uncertainties and assumptions described in the section titled “Risk Factors” and elsewhere in this Annual Report on Form 10-K. Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, you should not rely on these forward-looking statements as predictions of future events. The events and circumstances reflected in our forward-looking statements may not be achieved or occur and actual results could differ materially from those projected in the forward-looking statements. We disclaim any intention or obligation to publicly update or revise any forward-looking statements for any reason or to conform such statements to actual results or revised expectations, except as required by law.

“Hydrofarm” and other trade names and trademarks of ours appearing in this Annual Report on Form 10-K are our property. This Annual Report on Form 10-K contains trade names and trademarks of other companies, which are the property of their respective owners. We do not intend our use or display of other companies’ trade names or trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

Unless the context otherwise indicates, references in this Annual Report on Form 10-K to the terms “Hydrofarm”, “the Company,” “we,” “our” and “us” refer to Hydrofarm Holdings Group, Inc. and its subsidiaries.

## PART I

### Item 1. BUSINESS

#### Introduction

We are a leading independent manufacturer and distributor of controlled environment agriculture ("CEA") equipment and supplies, including a broad portfolio of our own innovative and proprietary branded products. We primarily serve the U.S. and Canadian markets, and believe we are one of the leading competitors in these markets in an otherwise highly fragmented industry. For over 40 years, we have helped growers make growing easier and more productive. Our mission is to empower growers, farmers and cultivators with products that enable greater quality, efficiency, consistency and speed in their grow projects. For the 2022 fiscal year, our net sales were \$345 million. From 2005 through 2022, we generated a net sales compound annual growth rate ("CAGR") of approximately 15%.

Hydroponics is the farming of plants using soilless growing media and often artificial lighting in a controlled indoor or greenhouse environment. Hydroponics is the primary category of CEA, and we use the terms CEA and hydroponics interchangeably. Our products are used to grow, farm and cultivate cannabis, flowers, fruits, plants, vegetables, grains and herbs in controlled environment settings that allow end users to control key farming variables including temperature, humidity, CO<sub>2</sub>, light intensity spectrum, nutrient concentration and pH. Through CEA, growers are able to be more efficient with physical space, water and resources, while enjoying year-round and more rapid grow cycles as well as more predictable and abundant grow yields, when compared to other traditional growing methods.

We reach commercial farmers and consumers through a broad and diversified network of over 2,000 wholesale customer accounts, who we connect with primarily through our proprietary online ordering platform. Our products are distributed across the United States and Canada including through a diversified range of retailers of commercial and home gardening equipment and supplies. Our customers include specialty hydroponic retailers, commercial resellers and greenhouse builders, garden centers, hardware stores, and e-commerce retailers. Specialty hydroponic retailers can provide growers with specialized merchandise assortments and knowledgeable staff.

#### How We Serve Our Customers

Our customer value proposition is centered on two pillars. First, we strive to offer the best selection by being a branded provider of all CEA needs. Second, we seek to be the gold standard in distribution and service, leveraging our infrastructure and reach to provide customers with just-in-time ("JIT") delivery capabilities and exceptional service across the United States and Canada.

#### *Complete Range of Innovative CEA Products*

We offer thousands of innovative, branded CEA products spanning lighting solutions, growing media (i.e., premium soils and soil alternatives), nutrients, equipment and supplies.

Some of our most well-known proprietary brands include Phantom, PhotoBio, Active Aqua, Active Air, HEAVY 16, House & Garden, Mad Farmer, Roots Organics, Soul, Precision, Grotek, Gaia Green, and Innovative Growers Equipment. We estimate that approximately two-thirds of our net sales relate to recurring consumable products, including growing media, nutrients and supplies that are subject to regular replenishment. The remaining portion of our net sales relate to durable products such as hydroponic lighting and equipment. The majority of products we offer are produced by us or are supplied to us under exclusive or preferred brand relationships. These exclusive and preferred brands generally provide higher gross profit margins compared to distributed brands and provide a competitive advantage as we offer our customers a breadth of products that cannot be purchased elsewhere.

We source individual components from our supplier base to assemble certain products, and use a purchasing team in China. Raw materials used in our nutrient manufacturing operations primarily include nitrogen, potassium, and phosphate. In addition, our durables manufacturing operations primarily use steel, plastic, and aluminum as raw materials. We source these raw materials from suppliers located primarily in the United States, Canada, Europe, and China. One supplier accounted for over 10% of purchases in 2022 and 10% of purchases in 2021.

The following graphic illustrates a representative set of our market-leading products across key CEA product categories:



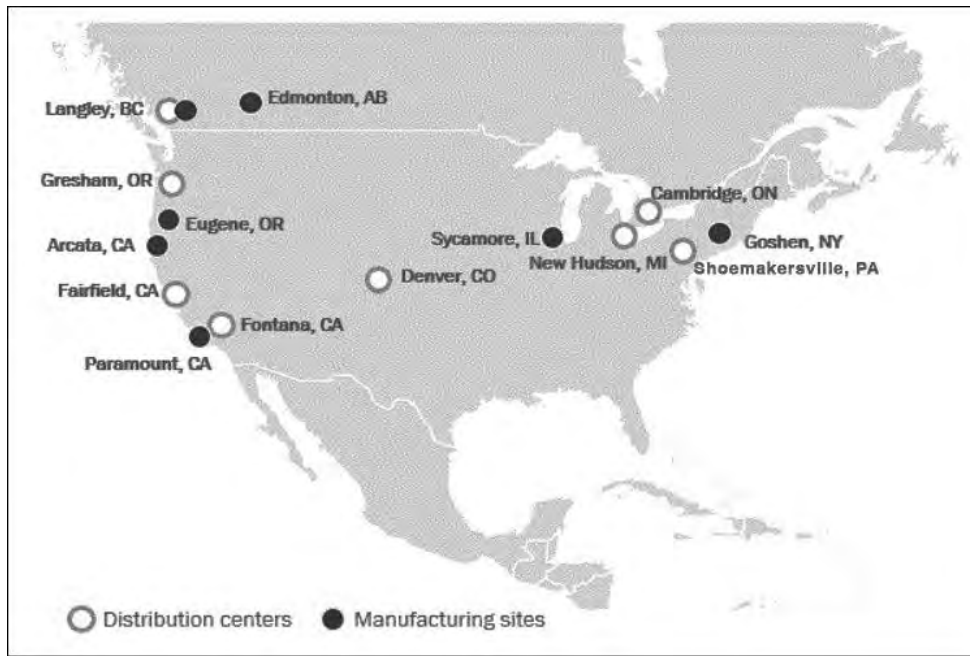
***Infrastructure and Reach for Fast Delivery, High In-Stock Availability and Exceptional Service***

Our infrastructure and reach enables us to provide delivery and service capabilities to a highly diverse group of customers across the United States and Canada. We believe that our six U.S.-based distribution centers can reach a significant majority of our U.S. customers within 48 hours and that our two Canadian distribution centers can provide timely coverage to the full Canadian market.

In the United States, we currently operate distribution centers in Fairfield, California; Fontana, California; Gresham, Oregon; Denver, Colorado; Shoemakersville, Pennsylvania; and New Hudson, Michigan. In Canada, we currently operate distribution centers in Langley, British Columbia and Cambridge, Ontario. Outside of North America, we operate a distribution center in Zaragoza, Spain, and we maintain product quality assurance and supply chain management in Shenzhen, China. We partner with a network of third-party logistics companies that facilitate expeditious delivery to our customers across the globe. The majority of customer orders are received through our business-to-business e-commerce platform. Through our differentiated Distributor Managed Inventory (“DMI”) Program, we partner with our network of retailers and resellers to create customized, JIT supply chain solutions for large commercial end users.

In the United States, we currently operate manufacturing facilities in Paramount, California; Arcata, California; Eugene, Oregon; Goshen, New York; and Sycamore, Illinois. In Canada, we currently have manufacturing facilities in Edmonton, Alberta and Langley, British Columbia.





### The CEA Industry

Our principal industry opportunity is in the wholesale distribution of CEA equipment and supplies, which generally include grow light systems; advanced heating, ventilation, and air conditioning (“HVAC”) systems; humidity and carbon dioxide monitors and controllers; water pumps, heaters, chillers, and filters; nutrient and fertilizer delivery systems; and various growing media typically made from soil, rock wool or coconut fiber, among others. Today, we believe that a majority of our products are sold for use in CEA applications.



*Pictured: PHOTOBIO MX LED, Active Air Commercial Humidifier, Active Aqua Submersible Water Pump, Active Air Heavy Duty 16" Metal Wall Mount Fan, IGE Grow Racks, House & Garden Bud XL, and Roots Organics Soilless Hydroponic Coco Mix.*

CEA is a component of the global commercial agriculture and consumer gardening sectors. According to industry publications, it estimated that the global CEA industry grew to total approximately \$75 billion in 2022<sup>1</sup>, and is expected to grow at a CAGR of 19% from 2022 to 2027<sup>1</sup>. The growth of CEA crop output may subsequently drive growth in the wholesale CEA equipment and supplies industry. According to industry publications, the global hydroponic system market, which primarily represents the categories in which we operate, had an estimated total of approximately \$12.1 billion in 2022 and had an expectation to grow at a CAGR of 16% from 2022 to 2027<sup>2</sup>. We estimate, based upon segmentation data available in industry reports, that the North America hydroponic system market had an estimated value of approximately \$3.7 billion in 2022<sup>3</sup>.

Since 2005, we have grown our net sales at an approximate 15% CAGR. This historical growth is largely due to the CEA market growth, including from cannabis, and our ability to serve these markets with innovative branded products.

While the CEA cannabis market has experienced an agricultural oversupply, we believe that our industry continues to maintain future growth prospects as it matures. Expanding populations, limited natural resources and a focus on the environment and the security of our agricultural systems have illuminated the benefits of CEA compared to traditional outdoor agriculture. We believe the adoption of CEA will grow particularly in the commercial agriculture industry, where CEA can be

<sup>1</sup> KD Market Insights Controlled Environment Agriculture Market, February 2022

<sup>2</sup> Markets and Markets™ Hydroponics Market Global Forecast, September 2022

<sup>3</sup> Hydroponics Market Global Forecast to 2025, July 2020

deployed to achieve results that are simultaneously more efficient for the planet and profitable for growers. The global cannabis industry is a developing business opportunity for us, particularly as the legal market in the United States continues to expand.

Today, we believe that a majority of the CEA equipment and supplies we sell to our customers is ultimately purchased by participants in the cannabis industry, though we do not sell to cannabis growers or to retailers that sell only to the cannabis industry in the United States. As previously described, an agricultural oversupply has impacted our industry, driving cannabis wholesale prices down significantly and resulting in a decrease in indoor and outdoor cultivation. The oversupply has been impacted by increased licensing activity across the United States, as well as significant capital investment in the cannabis production marketplace over the past several years and the market impacts of the COVID-19 pandemic. Despite these current factors negatively impacting the industry, according to certain industry publications<sup>4</sup>, the U.S. cannabis market is projected to reach approximately \$52.6 billion by 2026, up from approximately \$33.0 billion in 2022, representing a 12.4% CAGR.

We believe this forecasted growth in the U.S. cannabis market may be attributable to (i) state initiatives for new adult use and/or medical use programs in additional U.S. states, (ii) expanded access for patients or consumers in existing state medical or adult use cannabis programs, and (iii) increased consumption driven by greater product diversity and choice, reduced stigma, and real and perceived health benefits in states with existing adult use or medical use programs. According to a November 2022 poll by Pew Research Center, public support for the legalization of cannabis in the United States has significantly increased. Approximately 59% of U.S. adults say that cannabis should be legal for recreational and medical use, while an additional 30% say it should be legal for medical use only. In addition, states with legalized adult use cannabis may offer state governments with additional taxation revenue and state job creation. A number of states are at various stages of considering implementing laws permitting cannabis use or further liberalizing their existing laws permitting such use. Our sales in U.S. states with legalized adult use recreational programs are on average several multiples higher than our sales in states without adult use recreational programs. We believe this supports the market opportunity available to us if additional U.S. states legalize adult use recreational programs.

Several key developments have contributed to an increase in cannabis product availability and breadth, including the proliferation of cannabidiol (CBD) and other cannabis-infused products, including edibles, oils, tinctures, and topical treatments. We believe that the historical stigmatization of cannabis use has diminished, driven by generally a more supportive legislative environment, a rise in progressive sociopolitical views and greater consumer awareness of the potential health benefits of cannabis consumption. According to industry publications, real and perceived health benefits extend into areas including cancer treatment, pain management, the treatment of neurological and mental conditions, and sleep management.

### ***Benefits of CEA Adoption***

Both the commercial agriculture and cannabis industries are adopting more advanced agricultural technologies in order to enhance the productivity and efficiency of operations. The benefits of CEA include:

- Greater product safety, quality and consistency;
- More reliable, climate-agnostic year-round crop supply from multiple, faster harvests per year as opposed to a single, large harvest with outdoor cultivation;
- Lower risk of crop loss from pests (and subsequently lower need for pesticides) and plant disease;
- Lower required water and pesticide use compared to conventional farming, offering incremental benefits in the form of reduced chemical runoff and lower labor requirements; and
- Potentially lower operating expenses from resource-saving technologies such as high-efficiency LED lights, precision nutrient and water systems and automation.

CEA implementation is driven by the factors listed above as well as growth in fruit and vegetable farming, consumer gardening and the adoption of vertical farming. Vertical farming, a subsector of CEA, has gained popularity mainly due to its unique advantage of maximizing yield by growing crops in layers.

While a small portion of cannabis cultivation may be grown in non-CEA settings, given the benefits of CEA cultivation, we believe CEA will continue to be the primary method of growing cannabis. In the United States and Canada there has been an increase in regulatory oversight and statutory requirements for growers and their products. These regulations

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<sup>4</sup> MJBiz Daily, June 2022

enhance product safety and transparency to consumers but usually necessitate the use of CEA in cannabis cultivation in order to meet mandated tetrahydrocannabinol (THC) content or impurity tolerances.

### ***Increased Focus on Environmental, Social, and Governance (“ESG”) Issues***

We believe certain of our CEA end-markets support ESG trends as they may preserve resources, enhance the transparency and safety of our food supply chains, and deliver superior performance characteristics versus traditional agriculture. On January 11, 2022, we released our first ESG report to stakeholders, highlighting our environmental, health and safety focus and sustainable governance practices during the 2021 fiscal year.

## **Our Competitive Strengths**

### ***Leading Market Position in our Industry***

We are a leading independent manufacturer and distributor of CEA equipment and supplies in the United States and Canada and one of the two major consolidators in the CEA industry. The broader market is comprised of a fragmented group of smaller competitors. Over the course of our long operating history, we have developed product and market expertise that we believe has made us a leader in our industry.

### ***Experienced Management Team with Proven Track Record***

Our management team possesses significant public market experience, a history of driving long-term organic growth and a track record of successful business consolidations. Bill Toler, Chairman and Chief Executive Officer, has over 35 years of executive leadership experience in supply chain and consumer packaged goods, most recently serving as President and Chief Executive Officer of Hostess Brands from April 2014 to March 2018. Under his leadership, Hostess Brands transitioned from a private to public company, regained a leading market position within the sweet baked goods category and returned to profitability. Bill also previously served as Chief Executive Officer of AdvancePierre Foods and President of Pinnacle Foods, in addition to holding executive roles at Campbell Soup Company, Nabisco and Procter & Gamble. B. John Lindeman, Chief Financial Officer, brings us more than 25 years of finance and leadership experience. Most recently, he served as Chief Financial Officer and Corporate Secretary at Calavo Growers, Inc., a fresh food company, where he was responsible for the finance, accounting, IT and human resource functions. Prior to joining Calavo, he held various leadership positions within the finance and investment banking industries at Janney Montgomery Scott, Stifel Nicolaus, Legg Mason and PricewaterhouseCoopers LLP.

### ***Broad Portfolio with Innovative Proprietary Offerings and Recurring Consumables Sales***

We have a large equipment and consumable product offering, including lighting solutions, growing media, nutrients, equipment and supplies. We offer everything growers need to ensure their operations are maximizing efficiency, output and quality. We maintain an extensive portfolio of products which includes over 35 internally developed or acquired proprietary brands across thousands of stock keeping units ("SKUs") as well as over 60 preferred brands. Approximately 75% of our sales relate to proprietary and preferred brands. We sell proprietary and preferred brands across all of our product categories. In 2021, we completed five acquisitions of branded manufacturers of CEA products, resulting in a significant expansion of our portfolio of proprietary branded products, which generally earn a significant gross margin premium relative to distributed brands. We believe that approximately two-thirds of our net sales are generated from the sale of recurring consumable products including growing media, nutrients and supplies.

### ***Manufacturing Capabilities***

Following our 2021 acquisitions, we now maintain internal manufacturing capabilities across seven locations in North America which includes organic certified and synthetic liquid and dry nutrient blending and bottling, organic certified soil blending and bagging, perlite production, injection molding capabilities, custom and off the shelf horticulture benches and racking system fabrication, automated LED light manufacturing (LED surface mounting and light fixture assembly), and peat harvesting and baling. Our peat harvesting operation provides useful products for improving grow media and organic farming.

### ***Supplier Relationships and Geographic Footprint***

We have developed distribution relationships with a network of approximately 400 suppliers, giving us access to a best-in-class diverse product portfolio and allowing us to provide a full range of CEA solutions to our customers. We have cultivated long-term relationships with several of our main suppliers. We also maintain a geographic footprint that enables us to efficiently serve our customers across North America. We believe that our six distribution centers in the United States can reach



a significant majority of our U.S. customers within 48 hours and our two distribution centers in British Columbia and Ontario can provide timely coverage to the full Canadian market.

### ***Solution Based Approach to Serve Our Customers***

We maintain long-standing relationships with a diversified range of specialty hydroponic retailers, commercial resellers and greenhouse builders, garden centers, hardware stores, and e-commerce retailers. We serve over 2,000 wholesale customer accounts across multiple channels in North America, providing customers with the capability to purchase their entire product range from us. To better serve our customers, we are reorganizing our commercial sales team to drive a solution based approach, focusing on added competencies and product assortment gained from our recent acquisitions. DMI programs further enhance our customer capabilities, offering consultation, technical expertise, facilitated order fulfillment and JIT delivery of consumables. We leverage a seasoned sales team and our internal product category experts to provide industry insights, product capabilities and customer support. We maintain long-term relationships with the majority of our largest customers.

### **Our Growth and Productivity Strategies**

#### ***Capitalizing on the Growing CEA Market***

Our customers benefit from macroeconomic factors driving the growth of CEA, including expanded adoption of CEA by commercial growers and consumers, as well as the growth in cannabis, and other end-markets. Industry publications estimate that the global CEA industry will grow at a 19% CAGR from 2022 to 2027. Moreover, the North America hydroponic system market had an estimated value of approximately \$3.7 billion in 2022, and is projected to grow at a CAGR of 16% from 2022 to 2027.

#### ***Strategic Enhancements to our Product Offering***

We significantly expanded the breadth of our proprietary product assortment through five acquisitions in 2021:

- Heavy 16, a manufacturer of plant nutrients and additives, in May 2021;
- House & Garden, a manufacturer of plant nutrients and additives, in June 2021;
- Aurora Innovations, a manufacturer of soil, grow media, plant nutrients and additives, in July 2021;
- Greenstar Plant Products, a manufacturer of plant nutrients and additives, in August 2021; and
- Innovative Growers Equipment, a manufacturer of horticultural benches, racks and grow lights, in November 2021.

Our proprietary brands generally provide for higher gross profit margins compared to distributed brands and a competitive advantage as we offer products that cannot be purchased elsewhere. We invest in research and development to improve our products and manufacturing processes and to expand our overall brand value. We have launched several new product lines over the last two years, most notably PhotoBio LED lighting equipment. Through recent acquisitions, we have expanded our proprietary brands to include Heavy 16, House & Garden, Mad Farmer, Roots Organics, Soul, Procision, Grotek, Gaia Green, and Innovative Growers Equipment. In addition, we selectively add distributed products when the brand or technology provides us with a more comprehensive assortment to satisfy our customers' needs. In the fourth quarter of 2022, we strategically identified products and brands to exit from our portfolio, enabling to better focus on higher value proprietary products and solutions for our customers.

#### ***Enabling Wholesaler Network to Effectively Serve Commercial Growers***

Working with our wholesale network, we are leveraging our sophisticated product experts and technical sales team to provide our wholesale network the ability to address the needs, demanding requirements and higher volume of their larger-scale commercial customers. Establishing these relationships with our channel provides us with insight and access to growers' evolving demands, leading to both increased equipment sales and recurring sales of consumables through our wholesale network. Our commercial grower outreach program, our analytically driven supply chain function and DMI capabilities enable our wholesaler network to anticipate customer demand for products and ensure their availability. The goal of these efforts is to maintain long-term relationships with our wholesalers by helping them be successful in providing cultivation square footage savings and access to JIT inventory to their customer base. We believe this can result in profitability for our wholesalers' customers on consumables and equipment. We also believe that increasing the value to our wholesale network will allow us to grow within key accounts and expand sales of our products and services to new accounts.

## *Expanding our Offerings within CEA Food and Floral Markets and Garden Centers*

CEA offers a more sustainable and secure alternative to traditional outdoor agriculture, allowing food to be grown closer to where it is ultimately consumed, thereby reducing supply chain-related risks and food waste. Additionally, we believe consumer gardening can be an important driver of future CEA growth, as many U.S. households participate in lawn and gardening activities today. To that end, we have reorganized our sales efforts, including added competencies and product assortment from our recent acquisitions, to focus on the CEA food and floral market, and the consumer gardening markets, where we are well suited to expand our business.

## *Acquiring Value-Enhancing Businesses*

The hydroponics industry is highly fragmented, which we believe presents an opportunity for growth through acquisitions. We utilize clear investment criteria to make disciplined M&A decisions with the goal of accelerating sales and EBITDA growth, increasing competitive strength and market share and expanding our proprietary brand portfolio. We pursue opportunities to grow our business through acquisitions of strategically complementary businesses. We aim primarily to acquire companies that have a competitive market position with the potential to increase market share, a strong brand, high recurring revenue and strong margin potential. We seek acquisition targets that can accelerate our growth and generate significant cash flows over time. As previously discussed, we completed five acquisitions in fiscal 2021. Refer to Part II, Item 8, Financial Statements, Note 10 - *Debt*, for details regarding certain covenants in our JPMorgan Revolving Loan Facility that currently limit the Company's ability to consummate acquisitions.

Acquisitions involve a number of risks and may not achieve our expectations; and, therefore, we could be adversely affected by any such acquisition. There are a number of risks inherent in assessing the value, strengths, weaknesses, contingent or other liabilities, and potential profitability of acquisition candidates, as well as the challenges of integrating acquired companies and achieving potential synergies once an acquisition is consummated, that may cause an acquisition to fail.

## **Effects of COVID-19 on Our Business**

The World Health Organization recognized COVID-19 as a global pandemic on March 11, 2020, and COVID-19 has had significant and ongoing negative impacts on global societies, workplaces, economies and health systems. Authorities throughout the world have implemented measures to contain or mitigate the spread of the virus, including at various times physical distancing, travel bans and restrictions, closure of non-essential businesses, quarantines, work-from-home directives, mask requirements, shelter-in-place orders and vaccination programs, but despite these efforts, COVID-19 has persisted, has mutated into new variants, and is expected to become endemic.

We have implemented business continuity plans and followed safety protocols as recommended by government guidelines, and we will continue to do so as the state of COVID-19 evolves. As of the filing of this Annual Report on Form 10-K, our operations are not impacted by any COVID-19 related facility closures, lockdown measures, travel restrictions or similar limitations. However, new waves of COVID-19 or its variants could cause the reinstatement of such limitations, and such limitations may adversely impact our supply chains, the manufacturing of our own products and our ability to obtain necessary materials, all of which could adversely affect our business, results of operations and financial condition. We have historically and may continue to source select products from China. We have experienced in the past, and may again in the future experience some extended lead times in our supply chain, as well as increased shipping costs, and we believe the COVID-19 pandemic is a contributing factor to those extended lead times and increased costs. Furthermore, potential suppliers or sources of materials may pass the increase in sourcing costs due to the COVID-19 pandemic to us through price increases, thereby impacting our potential future profit margins.

The extent to which the COVID-19 pandemic will ultimately impact our business, results of operations, financial condition and cash flows depends on future developments that are highly uncertain, rapidly evolving and difficult to predict at this time. It is difficult to assess or quantify with precision the impact COVID-19 has directly had on our business since we cannot precisely quantify the impacts, if any, that the various effects have had on the overall business. We believe COVID-19 may have provided a positive demand impact in 2020 and 2021 from shelter-in-place orders in the United States, a possible negative supply chain impact from workforce disruption at international and domestic suppliers, and a possible negative growth rate impact in 2022 due to agricultural oversupply initiated during the height of COVID-related shelter-in-place orders in 2020 and 2021. Management believes that COVID-19 drove a greater volume of sales by our customers in select time periods, thus creating demand for our CEA supplies and equipment. We continue to monitor the COVID-19 pandemic and will adjust our mitigation strategies as necessary to address changing health, operational or financial risks that may arise.

## **Government Regulation**

For U.S. based operations, there is no national regulatory body providing oversight of the Hydrofarm portfolio of products. A substantial number of our products in our growing media and nutrients product lines are subject to U.S. state specific registration requirements. Organic listed products are audited by the California Department of Food and Agriculture and the Organic Materials Review Institute. Finished goods and ingredients labeled as pesticides are regulated by the Environmental Protection Agency (the “EPA”). Canadian based operations and product lines are regulated under the Canadian Food Inspection Agency. Organic certified products are attested by EcoCert. Our peat harvesting operations are regulated by provincial and municipal bodies, including Alberta Environment and Parks regulations.

### ***Grow Media and Nutrients***

Our leading product lines are growing media and nutrients products. These product lines include organic listed soils, soils without organic listings, and both organic listed and synthetic nutrients that contain ingredients requiring supplier registration with certain regulators. The use and disposal of these products in some jurisdictions are subject to regulation by various agencies. A decision by a regulatory agency to significantly restrict the use of these products impacts those companies providing us with such regulated products, and as a result, limits our ability to sell these products.

International, federal, state, provincial and local laws and regulations relating to environmental, health and safety matters affect us in several ways in light of the ingredients that are used in products included in our growing media and nutrients product line. In the United States, products containing pesticides generally must be registered with the EPA and similar state agencies before they can be sold or applied. The failure by one of our partners to obtain, or the cancellation of any such registration, or the withdrawal from the marketplace of such pesticides, could have an adverse effect on our businesses, the severity of which would depend on the products involved, whether other products could be substituted and whether our competitors were similarly affected. The pesticides we use are either granted a license by the EPA or exempt from such a license and may be evaluated by the EPA as part of its ongoing exposure risk assessment. The EPA may decide that a pesticide we distribute will be limited or will not be re-registered for use in the United States. We cannot predict the outcome or the severity of the effect on our business of any future evaluations, if any, conducted by the EPA.

In addition, the use of certain pesticide products is regulated by various international, federal, state, provincial and local environmental and public health agencies. Although we strive to comply with such laws and regulations and have processes in place designed to achieve compliance, we may be unable to prevent violations of these or other laws and regulations from occurring. Even if we are able to comply with all such laws and regulations and obtain all necessary registrations and licenses, the pesticides or other products we apply or use, or the manner in which we apply or use them, could be effected by changing regulations or changing interpretations of the regulations, could be alleged to cause injury to the environment, to people or to animals, or such products could be banned in certain circumstances.

### ***Cannabis Industry***

We sell our products through third-party retailers and resellers and not directly to cannabis growers in countries that prohibit the sale and use of cannabis, including the United States. Nonetheless, it is evident to us that the legalization of cannabis in many U.S. states and Canada has ultimately had a significant, positive impact on our industry. Accordingly, laws and regulations governing the cultivation and sale of cannabis and related products have an indirect effect on our business. Legislation and regulations pertaining to the use and growth of cannabis are enacted on both the state and federal government level within the United States. The federal and state laws and regulations governing the growth and use of cannabis are subject to change. New laws and regulations pertaining to the use or cultivation of cannabis and enforcement actions by state and federal authorities concerning the cultivation or use of cannabis could indirectly reduce demand for our products, and may impact our current and planned future operations.

Individual state laws regarding the cultivation, possession, and use of cannabis for adult and medical uses conflict with federal laws prohibiting the cultivation, possession and use of cannabis for any purpose. A number of states have passed legislation legalizing or decriminalizing cannabis for adult use, other states have enacted legislation specifically permitting the cultivation and use of cannabis for medicinal purposes, and several states have enacted legislation permitting cannabis cultivation and use for both adult and medicinal purposes.

Certain of our products may be purchased for use in new and emerging industries and/or be subject to varying, inconsistent, and rapidly changing laws, regulations, administrative practices, enforcement approaches, judicial interpretations, future scientific research and public perception.

We sell products, including hydroponic gardening products, through third-party retailers and resellers. End users may purchase these products for use in new and emerging industries, including the growing of cannabis, that may not grow or



achieve market acceptance in a manner that we can predict. The demand for these products is dependent on the growth of these industries, which is uncertain, as well as the laws governing the growth, possession, and use of cannabis by adults for both adult and medical use.

Laws and regulations affecting the U.S. cannabis industry are continually changing, which could detrimentally affect our growth, revenues, results of operations and success generally. Local, state and federal cannabis laws and regulations are broad in scope and subject to evolving interpretations, which could require the end users of certain of our products or us to incur substantial costs associated with compliance or to alter our respective business plans. In addition, violations of these laws, or allegations of such violations, could disrupt our business and result in a material adverse effect on our results of operation and financial condition.

The public's perception of cannabis may significantly impact the cannabis industry's success. Both the medical and adult use of cannabis are controversial topics, and there is no guarantee that future scientific research, publicity, regulations, medical opinion, and public opinion relating to cannabis will be favorable. The cannabis industry is an early-stage business that is constantly evolving with no guarantee of viability. The market for medical and adult use of cannabis is uncertain, and any adverse or negative publicity, scientific research, limiting regulations, medical opinion and public opinion (whether or not accurate or with merit) relating to the consumption of cannabis, whether in the United States or internationally, may have a material adverse effect on our operational results, consumer base, and financial results. Among other things, such a shift in public opinion could cause state jurisdictions to abandon initiatives or proposals to legalize medical or adult cannabis or adopt new laws or regulations restricting or prohibiting the medical or adult use of cannabis where it is now legal, thereby limiting the potential customers and end-users of our products who are engaged in the cannabis industry (collectively "Cannabis Industry Participants").

Demand for our products may be negatively impacted depending on how laws, regulations, administrative practices, enforcement approaches, judicial interpretations, and consumer perceptions develop. We cannot predict the nature of such developments or the effect, if any, that such developments could have on our business.

We are subject to a number of risks, directly and indirectly through our Cannabis Industry Participants, because cannabis is illegal under federal law. Federal law and enforcement may adversely affect the implementation of medical cannabis and/or adult use cannabis laws, and may negatively impact our revenues and profits.

Under the U.S. Controlled Substances Act of 1970 (the "CSA"), the U.S. government lists cannabis as a Schedule I controlled substance (i.e., deemed to have no medical value), and accordingly the manufacturing (cultivation), sale, or possession of cannabis is federally illegal. It is also federally illegal to advertise the sale of cannabis or to sell paraphernalia designed or intended primarily for use with cannabis, unless the paraphernalia is authorized by federal, state, or local law. The U.S. Supreme Court ruled in *United States v. Oakland Cannabis Buyers' Cooperative*, 532 U.S. 483 (2001), and *Gonzales v. Raich*, 545 U.S. 1 (2005), that the federal government has the right to regulate and criminalize cannabis, even for medical purposes. The illegality of cannabis under federal law preempts state laws that legalize or decriminalize its use. Therefore, strict enforcement of federal law regarding cannabis would likely adversely affect our revenues and results of operations.

Other laws that directly impact the cannabis growers that are end users of certain of our products include:

- Businesses trafficking in cannabis may not take tax deductions for costs beyond costs of goods sold under Code Section 280E. There is no way to predict how the federal government may treat cannabis businesses from a taxation standpoint in the future, and no assurance can be given to what extent Code Section 280E, or other tax-related laws and regulations, may be applied to cannabis businesses in the future.
- Because the manufacturing (cultivation), sale, possession and use of cannabis is illegal under federal law, cannabis businesses may have restricted intellectual property and proprietary rights, particularly with respect to obtaining and enforcing patents and trademarks. Our inability to register, or maintain, our trademarks or file for or enforce patents on any of our inventions could materially affect our ability to protect our name, brand and proprietary technologies. In addition, cannabis businesses may face court action by third parties under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Our intellectual property and proprietary rights could be impaired as a result of our retailers' and resellers' involvement with cannabis business, and we could be named as a defendant in an action asserting a RICO violation.

- Similar to the risks relating to intellectual property and proprietary rights, there is an argument that the federal bankruptcy courts cannot provide relief for parties who engage in cannabis. Recent bankruptcy rulings have denied bankruptcies for cannabis dispensaries upon the justification that businesses cannot violate federal law and then claim the benefits of federal bankruptcy for the same activity and upon the justification that courts cannot ask a bankruptcy trustee to take possession of, and distribute cannabis assets as such action would violate the CSA. Therefore, due to our retailers' and resellers' involvement with cannabis businesses, we may not be able to seek the protection of the bankruptcy courts and this could materially affect our financial performance and/or our ability to obtain or maintain credit.
- Since cannabis is illegal under federal law, there is a strong argument that banks cannot accept deposit funds from businesses involved in the cannabis industry. Consequently, businesses involved in the cannabis industry often have difficulty finding a bank willing to accept their business. Any such inability to open or maintain bank accounts may make it difficult for us to operate our business. Under the Bank Secrecy Act ("BSA"), banks must report to the federal government any suspected illegal activity, which includes any transaction associated with a cannabis business. These reports must be filed even though the business is operating legitimately under state law. In addition, due to our retailers' and resellers' involvement with cannabis businesses, our existing bank accounts could be closed.
- Insurance that is otherwise readily available, such as general liability and directors and officer's insurance, may be more difficult for us to find, and more expensive, to the extent we are deemed to operate in the cannabis industry.

Any presidential administration, current or future, could change federal enforcement policy or execution and decide to enforce the federal cannabis laws more strongly. Recent administrations have disagreed on how strongly to enforce federal cannabis laws. For example, on August 29, 2013, the U.S. Department of Justice (the "DOJ") under the Obama administration issued a memorandum (the "Cole Memorandum"), characterizing strict enforcement as an inefficient use of federal investigative and prosecutorial resources. The Cole Memorandum provided guidance to all federal prosecutors and indicated that federal enforcement of the CSA against cannabis-related conduct should be focused on specific priorities, including cannabis distribution to minors, violence in connection with cannabis distribution, cannabis cultivation on federal property, and collection of cannabis-derived revenue by criminal enterprises, gangs and cartels. On January 4, 2018, the DOJ under the Trump administration issued a memorandum (the "Sessions Memorandum"), which effectively rescinded the Cole Memorandum and directed federal prosecutors to enforce the CSA and to follow well-established principles when pursuing prosecutions related to cannabis activities. The DOJ under the Biden administration has not readopted the Cole Memorandum, but President Biden has indicated support for decriminalization of cannabis. On October 6, 2022, President Biden issued an executive order pardoning all persons convicted of simple possession of cannabis under the CSA and directed the Secretary of Health and Human Services and the Attorney General to initiate an administrative process to review the scheduling of cannabis under the CSA. Further, on December 2, 2022, President Biden signed into law the Medical Marijuana and Cannabidiol Research Expansion Act, which streamlines and expands the process for researching the medical use of cannabis. We cannot predict how the current administration or future administrations will enforce the CSA or other laws against cannabis activities. Any change in the federal government's enforcement of current federal laws could cause significant financial damage to us. The legal uncertainty and possible future changes in law could negatively affect our growth, revenues, results of operations and success generally.

Unless and until Congress amends the CSA with respect to medical and/or adult use cannabis, there is a risk that federal prosecutors may enforce the existing CSA. Federal authorities may decide to change their current posture and begin to enforce current federal cannabis law and, if they begin to aggressively enforce such laws, it is possible that they could allege that we violated federal laws by selling products used in the cannabis industry. As a result, active enforcement of the current federal regulatory position on cannabis may directly or indirectly adversely affect our revenues and profits.

Violations of any U.S. federal laws and regulations could result in significant fines, penalties, administrative sanctions, convictions or settlements arising from civil proceedings conducted by either the U.S. federal government or private citizens, or criminal charges, including, but not limited to, disgorgement of profits, cessation of business activities or divestiture. This could have a material adverse effect on our business, including our reputation and ability to conduct business, the listing of our securities on any stock exchanges, the settlement of trades of our securities, our ability to obtain banking services, our financial position, operating results, profitability or liquidity or the market price of our publicly-traded shares. In addition, it is difficult for us to estimate the time or resources that would be needed for the investigation of any such matters or their final resolution.

because, in part, the time and resources that may be needed are dependent on the nature and extent of any information requested by the applicable authorities involved, and such time or resources could be substantial.

Businesses involved in the cannabis industry, and investments in such businesses, are subject to a variety of laws and regulations related to money laundering, financial recordkeeping and proceeds of crimes.

We sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry. Investments in the U.S. cannabis industry are subject to a variety of laws and regulations that involve money laundering, financial recordkeeping and proceeds of crime, including the BSA, as amended by the USA Patriot Act, other anti-money laundering laws, and any related or similar rules, regulations or guidelines, issued, administered or enforced by governmental authorities in the United States. In February 2014, the Financial Crimes Enforcement Network (“FinCEN”) of the Treasury Department issued a memorandum (the “FinCEN Memo”) providing guidance to banks seeking to provide services to cannabis businesses. The FinCEN Memo outlines circumstances under which banks may provide services to cannabis businesses without risking federal prosecution for violation of U.S. federal money laundering laws. It refers to supplementary guidance that Deputy Attorney General Cole issued to U.S. federal prosecutors relating to the prosecution of U.S. money laundering offenses predicated on cannabis violations of the CSA and outlines extensive due diligence and reporting requirements. The FinCEN Memo currently remains in place, but it is unclear at this time whether current or future administrations will continue to follow the guidelines of the FinCEN Memo. Any abrogation or modification of the FinCEN Memo could negatively affect the ability of certain of the end users of our products to establish and maintain banking relationships.

The U.S. House of Representatives has passed the Secure and Fair Enforcement (SAFE) Act (the “SAFE Banking Act”) numerous times, and, if enacted, this bill would protect banks and credit unions from federal prosecution for providing services to cannabis companies. However, the Senate has thus far failed to pass the SAFE Banking Act or other similar legislation, despite industry expectations that the Senate would pass the SAFE Banking Act in late 2022.

We sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry. Some of our products are sold to Cannabis Industry Participants and used in connection with cannabis businesses that are subject to federal and state controlled substance laws and regulations. Cannabis businesses are subject to a number of risks related to controlled substances, which risks could reduce demand for our products by Cannabis Industry Participants. Such risks include, but are not limited to, the following:

- Cannabis is a Schedule I drug under the CSA and regulated by the Drug Enforcement Administration (the “DEA”) as an illegal substance. The Food and Drug Administration (“FDA”), in conjunction with the DEA, licenses cannabis research and drugs containing active ingredients derived from cannabis. If cannabis were to become legal under federal law, its sale and use could become regulated by the FDA or another federal agency.
- If cannabis were to become regulated by the FDA or another federal agency, extensive regulations may be imposed on the sale or use of cannabis. Such regulations could result in a decrease in cannabis sales and have a material adverse impact on the demand for our products. If we or our Cannabis Industry Participants are unable to comply with any applicable regulations and/or registration prescribed by the FDA, we may be unable to continue to conduct business with retailers and resellers that transact with cannabis businesses and/or our financial condition may be adversely impacted.
- Controlled substance legislation differs between states, and legislation in certain states may restrict or limit our ability to sell products to Cannabis Industry Participants. Our Cannabis Industry Participants may be required to obtain separate state registrations, permits or licenses in order to be able to obtain, handle and/or distribute controlled substances in a state. Such state regulatory requirements may be costly and, the failure of such Cannabis Industry Participants to meet such regulatory requirements could lead to enforcement and sanctions by the states in addition to any from the DEA or otherwise arising under federal law. We could be implicated in such enforcement or sanctions because of the sale of our products to such Cannabis Industry Participants.
- The failure of our Cannabis Industry Participants to comply with applicable controlled substance laws and regulations, or the cost of compliance with these laws and regulations, may adversely affect the demand for our products and, as a result, the financial results of our business operations and our financial condition.

Furthermore, the Loan and Security Agreement by and among certain of our subsidiaries (the “Subsidiary Obligors”) and JPMorgan Chase Bank, N.A., dated March 29, 2021, (the “JPMorgan Credit Facility”) restricts our ability to sell our products directly to cannabis growers or to retailers that sell only to the cannabis industry in countries where it is federally illegal. As a result, the Subsidiary Obligors do not sell our products directly to the cannabis industry, cannabis growers or cultivators, or to sellers or retailers that sell only to the cannabis industry. See “— Risks Relating to our Indebtedness” for further detail.

## **Intellectual Property**

We own 15 issued U.S. design patents, 2 issued U.S. utility patents, 4 issued foreign patents and designs, 104 registered U.S. trademarks, and 114 registered foreign trademarks that enable us to position ourselves and our products to a wide range of customers. Our 21 issued patents cover grow lighting and hydroponic systems and components. These issued patents and our registered trademarks allow us to build out our proprietary brand products, which we believe are high quality products and generate higher sales margins than the distributed products that we sell. Our owned U.S. and foreign issued patents are expected to expire between 2023 and 2035.

Our ability to compete effectively depends in part on our rights to trademarks, patents and other intellectual property rights we own or license. We have not sought to register every one of our trademarks either in the United States or in every country in which such mark is used. Furthermore, because of the differences in foreign trademark, patent and other intellectual property or proprietary rights laws, we may not receive the same protection in other countries as we would in the United States with respect to the registered brand names and issued patents we hold. Litigation may be necessary to enforce our intellectual property and proprietary rights and protect our proprietary information, or to defend against claims by third parties that our products or services infringe, misappropriate or otherwise violate their intellectual property or proprietary rights. Any litigation or claims brought by or against us could result in substantial costs and diversion of our resources.

We may need to obtain licenses to patents and other intellectual property and proprietary rights held by third parties to develop, manufacture and market our products, if, for example, we sought to develop our products, in conjunction with any patented technology. If we are unable to timely obtain these licenses on commercially reasonable terms (or at all) and maintain these licenses, our ability to commercially market our products, may be inhibited or prevented.

In addition, because the manufacturing (cultivation), sale, possession and use of cannabis is illegal under federal law, companies that transact with cannabis businesses may have restricted intellectual property and proprietary rights particularly with respect to obtaining and enforcing patents and trademarks. We do not believe these restrictions apply to our business. However, if we are unable to register, or maintain, our trademarks or file for or enforce patents on any of our inventions, such an inability could materially affect our ability to protect our name, brand and proprietary technologies. See “— Risks Relating to Our Intellectual Property” for more information on the risks associated with intellectual and proprietary rights.

## **Human Capital**

Our success depends on management implementing effective human resource initiatives in order to recruit, develop and retain key employees. At Hydrofarm we believe that having a strong support base will allow for greater productivity and satisfaction and we are committed to open and healthy communication with our workforce. We seek to create an inclusive work environment in order to foster an innovative and team-oriented culture.

As of December 31, 2022, we had approximately 498 full time employees globally, as compared to 709 full time employees as of December 31, 2021. Of this amount, approximately 67% are located in the United States, and the remainder primarily in Canada. During 2022, we reduced headcount and implemented temporary employee furloughs and we may implement further reductions in the future to create operational efficiencies. Additionally, we use temporary workers as needed to provide flexibility for our business including for seasonal projects.

Our compensation philosophy is to implement a program that enables us to attract, motivate, reward, and retain high-performing employees who can create and sustain value for our stockholders over the long term. In addition, our compensation program is designed to provide a fair and balanced opportunity that appropriately rewards employees for their direct contributions to our success. We offer a comprehensive benefits platform including an Employee Assistance Program where our employees can seek professional assistance with psychological and other challenges.

Workplace safety is important to our business culture and we believe that a safe and empowered workforce is critical to the success of our business. We maintain several health and safety programs, including our comprehensive Environmental Health and Safety (“EHS”) management system. Our associates participate in safety committees, hazard identification, work order resolutions and mandatory compliance training. Additionally, we participate in third party health and safety inspections to

meet regulatory requirements. To evaluate our health and safety performance, we use an EHS scorecard composed of leading and lagging indicators, such as progress measurements for behavioral-based safety and hazard observations, near-miss reporting, and total recordable incident rates.

### **Corporate Structure**

We have been in the business of supplying indoor gardeners since May 4, 1977. We conduct our business through our wholly-owned, direct and indirect subsidiaries.

### **Corporate Information**

We were incorporated in Delaware in January 2017 under the name Innovation Acquisition One Corp. Our predecessor company, originally called Applied Hydroponics, Inc., was founded in 1977 in Northern California. We changed our name to Hydrofarm Holdings Group, Inc. on August 3, 2018. Our principal executive offices are located at 1510 Main Street, Shoemakersville, Pennsylvania 19555 and our telephone number is (707) 765-9990. Our website address is [www.hydrofarm.com](http://www.hydrofarm.com). The information contained on, or that can be accessed through, our website is not, and shall not be deemed to be part of, this Annual Report on Form 10-K. We have included our website address in this Annual Report on Form 10-K solely as an inactive textual reference. Investors should not rely on any such information in deciding whether to purchase our common stock.

### **Available Information**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, are filed with the SEC. Such reports and other information filed by us with the SEC are available free of charge on our website at [investors.hydrofarm.com](http://investors.hydrofarm.com) when such reports are available on the SEC's website. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov). The information contained on the websites referenced in this Annual Report on Form 10-K is not incorporated by reference into this filing. Further, our references to website URLs are intended to be inactive textual references only.

### **Smaller Reporting Company**

We qualify as a smaller reporting company in accordance with Rule 12b-2 under the Exchange Act, and have elected to follow certain of the scaled back disclosure accommodations within this Annual Report on Form 10-K.



## **Item 1A. RISK FACTORS**

### **Summary of Risk Factors**

Our business is subject to a number of risks and uncertainties that are summarized below. The below summary of risk factors should be read together with the more detailed discussion of risks set forth following this section.

#### **Risks Relating to Our Business**

- our proprietary brand offerings expose us to various risks;
- our ability to keep pace with technological advances;
- competitive industry pressures;
- long-lived assets and inventories represent a significant portion of our total assets and we may be required to record impairments or write-downs in future periods;
- if we fail to manage our inventory effectively, our results of operations, financial condition and liquidity may be materially and adversely affected;
- the risk of damage to, loss of, or theft of our inventory;
- the risk that adverse weather may impact our peat harvest;
- the risk of product defects;
- general economic and/or industry and financial conditions, specifically in the United States and Canada;
- increased prices and inflation could negatively impact our margin performance and our financial results.
- acquisitions, other strategic alliances and investments could result in operating difficulties, dilution and other harmful consequences that may adversely impact our business and results of operations;
- our commitments to long-term leases and our ability to renew or exit our leases;
- the costs and risks of operating internationally;
- manufacturing risks as a result of recent acquisitions;
- our ability to comply with environmental regulations;
- interruptions in our supply chain;
- increasing scrutiny regarding environmental, social and governance practices;
- the impact of climate change on our facilities and operations;
- risks related to corporate and social responsibility and reputation;
- the costs of being a public company;
- limitations and possible failures of our internal control systems;
- our ability to maintain effective internal control over financial reporting;
- the adverse effects of public health epidemics, including the COVID-19 pandemic, on our business, results of operations and financial operations;
- damage to our reputation could have an adverse effect on our business;
- our marketing activities may not be successful;
- a disruption or breach of our information technology systems;
- potential inaccuracies in our estimates and assumptions relied upon in preparing consolidated financial statements;
- the costs of potential tariffs or a global trade war;
- possible difficulties in raising sufficient capital to fund our operations; and
- the potential for product liability lawsuits.

#### **Risks Relating to Our Indebtedness**

- significant risks associated with our outstanding and future indebtedness of certain of our subsidiaries;
- our ability to make our debt service payments pursuant to the JPMorgan Credit Facilities;
- restrictions imposed by our JPMorgan Credit Facilities, including on our ability to sell products directly to the cannabis industry; and
- the impact of the transition from the London Interbank Offered Rate ("LIBOR") to the Secured Overnight Funding Rate ("SOFR") as a reference rate.

#### **Risks Relating to Third Parties**

- we rely on a limited base of suppliers for certain products, which may result in disruptions to our business;

- if our suppliers are unable to source raw materials or the prices of raw materials increase, this may adversely affect our results of operations; and
- if our suppliers decide to sell directly into the retail market that we conduct our current or future business in, we may face increased competition.

#### **Risks Relating to the Cannabis Industry**

- federal and state regulations pertaining to the use and cultivation of cannabis may adversely affect our business;
- new California regulations have caused licensing shortages and future regulations may create other limitations that decrease demand for our products;
- our products are subject to varying, inconsistent and rapidly changing laws;
- we are subject to a number of risks, directly and indirectly, because cannabis is illegal under federal law;
- our indirect involvement in the cannabis industry could adversely affect our public reputation; and
- businesses involved in the cannabis industry are subject to a variety of laws and regulations related to money laundering, financial recordkeeping and proceeds of crimes.

#### **Risks Relating to Other Regulations**

- we may be restricted by certain state and other regulations pertaining to the use of certain ingredients in growing media and plant nutrients, including the use of pesticides; and
- we may be restricted by certain U.S., state and foreign laws regarding how we collect, store and process personal information.

#### **Risks Relating to Our Intellectual Property**

- recent changes in laws make it difficult to predict how patents will be issued or enforced in our industry;
- we may not be able to adequately obtain, maintain, protect or enforce our intellectual property and other proprietary rights;
- we may need to rely on licenses to proprietary technologies, which could be difficult or expensive to obtain;
- we may be subject to infringement claims or claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers; and
- we may become subject to costly intellectual property disputes that require us to divert resources from our usual operations.

#### **Risks Relating to Our Capital Stock**

- we may incur indebtedness or issue capital stock that ranks senior or equally to our common stock with certain liquidation preference and other rights, which may dilute our stockholders' ownership interest;
- certain provisions in the JPMorgan Credit Facility, our corporate charter documents and in our current loan agreement and credit facility and under Delaware law could make an acquisition of our company more difficult and may prevent attempts by our stockholders to replace or remove current management or to obtain a favorable judicial forum for disputes with directors, officers or employees;
- risks related to us being a holding company;
- our ability to meet the continued listing standards of The Nasdaq Capital Market;
- our largest stockholders will exercise significant influence over our company for the foreseeable future, including the outcome of matters requiring stockholder approval; and
- our common stock has only recently become publicly-traded and the market price of our common stock may be volatile.

Our operations and financial results are subject to various risks and uncertainties including those described below. You should consider carefully the risks and uncertainties described below, in addition to other information contained in this Annual Report on Form 10-K, including our consolidated financial statements and related notes. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that adversely affect our business. If any of the following risks or others not specified below materialize, our business, financial condition and results of operations could be materially and adversely affected. In that case, the trading price of our common stock could decline.

## **Risks Relating to Our Business**

### ***Our proprietary brand offerings expose us to various risks.***

We expect to continue to grow our portfolio of proprietary brand offerings. We have invested in development and procurement resources and marketing efforts relating to these proprietary brand offerings. Although we believe that our proprietary brand products offer value to our customers at each price point and provide us with higher gross margins than comparable third-party branded products we sell, the expansion of our proprietary brand offerings also subjects us to certain specific risks in addition to those discussed elsewhere in this section, such as:

- potential mandatory or voluntary product recalls;
- supply chain disruptions;
- our ability to successfully obtain, maintain, protect and enforce our intellectual property and proprietary rights (including defending against counterfeit, knock offs, grey-market, infringing or otherwise unauthorized goods); and
- our ability to successfully navigate and avoid claims related to the proprietary rights of third parties.

An increase in sales of our proprietary brands may also adversely affect our sales of our vendors' products, which may, in turn, adversely affect our relationship with our vendors. Our failure to adequately address some or all of these risks could have a material adverse effect on our business, results of operations and financial condition.

### ***Our competitors and potential competitors may develop products and technologies that are more effective or commercially attractive than our products.***

Our products compete against national and regional products and private label products produced by various suppliers, many of which are established companies that provide products that perform functions similar to our products. Our competitors may develop or market products that are more effective or commercially attractive than our current or future products. Some of our competitors have substantially greater financial, operational, marketing and technical resources than we do. Moreover, some of these competitors may offer a broader array of products and sell their products at prices lower than ours, and may have greater name recognition. In addition, if demand for our specialty indoor gardening supplies and products continues to grow, we may face competition from new entrants into our field. Due to this competition, there is no assurance that we will not encounter difficulties in generating or increasing revenues and capturing market share. In addition, increased competition may lead to reduced prices and/or margins for products we sell. We may not have the financial resources, relationships with key suppliers, technical expertise or marketing, distribution or support capabilities to compete successfully in the future.

### ***We may not successfully develop new products or improve existing products or maintain our effectiveness in reaching consumers through rapidly evolving communication vehicles.***

Our future success depends, in part, upon our ability to improve our existing products and to develop, manufacture and market new products to meet evolving consumer needs. We cannot be certain that we will be successful in developing, manufacturing and marketing new products or product innovations which satisfy consumer needs or achieve market acceptance, or that we will develop, manufacture and market new products or product innovations in a timely manner. If we fail to successfully develop, manufacture and market new products or product innovations, or if we fail to reach existing and potential consumers, our ability to maintain or grow our market share may be adversely affected, which in turn could materially adversely affect our business, financial condition and results of operations. In addition, the development and introduction of new products and product innovations require substantial research, development and marketing expenditures, which we may be unable to recoup if such new products or innovations do not achieve market acceptance.

Many of the products we distribute and market, such as our fertilizers and nutrients, contain ingredients that are subject to regulatory approval or registration with certain U.S. state and Canadian regulators. The need to obtain such approval or registration could delay the launch of new products or product innovations that contain such ingredients or otherwise prevent us

from developing and manufacturing certain products and product innovations. Failure to properly register and maintain these registrations for these products could result in significant penalties, additional costs, product stop-sales or recalls.

***Long-lived assets and inventories represent a significant portion of our total assets and we may be required to record impairments or write-downs in future periods.***

Our consolidated balance sheet as of December 31, 2022, includes \$300.4 million of intangible assets, net, \$111.4 million of inventories, \$51.1 million of property, plant, and equipment, net, and \$65.3 million of operating lease right-of-use assets. As of June 30, 2022, we recorded a \$189.6 million goodwill impairment charge due to a decline in the estimated fair value of our reporting units, which reduced the carrying value of our goodwill to zero. During the year ended December 31, 2022, we recorded allowances for inventory obsolescence of \$18.5 million, primarily due to certain durable lighting products.

Long-lived assets, such as intangible assets, property, plant and equipment and operating lease right-of-use assets are reviewed for impairment whenever events, changes or circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. If we were to conclude that a future write-down of our long-lived assets is necessary, we would have to record the appropriate charge, which could result in a material adverse effect on our results of operations. Inventories consist of manufactured goods, goods acquired for resale, and materials consumed in business operations. Inventories are stated at the lower of cost or net realizable value, and we maintain an allowance for excess and obsolete inventory. The estimate for excess and obsolete inventory is based upon assumptions about current and anticipated demand, customer preferences, business strategies, and market conditions. We have experienced recent sales declines, which we believe are primarily a result of agricultural oversupply impacting our market. The extent to which these market conditions will continue to impact our business, results of operations, and cash flows are uncertain and difficult to predict at this time, and may result in lower margins, inventory write-downs, accounts receivable allowances, and impairments of our long-lived assets which could have a material adverse effect on our business, financial condition and results of operations.

***If we fail to manage our inventory effectively, our results of operations, financial condition and liquidity may be materially and adversely affected.***

Our business requires us to manage inventory effectively. We depend on our forecasts of demand for, and popularity of, various products to make purchase decisions and to manage our inventory of stock-keeping units. Demand for products, however, can change significantly between the time inventory or components are ordered and the date of sale. Demand may be affected by seasonality, new product launches, rapid changes in product cycles and pricing, product defects, promotions, changes in consumer spending patterns, changes in consumer tastes with respect to our products and other factors, and our consumers may not purchase products in the quantities that we expect. It may be difficult to accurately forecast demand and determine appropriate levels of product or components. From time to time in the normal course of business, we enter into agreements with our suppliers pursuant to which we are required to purchase minimum amounts of inventory over a defined time period. We receive favorable pricing terms in exchange for this arrangement, but such agreements could lead to an oversupply of inventory. If we fail to manage our inventory effectively or negotiate favorable credit terms with third-party suppliers, we may be subject to a heightened risk of inventory obsolescence, a decline in inventory values, and significant inventory write-downs or write-offs. In addition, if we are required to lower sale prices in order to reduce inventory level or to pay higher prices to our suppliers, our profit margins might be negatively affected. Any of the above may materially and adversely affect our business, financial condition and results of operations.

***Our inventory is vulnerable to damage or loss caused by accidents or natural disasters, and we face the risk of theft of our products from inventory or during shipment.***

Our inventory is stored at warehouses in the United States and Canada. Our inventory is vulnerable to accidents, fire, flood, earthquakes, and similar events that may impact our facilities. Any damage to or loss of all or a significant portion of our inventory could cause significant delays in shipment of goods to our customers, resulting in negative publicity about and diminished customer confidence in our business. In addition, we may experience theft of our products while they are being held in inventory or during the course of their shipment to our customers by third-party carriers. We maintain insurance to cover losses resulting from theft. Nevertheless, if our security measures fail, losses exceed our insurance coverage, or we are not able to maintain insurance at a reasonable cost, we could incur significant losses from damage, loss or theft, any of which could substantially harm our business and results of operations.

***Our peat bogs are susceptible to sudden changes in weather and the impacts of climate change.***

We maintain a peat moss harvesting operation in northern Alberta, Canada. Peat bogs rely on predictable weather; sun and wind are required to dry the top surface, and too much rain can cause compaction and impede the ability of vacuum harvesters to collect the peat. Peat must be harvested during a narrow window of one to two months during the summer, and if

summer is late or especially wet, this can have an adverse impact on the year's harvest. Conversely, if temperatures are too high, this can cause an increase in peat decomposition rates, and extended droughts can aggravate such decomposition. Any of these risks may be further exacerbated by climate change. If our peat bogs are damaged or our peat harvest is less than anticipated for one or more seasons, this could have an adverse impact on our business and results of operations.

***A significant product defect or product recall could materially and adversely affect our brand image, causing a decline in our sales and profitability, and could reduce or deplete our financial resources.***

Provided we are successful in developing and selling our products, any product defect could materially harm our brand image and could force us to conduct a product recall. This could damage our relationships with our customers. A product recall would be particularly harmful to us because we will likely have limited financial and administrative resources to effectively manage a product recall and it would detract management's attention from implementing our core business strategies. As a result, a significant product defect or product recall could cause a decline in our sales and profitability and could reduce or deplete our financial resources.

***Negative economic and/or industry conditions, specifically in the United States and Canada, could adversely affect our business.***

Uncertain global economic and/or industry conditions could adversely affect our business. Negative global economic trends, particularly in the United States and Canada, such as decreased consumer and business spending, high unemployment levels, reduced rates of home ownership and housing starts, high foreclosure rates and declining consumer and business confidence, pose challenges to our business and could result in declining revenues, profitability and cash flow. Although we continue to devote significant resources to support our brands, unfavorable economic and/or industry conditions may negatively affect consumer demand for our products. Our most price-sensitive customers may trade down to lower priced products during challenging economic times or if current economic conditions worsen, while other customers may reduce discretionary spending during periods of economic uncertainty, each of which could reduce sales volumes of our products in favor of our competitors' products or result in a shift in our product mix from higher margin to lower margin products.

***Increased prices and inflation could negatively impact our margin performance and our financial results.***

Increased inflation, including rising prices for raw materials, parts and components, freight, packaging, labor and energy increases, the costs to manufacture and distribute our products, and we may be unable to pass these costs on to our customers. Additionally, we are exposed to fluctuations in other costs such as packaging, freight, labor and energy prices. If inflation in these costs increases beyond our ability to control for them through measures such as implementing operating efficiencies, we may not be able to increase prices to sufficiently offset the effect of various cost increases without negatively impacting customer demand, thereby negatively impacting our margin performance and results of operations.

***Acquisitions, other strategic alliances and investments could result in operating difficulties, dilution, and other harmful consequences that may adversely impact our business and results of operations.***

Acquisitions are an important element of our overall corporate strategy, and these transactions entail material investments by us and are material to our financial condition and results of operations. We expect to evaluate and enter into discussions regarding a wide array of potential strategic transactions. The process of integrating an acquired company, business, or product has created, and will continue to create, unforeseen operating difficulties and expenditures. The areas where we face risks may include, but are not limited to:

- diversion of management's time and focus from operating our business to acquisition integration challenges;
- failure to successfully further develop the acquired business or products;
- implementation or remediation of controls, procedures and policies at the acquired company;
- integration of the acquired company's accounting, information technology (IT) systems, human resources and other administrative systems, and coordination of product, engineering and sales and marketing functions;
- transition of operations, users and customers onto our existing platforms;
- reliance on the expertise of our strategic partners with respect to market development, sales, local regulatory compliance and other operational matters;



- failure to obtain required approvals on a timely basis, if at all, from governmental authorities, or conditions placed upon approval, under competition and antitrust laws which could, among other things, delay or prevent us from completing a transaction, or otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition;
- in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries;
- cultural challenges associated with integrating employees from the acquired company into our organization, and retention of employees from the businesses we acquire;
- liability for or reputational harm from activities of the acquired company before the acquisition or from our strategic partners, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities and other known and unknown liabilities; and
- litigation or other claims in connection with the acquired company, including claims from terminated employees, customers, former stockholders or other third parties.

Our due diligence may fail to identify all liabilities associated with acquisitions and we may not assess the relative benefits and detriments of making an acquisition and may pay acquisition consideration exceeding the value of the acquired business. Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and investments or strategic alliances could cause us to fail to realize the anticipated benefits of such acquisitions, investments or alliances, incur unanticipated liabilities, and harm our business generally.

Our acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or impairment of goodwill and purchased long-lived assets, and restructuring charges, any of which could harm our financial condition or results of operations and cash flows.

Although acquisitions are an important element of our overall corporate strategy, there can be no assurance that we will be able to identify appropriate acquisition targets, successfully acquire identified targets or successfully integrate the business of acquired companies to realize the full, anticipated benefits of such acquisitions.

***We occupy many of our facilities under long-term non-cancellable leases, and we may be unable to renew or exit our leases.***

Many of our manufacturing facilities and distribution centers are located on leased premises subject to non-cancellable leases. Typically, our leases have initial terms ranging from two to twelve years, with options to renew for specified periods of time. We believe that our future leases will likely also be long-term and non-cancellable and have similar renewal options. If we close or stop fully utilizing a facility, we will most likely remain obligated to perform under the applicable lease, which would include, among other things, making the base rent payments and paying insurance, taxes and other expenses on the leased property for the remainder of the lease term. Our inability to terminate a lease when we stop fully utilizing a facility or exit a market can have a significant adverse impact on our financial condition, operating results and cash flows.

In addition, at the end of the lease term and any renewal period for a facility, we may be unable to renew the lease without substantial additional cost, if at all. If we are unable to renew our facility leases, we may close or relocate a facility, which could subject us to construction and other costs and risks, which in turn could have a material adverse effect on our business and operating results. Further, we may not be able to secure a replacement facility in a location that is as commercially viable, including access to rail service. Having to close a facility, even briefly to relocate, could reduce the sales that such facility would have contributed to our revenues. We have experienced delays in relocating certain of our facilities as a result of issues impacting the availability of transportation and the provision of other services necessary to open the new location, and may continue to experience similar delays in the future.

***A disruption in the operations of our freight carriers, higher shipping costs or shipping delays could disrupt our supply chain and could negatively impact our margin performance and our financial results.***

We are dependent on commercial freight carriers to deliver our products. If the operations of these carriers are disrupted for any reason, we may be unable to timely deliver our products to our customers who may choose alternative products causing our net revenues and gross margin to decline. When fuel costs increase, our freight costs generally do so as well. In addition, we operate abroad and international sales carry higher shipping costs which could negatively impact our gross margin and results of operations. If freight and energy costs materially increase and we are unable to successfully pass all or significant portions of the increase along to our customers, or we cannot otherwise offset such increases in our cost of net revenues, our gross margin and financial results could be adversely affected.

***Our international operations make us susceptible to the costs and risks associated with operating internationally.***

We operate some of our distribution centers in Canada and Spain and we source and sell products globally. We also use a purchasing team in China. Accordingly, we are subject to risks associated with operating in foreign countries, including:

- fluctuations in currency exchange rates;
- limitations on the remittance of dividends and other payments by foreign subsidiaries;
- additional costs of compliance with local regulations;
- additional costs associated with fuel prices and freight/import expenses;
- in certain countries, historically higher rates of inflation than in the United States;
- changes in the economic conditions or consumer preferences or demand for our products in these markets;
- restrictive actions by multi-national governing bodies, foreign governments or subdivisions thereof;
- changes in foreign labor laws and regulations affecting our ability to hire and retain employees;
- changes in U.S. and foreign laws regarding trade and investment;
- less robust protection of our intellectual property and proprietary rights under foreign laws;
- difficulty in obtaining distribution and support for our products; and
- our ability to collect trade receivables in foreign jurisdictions.

In addition, our operations outside the United States are subject to the risk of new and different legal and regulatory requirements in local jurisdictions, potential difficulties in staffing and managing local operations and potentially adverse tax consequences. The costs associated with operating our continuing international business could adversely affect our results of operations, financial condition and cash flows in the future.

***As a result of acquisitions, we are exposed to manufacturing risks that could adversely affect our business and results of operations.***

In connection with our acquisitions, we have acquired several manufacturing facilities. Expansion into manufacturing exposes us to all of the risks entailed in manufacturing activities generally and there is no assurance that our manufacturing activities will not cause us to incur material unexpected costs or liabilities. Our manufacturing processes may experience problems including equipment malfunctions, facility contamination, labor problems, raw material shortages or contamination, natural disasters, power outages, terrorist activities, safety and certification issues, or disruptions in the operations of our suppliers which could result in product defects, product recalls, product liability claims and insufficient inventory or supply of product for our customers. For example, our acquisition of the House & Garden Entities and their plant nutrient and fertilizer business may expose us to handling potentially hazardous or explosive chemicals. We cannot eliminate the risk of accidental contamination or injury from such chemicals, and any accident caused by such chemicals could result in cleanup costs, diversion of management attention and potential liability, all of which could affect our reputation, business and results of operations. Any defects in the products we manufacture may result in delayed shipments to customers or reduced or canceled customer orders. If these defects or deficiencies are significant, our business reputation may be damaged. The failure of the products that we manufacture or of our manufacturing processes or facilities may subject us to regulatory enforcement, fines or penalties and, in some cases, require us to shut down, temporarily halt operations or incur considerable expense to correct a manufacturing process or facility. In addition, these defects may result in liability claims against us, expose us to liability to pay for the recall or remanufacture of a product or adversely affect product sales or our reputation. The storage, handling, production and disposal of materials in our manufacturing facilities may expose us to liability under environmental laws and regulations. Potentially significant expenditures could also be required to comply with evolving interpretations of existing environmental, health and safety laws and regulations or any new such laws and regulations (including concerns about global climate change and its impact) that may be adopted in the future. Costs associated with failure to comply with such laws and regulations could have an adverse effect on our business.

***Government laws and regulations, including environmental laws and regulations, could result in material costs or otherwise adversely affect our financial condition and results of operations.***

The manufacturing, composition, packaging, storage, distribution and labeling of our products and the manner in which our business operations are conducted must comply with an extensive array of federal, state and foreign laws and regulations. If we are not successful in complying with the requirements of all such regulations, we could be fined or other actions could be taken against us by the applicable governing body, including the possibility of a required product recall. Any such regulatory action could adversely affect our financial condition and results of operations. It is also possible that governments and regulatory agencies will increase regulation, including the adoption of further regulations relating to the transportation, storage or use of certain ingredients, to enhance homeland security or protect the environment and such increased regulation could negatively impact our ability to obtain raw materials, components and/or finished goods or could result in increased costs. In particular, legislators, consumers, investors and other stakeholders are increasingly focusing on climate change, petroleum usage, waste, recycled material content, and other sustainability concerns pertaining to companies' ESG policies. Concern over climate change may result in new or increased legal and regulatory requirements to reduce or mitigate negative impacts to the environment or may result in new reporting and disclosure requirements. In the event that such regulations result in increased product or administrative costs, we may not be in a position to increase selling prices, and therefore an increase in costs could have a material adverse effect on our business, financial condition and results of operations.

Some of our products have compositions that are controlled by various state, federal and international laws and regulations that are subject to change. We are required to comply with these laws and regulations and we seek to anticipate regulatory developments that could impact our ability to continue to produce and market our products. We invest in research and development to maintain product formulations that comply with such laws and regulations. There can be no assurance that we will not be required to alter the composition of one or more of our products in a way that will have an adverse effect upon the product's efficacy or marketability. A delay or other inability of the Company to complete product research and development and successfully reformulate our products in response to any such regulatory requirements could have a material adverse effect on our business, financial condition and results of operations.

We are subject to numerous environmental laws and regulations that impose various environmental controls on our business operations, including, among other things, the discharge of pollutants into the air and water, the handling, use, treatment, storage and clean-up of solid and hazardous wastes and the investigation and remediation of soil and groundwater affected by hazardous substances. Such laws and regulations may otherwise relate to various health and safety matters that impose burdens upon our operations. These laws and regulations also impose strict, retroactive and joint and several liability for the costs of, and damages resulting from, cleaning up current sites, past spills, disposals and other releases of hazardous substances. We believe that our expenditures related to environmental matters have not had, and are not currently expected to have, a material adverse effect on our financial condition, results of operations or cash flows. However, the environmental laws under which we operate are complicated, often become increasingly more stringent and may be applied retroactively. Accordingly, there can be no assurance that we will not be required to incur additional expenditures to remain in or to achieve compliance with environmental laws in the future or that any such additional expenditures will not have a material adverse effect on our business, financial condition or results of operations.

Additional laws and regulations require that we carefully manage our supply chain for the production, distribution and sale of goods. Our failure to comply with any of these regulations or our inability to adequately predict the manner in which these local regulations are interpreted and applied to our business by the applicable enforcement agencies could have a materially adverse effect on our business, financial condition and results of operations.

***Failure to optimize our supply chain or disruption of our supply chain could have an adverse effect on our business, financial condition and results of operations.***

Our ability to make, move and sell products in coordination with our suppliers is critical to our success. Our inability to maintain sufficient internal production capacity or our inability to enter into co-packing arrangements on terms that are beneficial to us could have an adverse effect on our business. Failure to adequately handle increasing production costs and complexity, turnover of personnel, or production capability and efficiency issues could materially impact our ability to cost effectively produce our products and meet customer demand.

Additionally, damage or disruption to our production or distribution capabilities resulting from weather, any potential effects of climate change, natural disaster, disease, crop spoilage, fire or explosion, terrorism, pandemics, strikes, repairs or enhancements at our facilities, or other reasons, could impair our ability to produce or sell our products. Failure to take adequate steps to mitigate the likelihood or potential impact of such events, or to effectively manage such events if they occur, could adversely affect our business, financial condition and results of operations, and may require additional resources to restore our supply chain.

***Increasing scrutiny and evolving expectations from customers, regulators, investors, and other stakeholders with respect to our environmental, social and governance practices may impose additional costs on us or expose us to new or additional risks.***

Companies are facing increasing scrutiny from customers, regulators, investors, and other stakeholders related to their ESG practices and disclosure. Investor advocacy groups, investment funds and influential investors are also increasingly focused on these practices, especially as they relate to the environment, climate change, health and safety, supply chain management, diversity, labor conditions and human rights, both in our own operations and in our supply chain. Increased ESG-related compliance costs for us as well as among our suppliers, vendors and various other parties within our supply chain could result in material increases to our overall operational costs. Failure to adapt to or comply with regulatory requirements or investor or stakeholder expectations and standards could negatively impact our reputation, ability to do business with certain partners, access to capital, and our stock price.

***Climate Change may impact the availability of our facilities, we may incur substantial costs to comply with climate change legislation and related regulatory initiatives, and weather conditions could adversely impact financial results.***

Changing weather patterns and the increase in frequency of weather events such as forest fires, hurricanes and tornadoes could cause disruptions or the complete loss of our facilities. In addition, climate change concerns, and changes in the regulation of such concerns, including greenhouse gas emissions, could also subject us to additional costs and restrictions, including increased energy and raw materials costs which could negatively impact our financial condition and results of operations. The effects of climate change can have an adverse effect not only to our operations, but also that of our suppliers and customers, and can lead to increased regulations and changes in consumer preferences, which could adversely affect our business, results of operations, and financial condition.

Our garden center customers and certain of our manufacturing facilities can be heavily impacted by weather conditions. For example, periods of abnormally wet or dry weather can adversely impact the sale of certain products, while increasing demand for other products with the overall impact to us difficult to predict. Additionally, our outdoor harvesting and other manufacturing operations may be impacted by adverse weather conditions or changing weather patterns which may adversely impact our ability to produce and sell our products.

***We are subject to risks related to corporate and social responsibility and reputation.***

Many factors influence our reputation including the perception of us held by our customers, suppliers, partners, stockholder, other key stakeholders, and the communities in which we operate. We face increasing scrutiny related to environmental, social and governance activities. We risk damage to our reputation if we fail to act responsibly in a number of areas, such as diversity and inclusion, environmental stewardship, sustainability, supply chain management, climate change, workplace conduct, and human rights. Any harm to our reputation could impact employee engagement and retention, our corporate culture, and the willingness of customers, suppliers, and partners to do business with us, which could have a material adverse effect on our business, results of operations and cash flows. Further, despite our policies to the contrary, we may not be able to control the conduct of every individual actor, and our employees and personnel may violate environmental, social or governance standards or engage in other unethical conduct. These acts, or any accusation of such conduct, even if proven to be false, could adversely impact the reputation of our business.

***We have incurred and will continue to incur increased costs as a result of being a public company.***

We became a public company on December 9, 2020. As a public company, we have incurred and will continue to incur significant legal, accounting, Sarbanes-Oxley compliance, insurance and other expenses that we did not incur as a private company. For example, we have incurred and will continue to incur increased legal and accounting costs as a result of being subject to the information and reporting requirements of the Exchange Act, and other federal securities laws. The costs of preparing and filing periodic and other reports, proxy statements and other information with the SEC and furnishing audited reports to stockholders, will cause significant increases in our expenses than if we had remained privately-held. The cost of being a public company diverts resources that might otherwise have been used to develop our business, which could have a material adverse effect on our company.

As a privately held company, we were not required to comply with certain corporate governance and financial reporting practices and policies required of a public reporting company. As a public company, we are required to file with the SEC annual and quarterly information and other reports pursuant to the Exchange Act. We are also required to ensure that we have the ability to prepare financial statements that are fully compliant with all SEC reporting requirements on a timely basis. In addition, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the listing requirements of the Nasdaq Global Select Market and other applicable securities rules and regulations impose various requirements on public

companies. Our management and other personnel devote a substantial amount of time to compliance with these requirements. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. We cannot predict or estimate the amount of additional costs we incur as a public company or the specific timing of such costs.

As a public company, we, among other things:

- prepare and distribute periodic public reports and other stockholder communications in compliance with applicable laws;
- comply with our obligations under the federal securities laws and applicable listing rules;
- create or expand the roles and duties of our board of directors and committees of the board of directors;
- institute more comprehensive financial reporting and disclosure compliance functions;
- enhance our investor relations function;
- establish new internal policies, including those relating to disclosure controls and procedures; and
- involve and retain to a greater degree outside counsel and accountants in the activities listed above.

These matters require a significant commitment of additional resources and many of our competitors already comply with these obligations. We may not be successful in complying with these obligations and the significant commitment of resources required for complying with them could have a material adverse effect on our business, financial condition and results of operations. These laws and regulations also make it more difficult or costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. These laws and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our committees of our board of directors or as our executive officers.

In addition, if we fail to implement the requirements with respect to our internal accounting and audit functions, our ability to report our results of operations on a timely and accurate basis could be impaired and we could suffer adverse regulatory consequences or violate applicable listing standards. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements, which could have a material adverse effect on our business, financial condition and results of operations.

The changes necessitated by becoming a public company require a significant commitment of resources and management supervision that has increased and may continue to increase our costs and might place a strain on our systems and resources. As a result, our management's attention might be diverted from other business concerns. If we fail to maintain an effective internal control environment or to comply with the numerous legal and regulatory requirements imposed on public companies, we could make material errors in, and be required to restate, our financial statements. Any such restatement could result in a loss of public confidence in the reliability of our financial statements and sanctions imposed on us by the SEC. We cannot predict or estimate the amount of additional costs we may incur or the timing of such costs. If we are unable to satisfy our obligations as a public company, we could be subject to delisting of our common stock, as applicable, fines, sanctions and other regulatory action and potentially civil litigation.

***We are a “smaller reporting company” and, because we have opted to use the reduced reporting requirements available to us, certain investors may find investing in our securities less attractive.***

We are a “smaller reporting company” under the SEC’s disclosure rules, and as such, we are permitted to comply with scaled-back disclosure obligations in our SEC filings compared to other issuers, including with respect to disclosure obligations regarding executive compensation in our periodic reports and proxy statements. We have elected to adopt certain of the accommodations available to smaller reporting companies. Until we cease to be a smaller reporting company, the scaled-back disclosure in our SEC filings will result in less information about our company being available than for other public companies. If investors consider our common stock less attractive as a result of our election to use the scaled-back disclosure permitted for smaller reporting companies, there may be a less active trading market for our common stock and our share price may be more volatile.

***We previously identified material weaknesses in our internal control over financial reporting and we may identify additional material weaknesses in the future, and if we are unable to achieve and maintain effective internal control over financial reporting, the accuracy and timing of our financial reporting may be adversely affected.***

As a result of being a public company, we are required to comply with Section 404 of the Sarbanes-Oxley Act and to develop and maintain proper and effective internal controls over financial reporting. Any failure to maintain the adequacy of these internal controls may adversely affect investor confidence in our company and, as a result, the value of our common stock. Compliance with these requirements may strain our resources, increase our costs, and we may, in the future, be unable to comply with these requirements in a timely or cost-effective manner.

Prior to our initial public offering (“IPO”) in December 2020, we were a private company with limited accounting and finance personnel and other resources with which to address our internal controls and procedures. In connection with the audit of our financial statements for fiscal 2019, we and our independent registered public accounting firm identified control deficiencies in the design and operation of our internal control over financial reporting that constituted material weaknesses previously disclosed in our registration statement on Form S-1 which was declared effective on December 9, 2020.

A “material weakness” is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Our management determined that the previously disclosed material weaknesses were not remediated as of December 31, 2020: that (i) we did not maintain a sufficient complement of personnel with an appropriate degree of technical knowledge commensurate with our accounting and reporting requirements and (ii) our controls related to the preparation, review, and analysis of accounting information and financial statements were not adequately designed or appropriately implemented to identify material misstatements in our financial reporting on a timely basis for our U.S. entities and Eddi’s Wholesale Garden Supplies, Ltd. (“Eddi’s”). These material weaknesses could result in a misstatement of account balances or disclosures that would result in a material misstatement to the annual or interim financial statements that would not be prevented or detected.

During 2021, we remediated the identified material weaknesses. In particular, we (i) hired additional qualified accounting and financial reporting personnel with technical and/or public company experience, (ii) implemented new control procedures over certain areas previously deemed ineffective related to the preparation, review, and analysis of accounting information and financial statements and (iii) engaged an external advisor to assist management in completing a Sarbanes-Oxley Act compliant risk assessment, creating detailed control documentation for in-scope business and information technology processes, identifying further control gaps and providing assistance on remediation procedures, and designing and implementing a Sarbanes-Oxley Act sub-certification process. Although we have remediated previously identified material weaknesses, we cannot assure you that the steps we have taken will prevent future material weaknesses from occurring.

For the 2022 fiscal year, management and our independent outside auditor have attested that our internal control environment was operating effectively and in compliance with Section 404 of the Sarbanes-Oxley Act. However, in the future during the evaluation and testing process of our internal controls, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to certify that our internal control over financial reporting is effective. We cannot assure you that there will not be material weaknesses or significant deficiencies in our internal control over financial reporting in the future. Any failure to maintain internal control over financial reporting could severely inhibit our ability to accurately report our financial condition or results of operations. If we are unable to conclude that our internal control over financial reporting is effective, or if our independent registered public accounting firm determines we have a material weakness or significant deficiency in our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, the market price of our common stock could decline, and we could be subject to sanctions or investigations by the SEC or other regulatory authorities. Failure to remedy any material weakness in our internal control over financial reporting, or to implement or maintain other effective control systems required of public companies, could also restrict our future access to the capital markets.

***The effects of the COVID-19 pandemic are unpredictable and may materially affect our customers and how we operate our business, and the duration and extent to which the pandemic continues (including any re-emergence of COVID-19) to threaten our future results of operations and overall financial performance remains uncertain.***

The World Health Organization recognized COVID-19 as a global pandemic on March 11, 2020, and COVID-19 has had significant and ongoing negative impacts on global societies, workplaces, economies and health systems. Authorities throughout the world have implemented measures to contain or mitigate the spread of the virus, including at various times physical distancing, travel bans and restrictions, closure of non-essential businesses, quarantines, work-from-home directives,



mask requirements, shelter-in-place orders and vaccination programs, but despite these efforts, COVID-19 has persisted, has mutated into new variants, and is expected to become endemic.

Examples of how COVID-19 may impact our business, results of operations and stock price include, but are not limited to:

- COVID-19 may cause consumers to decrease spending, or pause such spending altogether, making it more difficult for us to acquire new customers, as well as retain and upsell existing customers;
- COVID-19 may interfere with our ability, or the ability of our employees, workers, contractors, suppliers and other business partners to perform our and their respective responsibilities and obligations relative to the conduct of our business. COVID-19 may also cause disruptions from the temporary closure or suspension of activities related to the relocation of our facilities, third-party suppliers and manufacturers, restrictions on the shipment of our products, restrictions on our employees' and other service providers' ability to travel, the decreased willingness or ability of our customers to travel or to utilize our services and shutdowns that may be requested or mandated by governmental authorities;
- COVID-19 and related government responses to address the COVID-19 pandemic may cause sudden and extreme changes in our stock price. Since COVID-19 was first reported, the volatility of U.S. equity markets increased to historic levels. This may cause extreme fluctuations in the market price of our stock. We cannot predict if and when these fluctuations will decrease or increase. In addition to general market conditions, the market price of our stock may become volatile or decline due to actual or anticipated impact of COVID-19 on our financial condition and results of operations or if our results of operations do not meet the expectations of the investor community or one or more of the analysts who cover our company change their recommendations regarding our company.

Our limited operating history combined with the uncertainty created by the COVID-19 pandemic significantly increases the difficulty of forecasting operating results and of strategic planning. The COVID-19 pandemic has resulted in global supply chain constraints and transportation disruptions that have led to increased costs of goods and higher freight/import costs. If we are unable to effectively predict and manage the impact of the COVID-19 pandemic on our business, our results of operations and financial condition may be negatively impacted.

***Damage to our reputation could have an adverse effect on our business.***

Maintaining our strong reputation is a key component in our success. Product recalls, any inability to ship, sell or transport our products, governmental investigations and other matters may harm our reputation and acceptance of our products, which may materially and adversely affect our business operations, decrease sales and increase costs.

In addition, perceptions that the products we distribute and market are not safe could adversely affect us and contribute to the risk that we will be subjected to legal action. We distribute and market a variety of products, such as nutrients, and growing media. On occasion, allegations or news reports may be made that some of these products have failed to perform up to expectations or have caused damage or injury to individuals or property. Public perception that the products we distribute or market are not safe could impair our reputation, involve us in litigation, damage our brand names and have a material adverse effect on our business.

***Our marketing activities may not be successful.***

We invest substantial resources in advertising, consumer promotions and other marketing activities to maintain, extend and expand our brand image. There can be no assurance that our marketing strategies will be effective or that the amount we invest in advertising activities will result in a corresponding increase in sales of our products. If our marketing initiatives are not successful, we will have incurred significant expenses without the benefit of higher revenues.

***Our operations may be impaired if our information technology systems, or those of our third-party vendors, fail to perform adequately or if we or our third-party vendors are the subject of a data breach or cyber-attack.***

We rely on information technology systems in order to conduct business, including communicating with employees and our distribution centers, ordering and managing materials from suppliers, selling and shipping products to retail customers and analyzing and reporting results of operations, as well as for storing sensitive, personal and other confidential information. While we have taken steps to ensure the security of our information technology systems, our security measures or those of our third-party vendors may not be effective and our or our third-party vendors' systems may nevertheless be vulnerable to computer viruses, security breaches and other disruptions from unauthorized users. If our or our third-party vendors' information technology systems are damaged or cease to be available or function properly for an extended period of time,

whether as a result of a significant cyber incident or otherwise, our ability to communicate internally as well as with our retail customers could be significantly impaired, which may adversely impact our business. Our acquisition strategy may also result in exposure to certain technology risks during integration of systems of acquired companies to our existing platform.

For example on January 31, 2022, certain of our computer systems related to the “Aurora” acquisition that had not yet been integrated into our main systems were the victim of a cybersecurity attack. We immediately took steps to isolate those systems and implemented measures to prevent the spread of the attack, including taking systems offline in an abundance of caution. Together with an outside cybersecurity forensics firm, we investigated the attack to determine its nature, scope, duration, and impacts, as well as our vulnerability to another such attack and whether there was any exfiltration or misappropriation of data. There was no evidence that the attack extended beyond the Aurora acquisition’s systems, and it was determined that no critical data was accessed. We have subsequently taken steps to integrate the acquisition’s systems with our main systems, and expect to complete this integration in the first half of 2023.

Additionally, the techniques used to obtain unauthorized, improper or illegal access to information technology systems are constantly evolving, may be difficult to detect quickly and often are not recognized until after they have been launched against a target. We may be unable to anticipate these techniques, react in a timely manner or implement adequate preventative or remedial measures. Any operational failure or breach of security from these increasingly sophisticated cyber threats could lead to the loss or disclosure of both our and our retail customers’ financial, product, and other confidential information, as well as personally identifiable information about our employees or customers, result in negative publicity and expensive and time-consuming regulatory or other legal proceedings, damage our relationships with our customers and have a material adverse effect on our business and reputation. In addition, we may incur significant costs and operational consequences in connection with investigating, mitigating, remediating, eliminating and putting in place additional tools and devices designed to prevent future actual or perceived security incidents, as well as in connection with complying with any notification or other obligations resulting from any security incidents. Because we do not control our third-party vendors, or the processing of data by our third-party vendors, our ability to monitor our third-party vendors’ data security is limited and we cannot ensure the integrity or security of the measures they take to protect and prevent the loss of our or our consumers’ data. As a result, we are subject to the risk that cyber-attacks on, or other security incidents affecting, our third-party vendors may adversely affect our business even if an attack or breach does not directly impact our systems.

While we maintain cyber risk insurance, this insurance may not be sufficient to cover all losses from any breaches of our systems and does not extend to reputational damage or costs incurred to improve or strengthen systems against future threats or activity. Cyber risk insurance has also become more difficult and expensive to obtain, and we cannot be certain that our current level of insurance or the breadth of its terms and conditions will continue to be available on economically reasonable terms.

***The estimates and judgments we make, or the assumptions on which we rely, in preparing our consolidated financial statements could prove inaccurate.***

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses, the amounts of charges accrued by us and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. We cannot assure, however, that our estimates, or the assumptions underlying them, will not change over time or otherwise prove inaccurate. Any potential litigation related to the estimates and judgments we make, or the assumptions on which we rely, in preparing our consolidated financial statements could have a material adverse effect on our financial results, harm our business, and cause our share price to decline.

***Potential tariffs or a global trade war could increase the cost of our products, which could adversely impact the competitiveness of our products and our financial results.***

Since 2018, the United States has imposed tariffs on certain imports from China, including on lighting and environmental control equipment manufactured in China. If the U.S. administration imposes additional tariffs, or if additional tariffs or trade restrictions are implemented by the United States or other countries the cost of our products manufactured in China and imported into the United States or other countries could increase, which in turn could adversely affect the demand for these products and have a material adverse effect on our business and results of operations.

***Unanticipated changes in our tax provisions, the adoption of new tax legislation or exposure to additional tax liabilities could affect our profitability and cash flows.***

We are subject to income and other taxes in the United States federal jurisdiction and various local, state and foreign jurisdictions. Our effective tax rate in the future could be adversely affected by changes to our operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets (such as net operating losses and tax credits) and liabilities, changes in tax laws and the discovery of new information in the course of our tax return preparation process. In particular, the carrying value of deferred tax assets, which are predominantly related to our operations in the United States, is dependent on our ability to generate future taxable income of the appropriate character in the relevant jurisdiction.

From time to time, tax proposals are introduced or considered by the U.S. Congress or the legislative bodies in local, state and foreign jurisdictions that could also affect our tax rate, the carrying value of our deferred tax assets, or our tax liabilities. Our tax liabilities are also affected by the amounts we charge for inventory, services, licenses and funding. We are subject to ongoing tax audits in various jurisdictions. In connection with these audits (or future audits), tax authorities may disagree with our determinations and assess additional taxes. We regularly assess the likely outcomes of our audits in order to determine the appropriateness of our tax provision. As a result, the ultimate resolution of our tax audits, changes in tax laws or tax rates, and the ability to utilize our deferred tax assets could materially affect our tax provision, net income and cash flows in future periods.

***We may be limited in our ability to utilize, or may not be able to utilize, net operating loss carryforwards to reduce our future tax liability.***

As of December 31, 2022, we had U.S. federal net operating loss (“NOL”) carryforwards of approximately \$107.1 million, the utilization of which may be limited annually due to certain change in ownership provisions of Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”). Our federal NOL carryforwards will begin to expire in 2037. See Note 13 - *Income Taxes*, in the notes to the consolidated financial statements included elsewhere in this Annual Report on Form 10-K for a further discussion of the carryforward of our NOLs. As of December 31, 2022, we maintained a valuation allowance of approximately \$39.3 million on the majority of our domestic and foreign net deferred tax assets.

An “ownership change” (generally defined as greater than 50-percentage-point cumulative changes in the equity ownership of certain stockholders over a rolling three-year period) under Section 382 of the Code may limit our ability to utilize fully our pre-change NOL carryforwards to reduce our taxable income in periods following the ownership change. In general, an ownership change would limit our ability to utilize NOL carryforwards to an amount equal to the aggregate value of our equity at the time of the ownership change multiplied by a specified tax-exempt interest rate, subject to increase by certain built-in gains. Similar provisions of state tax law may also apply to our state NOL carryforwards. In addition, future changes in our stock ownership, some of which may be beyond our control, could result in additional ownership changes under Section 382 of the Code.

***If we need additional capital to fund our operations, we may not be able to obtain sufficient capital and may be forced to limit the scope of our operations.***

In connection with our growth strategies, we may experience increased capital needs and accordingly, we may not have sufficient capital to fund our future operations without additional capital investments. There can be no assurance that additional capital will be available to us. If we cannot obtain sufficient capital to fund our operations, we may be forced to limit the scope of our expansion.

***If product liability lawsuits are brought against us, we may incur substantial liabilities.***

We face a potential risk of product liability as a result of any of the products that we offer for sale. For example, we may be sued if any product we sell allegedly causes injury or is found to be otherwise unsuitable during product testing, manufacturing, marketing or sale. Any such product liability claims may include allegations of defects in manufacturing, defects in design, a failure to warn of dangers inherent in the product, negligence, strict liability and a breach of warranties. Claims could also be asserted under state consumer protection acts. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities. Even successful defense would require significant financial and management resources. Regardless of the merits or eventual outcome, liability claims may result in: (i) decreased demand for products that we may offer for sale; (ii) injury to our reputation; (iii) costs to defend the related litigation; (iv) a diversion of management’s time and our resources; (v) substantial monetary awards to trial participants or patients; (vi) product recalls, withdrawals or labeling, marketing or promotional restrictions; or (vii) a decline in our stock price. Our inability to retain sufficient product liability insurance at an acceptable cost to protect against potential product liability claims could prevent or

inhibit the commercialization of products we develop. We may have to pay amounts awarded by a court or negotiated in a settlement that exceed our insurance coverage limitations or that are not covered by our insurance, and we may not have, or be able to obtain, sufficient capital to pay such amounts.

### ***Risks Relating to Our Indebtedness***

***The JPMorgan credit facilities contain, and future debt facilities may contain, restrictions that limit our flexibility in operating our business; we fund interest and amortization payments from cash flows generated in our operations, and to the extent that cash flows deteriorate, it could be difficult or impossible to timely make our debt service payments or obtain additional debt financing.***

We maintain a substantial amount of debt, and we may incur additional debt in the future to help fund our business. Our substantial indebtedness and interest expense could have important consequences to us, including:

- limiting our ability to use a substantial portion of our cash flow from operations in other areas of our business, including for working capital, expanding our infrastructure, capital expenditures and other general business activities and investment opportunities in our company, because we must dedicate a substantial portion of these funds to pay interest and/or service our debt and because the documents contain restrictions on certain of those actions;
- impacting our cash flows, results of operations and financial condition as interest rates rise, as our JPMorgan credit facilities incur interest at a floating rate;
- requiring us to seek to incur further indebtedness in order to make the capital expenditures and other expenses or investments necessary to operate the business to the extent our future cash flows are insufficient;
- requiring us to refinance the JPMorgan Revolving Loan Facility (as defined below) if the lenders do not agree to extend the maturity date beyond March 29, 2024;
- limiting our ability to obtain additional financing in the future for working capital, capital expenditures, debt service requirements, acquisitions and the execution of our strategy, and other expenses or investments planned by us;
- limiting our flexibility and our ability to capitalize on business opportunities and to react to competitive pressures and adverse changes in government regulation, our business and our industry;
- our inability to satisfy our obligations under our indebtedness (which could result in an event of default and acceleration if we fail to comply with the requirements of our indebtedness); and
- increasing our vulnerability to a downturn in our business and to adverse economic and industry conditions generally.

The existing JPMorgan credit facilities contain, and any documents governing our or our subsidiaries' future indebtedness may contain, numerous financial and operating covenants that limit the discretion of management with respect to certain business matters. Such restrictive covenants include restrictions on, among others, our or our subsidiaries' ability to: (1) incur additional indebtedness; (2) create or suffer to exist any liens upon any of our or our subsidiaries' property; (3) pay dividends and other distributions or enter into agreements restricting our subsidiaries' ability to pay dividends; (4) make investments; (5) make certain loans; (6) dispose of assets; (7) merge, amalgamate, combine or consolidate; (8) engage in certain transactions with stockholders or affiliates; (9) amend or otherwise alter the terms of our or our subsidiaries' indebtedness; and (10) alter the business that we conduct. The existing JPMorgan credit facilities also require, and any documents governing our or our subsidiaries' future indebtedness may require, us to meet certain financial ratios and tests in order to enter into certain transactions, incur additional indebtedness, pay dividends and other actions. In addition, if we become subject to the financial ratios and tests that are specified in the JPMorgan Revolving Loan Facility, noncompliance with such ratios and tests would be an event of default.

We and our Subsidiary Obligors' ability to comply with these and other provisions of the existing JPMorgan credit facilities is dependent on our future performance, which will be subject to many factors, some of which are beyond our control. The breach of any of these covenants or noncompliance with any applicable financial ratios and tests could result in an event of default under the existing debt agreements, which, if not cured or waived, could result in acceleration of the related debt and the acceleration of debt under other instruments evidencing indebtedness that may also contain cross-acceleration or cross-default provisions. Variable rate indebtedness subjects us and the Subsidiary Obligors to the risk of higher interest rates, which could cause our future debt service obligations to increase significantly.

***The JPMorgan credit facilities have restrictions on our ability to sell our products directly to the cannabis industry.***

On March 29, 2021, we and our subsidiaries (the “Subsidiary Obligors”) entered into a senior secured revolving loan facility with JPMorgan Chase Bank, N.A. (“JPMorgan”), as administrative agent for the lenders, which was subsequently amended and currently provides for a maximum commitment amount of \$75 million and terminates on March 20, 2024 (as amended, the “JPMorgan Revolving Loan Facility”). On October 25, 2021, we and the Subsidiary Obligors entered into a \$125 million senior secured term loan facility with JPMorgan, as administrative agent for the lenders (the “Term Loan”). The JPMorgan Revolving Loan Facility and the Term Loan each contain customary covenants, restrictions and defaults. The JPMorgan Revolving Loan Facility prohibits us and the Subsidiary Obligors from selling our products, inventory or services directly to cannabis growers or to retailers that sell only to the cannabis industry. The Term Loan prohibits us and the Subsidiary Obligors from selling our products, inventory or services directly to cannabis growers operating in any country that prohibits the sale and use of cannabis products other than in accordance with the applicable laws of such country. We are in compliance with the terms set forth in the JPMorgan Revolving Loan Facility and the Term Loan and maintain policies and procedures that are designed to promote and achieve continued compliance with such requirements.

These compliance requirements may require that we be more selective than our competitors when selecting to whom we sell our products, and in certain situations, may afford our competitors a competitive advantage if we are not able to sell our products to a certain customer, and may negatively impact our marketing efforts, sales and reputation in the market. Moreover, the breach of any of these compliance requirements may result in the occurrence of an event of default under each of the JPMorgan Revolving Loan Facility and the Term Loan, which would entitle JPMorgan to terminate the commitments thereunder and declare all loans then outstanding to be due and payable. The foregoing events would have a material adverse effect on our business, results of operations and financial condition.

***Substantially all of our and our Subsidiary Obligors’ assets are pledged to secure obligations under the JPMorgan credit facilities.***

We and our Subsidiary Obligors have granted a continuing security interest in substantially all of our assets to JPMorgan, as administrative agent on behalf of the lenders party to such agreements. If we or the Subsidiary Obligors default on any of our obligations under such agreements, JPMorgan will be entitled to exercise remedies available to them resulting from such default, including increasing the applicable interest rate on all amounts outstanding, declaring all amounts due thereunder immediately due and payable, assuming possession of the secured assets, and exercising rights and remedies of a secured party under the Uniform Commercial Code, as applicable then in the United States, or the Personal Property Security Act, as applicable then in Canada. Our ability to conduct our business may be materially harmed as a result of the exercise of any remedies, in the event that such remedies are exercisable, by JPMorgan.

***We may be adversely impacted by the transition from LIBOR to SOFR as a reference rate.***

The United Kingdom’s Financial Conduct Authority and the administrator of LIBOR have announced that the publication of U.S. dollar LIBOR settings will cease to be published or cease to be representative after June 30, 2023. The publication of all other LIBOR settings ceased to be published as of December 31, 2021. In the United States, the Alternative Reference Rates Committee, a committee convened by the Federal Reserve Board and the Federal Reserve Bank of New York, recommended SOFR plus a recommended spread adjustment as LIBOR’s replacement. SOFR is an index calculated by reference to short-term repurchase agreements backed by U.S. Treasury securities that was selected as a preferred replacement for U.S. dollar LIBOR by the U.S. Federal Reserve. SOFR is observed and backward looking, which stands in contrast to LIBOR under the current methodology, which is an estimated forward-looking rate and relies, to some degree, on the expert judgment of submitting panel members. LIBOR and SOFR have significant differences, such as LIBOR being an unsecured lending rate while SOFR is a secured lending rate, and SOFR is an overnight rate while LIBOR reflects term rates at different maturities.

The Term Loan continues to utilize LIBOR. The Term Loan agreement attempts to provide mechanisms whereby the tenor (one month, three months or six months) of the LIBOR based rates would remain the same even though SOFR is an overnight rate. In addition, LIBOR incorporates built in credit risk component because it is based on the aggregate cost of borrowing by a bank and SOFR does not have this component since it is based on overnight transactions in the Treasury repurchase market. Accordingly, there are inherent difficulties in matching these two rates and it is possible that the use of SOFR may result in a higher rate.

Given that the conversion to SOFR under the Term Loan has not yet occurred, we are unable to determine whether our interest obligations under the SOFR based rates will be higher than corresponding interest rates benchmarked to LIBOR.

The transition to SOFR may present challenges, including, but not limited to, the illiquidity of SOFR derivatives markets, which could make it difficult for financial institutions to offer SOFR-based debt products, the determination of the

spread adjustment required to convert LIBOR to SOFR (and the related determination of a term structure with different maturities), and that such transition may require substantial negotiations with counterparties. There is no guarantee that the transition from LIBOR to SOFR will not result in financial market disruptions, significant increases in benchmark rates, or borrowing costs to borrowers, any of which could affect our interest expense and earnings and may have an adverse effect on our business, results of operations, financial condition, and stock price.

Whether or not SOFR attains market acceptance as a LIBOR replacement tool remains in question. As such, the future of SOFR at this time remains uncertain.

### **Risks Relating to Third Parties**

***Our reliance on a limited base of suppliers for certain products, such as light ballasts, may result in disruptions to our business and adversely affect our financial results.***

Although we continue to implement risk-mitigation strategies for single-source suppliers, we rely on a limited number of suppliers for certain of our light ballasts, used in manufacturing our lighting systems. A portion of our key suppliers previously experienced significant volume demands, which impacted supplier performance. If we are unable to maintain supplier arrangements and relationships, if we are unable to contract with suppliers at the quantity and quality levels needed for our business, or if any of our key suppliers becomes insolvent or experience other financial distress, we could experience disruptions in production, which could have a material adverse effect on our financial condition, results of operations and cash flows.

***Disruption in our global supply chain has impacted and may continue to negatively impact our businesses.***

The products we sell are sourced from a wide variety of domestic and international vendors, and any disruption in our supply chain or inability to find qualified vendors and access products that meet requisite quality and safety standards in a timely and efficient manner could adversely impact our businesses. The loss or disruption of such supply arrangements for any reason, including for issues such as COVID-19 or other health epidemics or pandemics, labor disputes, loss or impairment of key manufacturing sites, inability to procure sufficient raw materials, quality control issues, ethical sourcing issues, a supplier's financial distress, natural disasters, looting, vandalism or acts of war or terrorism, trade sanctions or other external factors over which we have no control, could interrupt product supply and, if not effectively managed and remedied, have a material adverse impact on our business operations, financial condition and results of operations.

Also, geopolitical tensions and the conflict between Russia and Ukraine continue to escalate, and numerous jurisdictions have imposed harsh sanctions on certain industry sectors and parties in Russia, as well as enhanced export controls on certain products and industries. These and any additional sanctions and export controls, as well as any counter responses by the governments of Russia or other jurisdictions, could adversely affect, directly or indirectly, the global supply chain, with negative implications on the availability and prices of raw materials, energy prices, and our customers, as well as the global financial markets and financial services industry.

***A significant interruption in the operation of our or our suppliers' facilities could impact our capacity to produce products and service our customers, which could adversely affect revenues and earnings.***

Operations at our and our suppliers' facilities are subject to disruption for a variety of reasons, including fire, flooding or other natural disasters, disease outbreaks or pandemics, acts of war, terrorism, government shut-downs and work stoppages. Some of our key suppliers experienced significant demand and increased volume in prior years. A significant interruption in the operation of our or our suppliers' facilities, especially for those products manufactured at a limited number of facilities, such as fertilizer and liquid products, could significantly impact our capacity to sell products and service our customers in a timely manner, which could have a material adverse effect on our customer relationships, revenues, earnings and financial position.

***If our suppliers are unable to source raw materials in sufficient quantities, on a timely basis, and at acceptable costs, our ability to sell our products may be harmed.***

The manufacture of some of our products is complex and requires precise high quality manufacturing that is difficult to achieve. We have in the past experienced, and may in the future experience, difficulties in manufacturing our products on a timely basis and in sufficient quantities. These difficulties in the past have primarily related to difficulties associated with ramping up production of newly introduced products and may result in increased delivery lead-times and increased costs of manufacturing these products. Our failure to achieve and maintain the required high manufacturing standards could result in further delays or failures in product testing or delivery, cost overruns, product recalls or withdrawals, increased warranty costs or other problems that could harm our business and prospects.



In determining the required quantities of our products and the manufacturing schedule, we must make significant judgments and estimates based on historical experience, inventory levels, current market trends and other related factors. Because of the inherent nature of estimates, there could be significant differences between our estimates and the actual amounts of products we require, which could harm our business and results of operations.

***Disruptions in availability or increases in the prices of raw materials sourced by suppliers could adversely affect our results of operations.***

We source many of our product components from outside of the United States. The general availability and price of those components can be affected by numerous forces beyond our control, including political instability, trade restrictions and other government regulations, duties and tariffs, price controls, the availability of shipping and transportation services, changes in currency exchange rates and weather.

A significant disruption in the availability of any of our key product components could negatively impact our business. In addition, increases in the prices of key commodities and other raw materials could adversely affect our ability to manage our cost structure. Market conditions may limit our ability to raise selling prices to offset increases in our raw material costs. Our proprietary technologies can limit our ability to locate or utilize alternative inputs for certain products. For certain inputs, new sources of supply may have to be qualified under regulatory standards, which can require additional investment and delay bringing a product to market.

***If our suppliers that currently, or will in the future, sell directly to the retail market in which we conduct our current or future business, enhance these efforts and cease or decrease their sales through us, our ability to sell certain products could be harmed.***

Our distribution and sales and marketing capabilities provide significant value to our suppliers. Distributed brand suppliers sell through us in order to access thousands of retail and commercial customers across the United States and Canada with short order lead times, no minimum order quantity on individual items, free or minimal freight expense and trade credit terms. Based on our knowledge and communication with our suppliers, we believe some of our suppliers sell directly to the retail market. If these suppliers were to cease working with us, or proceed to enhance their direct-to-customer efforts, our product offerings, reputation, operation and business could be materially adversely affected.

## **Risks Relating to the Cannabis Industry**

In the United States, we sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry. It is evident to us that the movement towards the legalization of cannabis in the United States and its legalization in Canada has ultimately had a significant, positive impact on our industry. Accordingly, the risks referred to below, to the extent they relate to our customers could impact us indirectly. In addition, if our business is deemed to transact with companies in the United States involved in the cannabis business, these risks could apply directly to us. “Cannabis Industry Participants” means the potential customers and end-users of our products who are engaged in the cannabis industry.

***We are subject to a number of risks, directly and indirectly through Cannabis Industry Participants, because cannabis is illegal under federal law.***

Cannabis is illegal under U.S. federal law. Federal law and enforcement may adversely affect the implementation of medical cannabis and/or adult use cannabis laws, and may negatively impact our revenues and profits.

Under the Controlled Substances Act, the U.S. federal government lists cannabis as a Schedule I controlled substance (i.e., deemed to have no medical value), and accordingly the manufacturing (cultivation), sale, or possession of cannabis is federally illegal. It is also federally illegal in the United States to advertise the sale of cannabis or to sell paraphernalia designed or intended primarily for use with cannabis, unless the paraphernalia is authorized by federal, state, or local law. The U.S. Supreme Court ruled in *United States v. Oakland Cannabis Buyers' Cooperative*, 532 U.S. 483 (2001), and *Gonzales v. Raich*, 545 U.S. 1 (2005), that the U.S. federal government has the right to regulate and criminalize cannabis, even for medical purposes. The illegality of cannabis under U.S. federal law preempts state laws that legalize or decriminalize its use. Therefore, strict enforcement of U.S. federal law regarding cannabis would likely adversely affect our revenues and results of operations.

Other laws that directly impact the cannabis growers that are end users of certain of our products include:

- Businesses trafficking in cannabis may not take tax deductions for costs beyond costs of goods sold under Code Section 280E. There is no way to predict how the federal government may treat cannabis businesses from a

taxation standpoint in the future and no assurance can be given to what extent Code Section 280E, or other tax-related laws and regulations, may be applied to cannabis businesses in the future.

- Because the manufacturing (cultivation), sale, possession and use of cannabis is illegal under federal law, cannabis businesses may have restricted intellectual property and proprietary rights, particularly with respect to obtaining and enforcing patents and trademarks. In addition, cannabis businesses may face court action by third parties under RICO. Intellectual property and proprietary rights could be impaired as a result of cannabis business, and cannabis businesses could be named as a defendant in an action asserting a RICO violation.

- Federal bankruptcy courts cannot provide relief for parties who engage in cannabis or cannabis businesses. Recent bankruptcy rulings have denied bankruptcies for cannabis dispensaries upon the justification that businesses cannot violate federal law and then claim the benefits of federal bankruptcy for the same activity and upon the justification that courts cannot ask a bankruptcy trustee to take possession of, and distribute cannabis assets as such action would violate the CSA. Therefore, cannabis businesses may not be able to seek the protection of the bankruptcy courts and this could materially affect their financial performance and/or their ability to obtain or maintain credit.

- Since cannabis is illegal under federal law, there is a strong argument that banks cannot accept for deposit funds from businesses involved in the cannabis industry. Consequently, businesses involved in the cannabis industry often have difficulty finding a bank willing to accept their business. Any such inability to open or maintain bank accounts may make it difficult for cannabis businesses to operate. Under the BSA, banks must report to the federal government any suspected illegal activity, which includes any transaction associated with a cannabis business. These reports must be filed even though the business is operating legitimately under state law.

- Insurance that is otherwise readily available, such as general liability and directors and officer's insurance, may be more difficult to find, and more expensive.

Any presidential administration, current or future, could change federal enforcement policy or execution and decide to enforce the federal cannabis laws more strongly. Recent administrations have disagreed on how strongly to enforce federal cannabis laws. For example, on August 29, 2013, the DOJ under the Obama administration issued the Cole Memorandum, characterizing strict enforcement as an inefficient use of federal investigative and prosecutorial resources. The Cole Memorandum provided guidance to all federal prosecutors indicating that federal enforcement of the CSA against cannabis-related conduct should be focused on specific priorities, including cannabis distribution to minors, violence in connection with cannabis distribution, cannabis cultivation on federal property, and collection of cannabis-derived revenue by criminal enterprises, gangs and cartels. On January 4, 2018, the DOJ under the Trump administration issued the Sessions Memorandum, which effectively rescinded the Cole Memorandum and directed federal prosecutors to enforce the CSA and to follow well-established principles when pursuing prosecutions related to cannabis activities. The DOJ under the Biden administration has not readopted the Cole Memorandum, but President Biden has indicated support for decriminalization of cannabis. On October 6, 2022, President Biden issued an executive order pardoning all persons convicted of simple possession of cannabis under the CSA and directed the Secretary of Health and Human Services and the Attorney General to initiate an administrative process to review the scheduling of cannabis under the CSA. Further, on December 2, 2022, President Biden signed into law the Medical Marijuana and Cannabidiol Research Expansion Act, which streamlines and expands the process for researching the medical use of cannabis. We cannot predict how the current administration or future administrations will enforce the CSA or other laws against cannabis activities. Any change in the federal government's enforcement of current federal laws could cause significant financial damage to us. The legal uncertainty and possible future changes in law could negatively affect our growth, revenues, results of operations and success generally.

Unless and until Congress amends the CSA with respect to medical and/or adult use cannabis, there is a risk that federal prosecutors may enforce the existing CSA. Federal authorities may decide to change their current posture and begin to enforce current federal cannabis law and, if they decide to ignore the principles in the Cole Memorandum and begin to aggressively enforce such laws, it is possible that they could allege that we violated federal laws by selling products used in the cannabis industry. As a result, active enforcement of the current federal regulatory position on cannabis may directly or indirectly adversely affect our revenues and profits.

Violations of any U.S. federal laws and regulations could result in significant fines, penalties, administrative sanctions, convictions or settlements arising from civil proceedings conducted by either the U.S. federal government or private citizens, or criminal charges, including, but not limited to, disgorgement of profits, cessation of business activities or divestiture. This could have a material adverse effect on our business, including our reputation and ability to conduct business, the listing of our securities on any stock exchanges, the settlement of trades of our securities, our ability to obtain banking services, our financial position, operating results, profitability or liquidity or the market price of our publicly-traded shares. In addition, it is difficult for us to estimate the time or resources that would be needed for the investigation of any such matters or their final resolution.

because, in part, the time and resources that may be needed are dependent on the nature and extent of any information requested by the applicable authorities involved, and such time or resources could be substantial.

***Cannabis Industry Participants are subject to federal and state controlled substance laws and regulations. As a result, we are indirectly subject to a number of risks related to controlled substances.***

We sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry. Some of our products are sold to Cannabis Industry Participants and used in connection with cannabis businesses that are subject to federal and state controlled substance laws and regulations. Companies that transact directly or indirectly with cannabis businesses are subject to a number of risks related to controlled substances, which risks could reduce demand for our products by Cannabis Industry Participants. Such risks include, but are not limited to, the following:

- Cannabis is a Schedule I drug under the CSA and regulated by the DEA as an illegal substance. The FDA, in conjunction with the DEA, licenses cannabis research and drugs containing active ingredients derived from cannabis. If cannabis were to become legal under federal law, its sale and use could become regulated by the FDA or another federal agency.
- If cannabis were to become regulated by the FDA or another federal agency, extensive regulations may be imposed on the sale or use of cannabis. Such regulations could result in a decrease in cannabis sales and have a material adverse impact on the demand for our products. If we or our Cannabis Industry Participants are unable to comply with any applicable regulations and/or registration prescribed by the FDA, we may be unable to continue to transact with retailers and resellers who sell products to cannabis businesses and/or our financial condition may be adversely impacted.
- Controlled substance legislation differs between states, and legislation in certain states may restrict or limit Cannabis Industry Participants from buying our products. Cannabis Industry Participants may be required to obtain separate state registrations, permits or licenses in order to be able to obtain, handle and/or distribute controlled substances in a state. Such state regulatory requirements may be costly and, the failure of such Cannabis Industry Participants to meet such regulatory requirements could lead to enforcement and sanctions by the states in addition to any from the DEA or otherwise arising under federal law. We could be implicated in such enforcement or sanctions because of the purchase of our products by such Cannabis Industry Participants.
- The failure of our Cannabis Industry Participants to comply with applicable controlled substance laws and regulations, or the cost of compliance with these laws and regulations, may adversely affect the demand for our products and, as a result, the financial results of our business operations and our financial condition.

Furthermore, the JPMorgan Credit Facility restricts our ability and the ability of the Subsidiary Obligors to sell our products directly to U.S. cannabis growers or to retailers that sell only to the U.S. cannabis industry.

***Our growth is highly dependent on the U.S. cannabis market. In the past, California regulations caused licensing shortages and future regulations may create other limitations that decrease the demand for our products. State level regulations adopted in the future may adversely impact our business. Supply and demand and prevailing prices for cannabis may also adversely impact our business.***

The base of cannabis growers in the United States has grown over the past 20 years since the legalization of cannabis for medical uses in states such as California, Colorado, Michigan, Nevada, Oregon and Washington, with a large number of those growers depending on products similar to those we distribute. The U.S. cannabis market is still in its infancy and early adopter states such as California, Colorado and Washington represent a large portion of historical industry revenues. If the U.S. cannabis cultivation market does not grow as expected, our business, financial condition and results of operations could be adversely impacted.

Cannabis remains illegal under U.S. federal law, with cannabis listed as a Schedule I substance under the CSA. Notwithstanding laws in various states permitting certain cannabis activities, all cannabis activities, including possession, distribution, processing and manufacturing of cannabis and investment in, and financial services or transactions involving proceeds of, or promoting such activities remain illegal under various U.S. federal criminal and civil laws and regulations, including the CSA, as well as laws and regulations of several states that have not legalized some or any cannabis activities to date. Compliance with applicable state laws regarding cannabis activities does not protect us from federal prosecution or other enforcement action, such as seizure or forfeiture remedies, nor does it provide any defense to such prosecution or action. Cannabis activities conducted in or related to conduct in multiple states may potentially face a higher level of scrutiny from federal authorities. Penalties for violating federal drug, conspiracy, aiding, abetting, bank fraud and/or money laundering laws

may include prison, fines, and seizure/forfeiture of property used in connection with cannabis activities, including proceeds derived from such activities.

We sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry, however, it is evident to us that the movement towards the legalization of cannabis in the United States and its legalization in Canada has ultimately had a significant, positive impact on our industry. We are not currently subject directly to any state laws or regulations controlling participants in the legal cannabis industry. However, regulation of the cannabis industry does impact those that we believe represent many end-users for our products and, accordingly, there can be no assurance that changes in regulation of the industry and more rigorous enforcement by federal authorities will not have a material adverse effect on us.

***Legislation and regulations pertaining to the use and cultivation of cannabis are enacted on both the state and federal government level within the United States. As a result, the laws governing the cultivation and use of cannabis may be subject to change. Any new laws and regulations limiting the use or cultivation of cannabis and any enforcement actions by state and federal governments could indirectly reduce demand for our products, and may impact our current and planned future operations.***

Individual state laws allowing the cultivation and possession of cannabis for adult and medical uses conflict with federal laws prohibiting the cultivation, possession and use of cannabis for any purpose. A number of states have passed legislation legalizing or decriminalizing cannabis for adult use, other states have enacted legislation specifically permitting the cultivation and use of cannabis for medicinal purposes, and several states have enacted legislation permitting cannabis cultivation and use for both adult and medicinal purposes. Variations exist among those states' cannabis laws. Evolving federal and state laws and regulations pertaining to the use or cultivation of cannabis, as well as active enforcement by federal or state authorities of the laws and regulations governing the use and cultivation of cannabis may indirectly and adversely affect our business, our revenues and our profits.

Furthermore, the JPMorgan Credit Facility restricts our ability and the ability of the Subsidiary Obligors to sell our products directly to cannabis growers or to retailers that sell only to the cannabis industry. See “— Risks Relating to Our Indebtedness.”

***Certain of our products may be purchased for use in new and emerging industries and/or be subject to varying, inconsistent, and rapidly changing laws, regulations, administrative practices, enforcement approaches, judicial interpretations, future scientific research and public perception.***

We sell products, including hydroponic gardening products, through third-party retailers and resellers. End users may purchase these products for use in new and emerging industries, including the growing of cannabis that may not achieve market acceptance in a manner that we can predict. The demand for these products is dependent on the growth of these industries, which is uncertain, as well as the laws governing the growth, possession, and use of cannabis by adults for both adult and medical use.

Laws and regulations affecting the U.S. cannabis industry are continually changing, which could detrimentally affect our growth, revenues, results of operations and success generally. Local, state and federal cannabis laws and regulations are broad in scope and subject to evolving interpretations, which could require the end users of certain of our products or us to incur substantial costs associated with compliance or to alter our respective business plans. In addition, violations of these laws, or allegations of such violations, could disrupt our business and result in a material adverse effect on our results of operation and financial condition.

Scientific research related to the benefits of cannabis remains in its early stages, is subject to a number of important assumptions, and may prove to be inaccurate. Future research studies and clinical trials may reach negative conclusions regarding the viability, safety, efficacy, dosing, social acceptance or other facts and perceptions related to medical cannabis, which could materially impact the demand for our products for use in the cannabis industry.

The public's perception of cannabis may significantly impact the cannabis industry's success. Both the medical and adult use of cannabis are controversial topics, and there is no guarantee that future scientific research, publicity, regulations, medical opinion, and public opinion relating to cannabis will be favorable. The cannabis industry is an early-stage business that is constantly evolving with no guarantee of viability. The market for medical and adult use of cannabis is uncertain, and any adverse or negative publicity, scientific research, limiting regulations, medical opinion and public opinion (whether or not accurate or with merit) relating to the consumption of cannabis, whether in the United States or internationally, may have a material adverse effect on our operational results, consumer base, and financial results. Among other things, such a shift in public opinion could cause state jurisdictions to abandon initiatives or proposals to legalize medical or adult use cannabis or

adopt new laws or regulations restricting or prohibiting the medical or adult use of cannabis where it is now legal, thereby limiting the Cannabis Industry Participants.

Demand for our products may be negatively impacted depending on how laws, regulations, administrative practices, enforcement approaches, judicial interpretations, and consumer perceptions develop. We cannot predict the nature of such developments or the effect, if any, that such developments could have on our business.

***Our indirect involvement in the cannabis industry could affect the public's perception of us and be detrimental to our reputation.***

Damage to our reputation can be the result of the actual or perceived occurrence of any number of events, and could include any negative publicity, whether true or not. Cannabis has often been associated with various other narcotics, violence and criminal activities, the risk of which is that our retailers and resellers that transact with cannabis businesses might attract negative publicity. There is also risk that the action(s) of other participants, companies and service providers in the cannabis industry may negatively affect the reputation of the industry as a whole and thereby negatively impact our reputation. The increased use of social media and other web-based tools used to generate, publish and discuss user-generated content and to connect with other users has made it increasingly easier for individuals and groups to communicate and share opinions and views with regard to cannabis companies and their activities, whether true or not and the cannabis industry in general, whether true or not. We do not ultimately have direct control over how the cannabis industry is perceived by others. Reputation loss may result in decreased investor confidence, increased challenges in developing and maintaining community relations and an impediment to our overall ability to advance our business strategy and realize our growth prospects, thereby having a material adverse impact on our business.

In addition, third parties with whom we may do business could perceive that they are exposed to reputational risk as a result of our retailers' and resellers' involvement with cannabis businesses. Failure to establish or maintain business relationships due to reputational risk arising in connection with the nature of our business could have a material adverse effect on our business, financial condition and results of operations.

***Businesses involved in the cannabis industry, and investments in such businesses, are subject to a variety of laws and regulations related to money laundering, financial recordkeeping and proceeds of crimes.***

We sell our products through third-party retailers and resellers which do not exclusively sell to the cannabis industry. Investments in the U.S. cannabis industry are subject to a variety of laws and regulations that involve money laundering, financial recordkeeping and proceeds of crime, including the BSA, as amended by the USA PATRIOT Act, other anti-money laundering laws, and any related or similar rules, regulations or guidelines, issued, administered or enforced by governmental authorities in the United States. In February 2014, the FinCEN issued the FinCEN Memo providing guidance to banks seeking to provide services to cannabis businesses. The FinCEN Memo outlines circumstances under which banks may provide services to cannabis businesses without risking federal prosecution for violation of U.S. federal money laundering laws and outlines extensive due diligence and reporting requirements. On June 29, 2020, FinCEN issued additional guidance for financial institutions conducting due diligence and filing suspicious activity reports in connection with hemp-related business customers. While these guidelines clarify that financial institutions are not required to file suspicious activity reports solely based on a customer's hemp-related business operations that comply with applicable state law and regulations, these requirements can still present challenges for certain end users of our products in establishing and maintaining banking relationships, and restrictions on cannabis-related banking activities remain. The U.S. House of Representatives has passed the SAFE Banking Act numerous times, and, if enacted, this bill would protect banks and credit unions from federal prosecution for providing services to cannabis companies. However, the Senate has thus far failed to pass the SAFE Banking Act or other similar legislation, despite industry expectations that the Senate would pass the SAFE Banking Act in late 2022. Compliance with applicable state laws regarding cannabis activities does not protect from federal prosecution or other enforcement action, such as seizure or forfeiture remedies, nor does it provide any defense to such prosecution or action. Cannabis-related activities conducted in or related to conduct in multiple states may potentially face a higher level of scrutiny from federal authorities. Changes to current DOJ or Treasury Department policies or current state laws or regulations might adversely affect the legal risks under federal anti-money laundering laws posed by the acceptance directly by our distributors or indirectly by us of proceeds of our end users' cannabis growing activities.

### **Risks Relating to Other Regulations**

***Certain state and other regulations pertaining to the use of certain ingredients in growing media and plant nutrients could adversely impact us by restricting our ability to sell such products.***

One of our leading product lines is growing media and nutrients products. This product line includes certain products, such as organic soils and nutrients that contain ingredients that require the companies that provide us with these products to register the product with certain regulators. The use and disposal of these products in some jurisdictions are subject to regulation by various agencies. A decision by a regulatory agency to significantly restrict the use of such products that have traditionally been used in the cultivation of our leading products could have an adverse impact on those companies providing us with such regulated products, and as a result, limit our ability to sell these products.

Our products and operations may be subject to increased regulatory and environmental scrutiny in jurisdictions in which we do business. For example, we are subject to regulations relating to our harvesting of peat moss in Canada, which has come under increasing regulatory and environmental scrutiny at the federal, provincial and territorial levels.

***We are currently subject to, and may in the future become subject to additional, U.S., state and foreign laws and regulations imposing obligations on how we collect, store and process personal information. Our actual or perceived failure to comply with such obligations could harm our business.***

We are, and may increasingly become, subject to various laws and regulations, as well as contractual obligations, relating to data privacy and security in the jurisdictions in which we operate. The regulatory environment related to data privacy and security is increasingly rigorous, with new and constantly changing requirements applicable to our business, and enforcement practices are likely to remain uncertain for the foreseeable future. These laws and regulations may be interpreted and applied differently over time and from jurisdiction to jurisdiction, and it is possible that they will be interpreted and applied in ways that may have a material adverse effect on our business, financial condition, results of operations and prospects.

In the United States, various federal and state regulators, including governmental agencies like the Consumer Financial Protection Bureau and the Federal Trade Commission, have adopted, or are considering adopting, laws and regulations concerning personal information and data security. Certain state laws may be more stringent or broader in scope, or offer greater individual rights, with respect to personal information than federal, international or other state laws, and such laws may differ from each other, all of which may complicate compliance efforts. For example, the California Consumer Privacy Act (“CCPA”), which increases privacy rights for California residents and imposes obligations on companies that process their personal information, came into effect on January 1, 2020. Among other things, the CCPA requires covered companies to provide new disclosures to California consumers and provide such consumers new data protection and privacy rights, including the ability to opt-out of certain sales of personal information. The CCPA provides for civil penalties for violations, as well as a private right of action for certain data breaches that result in the loss of personal information. This private right of action may increase the likelihood of, and risks associated with, data breach litigation. In addition, on November 3, 2020, California voters approved a new privacy law, the California Privacy Rights Act (“CPRA”). The CPRA comes into effect on January 1, 2023, and will significantly modify the CCPA, including by expanding consumers’ rights with respect to certain personal information and creating a new state agency to oversee implementation and enforcement efforts. Virginia and Colorado also enacted comprehensive data privacy laws similar to the CCPA, both of which will be effective in 2023. In addition, laws in all 50 U.S. states require businesses to provide notice to consumers whose personal information has been disclosed as a result of a data breach. State laws are changing rapidly and there is discussion in the U.S. Congress of a new comprehensive federal data privacy law to which we would become subject if it is enacted.

Internationally, laws, regulations and standards in many jurisdictions apply broadly to the collection, use, retention, security, disclosure, transfer and other processing of personal information. For example, the E.U. General Data Protection Regulation (“GDPR”), which became effective in May 2018, greatly increased the European Commission’s jurisdictional reach of its laws and adds a broad array of requirements for handling personal data. EU member states are tasked under the GDPR to enact, and have enacted, certain implementing legislation that adds to and/or further interprets the GDPR requirements and potentially extends our obligations and potential liability for failing to meet such obligations. The GDPR, together with national legislation, regulations and guidelines of the EU member states and the United Kingdom governing the processing of personal data, impose strict obligations and restrictions on the ability to collect, use, retain, protect, disclose, transfer and otherwise process personal data. In particular, the GDPR includes obligations and restrictions concerning the consent and rights of individuals to whom the personal data relates, the transfer of personal data out of the European Economic Area or the United Kingdom, security breach notifications and the security and confidentiality of personal data. The GDPR authorizes fines for certain violations of up to 4% of global annual revenue or €20 million, whichever is greater.

All of these evolving compliance and operational requirements impose significant costs, such as costs related to organizational changes, implementing additional protection technologies, training employees and engaging consultants, which are likely to increase over time. In addition, such requirements may require us to modify our data processing practices and policies, distract management or divert resources from other initiatives and projects, all of which could have a material adverse effect on our business, financial condition, results of operations and prospects. Any failure or perceived failure by us to comply with any applicable federal, state or similar foreign laws and regulations relating to data privacy and security could result in

damage to our reputation, as well as proceedings or litigation by government agencies or other third parties, including class action privacy litigation in certain jurisdictions, which would subject us to significant fines, sanctions, awards, penalties or judgements, all of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

***Compliance with, or violation of, environmental, health and safety laws and regulations, including laws pertaining to the use of pesticides, could result in significant costs that adversely impact our reputation, businesses, financial position, results of operations and cash flows.***

International, federal, state, provincial and local laws and regulations relating to environmental, health and safety matters affect us in several ways in light of the ingredients that are used in products included in our growing media and nutrients product line. In the United States, products containing pesticides generally must be registered with the Environmental Protection Agency (the “EPA”), and similar state agencies before they can be sold. The failure by one of our partners to obtain or the cancellation of any such registration, or the withdrawal from the marketplace of such pesticides, could have an adverse effect on our businesses, the severity of which would depend on the products involved, whether other products could be substituted and whether our competitors were similarly affected. The pesticides we may produce or distribute are either granted a license by the EPA or exempt from such a license and may be evaluated by the EPA as part of its ongoing exposure risk assessment. The EPA may decide that a pesticide we distribute will be limited or will not be re-registered for use in the United States. We cannot predict the outcome or the severity of the effect on our business of any future evaluations, if any, conducted by the EPA.

In addition, the end user application or use of certain pesticide products is regulated by various international, federal, state, provincial and local environmental and public health agencies. Although we strive to educate the end user with such laws and regulations, we may be unable to prevent violations of these or other laws and regulations from occurring. Even if we are able to comply with all applicable laws and regulations and obtain all necessary registrations and licenses, the pesticides or other products we distribute, could be alleged to cause injury to the environment, to people or to animals, or such products could be banned in certain circumstances. The costs of compliance, noncompliance, investigation, remediation, combating reputational harm or defending civil or criminal proceedings, products liability, personal injury or other lawsuits could have a material adverse impact on our reputation, businesses, financial position, results of operations and cash flows.

## **Risks Relating to Our Intellectual Property**

***Recent laws make it difficult to predict how patents will be issued or enforced in our industry.***

Changes in either the patent laws or interpretation of the patent laws in the United States and other countries may have a significant impact on our ability to protect our technology and enforce our intellectual property and proprietary rights. There have been numerous changes to the patent laws and to the rules of the United States Patent and Trademark Office (the “USPTO”), which may have a significant impact on our ability to protect our technology and enforce our intellectual property and proprietary rights. For example, the Leahy-Smith America Invents Act, which was signed into law in 2011, includes a transition from a “first-to-invent” system to a “first-to-file” system, and changes the way issued patents can be challenged. Certain changes, such as the institution of inter partes review and post-grant and derivation proceedings, came into effect in 2012. Substantive changes to patent laws associated with the Leahy-Smith America Invents Act may affect our ability to obtain patents, and, if obtained, to enforce or defend them in litigation or inter partes review, or post-grant or derivation proceedings, all of which could harm our business.

***We may not be able to adequately obtain, maintain, protect or enforce our intellectual property and other proprietary rights that are material to our business.***

Our ability to compete effectively depends in part on our rights to trademarks, patents and other intellectual property rights we own or license. We have not sought to register every one of our trademarks either in the United States or in every country in which such mark is used. Furthermore, because of the differences in foreign trademark, patent and other intellectual property or proprietary rights laws, we may not receive the same protection in other countries as we would in the United States with respect to the registered brand names and issued patents we hold. If we are unable to obtain, maintain, protect and enforce our intellectual property and proprietary rights, including our information and/or brand names, we could suffer a material adverse effect on our business, financial condition and results of operations.

The steps we take to obtain, maintain, protect and enforce our intellectual property and proprietary rights may be inadequate and despite our efforts to protect these rights, unauthorized third parties, including our competitors, may duplicate, reverse engineer, access, obtain, use or copy the proprietary aspects of our technology, processes, products or services without our permission. In addition, we cannot guarantee that we have entered into confidentiality agreements with each party that has



or may have had access to our proprietary information, know-how and trade secrets. Moreover, our contractual arrangements may be breached or otherwise not effectively prevent disclosure of, or control access to, our intellectual property and confidential and proprietary information or provide an adequate remedy in the event of an unauthorized disclosure. If we are unable to obtain, maintain, protect or enforce our intellectual property and proprietary rights, including our proprietary information and/or brand names, we could suffer a material adverse effect on our business, financial condition and results of operations.

Litigation may be necessary to enforce our owned or in-licensed intellectual property rights and proprietary rights and protect our proprietary information against claims by third parties that our products or services infringe, misappropriate or otherwise violate their intellectual property rights or proprietary rights. Any litigation or claims brought by us could result in substantial costs and diversion of our resources and may not be successful, even when our rights have been infringed, misappropriated or otherwise violated. Our efforts to enforce our intellectual property and proprietary rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property and proprietary rights, and if such defenses, counterclaims or countersuits are successful, we could lose valuable intellectual property and proprietary rights. Additionally, the mechanisms for enforcement of intellectual property and proprietary rights in foreign jurisdictions may be inadequate.

***Obtaining and maintaining our patent protection depends on compliance with various procedural, document submissions, fee payment and other requirements imposed by governmental patent agencies, and our patent protection could be reduced or eliminated for noncompliance with these requirements.***

Periodic maintenance or annuity fees on any issued patents are due to be paid to the USPTO, and foreign patent agencies in several stages over the lifetime of the patent. The USPTO and various foreign governmental patent agencies require compliance with a number of procedural, documentary, fee payments and other similar provisions during the patent application process. While an inadvertent or unintentional lapse can in many cases be cured by payment of a late fee or by other means in accordance with the applicable rules, there are situations in which noncompliance can result in abandonment or lapse of the patent or patent application, resulting in partial or complete loss of patent rights in the relevant jurisdiction. Noncompliance events that could result in abandonment or lapse of a patent or patent application include, but are not limited to, failure to respond to official actions within prescribed time limits, nonpayment of fees and failure to properly legalize and submit formal documents. If we or our licensors fail to maintain the patents and patent applications covering our products, our competitors might be able to enter the market, which would have a material adverse effect on our business. Additionally, patents have a limited lifespan. In the United States, even if all maintenance fees are timely paid, the natural expiration of a patent is generally 20 years from its earliest U.S. non-provisional filing date and the natural expiration of a design patent is generally 14 years after its issue date, unless the filing date occurred on or after May 13, 2015, in which case the natural expiration of a design patent is generally 15 years after its issue date. Even if patents covering our products or services are obtained, once the patent life has expired, we may be open to competition from competitive products or services. If one of our products requires extended development, testing and/or regulatory review, patents protecting such products might expire before or shortly after such products are commercialized. As a result, our patent portfolio may not provide us with sufficient rights to exclude others from commercializing products similar or identical to ours.

***From time to time, we may need to rely on licenses to proprietary technologies, which may be difficult or expensive to obtain or we may lose certain licenses which may be difficult to replace, harming our competitive position.***

We may need to obtain licenses to patents and other intellectual property and proprietary rights held by third parties to develop, manufacture and market our products, if, for example, we sought to develop our products, in conjunction with any patented technology. If we are unable to timely obtain these licenses on commercially reasonable terms (or at all) and maintain these licenses, our ability to commercially market our products, may be inhibited or prevented, which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

In spite of our best efforts, our licensors might conclude that we have materially breached our license agreements and might therefore terminate the license agreements, thereby removing our ability to develop and commercialize products, services and technology covered by these license agreements. If these in-licenses are terminated, or if the underlying patents fail to provide the intended exclusivity, competitors may have the freedom to market products identical to ours and we may be required to cease using or commercializing our products, services and technology covered by such patents.

***Third parties may initiate legal proceedings alleging that we are infringing their intellectual property rights, the outcome of which would be uncertain and could have a material adverse effect on the success of our business.***

Our success depends upon our ability to develop, manufacture, market and sell our products, and to use our proprietary technologies without infringing, misappropriating or otherwise violating the intellectual property or proprietary rights of third

parties. We may become party to, or threatened with, future adversarial proceedings or litigation regarding intellectual property or proprietary rights with respect to our products and technology, including interference or derivation proceedings and various other post-grant proceedings before the USPTO and/or non-U.S. opposition proceedings. Third parties may assert infringement claims against us based on existing patents or patents that may be granted in the future. A successful claim of trademark, patent or other intellectual property or proprietary right infringement, misappropriation or other violation against us, or any other successful challenge to the use of our intellectual property and proprietary rights, could subject us to damages or prevent us from providing certain products or services, or using certain of our recognized brand names, which could have a material adverse effect on our business, financial condition and results of operations. As a result of any such infringement claims, or other intellectual property claims, regardless of merit, or to avoid potential claims, we may choose or be compelled to seek intellectual property licenses from third parties. These licenses may not be available on acceptable terms, or at all. Even if we are able to obtain a license, the license would likely obligate us to pay license fees, royalties, minimum royalties and/or milestone payments and the rights granted to us could be nonexclusive, which would mean that our competitors may be able to obtain licenses to the same intellectual property. Ultimately, we could be prevented from commercializing a product and/or technology or be forced to cease some aspect of our business operations if, as a result of actual or threatened infringement or other intellectual property claims, we are unable to enter into licenses of the relevant intellectual property on acceptable terms. Further, if we attempt to modify a product and/or technology or to develop alternative methods or products in response to infringement or other intellectual property claims or to avoid potential claims, we could incur substantial costs, encounter delays in product introductions or interruptions in sales.

***We may be subject to claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers.***

Although we try to ensure that our employees do not use the intellectual property and proprietary rights, including proprietary information or know-how, of others in their work for us, we may be subject to claims that we or these employees have used or disclosed intellectual property or proprietary rights, including trade secrets or other proprietary information, of any such employee's former employer. We are not aware of any threatened or pending claims related to these matters or concerning agreements with our employees, but in the future litigation may be necessary to defend against such claims. If we fail in defending any such claims, in addition to paying monetary damages, we may lose valuable intellectual property or proprietary rights or personnel. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management.

***Intellectual property disputes could cause us to spend substantial resources and distract our personnel from their normal responsibilities.***

Even if resolved in our favor, litigation or other legal proceedings relating to intellectual property claims may cause us to incur significant expenses, and could distract our personnel from their normal responsibilities. In addition, there could be public announcements of the results of hearings, motions or other interim proceedings or developments, and if securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the value of our common stock. Such litigation or proceedings could substantially increase our operating losses and reduce the resources available for development activities or any future sales, marketing or distribution activities. We may not have sufficient financial or other resources to adequately conduct such litigation or proceedings. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources. Uncertainties resulting from the initiation and continuation of patent and other intellectual property litigation or other proceedings could have a material adverse effect on our ability to compete in the marketplace.

***If our owned or in-licensed trademarks and trade names are not adequately protected, then we may not be able to build name recognition in our markets of interest and our business may be adversely affected.***

We regard our owned and in-licensed trademarks, trade names and service marks as having significant value and as an important factor in the success of our business. The registered or unregistered trademarks, trade names and service marks that we own or in-license from third parties may be challenged, infringed, circumvented, declared generic or determined to be infringing on or dilutive of other marks. Additionally, at times, competitors may adopt trademarks, trade names or service marks similar to the ones we own or in-license, thereby impeding our ability to build brand identity and possibly leading to market confusion. In addition, there could be potential trademark, trade name or service mark infringement claims brought against us or our licensors by owners of other trademarks, trade names and service marks. Over the long term, if we are unable to establish name recognition based on our owned and in-licensed trademarks and trade names, then we may not be able to compete effectively and our business may be adversely affected. We may also license our trademarks, trade names and service marks out to third parties, such as our distributors. Though these license agreements may provide guidelines for how our trademarks, trade names and service marks may be used, a breach of these agreements or misuse of our trademarks, trade names and service marks by our licensees may jeopardize our rights in or diminish the goodwill associated with our trademarks and

trade names. Our efforts to enforce or protect our intellectual property and proprietary rights related to trademarks, trade names and service marks may be ineffective and could result in substantial costs and diversion of resources and could adversely affect our business, financial condition, results of operations and prospects.

***Intellectual property and proprietary rights do not necessarily address all potential threats to our competitive advantage.***

The degree of future protection afforded by our intellectual property and proprietary rights is uncertain because intellectual property and proprietary rights have limitations, and may not adequately protect our business, or permit us to maintain our competitive advantage. The following examples are illustrative.

- Others may be able to construct products that are similar to our products but that are not covered by the claims of the patents that we own or have exclusively licensed;
- We or our licensors or strategic collaborators, if any, might not have been the first to make the inventions covered by the issued patent or pending patent application that we own or have exclusively licensed;
- We or our licensors or strategic collaborators, if any, might not have been the first to file patent applications covering certain of our inventions;
- Others may independently develop similar or alternative technologies or duplicate any of our technologies without infringing, misappropriating or otherwise violating our intellectual property and proprietary rights;
- It is possible that our current and future pending patent applications will not lead to issued patents;
- It is possible that our current and future pending trademark or service mark applications will not lead to registrations;
- We may fail to identify patentable aspects of our research and development output before it is too late to obtain patent protection;
- Issued patents and other intellectual property and proprietary rights that we own or have exclusively licensed may not provide us with any competitive advantages, may not be sufficiently broad in scope or may be held invalid or unenforceable, as a result of legal challenges by third parties, including our competitors;
- Our competitors might conduct research and development activities in countries where we do not have patent rights and then use the information learned from such activities to develop competitive products for sale in our major commercial markets;
- We may not develop additional proprietary technologies that are patentable; and
- The patents of others may have an adverse effect on our business.

Should any of these events occur, they could significantly harm our business, results of operations and prospects.

**Risks Relating to Our Capital Stock**

***We may incur indebtedness or issue capital stock that ranks senior or equally to our common stock as to liquidation preference and other rights and which may dilute our stockholders' ownership interest.***

Shares of our common stock are common equity interests in us and, as such, will rank junior to all of our existing and future indebtedness and other liabilities. Additionally, our amended and restated certificate of incorporation (the "Certificate of Incorporation") does not prohibit us from issuing any series of preferred stock that would rank senior or equally to our common stock as to dividend payments and liquidation preference. Our Certificate of Incorporation allows for our board of directors to create new series of preferred stock without further approval by our stockholders, which could adversely affect the rights of the holders of our common stock. We have the authority to issue up to 50,000,000 shares of our preferred stock without further stockholder approval. The issuances of any series of preferred stock could have the effect of reducing the amounts available to our holders of common stock in the event of our liquidation. In addition, if we issue preferred stock with voting rights that dilute the voting power of our common stock, the market price of our common stock could decrease. Additional issuances and sales of preferred stock, or the perception that such issuances and sales could occur, may cause prevailing market prices for our common stock to decline and may adversely affect our ability to raise additional capital in the financial markets at times and

prices favorable to us. In addition, any additional capital raised through the sale of equity or equity-backed securities may dilute our stockholders' ownership percentages and could also result in a decrease in the market value of our common stock.

***Provisions in our corporate charter documents and under Delaware law could make an acquisition of our company, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.***

These provisions might discourage, delay or prevent a change in control of our company or a change in our management. The existence of these provisions could adversely affect the voting power of holders of common stock and limit the price that investors might be willing to pay in the future for shares of our common stock. Furthermore, we have the authority to issue up to 50,000,000 shares of our preferred stock without further stockholder approval, the rights of which will be determined at the discretion of the board of directors and that, if issued, could operate as a "poison pill" to dilute the stock ownership of a potential hostile acquirer to prevent an acquisition that our board of directors does not approve. In addition, our Certificate of Incorporation and amended and restated bylaws (the "Bylaws") contain provisions that may make the acquisition of our company more difficult, including the following:

- our authorized but unissued and unreserved common stock and preferred stock could make more difficult or discourage an attempt to obtain control of us by means of a proxy contest, tender offer, merger or otherwise;
- our board of directors is classified into three classes of directors with staggered three-year terms and directors are only able to be removed from office for cause;
- stockholders will only be able to take action at a meeting of stockholders and will not be able to take action by written consent for any matter, except in certain circumstances;
- a special meeting of our stockholders may only be called by the chairperson of our board of directors or a majority of our board of directors;
- advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and
- certain amendments to our Certificate of Incorporation and any amendments to our Bylaws by our stockholders will require the approval of at least two-thirds of our then-outstanding voting power entitled to vote generally in an election of directors, voting together as a single class.

***Various provisions of our lending agreements with JPMorgan, in addition to our Certificate of Incorporation, Bylaws and other corporate documents, could delay or prevent a change of control.***

The JPMorgan Credit Facility prohibits us from undergoing a change of control. Any takeover attempt could be delayed, or prevented, if an amendment or waiver is not provided by the respective lenders. See "— Risks Relating to Our Indebtedness". Moreover, certain provisions of our Certificate of Incorporation and Bylaws and provisions of Delaware General Corporation Law could delay or prevent a change of control or may impede the ability of the holders of our common stock to change our management. In particular, our Certificate of Incorporation and Bylaws, among other things will regulate how stockholders may present proposals or nominate directors for election at stockholders' meetings and authorize our board of directors to issue preferred stock in one or more series, without stockholder approval. See "Description of Capital Stock — Anti-Takeover Provisions" which is attached to this Annual Report on Form 10-K as Exhibit 4.2.

We have no direct operations and no significant assets other than the ownership of capital stock and equity interests of our subsidiaries. Because we conduct our operations through our subsidiaries, we depend on those entities for dividends and other payments to generate the funds necessary to meet our financial obligations. Legal and contractual restrictions in the JPMorgan Credit Facility and other agreements which may govern future indebtedness of our subsidiaries, as well as the financial condition and operating requirements of our subsidiaries, may limit our ability to obtain cash from our subsidiaries. The earnings from, or other available assets of, our subsidiaries might not be sufficient to pay dividends or make distributions or loans to enable us to pay any dividends on our common stock or other obligations. Any of the foregoing could materially and adversely affect our business, financial condition, results of operations and cash flows. In addition, our ability to pay dividends is restricted by the terms of the JPMorgan Credit Facility and, in addition, future debt financing, if any, may contain terms prohibiting or limiting the amount of dividends that may be declared or paid on our securities.

We currently intend to retain any future earnings for use in the operation and expansion of our business. Accordingly, we do not expect to pay any dividends to holders of our common stock in the foreseeable future, but will review this policy as circumstances dictate. The declaration and payment of all future dividends to holders of our common stock, if any, will be at the sole discretion of our board of directors, which retains the right to change our dividend policy at any time. In addition, our ability to pay dividends is restricted by the terms of the JPMorgan Credit Facility and, in addition, future debt financing, if any, may contain terms prohibiting or limiting the amount of dividends that may be declared or paid on our securities. Consequently, capital appreciation, if any, of our common stock may be the sole source of gain on investment for the foreseeable future.

***If we fail to meet the continued listing standards of Nasdaq, our common stock may be delisted, which may adversely affect the market price and liquidity of our common stock.***

Our common stock is currently traded on the Nasdaq Global Select Market (“Nasdaq”). Nasdaq requires us to meet certain financial, public float, bid price and liquidity standards on an ongoing basis in order to continue the listing of our common stock, including that we maintain a minimum closing bid price of \$1.00 per share. There can be no assurance that we will be able to maintain compliance with the requirements for continued listing of our common stock on Nasdaq. If our common stock is delisted and we are unable to list our common stock on another U.S. national securities exchange, we expect our securities would be quoted on an over-the-counter market. If this were to occur, our stockholders could face significant material adverse consequences, including limited availability of market quotations for our common stock and reduced liquidity for the trading of our securities. Furthermore, if our common stock were delisted it could adversely affect our ability to obtain financing for the continuation of our operations and/or result in the loss of confidence by investors, customers, suppliers and employees.

***Our largest stockholders will exercise significant influence over our company for the foreseeable future, including the outcome of matters requiring stockholder approval.***

If our former directors and their affiliates were to choose to act together, they could have a significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or all or a significant percentage of our assets. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

We cannot assure you that the interests of our former directors and affiliated persons will coincide with the interests of the investors. So long as our former directors and affiliated persons collectively controls a significant portion of our common stock, these individuals and/or entities controlled by them, will continue to collectively be able to strongly influence or effectively control our decisions. Therefore, you should not invest in reliance on your ability to have any control over our company. See “Principal Stockholders,” “Certain Relationships and Related Party Transactions” and “Description of Capital Stock” which is attached to this Annual Report on Form 10-K as Exhibit 4.2.

***The market price of our common stock could be negatively affected by future sales of our common stock.***

If our existing stockholders, our directors, their affiliates, or our executive officers, sell a substantial number of shares of our common stock in the public market, the market price of our common stock could decrease significantly. The perception in the public market that these stockholders might sell our common stock could also depress the market price of our common stock and could impair our future ability to obtain capital, especially through an offering of equity securities.

***Our common stock has only recently become publicly-traded, and the market price of our common stock has been volatile.***

The market price of our common stock has fluctuated substantially due to a number of factors. These fluctuations could cause you to lose all or part of your investment in our common stock since you might be unable to sell your shares at or above the price you paid. Factors that could cause fluctuations in the trading price of our common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- volatility in the trading prices and trading volumes of stocks in our industry;
- changes in operating performance and stock market valuations of other companies generally, or those in our industry in particular;
- sales of shares of our common stock by us or our stockholders;

- failure of securities analysts to maintain coverage of us, changes in financial estimates by securities analysts who follow our company or our failure to meet these estimates or the expectations of investors;
- the financial projections we may provide to the public, any changes in those projections or our failure to meet those projections;
- announcements by us or our competitors of new offerings or platform features;
- the public’s reaction to our press releases, other public announcements and filings with the SEC;
- rumors and market speculation involving us or other companies in our industry;
- actual or anticipated changes in our results of operations or fluctuations in our results of operations;
- actual or anticipated developments in our business, our competitors’ businesses or the competitive landscape generally;
- litigation involving us, our industry or both, or investigations by regulators into our operations or those of our competitors;
- developments or disputes concerning our intellectual property or other proprietary rights;
- announced or completed acquisitions of businesses, services or technologies by us or our competitors;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidelines, interpretations or principles;
- any significant change in our management;
- the continued threat of terrorism and the impact of military and other action, including military actions involving Russia and Ukraine; and
- general economic conditions and slow or negative growth of our markets.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company’s securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management’s attention and resources.

***Our Certificate of Incorporation provides that the doctrine of “corporate opportunity” will not apply with respect to any director or stockholder who is not employed by us or our affiliates.***

The doctrine of corporate opportunity generally provides that a corporate fiduciary may not develop an opportunity using corporate resources, acquire an interest adverse to that of the corporation or acquire property that is reasonably incident to the present or prospective business of the corporation or in which the corporation has a present or expectancy interest, unless that opportunity is first presented to the corporation and the corporation chooses not to pursue that opportunity. The doctrine of corporate opportunity is intended to preclude officers or directors or other fiduciaries from personally benefiting from opportunities that belong to the corporation. Our Certificate of Incorporation provides that the doctrine of “corporate opportunity” does not apply with respect to any director or stockholder who is not employed by us or our affiliates. Any director or stockholder who is not employed by us or our affiliates will therefore have no duty to communicate or present corporate opportunities to us, and will have the right to either hold any corporate opportunity for their (and their affiliates’) own account and benefit or to recommend, assign or otherwise transfer such corporate opportunity to persons other than us, including to any director or stockholder who is not employed by us or our affiliates.

As a result, certain of our stockholders, directors and their respective affiliates will not be prohibited from operating or investing in competing businesses. We therefore may find ourselves in competition with certain of our stockholders, directors or their respective affiliates, and we may not have knowledge of, or be able to pursue, transactions that could potentially be beneficial to us. Accordingly, we may lose a corporate opportunity or suffer competitive harm, which could negatively impact our business or prospects.

***Our Certificate of Incorporation and our Bylaws provide that the Court of Chancery of the State of Delaware will be the exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.***

Our Certificate of Incorporation and our Bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for any derivative action or proceeding brought on our behalf; any action asserting a breach of fiduciary duty; any action asserting a claim against us arising pursuant to the Delaware General Corporation Law, our Certificate of Incorporation or our Bylaws; or any action asserting a claim against us that is governed by the internal affairs doctrine. Notwithstanding the foregoing, the exclusive forum provision does not apply to suits brought to enforce any liability or duty created by the Exchange Act, the Securities Act or any other claim for which the federal courts have exclusive jurisdiction. Unless we consent in writing to the selection of an alternative forum, the federal district courts of the United States of America shall, to the fullest extent permitted by applicable law, be the sole and exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act. The choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and other employees. Alternatively, if a court were to find the choice of forum provision contained in our Certificate of Incorporation and our Bylaws to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could materially and adversely affect our business, financial condition, and results of operations.

### **General Risk Factors**

***If we are unable to hire and retain key personnel, we may not be able to implement our business plan and our business may fail; our headcount reductions may cause undesirable consequences.***

Our future success depends to a large extent on our ability to attract, hire, train and retain qualified managerial, operational and other personnel. We face significant competition for qualified and experienced employees in our industry and from other industries and, as a result, we may be unable to attract and retain the personnel needed to successfully conduct and grow our operations. Additionally, key personnel, including members of management, may leave and compete against us. If we are unable to hire and retain key personnel, our business will be materially adversely affected. In light of recent inflation, we may be required to increase the compensation we offer to current and prospective employees in order to compete for talent, and any wage increases may make it more difficult for us maintain general operating expenses at desired levels.

Additionally, we reduced headcount and implemented temporary employee furloughs in 2022, and may implement further reductions in the future to create operational efficiencies. This workforce reduction may yield unintended consequences, such as attrition beyond our intended reductions and reduced employee morale, which may cause our employees who were not affected by the headcount reductions to seek alternate employment. We cannot provide assurance that we will not undertake additional workforce reductions or that we will be able to realize cost savings and other anticipated benefits from our previous or any future workforce reduction plans. In addition, this may adversely impact our ability to respond rapidly to any new product, growth or revenue opportunities and to execute on our business plans.

***Litigation may adversely affect our business, financial condition and results of operations.***

From time to time in the normal course of our business operations, we may become subject to litigation that may result in liability material to our financial statements as a whole or may negatively affect our operating results if changes to our business operation are required. The cost to defend such litigation may be significant and may require a diversion of our resources. There also may be adverse publicity associated with litigation that could negatively affect customer perception of our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may adversely affect our business, financial condition and results of operations.

***Exercise of options may have a dilutive effect on your percentage ownership and may result in a dilution of your voting power and an increase in the number of shares of common stock eligible for future resale in the public market, which may negatively impact the trading price of our shares of common stock.***

The exercise of some or all of our outstanding options could result in significant dilution in the percentage ownership interest of existing investors and in the percentage ownership interest of our existing common stockholders and in a significant dilution of voting rights and earnings per share. As of December 31, 2022, we have outstanding options, held primarily by our current and former employees, for the issuance of up to 670,026 shares of common stock at a weighted exercise price of \$9.50 per share. The exercise of such existing outstanding stock options will further dilute our stockholders' voting interests. To the extent options are exercised, additional shares of common stock will be issued, and such issuance will dilute stockholders.



In addition to the dilutive effects described above, the exercise of those securities would lead to an increase in the number of shares of common stock eligible for resale in the public market. Sales of substantial numbers of such shares of common stock in the public market could adversely affect the market price of our shares of common stock. Substantial dilution and/or a substantial increase in the number of shares of common stock available for future resale may negatively impact the trading price of our shares of common stock.

***Our security holders may be diluted by future issuances of securities by us.***

In the future, we may issue our authorized but previously unissued equity securities, including additional shares of capital stock or securities convertible into or exchangeable for our capital stock. Such issuance of additional securities would dilute the ownership stake in us held by our existing stockholders and could adversely affect the value of our securities.

We may also issue additional shares of our common stock, warrants or other securities that are convertible into or exercisable for the purchase of shares of our common stock in connection with hiring and/or retaining employees or consultants, future acquisitions, future sales of our securities for capital raising purposes, or for other business purposes. The future issuance of any such additional shares of our common stock or other securities, for any reason including those stated above, may have a negative impact on the market price of our common stock. There can be no assurance that the issuance of any additional shares of common stock, warrants or other convertible securities may not be at a price (or exercise prices) below the price of the common stock offered hereby.

***Failure to comply with the U.S. Foreign Corrupt Practices Act could subject us to penalties and other adverse consequences.***

As a Delaware corporation, we are subject to the U.S. Foreign Corrupt Practices Act, which generally prohibits U.S. companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Some foreign companies, including some that may compete with us, may not be subject to these prohibitions. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices may occur from time-to-time in countries in which we conduct our business. However, our employees or other agents may engage in conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties and other consequences that may have a material adverse effect on our business, financial condition and results of operations.

***Delaware law contains anti-takeover provisions that could deter takeover attempts that could be beneficial to our stockholders.***

Provisions of Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. Section 203 of the Delaware General Corporation Law may make the acquisition of our company and the removal of incumbent officers and directors more difficult by prohibiting stockholders holding 15% or more of our outstanding voting stock from acquiring us, without the consent of our board of directors, for at least three years from the date they first hold 15% or more of the voting stock.

**Item 1B. UNRESOLVED STAFF COMMENTS**

None.

## Item 2. PROPERTIES

Information regarding each of our significant facilities, which may include multiple leases at each location, is set forth below. We believe that our existing facilities are adequate for our needs at this time.

<b>Location<sup>3</sup></b>	<b>Square Footage</b>	<b>Owned or Leased</b>
<b>Distribution Centers:</b>		
Fairfield, CA, U.S.	175,000	Leased <sup>1</sup>
Fontana, CA, U.S.	147,000	Leased
Gresham, OR, U.S.	98,000	Leased
Denver, CO, U.S.	87,000	Leased
Shoemakersville, PA, U.S.	303,000	Leased <sup>1</sup>
New Hudson, MI, U.S.	126,000	Leased <sup>1</sup>
Langley, BC, Canada	157,000	Leased
Cambridge, ON, Canada	53,000	Leased
<b>Manufacturing Facilities:</b>		
Paramount, CA, U.S.	25,000	Leased
Arcata, CA, U.S.	115,000	Leased
Eugene, OR, U.S.	242,000	Owned <sup>2</sup>
Goshen, NY, U.S.	21,000	Owned
Sycamore, IL, U.S.	316,000	Leased <sup>1</sup>
Edmonton, AB, Canada	26,000	Leased
Langley, BC, Canada	79,000	Leased

<sup>1</sup> We have one or more operating subleases or third-party logistics agreements at this location.

<sup>2</sup> In January 2023, we entered into a sale-leaseback transaction. Refer to Part II, Item 8, Financial Statements, Note 16 - *Subsequent Events* for additional information about the sale and leaseback transaction at the Eugene, OR location.

<sup>3</sup> In addition, we operate a distribution center in Zaragoza, Spain.

## Item 3. LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings, which arise in the ordinary course of business. We are currently not aware of any legal proceedings or claims that we believe will have a material adverse effect on our business, financial condition or operating results.

## Item 4. MINE SAFETY DISCLOSURES

Not applicable.

## **PART II**

### **Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

#### **Market Information**

Our common stock began trading on The Nasdaq Global Select Market under the symbol "HYFM" on December 10, 2020. Prior to that date, there was no public trading market for our common stock.

#### **Holders of our Common Stock**

As of March 1, 2023, there were approximately 79 stockholders of record of our common stock. The number of stockholders of record does not include beneficial owners of our securities whose shares are held in the name of various security brokers, dealers and registered clearing agencies.

#### **Dividend Policy**

We have never declared or paid any dividends on our common stock. We currently intend to retain all available funds and any future earnings for the operation and expansion of our business. Accordingly, we do not anticipate declaring or paying dividends in the foreseeable future. The payment of any future dividends will be at the discretion of our Board of Directors and will depend on our results of operations, capital requirements, financial condition, prospects, contractual arrangements, any limitations on payment of dividends present in any debt agreements, and other factors that our Board of Directors may deem relevant.

#### **Recent Sales of Unregistered Securities**

None.

#### **Issuer Purchases of Equity Securities**

None.

### **Item 6. RESERVED**

Reserved.

## **Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis provides information that we believe is relevant to an assessment and understanding of our results of operations and financial condition. You should read this analysis in conjunction with our audited consolidated financial statements and the notes contained elsewhere in this Annual Report on Form 10-K. This discussion and analysis contains statements of a forward-looking nature relating to future events or our future financial performance. These statements are only predictions, and actual events or results may differ materially. In evaluating such statements, you should carefully consider the various factors identified in this Annual Report on Form 10-K, which could cause actual results to differ materially from those expressed in, or implied by, any forward-looking statements, including those set forth in “Risk Factors” in this Annual Report on Form 10-K. See “Special Note Regarding Forward-Looking Statements.”*

### **Company Overview**

We are a leading independent manufacturer and distributor of CEA equipment and supplies, including a broad portfolio of our own innovative proprietary branded products. We primarily serve the U.S. and Canadian markets, and believe we are one of the leading competitors in these markets in an otherwise highly fragmented industry. For over 40 years, we have helped growers make growing easier and more productive. Our mission is to empower growers, farmers and cultivators with products that enable greater quality, efficiency, consistency, and speed in their grow projects.

Hydroponics is the farming of plants using soilless growing media and often artificial lighting in a controlled indoor or greenhouse environment. Hydroponics is the primary category of CEA and we use the terms CEA and hydroponics interchangeably. Our products are used to grow, farm and cultivate cannabis, flowers, fruits, plants, vegetables, grains and herbs in controlled environment settings that allow end users to control key farming variables including temperature, humidity, CO<sup>2</sup>, light intensity spectrum, nutrient concentration and pH. Through CEA, growers are able to be more efficient with physical space, water and resources, while enjoying year-round and more rapid grow cycles as well as more predictable and abundant grow yields, when compared to other traditional growing methods.

We reach commercial farmers and consumers through a broad and diversified network of over 2,000 wholesale customer accounts, who we connect with primarily through our proprietary online ordering platform. Our products are distributed across the United States and Canada through a diversified range of retailers of commercial and home gardening equipment and supplies. Our customers include specialty hydroponic retailers, commercial resellers and greenhouse builders, garden centers, hardware stores, and e-commerce retailers. Specialty hydroponic retailers can provide growers with specialized merchandise assortments and knowledgeable staff.

### **Market Conditions**

We experienced adverse financial results during 2022 which we believe is primarily a result of an agricultural oversupply impacting our market. This has led to a reduction in our 2022 profitability, as compared to the prior year, and a loss from operations. These market conditions continued to negatively impact our business and results of operations, and the extent to which this will continue is uncertain and difficult to predict at this time.

In connection with our previously disclosed evaluation of our facility footprint and product and brand portfolio, we began a restructuring plan during the quarter ended December 31, 2022. We are undertaking significant actions to streamline our operations, reduce costs and improve efficiencies during the industry recession. Our major initiatives include (i) narrowing our product and brand portfolio and (ii) relocating and consolidating certain manufacturing and distribution centers including headcount reductions and reorganization to drive a solution based approach. We are focusing commercial sales on competencies and product assortment gained from our recent acquisitions. During the year ended December 31, 2022, we recorded pre-tax charges of \$6.8 million relating to inventory markdowns of products and brands being removed from our portfolio, which is primarily non-cash, and \$0.9 million relating primarily to the relocation and termination of certain facilities in Canada, which are primarily cash charges. Restructuring charges are primarily recorded within Cost of goods sold on the consolidated statement of operations for the year ended December 31, 2022.

We plan to incur approximately \$1.7 million of additional charges in 2023, which are primarily cash, associated with the execution of our restructuring plan, which we expect to complete in the first half of 2023. We may also execute a second phase of our restructuring plan in 2023 and incur additional costs. Our strategic product consolidation entails removing approximately one-third of all products and one-fifth of all brands relating to our primary product portfolio, which excludes our garden center business in Canada. We expect the restructuring and related actions to result in cost savings of approximately \$7.0 million on an annualized basis.

As of June 30, 2022, primarily due to a sustained decline in the market value of our common stock and the market conditions described above, we identified a triggering event requiring a test for goodwill impairment. We completed our goodwill impairment testing and recorded an impairment charge of \$189.6 million as the test determined that the carrying value of the reporting units of U.S. and Canada was in excess of the fair value. The recognized impairment reduced the goodwill balance to zero as of June 30, 2022. The impairment was primarily due to a deterioration in customer demand in the U.S. and Canada caused by macroeconomic and industry conditions. We also review intangible assets with finite lives and indefinite lives for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. We did not identify a triggering event requiring a test for impairment of intangible assets during the remainder of 2022.

In connection with the goodwill impairment analysis performed as of June 30, 2022, we determined the fair value of the U.S. and Canada reporting units based on an income approach, using the present value of future discounted cash flows, and based on a market approach. The fair values were reconciled to the market value of our common stock to corroborate the estimates used in the interim test for impairment. The fair value determinations were a reflection of recent sales declines we have experienced, which we believe are primarily a result of an agricultural oversupply impacting our market, and a reduction to our 2022 profitability and loss from operations.

We maintain an allowance for excess and obsolete inventory that is based upon assumptions about future demand and market conditions. During the year ended December 31, 2022, our consolidated statements of operations included charges of \$18.5 million, primarily relating to increases to our allowance for inventory obsolescence relating to certain lighting products, which are incremental to the restructuring costs described above. In addition, during the year ended December 31, 2022, our consolidated statements of operations included \$2.9 million of accounts receivable allowances and write downs.

While we believe our estimates of charges relating to our restructuring plan, long-lived assets, inventory obsolescence, and accounts receivable allowances are reasonable, it is possible that we may incur additional charges in the future and actual results may differ significantly from these estimates and assumptions. Depending on the length and severity of the industry and market conditions impacting our business, it is possible we may execute additional restructuring plans and incur future associated charges, and we may not be able to realize the full extent of our anticipated cost savings.

### **Five Acquisitions Completed in 2021**

During the year ended December 31, 2021, we completed the following five acquisitions of branded manufacturers of CEA products, resulting in a significant expansion of our portfolio of proprietary branded products and manufacturing capabilities. Our proprietary brands generally provide for higher gross profit margins compared to distributed brands.

- Heavy 16, a manufacturer of plant nutrients and additives, in May 2021. Heavy 16 was a leading manufacturer and supplier of branded plant nutritional products, with nine core products featuring a full line of premium nutrients used in all stages of plant growth, helping to increase the yield and quality of crops.
- House & Garden, a manufacturer of plant nutrients and additives, in June 2021. House & Garden is located in Arcata, California, and produces and distributes premium grade plant nutrients and fertilizers, offering a strong product line to strengthen our position in the nutrient sector.
- Aurora, a manufacturer of soil, grow media, plant nutrients and additives, in July 2021. Aurora provides comprehensive plant fertility products and grow media and includes organic nutrient and premium soil brands. With the Aurora acquisition, we gained new domestic manufacturing and distribution capabilities on the east and west coasts along with a peat moss harvesting operation in Canada.
- Greenstar Plant Products, a manufacturer of plant nutrients and additives, in August 2021. Greenstar produces premium horticultural products and solutions with brands including Grotek, Gaia Green, Supergreen, and EarthSafe.
- Innovative Growers Equipment, a manufacturer of horticultural benches, racks and grow lights, in November 2021. The acquisition of Innovative Growers Equipment added to our existing lineup of high performance, proprietary branded products.

See Note 3 - *Business Combinations* in the notes to the consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

## Recent Financing Arrangements and Other Transactions

During the years ended December 31, 2022, and 2021, we entered into new financing arrangements and other significant transactions including:

- Term Loan: On October 25, 2021, we entered into a senior secured term loan facility, in the aggregate principal amount of \$125.0 million, with JPMorgan Chase Bank, N.A. as administrative agent for the lenders (the "Term Loan"). The Term Loan bears interest at a rate of either LIBOR (with a 1.0% floor) plus 5.50%, or an alternate base rate (with a 2.0% floor) plus 4.50% and matures on October 25, 2028.
- Investor Warrant Redemption: On July 19, 2021, we completed the redemption (the "Warrant Redemption") of certain of our outstanding warrants (the "Investor Warrants") to purchase shares of our common stock that were issued in connection with a private placement of units. Prior to the redemption date, 3,367,647 Investor Warrants were exercised, generating total gross proceeds of approximately \$56.8 million. As of December 31, 2022, and 2021, respectively, there were no Investor Warrants outstanding.
- Follow-on Public Offering: On May 3, 2021, we closed our follow-on offering, in which we issued and sold 5,526,861 shares of our common stock, including the full exercise by the underwriters of their option to purchase 720,894 additional shares of our common stock, at a public offering price of \$59.00 per share, which resulted in net proceeds of approximately \$309.8 million after deducting underwriting discounts and commissions and offering expenses.
- JPMorgan Revolving Loan Facility: On March 29, 2021, we and certain of our subsidiaries entered into a Senior Secured Revolving Credit Facility (the "JPMorgan Revolving Loan Facility") with JPMorgan Chase Bank, N.A., as administrative agent, issuing bank and swingline lender for a three-year revolving line of credit up to \$50 million. Our and our subsidiaries' obligations under the JPMorgan Revolving Loan Facility are secured by first priority liens (subject to certain permitted liens) in substantially all of our and our subsidiaries' respective personal property assets pursuant to the terms of a U.S. and a Canadian Pledge and Security Agreement, dated March 29, 2021, and the other security documents. The JPMorgan Revolving Loan Facility was amended by the First Amendment dated August 31, 2021, which increased the revolving line of credit by an additional \$50 million for an aggregate borrowing limit of \$100 million. The JPMorgan Revolving Loan Facility was further amended by the Second Amendment dated October 25, 2021, which, among other things, permitted the incurrence of the Term Loan and made certain other changes. The JPMorgan Revolving Loan Facility was further amended by the Third Amendment and Joinder dated August 23, 2022, pursuant to which several previously acquired subsidiaries became parties to the JPMorgan Revolving Loan Facility and granted liens on their assets. On December 22, 2022, we entered into a Fourth Amendment pursuant to which the maximum commitment amount under the JPMorgan Revolving Loan Facility was reduced from \$100 million to \$75 million, and certain other changes were made, including transitioning the LIBOR based rates to SOFR based rates.

The aforementioned financing arrangements and other transactions are more fully described in the notes to the consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

## Effects of COVID-19 on Our Business

The World Health Organization recognized COVID-19 as a global pandemic on March 11, 2020, and COVID-19 has had significant and ongoing negative impacts on global societies, workplaces, economies and health systems. Authorities throughout the world have implemented measures to contain or mitigate the spread of the virus, including at various times physical distancing, travel bans and restrictions, closure of non-essential businesses, quarantines, work-from-home directives, mask requirements, shelter-in-place orders, and vaccination programs, but despite these efforts, COVID-19 has persisted, has mutated into new variants, and is expected to become endemic. We have implemented business continuity plans and followed safety protocols as recommended by government guidelines, and we will continue to do so as the state of COVID-19 evolves. As of the filing of this Annual Report on Form 10-K, our operations are not impacted by any COVID-19 related facility closures, lockdown measures, travel restrictions or similar limitations. However, new waves of COVID-19 or its variants could cause the reinstatement of such limitations, and such limitations may adversely impact our supply chains, the manufacturing of our own products and our ability to obtain necessary materials, all of which could adversely affect our business, results of operations and financial condition. We have historically and may continue to source select products from China. We have in the past, and may again in the future experience some extended lead times in our supply chain, as well as increased shipping costs and believe the COVID-19 pandemic is a contributing factor to those extended lead times and increased costs. Furthermore, potential suppliers or sources of materials may pass the increase in sourcing costs due to the COVID-19 pandemic to us through price increases, thereby impacting our potential future profit margins.

The extent to which the COVID-19 pandemic will ultimately impact our business, results of operations, financial condition and cash flows depends on future developments that are highly and rapidly evolving and difficult to predict at this time. It is difficult to assess or quantify with precision the impact COVID-19 has directly had on our business since we cannot precisely quantify the impacts, if any, that the various effects have had on the overall business.

We believe COVID-19 may have provided a positive demand impact in 2020 and 2021 from shelter-in-place orders in the United States, a possible negative supply chain impact from workforce disruption at international and domestic suppliers, and a possible negative growth rate impact in 2022 due to agricultural oversupply initiated during the height of COVID-related shelter-in-place orders in 2020 and 2021. We continue to monitor the COVID-19 pandemic and will adjust our mitigation strategies as necessary to address changing health, operational or financial risks that may arise.

## **Components of Results of Operations**

### ***Net sales***

We generate net sales from the distribution and manufacturing of hydroponic equipment and supplies to our customers. The hydroponic equipment and supplies that we sell include consumable products, such as growing media, nutrients and supplies that are subject to regular replenishment and durable products, such as lighting and hydroponic equipment. Our scale allows us to provide delivery and service capabilities to customers across the U.S. and Canada.

We periodically offer sales incentives to our customers, including early pay discounts, volume-based rebates, temporary price reductions, advertising credits and other trade activities. Net sales reflect our gross sales less sales incentives which are estimated and recorded at the time of sale plus amounts billed to customers for shipping and handling costs. We anticipate that sales incentives and/or the amount billed to customers for shipping and handling costs could impact our net sales and that changes in such promotional activities or freight recovery charges could impact period-over-period results.

### ***Cost of goods sold***

Cost of goods sold consists primarily of material costs, inbound and outbound freight costs, direct labor costs primarily for manufacturing and warehouse personnel, facility costs for manufacturing operations, depreciation, depletion and amortization of manufacturing and warehouse improvements and equipment, inventory allowances, restructuring costs, and certain acquisition and integration expenses. We expect that our cost of goods sold would increase in absolute dollars in conjunction with net sales growth if that occurs in the future. However, we expect that, over time, cost of goods sold may decrease as a percentage of net sales if we are able to scale our business as we obtain a higher proportion of net sales associated with proprietary and exclusive branded products.

### ***Selling, general and administrative***

Selling, general and administrative expenses ("SG&A") consists primarily of marketing and advertising, facility costs for distribution operations, depreciation and amortization of all other assets, certain acquisition and integration expenses and other selling, general and administrative costs, including but not limited to salaries, benefits, bonuses, stock-based compensation, professional fees, and various costs related to being a publicly-traded company.

## **Results of Operations Data**

The results of operations data in the following table for the years ended December 31, 2022, and 2021 have been derived from the audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

## Results of Operations - Comparison of Years Ended December 31, 2022, and 2021

The results of operations data in the following table, including amounts and percentages of net sales for each year and the year-to-year change in dollars and percent, for the years ended December 31, 2022, and 2021, have been derived from the audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K (amounts in thousands):

	Years ended December 31,					
	2022		2021		Year to year change	
Net sales	\$ 344,501	100.0 %	\$ 479,420	100.0 %	\$ (134,919)	-28.1 %
Cost of goods sold	315,165	91.5 %	377,934	78.8 %	(62,769)	-16.6 %
<b>Gross profit</b>	29,336	8.5 %	101,486	21.2 %	(72,150)	-71.1 %
Operating expenses:						
Selling, general and administrative	118,604	34.4 %	104,185	21.7 %	14,419	13.8 %
Impairments	192,328	55.8 %	—	0.0 %	192,328	N/A
<b>Loss from operations</b>	(281,596)	-81.7 %	(2,699)	-0.6 %	278,897	10,333.3 %
Interest expense	(10,958)	-3.2 %	(2,138)	-0.4 %	8,820	412.5 %
Loss on debt extinguishment or modification	(145)	0.0 %	(680)	-0.1 %	(535)	-78.7 %
Other income (expense), net	841	0.2 %	(204)	0.0 %	1,045	512.3 %
<b>Loss before tax</b>	(291,858)	-84.7 %	(5,721)	-1.2 %	286,137	5,001.5 %
Income tax benefit	6,443	1.9 %	19,137	4.0 %	(12,694)	-66.3 %
<b>Net (loss) income</b>	(285,415)	-82.8 %	13,416	2.8 %	(298,831)	-2,227.4 %

### *Net sales*

Net sales for the year ended December 31, 2022, were \$344.5 million, a decrease of \$134.9 million, or 28.1%, compared to the same period in 2021. The 28.1% decrease was due to a 29.5% decline in volume of products sold (a 46.5% decline in organic sales and a 17.0% increase from 2021 acquired proprietary brands), a 1.7% increase in price and mix of products sold, and a 0.3% decline from unfavorable foreign exchange rates. The decrease in volume of products sold was primarily related to the aforementioned oversupply in the cannabis industry. The increase in price was primarily related to list price increases, as well as higher freight recovery as we put multiple measures in place to combat rising freight costs. The decrease in foreign exchange related to recent strength in the U.S. Dollar relative to the Canadian Dollar and to the Euro.

### *Gross profit*

Gross profit for the year ended December 31, 2022, was \$29.3 million, a decrease of \$72.2 million, or 71.1%, compared to the same period in 2021. The decrease in gross profit was primarily related to the aforementioned decrease in net sales and a significant decrease in our gross profit margin percentage. Our gross profit margin percentage decreased to 8.5% for the year ended December 31, 2022, from 21.2% in the same period in 2021. The lower gross profit margin percentage is primarily due to an increase in the inventory obsolescence allowances and related charges of \$18.5 million primarily related to certain lighting products, and restructuring costs of \$7.5 million associated with inventory markdowns of products and brands being removed from our portfolio and the relocation and termination of certain facilities in Canada. Also negatively impacting gross profit margin were freight and labor costs which were higher as a percentage of net sales. These were partially offset by the aforementioned list price increases, as well as a higher proportion of higher-margin proprietary brand sales.

### *Selling, general and administrative expenses*

SG&A expenses for the year ended December 31, 2022, were \$118.6 million, an increase of \$14.4 million, or 13.8% compared to the same period in 2021. The increase is primarily related to (i) a \$23.4 million increase in depreciation, depletion and amortization expense primarily due to the acquisitions completed in 2021 which includes \$5.9 million of additional amortization expense from adjustments to useful lives that were determined this year, (ii) a \$2.9 million increase in accounts receivable allowances and write-offs, (iii) a \$2.8 million increase in share-based compensation, (iv) a \$2.1 million increase in compensation costs (primarily salaries and benefits for employees from companies acquired in 2021), of which \$0.7 million was an increase in severance associated with a recent reduction-in-force, and (v) a \$2.0 million increase in insurance costs. The SG&A increases compared to the prior year were partially offset by (i) a \$16.8 million decrease in acquisition and integration expenses, and (ii) a \$1.9 million decrease from investor warrant solicitation fees incurred last year.



### ***Impairments***

We recorded goodwill impairment charges of \$189.6 million for the year ended December 31, 2022, as we determined that the carrying value of the reporting units of U.S. and Canada were in excess of the fair value. The recognized impairment reduced the goodwill balance to zero as of December 31, 2022. The impairment was primarily due to a deterioration in customer demand in the U.S. and Canada caused by macroeconomic and industry conditions. For the year ended December 31, 2022, we also recorded an impairment of a note receivable of \$2.6 million.

### ***Interest expense***

Interest expense for the year ended December 31, 2022, was \$11.0 million, an increase of \$8.8 million, or 412.5%, compared to the same period in the prior year. The increase was primarily due to the interest-bearing Term Loan entered into in the fourth quarter of 2021 and outstanding for the entirety of 2022, as well as interest rate increases through the year.

### ***Loss on debt extinguishment or modification***

Loss on debt extinguishment or modification for the year ended December 31, 2022, was \$0.1 million, a decrease of \$0.5 million, or 78.7%, compared to the same period in 2021. The Loss on debt extinguishment or modification for the year ended December 31, 2022, resulted primarily from the write-off of unamortized deferred financing costs associated with the modification of the JPMorgan Revolving Loan Facility entered into during the fourth quarter of 2022, which reduced our borrowing capacity from \$100 million to \$75 million, permitted a sale and leaseback transaction, and made certain other changes, including transitioning the LIBOR based rates to SOFR based rates. Loss on debt extinguishment or modification for the year ended December 31, 2021, resulted primarily from the write-off of unamortized deferred financing costs associated with the termination of the Encina Credit Facility.

### ***Other income (expense), net***

Other income for the year ended December 31, 2022, was \$0.8 million compared to Other expense of \$0.2 million for the year ended December 31, 2021. The increase in other income compared to the prior year periods relates primarily to foreign currency exchange rate gains in 2022.

### ***Income tax benefit***

Income tax benefit for the year ended December 31, 2022, was \$6.4 million, compared to \$19.1 million in the prior year. Our effective income tax rate was 2.2% for the year ended December 31, 2022, and differs from the U.S. federal statutory rate of 21% primarily due to the impairment of goodwill for certain 2021 acquisitions which was not deductible for U.S. tax purposes, increases in our valuation allowance on U.S. deferred tax assets, and the establishment of a valuation allowance for Canadian deferred tax assets. As described in Note 4 - *Goodwill and Intangible Assets, Net*, during the year ended December 31, 2022, we fully impaired the goodwill associated with all 2021 acquisitions. In connection with the measurement period adjustments associated with 2021 acquisitions, the Company recorded a net deferred tax liability which provided an additional source of taxable income to support the realization of the pre-existing deferred tax assets. The Company's income tax benefit was partially offset by income taxes from certain foreign subsidiaries. For the year ended December 31, 2021, income tax benefit was primarily the result of a reduction in the valuation allowance recorded against our net deferred tax assets. In connection with the acquisition of the H&G Entities, we recorded a net deferred tax liability in 2021 which provided an additional source of taxable income to support the realization of the pre-existing deferred tax assets.

## Non-GAAP Financial Measures

We report our financial results in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP” or “GAAP”). However, management believes that certain non-GAAP financial measures provide investors with additional useful information in evaluating our performance and that excluding certain items that may vary substantially in frequency and magnitude period-to-period from net (loss) income provides useful supplemental measures that assist in evaluating our ability to generate earnings and to more readily compare these metrics between past and future periods. These non-GAAP financial measures may be different than similarly titled measures used by other companies.

To supplement our audited consolidated financial statements which are prepared in accordance with GAAP, and to supplement "net (loss) income" and "net (loss) income as a percent of sales", we use “Adjusted EBITDA” and “Adjusted EBITDA as a percent of sales” which are non-GAAP financial measures. Our non-GAAP financial measures should not be considered in isolation from, or as substitutes for, financial information prepared in accordance with GAAP. There are several limitations related to the use of our non-GAAP financial measures as compared to the closest comparable GAAP measures. Some of these limitations include:

- Adjusted EBITDA does not reflect the significant interest expense, or the amounts necessary to service interest or principal payments on our indebtedness;
- Adjusted EBITDA excludes depreciation, depletion and amortization, and although these are non-cash expenses, the assets being depreciated and amortized may have to be replaced in the future;
- Adjusted EBITDA does not reflect our tax provision that adjusts cash available to us;
- Adjusted EBITDA excludes the non-cash component of stock-based compensation;
- Adjusted EBITDA excludes the amount of employer payroll taxes on stock-based compensation; and
- Adjusted EBITDA does not reflect the impact of earnings or charges resulting from matters we consider not to be reflective, on a recurring basis, of our ongoing operations. These items include restructuring, impairments, severance and other expenses, acquisition and integration expenses, distribution center exit costs, loss on debt extinguishment or modification, investor warrant solicitation fees, and other (expense) income, net.

We define Adjusted EBITDA as net (loss) income excluding interest expense, income taxes, depreciation, depletion and amortization, stock-based compensation including employer payroll taxes on stock-based compensation and other non-cash, unusual and/or infrequent costs (i.e., restructuring, impairments, severance and other expenses, acquisition and integration expenses, distribution center exit costs, loss on debt extinguishment or modification, investor warrant solicitation fees, and other income/expense, net), which we do not consider in our evaluation of ongoing operating performance.

The following table presents a reconciliation of net (loss) income, the most comparable GAAP financial measure, to Adjusted EBITDA for the years ended December 31, 2022, and 2021 (in thousands):

	<b>Years ended December 31,</b>	
	<b>2022</b>	<b>2021</b>
Net (loss) income (GAAP)	\$ (285,415)	\$ 13,416
Interest expense	10,958	2,138
Income tax benefit	(6,443)	(19,137)
Distribution center exit costs and other <sup>1</sup>	1,412	2,641
Depreciation, depletion and amortization	41,527	14,934
Impairments <sup>2</sup>	192,328	—
Restructuring expenses <sup>3</sup>	7,687	—
Severance and other <sup>4</sup>	1,224	297
Acquisition and integration expenses <sup>5</sup>	7,682	24,210
Other (income) expense, net <sup>6</sup>	(841)	204
Stock-based compensation <sup>7</sup>	8,543	5,750
Loss on debt extinguishment or modification <sup>8</sup>	145	680
Investor warrant solicitation fees <sup>9</sup>	—	1,949
Adjusted EBITDA (Non-GAAP)	<u>\$ (21,193)</u>	<u>\$ 47,082</u>
<i>As a percent of net sales:</i>		
Net (loss) income (GAAP)	(82.8)%	2.8 %
Adjusted EBITDA (Non-GAAP)	(6.2)%	9.8 %

Net (loss) income (GAAP) and Adjusted EBITDA (Non-GAAP) for the year ended December 31, 2022, were negatively impacted by \$21.4 million of inventory and accounts receivable reserves and related charges.

1. For the 2022 and 2021 periods presented, this relates to costs incurred to exit and relocate distribution centers in California and Pennsylvania including lease exit costs, transportation, and labor related costs.

2. The Company completed its goodwill impairment testing and recorded an impairment charge of \$189.6 million during year ended December 31, 2022, due to market softness in demand in the U.S. and Canada. Additionally, during the year ended December 31, 2022, the Company recorded an impairment primarily related to a \$2.6 million charge associated with a note receivable that originated in 2019 in connection with a third party independent processor serving the CBD market.

3. During the year ended December 31, 2022, the Company recorded pre-tax charges of \$6.8 million relating to the inventory markdowns of products and brands being removed from our portfolio and \$0.9 million relating primarily to the relocation and termination of certain facilities in Canada.

4. Severance and other primarily consists of severance costs incurred during the year ended December 31, 2022, related to workforce reductions to optimize our cost structure. Severance and other primarily consists of costs related to an aborted financing during the year ended December 31, 2021.

5. For the year ended December 31, 2022, acquisition and integration expenses include non-cash purchase accounting inventory adjustments for House and Garden, Aurora, Greenstar and Innovative Growers Equipment of \$4.8 million, and acquisition and integration consulting, transaction services and legal fees incurred for the completed Heavy 16, House and Garden, Aurora, Greenstar, and Innovative Growers Equipment acquisitions and certain potential acquisitions of \$4.5 million, partially offset by the change in fair value of contingent consideration for Aurora of (\$1.6 million). For the prior year period, acquisition and integration expenses primarily include investment banking, consulting, transaction services and legal fees incurred for the completed Heavy 16, House & Garden, Aurora, Greenstar, and Innovative Growers Equipment acquisitions and certain potential acquisitions, including non-cash purchase accounting inventory adjustments of \$4.5 million, partially offset by the change in fair value of contingent consideration for Aurora of (\$2.5 million) for the year ended December 31, 2021.

6. Other (income) expense, net relates primarily to foreign currency exchange rate gains and losses and other non-operating income and expenses.

*7. Includes stock-based compensation and related employer payroll taxes on stock-based compensation for the periods presented.*

*8. For the year ended December 31, 2022, loss on debt extinguishment or modification resulted primarily from the write-off of unamortized deferred financing costs associated with the modification of the JPMorgan Revolving Loan Facility. For the year ended December 31, 2021, loss on debt extinguishment resulted primarily from the write-off of unamortized deferred financing costs associated with the termination of the Encina Credit Facility.*

*9. Reflects the elimination of investor warrant solicitation fees.*

## Liquidity and Capital Resources

### Cash Flow from Operating, Investing, and Financing Activities

#### Comparison of Years Ended December 31, 2022, and 2021

The following table summarizes our cash flows for the years ended December 31, 2022, and 2021 (amounts in thousands):

	Years ended December 31,	
	2022	2021
Net cash from (used in) operating activities	\$ 21,989	\$ (45,067)
Net cash used in investing activities	(8,487)	(468,184)
Net cash (used in) from financing activities	(20,200)	464,707
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(395)	(27)
<b>Net decrease in cash, cash equivalents and restricted cash</b>	<b>(7,093)</b>	<b>(48,571)</b>
Cash, cash equivalents and restricted cash at beginning of year	28,384	76,955
<b>Cash, cash equivalents and restricted cash at end of year</b>	<b>\$ 21,291</b>	<b>\$ 28,384</b>

#### *Operating Activities*

Net cash from operating activities was \$22.0 million for the year ended December 31, 2022, primarily due to a \$39.6 million net cash inflow from a reduction of working capital related assets and liabilities. This included a decrease of \$57.0 million in inventories and a decrease of \$16.7 million in accounts receivable, net, partially offset by decreases of \$13.3 million in deferred revenue and \$16.5 million in accounts payable, accrued expenses and other current liabilities. The net cash inflow from a reduction of working capital is partially offset by consolidated net loss on the statement of operations. During the year ended December 31, 2022, we paid \$9.6 million in cash interest, compared to \$1.6 million in the prior year.

Net cash used in operating activities was \$45.1 million for the year ended December 31, 2021, primarily consisting of \$13.4 million in net income, \$4.4 million in net non-cash expense reductions, which were largely comprised of depreciation, depletion and amortization, stock-based compensation expense, non-cash operating lease expense, deferred income tax benefit and other non-cash expenses, less a \$62.9 million increase in working capital. This change in working capital primarily reflects an aggregate increase of \$47.8 million in accounts receivable, inventories, prepaid expenses and other current assets, and other assets for the period as well as an aggregate net decrease of \$15.1 million in accounts payable, accrued expenses and other current liabilities, deferred revenue, and a decrease in lease liabilities due to payments on lease obligations during the period.

#### *Investing Activities*

Net cash used in investing activities for the year ended December 31, 2022, was \$8.5 million, due primarily to capital expenditures for property, plant and equipment, which increased over the prior year primarily due to growth investments in our manufacturing operations and the expansion and relocation of certain of our distribution centers. The 2022 cash usage primarily includes our growth-oriented investments in the peat moss harvesting operation in Canada and IGE manufacturing operations in the U.S.

Net cash used in investing activities for the year ended December 31, 2021, was \$468.2 million, due primarily to five business acquisitions we completed during the period, which totaled \$462.2 million in cash outflows and \$6.0 million in capital expenditures for property, plant and equipment and other.

#### *Financing Activities*

Net cash used in financing activities was \$20.2 million for the year ended December 31, 2022, primarily consisting of \$15.5 million in payments to settle contingent consideration, primarily on our Aurora acquisition. We paid \$2.5 million related to employees' withholding tax in connection with the vesting of restricted stock units. In addition, we paid \$1.3 million in principal payments on the Term Loan.

Net cash provided by financing activities was \$464.7 million for the year ended December 31, 2021. We received \$309.8 million proceeds from our follow-on offering, \$119.9 million proceeds from the Term Loan, net of discount and

issuance costs, and received an additional \$56.8 million from the exercise of warrants, including the Warrant Redemption. We also paid \$20.0 million related to employees' withholding tax in connection with the vesting of certain restricted stock units.

### **JPMorgan Revolving Loan Facility**

On March 29, 2021, we entered into the JPMorgan Revolving Loan Facility, which provided for a borrowing limit of \$50 million. The JPMorgan Revolving Loan Facility replaced the Encina Credit Facility. The JPMorgan Revolving Loan Facility matures on March 29, 2024.

The JPMorgan Revolving Loan Facility was amended by the First Amendment dated August 31, 2021, which increased the revolving line of credit by an additional \$50 million for an aggregate borrowing limit of \$100 million. The JPMorgan Revolving Loan Facility was further amended by the Second Amendment dated October 25, 2021 which, among other things, permitted the incurrence of the Term Loan and made certain other changes including subordinating its liens on non-working capital assets to the obligations under the Term Loan. The JPMorgan Revolving Loan Facility was further amended by the Third Amendment and Joinder dated August 23, 2022, pursuant to which several previously acquired subsidiaries became parties to the JPMorgan Revolving Loan Facility and granted liens on their assets. On December 22, 2022, the Company entered into the Fourth Amendment pursuant to which the maximum commitment amount under the JPMorgan Revolving Loan Facility was reduced from \$100 million to \$75 million, a sale and leaseback transaction was permitted and certain other changes were made, including transitioning the LIBOR based rates to SOFR based rates.

The JPMorgan Revolving Loan Facility provides for various interest rate options including the Adjusted Term SOFR Rate, the Adjusted REVSOF30 Rate, the CB Floating Rate, the Adjusted Daily Simple SOFR, the CBFR, the Canadian Prime Rate, or the CDOR Rate. The rates that use SOFR as the reference rate (Adjusted Term SOFR Rate, the Adjusted REVSOF30 Rate, the Adjusted Daily Simple SOFR and the CBFR rate) use the Term SOFR Rate plus 1.95%. Each rate has a 0.0% floor. A fee of 0.25% per annum is charged for available but unused borrowings. Our obligations under the JPMorgan Credit Facility are secured by a first priority lien (subject to certain permitted liens) in substantially all of our and our subsidiaries' respective personal property assets pursuant to the terms of a U.S. and Canadian Pledge and Security Agreement dated March 29, 2021 and other security documents, as amended to include additional subsidiaries.

The JPMorgan Revolving Loan Facility maintains certain reporting requirements, affirmative covenants, negative covenants and financial covenants. A certain financial covenant becomes applicable in the event that our excess availability under the JPMorgan Revolving Loan Facility is less than an amount equal to 10% of the Aggregate Revolving Commitment (currently \$75 million) and would require us to maintain a minimum fixed charge coverage ratio of 1.1x on a rolling twelve-month basis.

In order to consummate permitted acquisitions or to make restricted payments, the Company would be required to comply with a higher fixed charge coverage ratio of 1.15x, but no such acquisitions or payments are currently contemplated.

We were in compliance with all debt covenants as of December 31, 2022. As of December 31, 2022, approximately \$40 million was available to borrow under the undrawn JPMorgan Revolving Loan Facility, before we would be required to comply with the minimum fixed charge coverage ratio of 1.1x.

### **Term Loan**

On October 25, 2021, we and certain of our direct and indirect subsidiaries entered into the Term Loan with JPMorgan Chase Bank, N.A., as administrative agent for the lenders, pursuant to which we borrowed a \$125.0 million senior secured term loan. The Term Loan bears interest at LIBOR (with a 1.0% floor) plus 5.50%, or an alternative base rate (with a 2.0% floor), plus 4.50%, and is subject to a call premium of 2% in year one, 1% in year two, and 0% thereafter, and matures on October 25, 2028. We received net proceeds of \$119.9 million from the Term Loan after deducting discounts and deferred financing costs.

The principal amounts of the Term Loan are scheduled to be repaid in consecutive quarterly installments in amounts equal to 0.25% of the \$125 million principal amount of the Term Loan on the last day of each fiscal quarter commencing March 31, 2022, with the balance of the Term Loan payable on the Maturity Date of October 25, 2028.

The Term Loan requires us to maintain certain reporting requirements, affirmative covenants, and negative covenants. We were in compliance with all debt covenants as of December 31, 2022. The Term Loan is secured by a first lien on our non-working capital assets and a second lien on our working capital assets.

## Cash and cash equivalents

The cash and cash equivalents balances of \$21.3 million and \$26.6 million at December 31, 2022, and December 31, 2021, respectively, included \$7.3 million and \$4.1 million, respectively, held by foreign subsidiaries.

## Material Cash Requirements

Our material cash requirements include interest payments on our long-term debt, operating lease payments, and purchase obligations to support our operations. Refer to Part II, Item 8, Financial Statements, Note 10 - *Debt*, Note 7 - *Leases*, and Note 14 - *Commitments and Contingencies, and Related Party Transactions* for details relating to our material cash requirements for debt, our leasing arrangements, including future maturities of our operating lease liabilities, and purchase obligations, respectively.

From time to time in the normal course of business, we will enter into agreements with suppliers which provide favorable pricing in return for a commitment to purchase minimum amounts of inventory over a defined time period.

## Seasonality

Our net sales are typically seasonally stronger in our fiscal second and third quarters due to robust sales in the warmer spring and summer months in North America (the United States and Canada are our primarily markets). This seasonal trend is primarily due to the garden center portion of our customer base, and because certain of our customers may use some of our products (such as grow media and nutrients) in outdoor applications. While this seasonal pattern did not hold true during fiscal 2022, likely due to the industry recession, we expect this typical seasonal pattern to return in fiscal 2023. Also, we typically expect to utilize cash from operating activities in the first quarter to fund our working capital requirements related to the seasonal sales pattern described above.

## Availability and Use of Cash

Our ability to make investments in our business, service our debt and maintain strong liquidity will depend upon our ability to generate excess operating cash flows through our operating subsidiaries. We believe that the Company will generate positive cash flows from operating activities over the next twelve months. We believe that our cash flows from operating activities, combined with current cash levels and borrowing availability under the JPMorgan Credit Facility, will be adequate to support our ongoing operations, to fund debt service requirements, capital expenditures, lease obligations and working capital needs through the next twelve months of operations. However, we cannot ensure that our business will generate sufficient cash flow from operating activities or that future borrowings will be available under our borrowing agreements in amounts sufficient to pay indebtedness or fund other working capital needs. Actual results of operations will depend on numerous factors, many of which are beyond our control as further discussed in *Item 1A. Risk Factors* included elsewhere in this Annual Report on Form 10-K.

In January 2023, Gotham Properties LLC, an Oregon limited liability company and our subsidiary (“Seller”), consummated a Purchase and Sale Agreement with J & D Property, LLC, a Nevada limited liability company (“Purchaser”) pursuant to which certain real property located in the City of Eugene, County of Lane, State of Oregon (the “Eugene Property”) was sold to Purchaser for \$8.6 million and then leased back by Seller (the “Sale-Leaseback Transaction”). The new lease has a term of 15 years with annual rent starting at approximately \$0.7 million and increases to the final year when annual rent is approximately \$1.0 million. The Eugene Property serves as the manufacturing and processing site for certain of our grow media and nutrient brands. We intend to reinvest the net cash proceeds into certain permitted investments in 2023, such as capital expenditures.

If necessary, we believe that we could supplement our cash position through additional sale/leasebacks, asset sales and equity financing. We believe it is prudent to be prepared if required and, accordingly, continue to be engaged in the process of evaluating and preparing to implement one or more of the aforementioned activities.

## Critical Accounting Policies and Estimates

Certain accounting policies require us to make estimates and judgments in determining the amounts reflected in the Consolidated Financial Statements. Such estimates and judgments necessarily involve varying, and possibly significant, degrees of uncertainty. Accordingly, certain amounts currently recorded in the financial statements will likely be adjusted in the future based on new available information and changes in other facts and circumstances. A discussion of our principal accounting policies that required the application of significant judgments as of December 31, 2022 follows.

### ***Goodwill and indefinite-lived intangible assets***

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net acquisition-date fair value amounts of the identified assets acquired and liabilities assumed in a business combination.

Goodwill is evaluated for impairment annually in the fourth quarter, or on an interim basis when an event or change in circumstances occurs, indicating that the carrying value may not be recoverable. Primarily due to a decline in the market value of our common stock and market conditions, we identified a triggering event requiring a test for impairment as of June 30, 2022. We completed our goodwill impairment testing and recorded an impairment charge due to market softness in demand in the U.S. and Canada. We determined the fair value of the U.S. and Canada reporting units based on an income approach, using the present value of future discounted cash flows, and based on a market approach. Significant estimates used to determine fair value include the weighted average cost of capital, financial forecasts, and pricing multiples derived from publicly-traded companies that are comparable to the reporting units. The fair values were reconciled to the market value of our common stock of to corroborate the estimates used in the interim test for impairment.

### ***Long-lived tangible and finite-lived intangible assets***

Long-lived tangible assets and finite-lived intangible assets are stated at cost. Depreciation, depletion and amortization expense is primarily provided on the straight-line method and based on the estimated useful economic lives of the long-lived tangible assets. Intangible assets with finite lives are subject to amortization. Intangible assets with finite lives and indefinite lives are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the quarter ended June 30, 2022, we performed an evaluation of intangible assets for impairment in connection with the triggering event identified requiring a quantitative test for goodwill impairment. This impairment evaluation includes a comparison of the undiscounted cash flows expected to be generated by that long-lived asset or asset group to its carrying amount. If the carrying amount of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying amount exceeds its fair value. Based on our evaluation, there was no impairment of intangible assets or other long-lived assets for the quarter ended June 30, 2022. No such triggering event was identified during the remainder of 2022.

We believe that the intangible asset impairment evaluations were based on reasonable assumptions that marketplace participants would use. However, such assumptions are inherently uncertain and actual results could differ from those estimates. Changes to or a failure to achieve our projected business assumptions, including growth and profitability, could result in a valuation that would trigger an impairment in future periods.

### ***Inventory valuation***

Inventories consist of finished goods, work-in-process, and raw materials used in manufacturing products. Inventories are stated at the lower of cost or net realizable value, principally determined by the first in, first out method of accounting. We maintain an allowance for excess and obsolete inventory. The estimate for excess and obsolete inventory is based upon assumptions about current and anticipated demand, customer preferences, business strategies, and market conditions. Management reviews these assumptions periodically to determine if any adjustments are needed to the allowance for excess and obsolete inventory. The establishment of an allowance for excess and obsolete inventory establishes a new cost basis in the inventory. Such allowance is not reduced until the product is sold. If inventory is sold, any related reserves would be reversed in the period of sale. The Company estimates inventory markdowns relating to restructuring charges based upon current and anticipated demand, customer preferences, business strategies, and market conditions including management's actions with respect to inventory products and brands being removed from our portfolio. Hydrofarm's strategic product consolidation entails removing approximately one-third of all products and one-fifth of all brands relating to our primary product portfolio.

### ***Recent accounting pronouncements***

For information regarding recent accounting pronouncements, refer to Note 2 - *Basis of presentation and significant accounting policies — Recently issued accounting pronouncements*, to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K.



## **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of economic losses due to adverse changes in financial market prices and rates. Our primary market risk has been interest rate, foreign currency and inflation risk. We do not have material exposure to commodity risk.

### ***Interest Rate Risk***

We are exposed to interest rate risk through our variable rate debt. As of December 31, 2022, we had \$124 million of debt under the Term Loan subject to variable interest rates that are based on LIBOR or an alternate base rate. Refer to Part I, Item 1, Financial Statements, Note 10 - *Debt* for details relating to the debt. If these rates were to increase by 100 basis points from the rates in effect as of December 31, 2022, our interest expense on the variable rate debt would increase by an average of \$1.2 million annually. There are inherent limitations in the sensitivity analysis presented, primarily due to the assumptions that interest rate changes would be instantaneous, while LIBOR changes regularly. We do not currently hedge our interest rate risks, but may determine to do so in the future. See *Risk Factors—We may be adversely impacted by the transition from the London interbank offered rate ("LIBOR") to the Secured Overnight Funding Rate ("SOFR") as a reference rate.*

### ***Foreign Currency Risk***

The functional currencies of our foreign subsidiary operations are predominantly in the Canadian dollar ("CAD") and the Euro. For the purposes of presenting these consolidated financial statements, the assets and liabilities of subsidiaries with CAD or Euro functional currencies are translated into USD using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average rate prevailing during the period with exchange differences impacting other comprehensive income (loss) in equity. Therefore, our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, principally the CAD. We are impacted by changes in foreign currency exchange rates when we sell product in currencies different from the currency in which costs were incurred. The functional currencies and our purchasing and sales activities primarily include USD, CAD and Euro. As these currencies fluctuate against each other, and other currencies, we are exposed to foreign currency exchange rate risk on sales, purchasing transactions, and labor. To date, we have not entered into any foreign currency exchange contracts and currently do not expect to enter into foreign currency exchange contracts for trading or speculative purposes.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Index to Consolidated Financial Statements**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the stockholders and the Board of Directors of Hydrofarm Holdings Group, Inc.

### Opinion of the Financial Statements

We have audited the accompanying consolidated balance sheets of Hydrofarm Holdings Group, Inc. and subsidiaries (the "Company") as of December 31, 2022 and 2021, the related consolidated statements of operations, comprehensive (loss) income, changes in stockholders' equity, and cash flows, for each of the two years in the period ended December 31, 2022, and the related notes listed in the Index to Consolidated Financial Statements (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2022, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2023, expressed an unqualified opinion on the Company's internal control over financial reporting.

### Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

### Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

## ***Inventory Valuation - Refer to Note 2 to the financial statements***

### *Critical Audit Matter Description*

As of December 31, 2022 the inventory excess and obsolescence reserve was \$15.7 million. The Company's inventories are stated at the lower of cost or net realizable value, principally determined by the first in, first out method of accounting. As described in Note 2 to the consolidated financial statements, the Company maintains an allowance for excess and obsolete inventory that is based upon assumptions about future demand, customer preferences, business strategies, and market conditions. The analysis of the required inventory valuation reserves includes consideration of current inventory levels, historical sales information, forecasted customer demand and current economic conditions and business trends.

Given the quantitative and qualitative materiality of the inventory excess and obsolescence reserve balance, coupled with the judgments necessary to identify and record the inventory excess and obsolescence reserve timely, performing audit procedures to evaluate management's estimates of the net realizable value for the inventory on-hand as of the reporting date involved a high degree of auditor judgment.

### *How the Critical Audit Matter Was Addressed in the Audit*

Our audit procedures related to the inventory valuation included the following, among other things:

- We tested the design and operating effectiveness of internal controls over the inventory valuation process, including controls over the inputs that are used in management's valuation of the excess and obsolescence reserve analysis.
- We evaluated the appropriateness and consistency of management's methodology and assumptions used in determining the inventory valuation of the excess and obsolescence reserve.
- We obtained the Company's valuation of the inventory excess and obsolescence reserve calculation and tested the mathematical accuracy.
- We tested the accuracy and completeness of the underlying data used in the calculation of the Company's valuation of the inventory excess and obsolescence reserve.
- We selected a sample of inventory items and compared the recorded unit cost against the most recent sales price to determine if inventory was recorded at lower of cost or net realizable value.
- We selected a sample of inventory items and evaluated historical sales performance relative to management's conclusions on the ability to sell through the inventory on-hand at the forecasted levels.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota

March 9, 2023

We have served as the Company's auditor since 2020.

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the stockholders and the Board of Directors of Hydrofarm Holdings Group, Inc.

### **Opinion on Internal Control over Financial Reporting**

We have audited the internal control over financial reporting of Hydrofarm Holdings Group, Inc. and subsidiaries (the “Company”) as of December 31, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended December 31, 2022, of the Company and our report dated March 9, 2023, expressed an unqualified opinion on those consolidated financial statements.

### **Basis for Opinion**

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

### **Definition and Limitations of Internal Control over Financial Reporting**

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Deloitte & Touche LLP

Minneapolis, Minnesota

March 9, 2023

**Hydrofarm Holdings Group, Inc.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share amounts)

	December 31,	
	2022	2021
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 21,291	\$ 26,607
Restricted cash	—	1,777
Accounts receivable, net	17,227	41,484
Inventories	111,398	189,134
Note receivable	—	622
Prepaid expenses and other current assets	5,032	9,760
<b>Total current assets</b>	<b>154,948</b>	<b>269,384</b>
Property, plant and equipment, net	51,135	50,473
Operating lease right-of-use assets	65,265	45,245
Goodwill	—	204,868
Intangible assets, net	300,366	314,819
Other assets	1,845	6,453
<b>Total assets</b>	<b>\$ 573,559</b>	<b>\$ 891,242</b>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 13,633	\$ 26,685
Accrued expenses and other current liabilities	13,208	33,996
Deferred revenue	3,654	18,273
Current portion of lease liabilities	9,099	7,198
Current portion of long-term debt	2,011	2,263
<b>Total current liabilities</b>	<b>41,605</b>	<b>88,415</b>
Long-term lease liabilities	56,299	38,595
Long-term debt	118,661	119,517
Deferred tax liabilities	2,685	5,631
Other long-term liabilities	4,428	3,904
<b>Total liabilities</b>	<b>223,678</b>	<b>256,062</b>
<b>Commitments and contingencies (Note 14)</b>		
<b>Stockholders' equity</b>		
Common stock (\$0.0001 par value; 300,000,000 shares authorized; 45,197,249 and 44,618,357 shares issued and outstanding at December 31, 2022, and December 31, 2021, respectively)	5	4
Additional paid-in capital	783,042	777,074
Accumulated other comprehensive loss	(7,235)	(1,382)
Accumulated deficit	(425,931)	(140,516)
<b>Total stockholders' equity</b>	<b>349,881</b>	<b>635,180</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 573,559</b>	<b>\$ 891,242</b>

*The accompanying notes are an integral part of the consolidated financial statements.*

## Hydrofarm Holdings Group, Inc.

### CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share amounts)

	Years ended December 31,	
	2022	2021
Net sales	\$ 344,501	\$ 479,420
Cost of goods sold	315,165	377,934
<b>Gross profit</b>	<b>29,336</b>	<b>101,486</b>
Operating expenses:		
Selling, general and administrative	118,604	104,185
Impairments	192,328	—
<b>Loss from operations</b>	<b>(281,596)</b>	<b>(2,699)</b>
Interest expense	(10,958)	(2,138)
Loss on debt extinguishment or modification	(145)	(680)
Other income (expense), net	841	(204)
<b>Loss before tax</b>	<b>(291,858)</b>	<b>(5,721)</b>
Income tax benefit	6,443	19,137
<b>Net (loss) income</b>	<b>\$ (285,415)</b>	<b>\$ 13,416</b>
Net (loss) income per share:		
Basic	\$ (6.35)	\$ 0.34
Diluted	\$ (6.35)	\$ 0.31
Weighted-average shares of common stock outstanding:		
Basic	44,974,856	39,991,809
Diluted	44,974,856	42,989,195

*The accompanying notes are an integral part of the consolidated financial statements.*

## Hydrofarm Holdings Group, Inc.

### CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

	Years ended December 31,	
	2022	2021
<b>Net (loss) income</b>	<b>\$ (285,415)</b>	<b>\$ 13,416</b>
<b>Other comprehensive loss:</b>		
Foreign currency translation loss	(5,853)	(1,981)
<b>Total comprehensive (loss) income</b>	<b>\$ (291,268)</b>	<b>\$ 11,435</b>

*The accompanying notes are an integral part of the consolidated financial statements.*



## Hydrofarm Holdings Group, Inc.

### CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except for share amounts)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
<b>Balance, January 1, 2021</b>	33,499,953	\$ 3	\$ 364,248	\$ 599	\$ (153,932)	\$ 210,918
Common stock issued upon exercise of options	186,633	—	1,595	—	—	1,595
Issuance of common stock for vesting of restricted stock units	851,741	—	—	—	—	—
Shares repurchased for withholding tax on restricted stock units	(268,867)	—	(13,945)	—	—	(13,945)
Issuance of common stock under cashless warrant exercise	418,633	—	—	—	—	—
Issuance of common stock under investor warrant exercise	3,367,647	—	56,778	—	—	56,778
Issuance of common stock in connection with follow-on public offering, net of offering costs of \$16,303	5,526,861	1	309,781	—	—	309,782
Issuance of common stock in connection with business combinations	1,035,756	—	53,611	—	—	53,611
Stock-based compensation expense	—	—	5,006	—	—	5,006
Net income	—	—	—	—	13,416	13,416
Foreign currency translation loss	—	—	—	(1,981)	—	(1,981)
<b>Balance, December 31, 2021</b>	<b>44,618,357</b>	<b>\$ 4</b>	<b>\$ 777,074</b>	<b>\$ (1,382)</b>	<b>\$ (140,516)</b>	<b>\$ 635,180</b>
Common stock issued upon exercise of options	8,283	—	75	—	—	75
Issuance of common stock for vesting of restricted stock units	818,489	1	—	—	—	1
Shares repurchased for withholding tax on restricted stock units	(247,979)	—	(2,461)	—	—	(2,461)
Issuance of common stock under cashless warrant exercise	99	—	—	—	—	—
Stock-based compensation expense	—	—	8,354	—	—	8,354
Net loss	—	—	—	—	(285,415)	(285,415)
Foreign currency translation loss	—	—	—	(5,853)	—	(5,853)
<b>Balance, December 31, 2022</b>	<b>45,197,249</b>	<b>\$ 5</b>	<b>\$ 783,042</b>	<b>\$ (7,235)</b>	<b>\$ (425,931)</b>	<b>\$ 349,881</b>

*The accompanying notes are an integral part of the consolidated financial statements.*

## Hydrofarm Holdings Group, Inc.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Years ended December 31,	
	2022	2021
<b>Operating activities</b>		
Net income (loss)	\$ (285,415)	\$ 13,416
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Depreciation, depletion and amortization	41,527	14,934
Provision for (benefit from) doubtful accounts	2,998	(110)
Provision for inventory obsolescence	16,449	1,201
Restructuring expenses	6,091	—
Stock-based compensation expense	8,354	5,006
Non-cash operating lease expense	9,751	5,660
Impairment charges	192,328	—
Change in fair value of contingent consideration	(1,560)	(2,610)
Deferred income tax benefit	(9,310)	(20,996)
Other	1,210	1,364
Changes in assets and liabilities:		
Accounts receivable	16,665	(1,926)
Inventories	57,023	(46,849)
Prepaid expenses and other current assets	3,663	2,761
Other assets	262	(1,781)
Accounts payable	(11,998)	(12,303)
Accrued expenses and other current liabilities	(4,532)	(3,238)
Deferred revenue	(13,297)	5,080
Lease liabilities	(7,850)	(4,676)
Other long-term liabilities	(370)	—
<b>Net cash provided by (used in) operating activities</b>	<b>21,989</b>	<b>(45,067)</b>
<b>Investing activities</b>		
Business combinations, net of cash and cash equivalents	190	(462,172)
Capital expenditures of property, plant and equipment	(8,229)	(5,402)
Other	(448)	(610)
<b>Net cash used in investing activities</b>	<b>(8,487)</b>	<b>(468,184)</b>
		Continued

## Hydrofarm Holdings Group, Inc.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Years ended December 31,	
	2022	2021
<b>Financing activities</b>		
Proceeds from issuance of common stock upon follow-on public offering, net of offering costs	—	309,782
Proceeds from exercises of investor warrants	—	56,778
Payment of withholding tax related to restricted stock units	(2,470)	(20,025)
Borrowings under revolving credit facilities	853	142,628
Repayments of revolving credit facilities	(1,102)	(143,003)
Repayments of Term Loan	(1,250)	—
Proceeds from issuance of Term Loan, net of discount and issuance costs	—	119,879
Payments to settle contingent consideration	(15,474)	—
Other	(757)	(1,332)
<b>Net cash (used in) provided by financing activities</b>	<b>(20,200)</b>	<b>464,707</b>
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(395)	(27)
<b>Net decrease in cash, cash equivalents and restricted cash</b>	<b>(7,093)</b>	<b>(48,571)</b>
Cash, cash equivalents and restricted cash at beginning of year	28,384	76,955
<b>Cash, cash equivalents and restricted cash at end of year</b>	<b>\$ 21,291</b>	<b>\$ 28,384</b>
<b>Non-cash investing and financing activities</b>		
Issuance of common stock as consideration in connection with business combinations	\$ —	\$ 53,611
Increase in accrued expenses and other current liabilities for contingent consideration	—	19,644
Right-of-use assets acquired under operating lease obligation	28,972	22,873
<b>Supplemental information</b>		
Cash paid for interest	9,643	1,621
Cash paid for income taxes	3,906	1,963
		<b>Concluded</b>

*The accompanying notes are an integral part of the consolidated financial statements.*

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(In thousands, except share and per share amounts)**

## **1. DESCRIPTION OF THE BUSINESS**

### ***Description of the business***

Hydrofarm Holdings Group, Inc. (collectively with its subsidiaries, the “Company”) was formed in May 2017 under the laws of the state of Delaware to acquire and continue the business originally founded in 1977. The Company is a leading independent manufacturer and distributor of controlled environment agriculture (“CEA”, principally hydroponics) equipment and supplies, including a broad portfolio of proprietary branded products. Products offered include agricultural lighting devices, indoor climate control equipment, nutrients, and plant additives used to grow, farm and cultivate cannabis, flowers, fruits, plants, vegetables, grains and herbs in controlled environment settings that allow end users to control key farming variables including temperature, humidity, CO<sub>2</sub>, light intensity and color, nutrient concentration and pH.

### ***Initial public offering and follow-on public offering***

On December 14, 2020, the Company closed its initial public offering (“IPO”) under a registration statement effective December 9, 2020, in which it issued and sold 9,966,667 shares of its common stock, including the full exercise by the underwriters of their option to purchase 1,300,000 additional shares of common stock. The public offering price was \$20.00 per share. The Company received net proceeds of \$182,271 from the IPO after deducting underwriting discounts and commissions and offering expenses, of which \$148 of offering expenses were paid in 2021.

On May 3, 2021, the Company closed its follow-on public offering (“follow-on offering”) under a registration statement effective April 28, 2021, in which it issued and sold 5,526,861 shares of its common stock, including the full exercise by the underwriters of their option to purchase 720,894 additional shares of common stock. The public offering price was \$59.00 per share. The Company received net proceeds of \$309,782 from the follow-on offering after deducting underwriting discounts and commissions and offering expenses.

## **2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

### ***Basis of consolidation and presentation***

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and the requirements of the U.S. Securities and Exchange Commission (“SEC”) for year end financial reporting. All intercompany balances and transactions have been eliminated in consolidation. The Company reclassified the balance within “Impairment, restructuring and other” on the consolidated statements of operations for the prior period into “Selling, general and administrative expenses” (“SG&A”) to conform to the current period presentation. The Company reclassified the balance of customer deposits, totaling \$18,273 as of December 31, 2021, previously reported in “Accounts payable” into “Deferred revenue” in the consolidated balance sheet as of December 31, 2021, to conform to the current period presentation. Consistent with the reclassifications on the consolidated balance sheet, the Company made corresponding reclassifications to conform with the current period presentation in the consolidated statement of cash flows.

### ***Use of estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Significant estimates include provisions for sales returns, rebates and claims from customers, realization of accounts receivable and inventories, fair value of assets acquired and liabilities assumed for business combinations, valuation of intangible assets and goodwill, estimated useful lives of long-lived assets, incremental borrowing rate applied in lease accounting, valuation of stock-based compensation, recognition of deferred income taxes, recognition of liabilities related to commitments and contingencies and valuation allowances. Actual results may differ from these estimates. On an ongoing basis, the Company reviews its estimates to ensure that these estimates appropriately reflect changes in its business or new information available.

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(In thousands, except share and per share amounts)**

***Business combinations***

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition date fair values of the assets transferred, liabilities incurred to the former owners of the acquiree, and the equity interests issued in exchange for control of the acquiree. Acquisition related costs are recognized in net (loss) income as incurred.

When the consideration transferred in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition date fair value and included as part of the consideration transferred in a business combination. Contingent consideration is established for business acquisitions where the Company has the obligation to transfer additional assets or equity interests to the former owners if specified future events occur or conditions are met. Contingent consideration is classified as a liability when the obligation requires settlement in cash or other assets and is classified as equity when the obligation requires settlement in the Company's own equity instruments. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with a corresponding adjustment to goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the measurement period (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date. All other subsequent changes in the fair value of contingent consideration classified as a liability are included in net (loss) income in the period. Changes in the fair value of contingent consideration classified as equity are not recognized.

For a given acquisition, the Company may identify certain pre-acquisition contingencies as of the acquisition date and may extend its review and evaluation of these pre-acquisition contingencies throughout the measurement period to obtain sufficient information to assess these contingencies as part of acquisition accounting, as applicable.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date fair value amounts of the identifiable assets acquired, and the liabilities assumed.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Company reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that time. Upon conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded to net (loss) income.

***Restructuring***

The Company began a restructuring plan during the quarter ended December 31, 2022, and is undertaking significant actions to streamline operations, reduce costs and improve efficiencies. The major initiatives of the restructuring plan include (i) narrowing the Company's product and brand portfolio and (ii) the relocation and consolidation of certain manufacturing and distribution centers, including headcount reductions and reorganization to drive a solution based approach.

During the year ended December 31, 2022, the Company recorded pre-tax charges of \$6,790 relating to the inventory markdowns of products and brands being removed from our portfolio, which is primarily non-cash, and \$897 relating primarily to the relocation and termination of certain facilities in Canada, which are primarily cash charges. The Company's strategic product consolidation entails removing approximately one-third of all products and one-fifth of all brands relating to our primary product portfolio, which excludes our garden center business in Canada. The Company expects the restructuring and related actions to result in cost savings of approximately \$7,000 on an annualized basis. The amounts the Company will ultimately realize or disburse could differ from these estimates.

The Company recorded \$7,466 of restructuring related charges within Cost of goods sold and \$221 within Selling, general and administrative expenses on the consolidated statement of operations for the year ended December 31, 2022. The Company's accrued liability for restructuring costs as of December 31, 2022, was \$696. The Company estimates it will incur additional restructuring charges of approximately \$1.7 million during the first half of 2023.

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(In thousands, except share and per share amounts)

***Segment and entity-wide information***

*Segment information*

The Company's chief operating decision maker is the chief executive officer ("CEO") who reviews financial information for the purposes of making operating decisions, assessing financial performance and allocating resources. The business is organized as two operating segments, the U.S. and Canada, which meet the criteria for aggregation, and the Company has elected to present them as one reportable segment, which is the distribution and manufacture of CEA equipment and supplies. Aggregation is based on similarities which include the nature of its products, production or acquisition of inventory, customer base, fulfillment and distribution and economic characteristics.

Since the Company operates as one reportable segment, all required segment financial information is found in the consolidated financial statements and footnotes with entity-wide disclosures presented below.

*Entity-wide information*

Sales to external customers and property, plant and equipment, and operating lease right-of-use assets, net in the United States and Canada, determined by the location of the subsidiaries, are shown below. Other foreign locations, which are immaterial, individually and in the aggregate, are included in the U.S. below.

	Years ended December 31,			
	2022		2021	
United States	\$	280,464	\$	399,749
Canada		68,153		87,281
Intersegment eliminations		(4,116)		(7,610)
<b>Total consolidated net sales</b>	<b>\$</b>	<b>344,501</b>	<b>\$</b>	<b>479,420</b>
	December 31,			
	2022		2021	
United States	\$	80,380	\$	85,167
Canada		36,020		10,551
<b>Total property, plant and equipment, and operating lease right-of-use assets, net</b>	<b>\$</b>	<b>116,400</b>	<b>\$</b>	<b>95,718</b>

All of the products sold by the Company are similar and classified as CEA equipment and supplies.

***Concentrations of business and credit risk***

The Company maintains cash balances at certain financial institutions that can, at times, exceed amounts insured by the Federal Deposit Insurance Corporation ("FDIC"). The Company has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk in this area.

Accounts receivable expose the Company to credit risks such as collectability and business risks such as customer concentrations. Exposure to losses on receivables is dependent on each customer's financial condition. Receivables arising from sales are not collateralized; however, credit risk is somewhat mitigated as a result of the large diverse customer base. No customer accounted for more than 10% of revenues in 2022, or 2021. No customer accounted for more than 10% of accounts receivable as of December 31, 2022, or December 31, 2021. One supplier accounted for more than 10% of purchases in 2022 and 2021.

***Fair value measurements***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company has applied the framework for measuring fair value which

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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requires a fair value hierarchy to be applied to all fair value measurements. All financial instruments recognized at fair value are classified into one of three levels in the fair value hierarchy as follows:

Level 1 — Valuation based on quoted prices (unadjusted) observed in active markets for identical assets or liabilities.

Level 2 — Valuation techniques based on inputs that are quoted prices of similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not in active markets; inputs other than quoted prices used in a valuation model that are observable for that instrument; and inputs that are derived from or, corroborated by, observable market data by correlation or other means.

Level 3 — Valuation techniques with significant unobservable market inputs.

The Company measures certain non-financial assets and liabilities, including long-lived assets, intangible assets and goodwill, at fair value on a nonrecurring basis. The fair value of contingent consideration is classified within level 3 of the fair value hierarchy (See discussion of contingent consideration in Note 3 - *Business Combinations* and Note 15 - *Fair Value Measurements*).

***Foreign currency matters***

The Company reports its financial results in United States dollars, which is the currency of the primary economic environment in which it operates. The functional currency for each of the Company's foreign subsidiaries is generally its local currency. Monetary assets and liabilities, and transactions denominated in currencies other than the functional currency are remeasured to the functional currency at the exchange rate in effect at the end of each period. Foreign currency transaction gains and losses are included in the determination of net (loss) income and classified as other income (expense), net in the consolidated statements of operations. Assets and liabilities of foreign subsidiaries are translated at the exchange rates in effect at the end of each period. Revenues, expenses, gains and losses are translated at the average rates of exchange prevailing during the period. Accumulated deficit and other equity accounts are translated at historical rates. Translation gains and losses are included in accumulated other comprehensive loss within stockholders' equity.

The effect of currency translation adjustments on cash, cash equivalents and restricted cash is presented separately in the consolidated statements of cash flows.

***Cash, cash equivalents and restricted cash***

Cash includes funds deposited in banks. Cash equivalents include highly liquid investments such as term deposits and money market instruments with original maturities of three months or less. As of December 31, 2021, amounts included in restricted cash represent those funds required to be set aside as security for letters of credits, and other various contractual arrangements. As of December 31, 2022, there were no amounts classified as restricted cash, as all previous restrictions lapsed during the year.

***Accounts receivable, net***

Trade accounts receivable represents amounts due from customers. Other receivables represent other current non-trade receivables. Allowance for doubtful accounts reflects the Company's estimate of amounts in its existing accounts receivable that may not be collected due to customer claims or customer inability or unwillingness to pay. The allowance is determined based on a combination of factors, including, but not limited to the age of the account, the credit worthiness of the customer, payment terms, the customer's historical payment history and general economic conditions. Management reviews these factors quarterly to determine if any adjustments are needed to the allowance for doubtful accounts. Accounts receivable are written off when the receivables are deemed uncollectible.

***Inventories***

Inventories consist of finished goods, work-in-process, and raw materials used in manufacturing products. Inventories are stated at the lower of cost or net realizable value, principally determined by the first in, first out method of accounting. The Company maintains an allowance for excess and obsolete inventory. The estimate for excess and obsolete inventory is based upon assumptions about current and anticipated demand, customer preferences, business strategies, and market conditions.

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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Management reviews these assumptions periodically to determine if any adjustments are needed to the allowance for excess and obsolete inventory. The establishment of an allowance for excess and obsolete inventory establishes a new cost basis in the inventory. Such allowance is not reduced until the product is sold. If inventory is sold, any related reserves would be reversed in the period of sale. The Company estimates inventory markdowns relating to restructuring charges based upon current and anticipated demand, customer preferences, business strategies, and market conditions including management's actions with respect to inventory products and brands being removed from our portfolio. Hydrofarm's strategic product consolidation entails removing approximately one-third of all products and one-fifth of all brands relating to our primary product portfolio.

***Leases***

Leases are accounted for under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 842, *Leases*. At inception of a contract, the Company determines whether that contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. Leases are then classified as either finance or operating, with classification affecting the location of expense recognition in the consolidated statements of operations.

Right-of-use assets ("ROU") represent the right to use an underlying asset for the lease term while lease liabilities represent the obligation to make lease payments arising from a lease, measured on a discount basis. All leases greater than 12 months result in the recognition of a ROU and a lease liability at the lease commencement date based on the present value of the lease payments over the lease term. The present value of the lease payments is calculated using the applicable weighted-average discount rate. The weighted-average discount rate is based on the discount rate implicit in the lease, or if the implicit rate is not readily determinable from the lease, the applicable incremental borrowing rate is estimated. The incremental borrowing rate is estimated using the currency denomination of the lease and the contractual lease term. To determine the incremental borrowing rate, reference is made to interest rates that would be available to finance assets similar to the assets under lease in their related geographical location.

The Company accounts for lease components separately from non-lease components, other than for office equipment. The Company has certain leases that include one or more options to renew with renewal terms that can extend the lease term. The exercise of the lease renewal options is at the Company's discretion. A lease renewal option is included in the determination of the ROU asset and lease liability when the option is reasonably certain of being exercised.

***Property, plant and equipment***

Property, plant and equipment ("PP&E") is recorded at cost less accumulated depreciation, depletion and amortization. PP&E assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

Property, plant and equipment, excluding peat bogs and related development, are depreciated using the straight-line method. The following table summarizes the estimated useful lives as follows:

Buildings and improvements	10 - 40 years
Machinery and equipment	5 - 15 years
Leasehold improvements	Lesser of useful life or term of the lease
Computer equipment	3 - 4 years
Furniture and fixtures	5 years

Peat bogs and related development costs are depleted using the units of production method over the total expected volume of the peat bogs.

***Intangible assets and goodwill***

Definite-lived intangible assets are amortized using the straight-line method over their estimated useful lives. The Company has one trade name that is considered to have an indefinite useful life. Intangible assets are also tested for impairment at least annually and when events or changes in circumstances indicate that, more-likely-than-not, the carrying



**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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amount may not be recoverable. Significant judgment is required in estimating fair values and performing goodwill and intangible asset impairment tests.

Goodwill represents the excess of the acquisition price of an acquired business over the fair value of the identifiable assets acquired and liabilities assumed in a business combination less any subsequent write-downs for impairment. Goodwill is tested for impairment on an annual basis in the fourth quarter and more frequently if indicators of potential impairment exist. Impairment testing is conducted at the reporting unit level, which is generally defined as an operating segment or one level below an operating segment (also known as a component), for which discrete financial information is available and segment management regularly reviews the operating results. The Company has determined that its reporting units for the purpose of goodwill impairment testing are the U.S. and Canada.

Goodwill impairment reviews include performing either an initial qualitative or quantitative evaluation for each of the reporting units. Several methods may be used to estimate a reporting unit's fair value, including market quotations, asset and liability fair values and other valuation techniques. If the carrying amount of a reporting unit, including goodwill, exceeds the estimated fair value, then the excess is charged to earnings as an impairment loss.

***Note Receivable***

In 2019, the Company executed a note receivable secured by equipment to a third-party, the terms of which were amended and restated during the first quarter of 2021. The note receivable provided for interest and installment payments to the Company, and full maturity of the note in 2024. During the first quarter of 2022 the third-party defaulted on interest payments, and the Company measured an impairment on the note receivable based on the estimated fair value of the collateral. The Company recorded an impairment loss of \$2,636 during the year ended December 31, 2022, respectively, in "Impairments" on the consolidated statements of operations. There were no impairment losses recorded in the year ended December 31, 2021. As of December 31, 2022, the note receivable carrying value was \$475 and is classified in Other assets on the consolidated balance sheet.

***Revenue recognition***

ASC 606, *Revenue from Contracts with Customers*, requires that revenue recognized from contracts with customers be disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The Company has determined that revenue is generated from one category, which is the distribution and manufacture of controlled environment agriculture equipment and supplies.

Revenue is recognized as control of promised goods is transferred to customers, which generally occurs upon receipt at customers' locations determined by the specific terms of the contract. Arrangements generally have a single performance obligation and revenue is reported net of variable consideration which includes applicable volume rebates, cash discounts and sales returns and allowances. Variable consideration is estimated and recorded at the time of sale.

The amount billed to customers for shipping and handling costs included in net sales was \$13,180, and \$8,050 in 2022, and 2021, respectively. Shipping and handling costs that occur before the customer obtains control of the goods are deemed to be fulfillment activities and are accounted for as fulfillment costs included in cost of goods sold. The Company does not receive noncash consideration for the sale of goods. Contract consideration received from a customer prior to revenue recognition is recorded as a contract liability and is recognized as revenue when the Company satisfies the related performance obligation under the terms of the contract. The Company's contract liabilities, which consist primarily of customer deposits are reported within deferred revenue in the consolidated balance sheets, totaled \$3,654 and \$18,273 as of December 31, 2022, and 2021, respectively. There are no significant financing components. Excluded from revenue are any taxes assessed by governmental authorities, including value-added and other sales-related taxes that are imposed on and concurrent with revenue-generating activities.

***Warrants issued in connection with financings***

The Company generally accounts for warrants issued in connection with debt and equity financings as a component of equity unless the warrants include a conditional obligation to issue a variable number of shares among other conditions or it is possible that the Company may need to settle the warrants in cash.

**Hydrofarm Holdings Group, Inc.**  
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***Stock-based compensation***

The Company accounts for stock-based compensation expense in accordance with the fair value recognition and measurement provisions of U.S. GAAP, which requires compensation cost for the grant-date fair value of stock-based awards to be recognized over the requisite service period. The Company accounts for forfeitures when they occur and any compensation expense previously recognized on unvested shares will be reversed when forfeited.

***Service-based awards***

The Company records stock-based compensation expense for restricted stock units (“RSUs”) and service-based stock options on a straight-line basis over the requisite service period.

The fair value of grants of restricted stock is based on the fair value of the common stock underlying the award. The fair value of the underlying common stock for RSUs prior to the Company’s IPO in December 2020, was determined by considering a number of objective, subjective, and highly complex factors including independent third-party valuations of the Company’s common stock, operating and financial performance, the lack of liquidity of capital stock and general and industry specific economic outlook among other factors. For awards granted after the Company's IPO, the fair value of the underlying common stock for RSUs is the closing date price of the Company's common stock at the grant-date.

The fair value of option-based awards is estimated using the Black-Scholes valuation model. The Black-Scholes model requires the use of highly subjective and complex assumptions. For inputs into the Black-Scholes model, the expected volatility is based on historical implied volatility from recent stock option transactions at the time of grant. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury implied yield at the date of grant. The Company has elected to use the “simplified method” to determine the expected term which is the midpoint between the vesting date and the end of the contractual term because it has insufficient history upon which to base an assumption about the term. The expected dividend yield is 0.0% as the Company has not paid and does not anticipate paying dividends on its common stock.

***Performance-based awards***

The Company has granted performance stock unit (“PSU”) awards that vest upon the satisfaction of both service-based and performance-based conditions. The service-based condition for these awards generally is satisfied over one year. The performance-based conditions generally are satisfied upon achieving specified performance targets. The Company records stock-based compensation expense for performance-based equity awards on a straight-line basis over the requisite service period and only if performance-based conditions are considered probable to be satisfied.

***Market-based awards***

The Company has granted RSUs that vest only upon the satisfaction of both performance-based and market-based conditions. The performance-based conditions are satisfied upon achieving specified performance targets, such as the occurrence of a qualifying event, as described above for performance-based awards. The market-based condition is satisfied upon the Company’s achievement of a qualifying traded share price within the specified time frame. The Company records stock-based compensation expense once the performance condition is satisfied regardless of whether the market condition is eventually met. For one award granted in 2020, the market condition was factored into its fair value and the Company used a “Monte Carlo Simulation Method” (“MCSM”) to estimate the fair value of the award. The MCSM assessed the likelihood of vesting of the RSU grants based on the probability of both a triggering event and qualifying traded share price within the specified time frame. For the years ended December 31, 2022, and 2021, there were no performance awards with market-based conditions granted.

***Income taxes***

The asset and liability method of accounting for income taxes is followed whereby deferred income tax assets are recognized for deductible temporary differences and operating loss carryforwards, and deferred income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes.

**Hydrofarm Holdings Group, Inc.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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Deferred income tax assets are recognized only to the extent that management determines that it is more-likely-than-not that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The income tax expense or benefit is the income tax payable or recoverable for the year plus or minus the change in deferred income tax assets and liabilities during the year.

The Company has deferred tax assets and liabilities and maintains valuation allowances where it is more likely than not that all or a portion of deferred tax assets will not be realized. Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. The determination of the amount of valuation allowance to be provided on recorded deferred tax assets involves consideration of estimates regarding the timing and amount of the reversal of taxable temporary differences, expected future taxable income by jurisdiction, and the impact of tax planning strategies. Changes in the relevant facts can impact the judgment or need for valuation allowances. In the event we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

The Company will establish a liability for tax return positions when there is uncertainty as to whether the position will ultimately be sustained. Amounts for uncertain tax positions will be adjusted when new information becomes available or when positions are effectively settled. The Company will recognize interest expense and penalties related to these unrecognized tax benefits within income tax expense. U.S. GAAP provides that a tax benefit from an uncertain tax position may be recognized when it is more-likely-than-not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits of the position. The amount recognized is measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the related tax authority.

***Recently issued accounting pronouncements***

The Company reviewed recently issued accounting pronouncements and noted no new pronouncements relevant to the Company.

**3. BUSINESS COMBINATIONS**

During 2021, the Company completed five acquisitions of branded manufacturers of CEA products, resulting in a significant expansion of its portfolio of proprietary branded products and specialized manufacturing capabilities. The Company finalized the determination of its allocation of the purchase price relating to these acquisitions during 2022, and obtained third-party valuation reports of certain tangible and identifiable intangible assets to support its evaluation.

Goodwill arose on the acquisitions because the consideration paid effectively included amounts in relation to the benefit of expected synergies, revenue growth, future market development and the assembled workforce. These benefits are not recognized separately from goodwill and they do not meet the recognition criteria for identifiable intangible assets.

During 2022, the Company evaluated and adjusted the useful lives of certain intangible assets associated with entities that were acquired during 2021. In addition, the Company determined that the preliminary allocation of assets acquired related to indefinite lived trade names have a finite useful life because the expected usefulness of the trade names is limited. As a result of these adjustments to the provisional amounts, the Company recorded \$5,894 of additional amortization expense during 2022, which related to amortization expense that would have been recorded in the previous reporting period from the acquisition date through December 31, 2021. The intangible assets were assigned estimated useful lives as follows: (i) customer relationships: 7 to 12 years, (ii) technology, formulations and recipes: 8 to 12 years, (iii) computer software: 3 years, and (iv) trade names and trademarks: 15 to 20 years.

The financial results of Heavy 16, the H&G Entities, Aurora and the IGE Entities (each as defined below) are included in the U.S. operating segment since the acquisition date. The financial results of Greenstar are included in the Canada operating segment since the acquisition date.

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***Heavy 16 Acquisition***

On May 3, 2021, the Company acquired 100% of the issued and outstanding membership interests of Field 16, LLC ("Heavy 16"), a manufacturer and supplier of branded plant nutritional products. As a result of the acquisition, the Company broadened its proprietary branded offering into the plant nutrients category complementing other product offerings. The acquisition fair value of the consideration transferred for Heavy 16 was \$77,367, consisting of \$60,287 in cash, \$16,736 of the Company's common stock and \$344 contingent consideration. The fair value of the common stock issued was determined based on the closing market price of the Company's common stock on the acquisition date.

Pursuant to the purchase agreement, the Company was required to pay up to an additional \$2,500 of contingent consideration based on \$200 for each \$1,000 above a \$21,000 threshold for net sales in calendar year 2021. As a result, the Company recorded a liability for contingent consideration at its estimated fair value of \$344 as of the acquisition date in the consolidated balance sheets. The contingent consideration was estimated using a Black-Scholes valuation model, which utilized Level 3 inputs as defined in ASC 820 - *Fair Value Measurements*. The key assumptions in applying the valuation model were as follows: a 10% required revenue metric risk premium and 0.33% discount periods. The contingent consideration was divided into thirteen standalone option calculations and utilized the same expected value of revenue which was calculated by discounting forecasted sales, by the revenue return metric, and adding year-to-date net sales. The contingent consideration was remeasured to fair value at each reporting date until the contingency was resolved with changes in fair value being recognized within "Selling, general and administrative expenses" ("SG&A") in the consolidated statements of operations. As of December 31, 2021, contingent consideration of \$200 was calculated utilizing actual net sales for the full year ended December 31, 2021. The change in the fair value of the contingent consideration of \$144 during the year ended December 31, 2021, was recognized as a benefit in SG&A on the consolidated statement of operations during the period. There were no changes to the fair value of contingent consideration in 2022, and the balance was paid in April 2022. The amount of goodwill is fully deductible for tax purposes.

***House & Garden Acquisition***

On June 1, 2021, the Company acquired 100% of the issued and outstanding shares of capital stock of House & Garden, Inc. ("HG"), Humboldt Wholesale, Inc. ("HW"), Allied Imports & Logistics, Inc. ("Allied"), South Coast Horticultural Supply, Inc. ("SC" and, together with HG, HW and Allied, the "H&G Entities"), a manufacturer and distributor of plant nutrients and fertilizers to domestic and various international markets. As a result of the acquisition, the Company is further broadening its proprietary branded offering into the plant nutrients category complementing other product offerings. The acquisition date fair value of the consideration transferred for the H&G Entities was \$133,483 in cash. The amount of goodwill is not deductible for tax purposes. As part of the share acquisition of the H&G Entities, the Company allocated a significant value of the acquisition to identified intangible assets that are not deductible for U.S. tax purposes. Therefore, a deferred tax liability arose providing an additional source of taxable income to support the realization of pre-existing deferred tax assets.

***Aurora Acquisition***

On July 1, 2021, the Company acquired 100% of the issued and outstanding membership interests of Gotham Properties LLC ("Gotham Properties"), Aurora Innovations LLC ("Aurora Innovations"), Aurora International LLC ("Aurora International" and, together with Gotham Properties and Aurora Innovations, "Aurora"), a manufacturer of plant fertility product lines. As a result of the acquisition, the Company broadened its proprietary branded offering into the plant nutrients and grow media category complementing other product offerings. The preliminary acquisition fair value of the consideration transferred for Aurora was \$178,871, consisting of \$133,962 in cash, \$25,824 of the Company's common stock, \$19,300 contingent consideration and \$215 forgiveness of accounts payable. The fair value of the common stock issued was determined based on the closing market price of the Company's common stock on the acquisition date. The forgiveness of accounts payable represents an effective settlement of a preexisting relationship between the parties. The amount of goodwill is fully deductible for tax purposes.

Pursuant to the purchase agreement, the Company was required to pay a maximum contingent consideration equal to \$70,997. To the extent 2021 EBITDA of Aurora exceeded \$15,556, the excess was multiplied by eleven to determine contingent consideration. As a result, the Company recorded a liability for contingent consideration at its estimated fair value of \$19,300 as of the acquisition date in the consolidated balance sheets. The contingent consideration was estimated using the discounted cash flow method, which estimated the incremental EBITDA based on the Company's forecasted 2021 EBITDA of

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Aurora as of the acquisition date, discounted to a present value as of the acquisition date using a discount rate of 15%. That measure was based on significant inputs that are not observable in the market, which utilized Level 3 inputs as defined in ASC 820 - Fair Value Measurements. The contingent consideration was remeasured to fair value at each reporting date until resolution with changes in fair value recognized within SG&A in the consolidated statements of operations. As of December 31, 2021, the contingent consideration of \$16,834 was calculated utilizing actual 2021 EBITDA for the full year ended December 31, 2021. The change in the fair value of the contingent consideration of \$2,466 during the year ended December 31, 2021, was recognized as a benefit in SG&A on the consolidated statement of operations during the period. During 2022, the Company recognized an additional \$1,560 benefit to SG&A as the contingent consideration was revalued to \$15,274, and paid in July 2022 using available cash on hand.

***Greenstar/Grotek Acquisition***

On August 3, 2021, the Company acquired 100% of the issued and outstanding shares of Greenstar Plant Products Inc., (“Greenstar”), a manufacturer of horticultural products and solutions for global, domestic and commercial use. As a result of the acquisition, the Company broadened its proprietary branded offering into the plant nutrients and grow media category complementing other product offerings. The preliminary acquisition fair value of the consideration transferred for Greenstar was \$83,520, consisting of \$85,121 in cash, less \$1,601 forgiveness of accounts payable, net, and obligations due under a distribution agreement. The forgiveness of accounts payable, net, and obligations due under a distribution agreement represent an effective settlement of a preexisting relationship between the parties. The amount of goodwill is not deductible for U.S. tax purposes, but it is partially deductible for Canadian tax purposes.

***Innovative Growers Equipment, Inc. Acquisition***

On November 1, 2021, the Company acquired 100% of the issued and outstanding shares of Innovative Growers Equipment, Inc., an Illinois corporation (“IGE”), Innovative AG Installation, Inc., an Illinois corporation (“IAG”), Innovative Racking Systems, Inc., an Illinois corporation (“IRS”), and Innovative Shipping Solutions, Inc., an Illinois corporation (“ISS” and, together with IGE, IAG, IRS, and their respective subsidiaries, the “IGE Entities”), a manufacturer of horticulture benches, racking and LED lighting systems which complement the Company’s existing lineup of high performance, proprietary branded products. The preliminary acquisition fair value of the consideration transferred for the IGE Entities was \$60,902, consisting of \$49,129 in cash, \$11,051 of the Company's common stock, and \$722 forgiveness of a contract asset. The fair value of the common stock issued was determined based on the closing market price of the Company's common stock on the acquisition date. The forgiveness of contract asset represents an effective settlement of a preexisting relationship between the parties. The amount of goodwill is not deductible for U.S. tax purposes.

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The following table sets forth the components and allocation of the purchase price for the Company's acquisition of Heavy 16, the H&G Entities, Aurora, Greenstar and the IGE Entities:

<b>Component of Purchase Price:</b>	<b>Heavy 16 Amount</b>	<b>H&amp;G Entities Amount</b>	<b>Aurora Amount</b>	<b>Greenstar Amount</b>	<b>IGE Entities Amount</b>
Cash	\$ 60,287	\$ 133,483	\$ 133,962	\$ 85,121	\$ 49,129
Common stock	16,736	—	25,824	—	11,051
Contingent consideration	344	—	19,300	—	—
Forgiveness of assets and liabilities	—	—	(215)	(1,601)	722
<b>Total purchase price</b>	<b>\$ 77,367</b>	<b>\$ 133,483</b>	<b>\$ 178,871</b>	<b>\$ 83,520</b>	<b>\$ 60,902</b>
<b>Acquisition-related costs</b>	<b>\$ 3,109</b>	<b>\$ 5,063</b>	<b>\$ 7,358</b>	<b>\$ 3,688</b>	<b>\$ 2,150</b>
<b>Allocation of Purchase Price:</b>					
<b>Identifiable assets (liabilities)</b>					
Accounts receivable	\$ 510	\$ 3,308	\$ 6,967	\$ 982	\$ 2,367
Inventories	1,451	6,559	11,031	8,728	30,592
Prepaid expenses and other current assets	34	493	1,086	447	470
Property and equipment	1,078	358	37,991	1,717	4,274
Operating lease right-of-use assets	1,088	1,921	—	2,736	4,447
Other assets	25	213	—	176	—
Accounts payable	(1,055)	(1,320)	(4,360)	(777)	(21,686)
Accrued expenses and other current liabilities	(226)	(445)	(768)	(1,421)	(859)
Current portion of lease liabilities	(274)	(447)	—	(624)	(815)
Current portion of long-term debt	—	—	—	—	(482)
Long-term deferred tax liabilities	—	(25,589)	—	—	(6,769)
Long-term lease liabilities	(868)	(1,501)	—	(1,836)	(3,116)
Long-term debt	—	—	—	—	(1,434)
Other long-term liabilities	—	—	(3,840)	—	—
<b>Net identifiable assets</b>	<b>1,763</b>	<b>(16,450)</b>	<b>48,107</b>	<b>10,128</b>	<b>6,989</b>
<b>Identifiable intangible assets</b>					
Other intangible assets	200	200	824	383	2,430
Customer relationships	5,100	12,500	6,400	11,100	6,300
Trademarks and trade names	18,500	31,400	59,100	9,100	14,000
Technology and formulations & recipes	33,600	56,200	18,000	2,800	3,800
<b>Total identifiable intangible assets</b>	<b>57,400</b>	<b>100,300</b>	<b>84,324</b>	<b>23,383</b>	<b>26,530</b>
<b>Goodwill</b>	<b>18,204</b>	<b>49,633</b>	<b>46,440</b>	<b>50,009</b>	<b>27,383</b>
<b>Total purchase price allocation</b>	<b>\$ 77,367</b>	<b>\$ 133,483</b>	<b>\$ 178,871</b>	<b>\$ 83,520</b>	<b>\$ 60,902</b>

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***Supplemental Disclosure of Financial Results***

The following represents estimated unaudited consolidated net sales and net income amounts for year ended December 31, 2021, as if the five acquisitions had been included in the consolidated results of the Company for the entire period. The estimated net income presented below also includes the impact of the aforementioned allocation adjustments to the useful lives of certain intangible assets, resulting in additional expense attributed to the year ended December 31, 2021. Management considers these estimates to represent an approximate measure of the performance of the combined Company:

	<b>Year ended December 31, 2021</b>	
	<i>Estimated (\$ in millions)</i>	
Net sales	\$	<b>596</b>
Net income	\$	<b>66</b>

**4. GOODWILL AND INTANGIBLE ASSETS, NET**

***Goodwill***

Primarily due to a sustained decline in the Company's market value of common stock and market conditions, the Company identified a triggering event requiring a test for impairment as of June 30, 2022. The Company completed its goodwill impairment testing and recorded an impairment charge of \$189,572 as the test determined that the carrying value of the reporting units of U.S. and Canada was in excess of the fair value. The recognized impairment reduced the goodwill balance to zero as of June 30, 2022. The impairment was primarily due to a deterioration in customer demand in the U.S. and Canada caused by macroeconomic and industry conditions.

The Company determined the fair value of the U.S. and Canada reporting units based on an income approach, using the present value of future discounted cash flows, and based on a market approach. The fair values were reconciled to the market value of common stock of Hydrofarm to corroborate the estimates used in the interim test for impairment. Significant estimates used to determine fair value include the weighted average cost of capital, financial forecasts, and pricing multiples derived from publicly-traded companies that are comparable to the reporting units. Refer to Note 15 - Fair Value Measurements, for further discussion of valuation inputs. There was no goodwill impairment recognized during the year ended December 31, 2021. The changes in goodwill are as follows:

	<b>Goodwill</b>	
<b>Balance at December 31, 2020</b>	\$	<b>—</b>
Acquisition - Heavy 16		<b>18,204</b>
Acquisition - H&G Entities		<b>49,707</b>
Acquisition - Aurora		<b>46,433</b>
Acquisition - Greenstar		<b>43,009</b>
Acquisition - IGE Entities		<b>48,687</b>
Foreign currency translation adjustments, net		<b>(1,172)</b>
<b>Balance at December 31, 2021</b>	<b>\$</b>	<b>204,868</b>
Acquisition - IGE Entities - measurement period adjustments		<b>(21,304)</b>
Acquisition - Greenstar - measurement period adjustments		<b>7,000</b>
Acquisition - all others - measurement period adjustments and foreign currency translation adjustments, net		<b>(992)</b>
Impairments		<b>(189,572)</b>
<b>Balance at December 31, 2022</b>	<b>\$</b>	<b>—</b>

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***Intangible Assets, net***

Intangible assets, net comprised the following:

	December 31, 2022			December 31, 2021		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Finite-lived intangible assets:						
Computer software	\$ 9,408	\$ (7,976)	\$ 1,432	\$ 8,814	\$ (7,208)	\$ 1,606
Customer relationship	99,933	(24,533)	75,400	101,222	(16,517)	84,705
Technology, formulations and recipes	114,187	(15,344)	98,843	110,561	(3,630)	106,931
Trade names and trademarks	131,410	(10,052)	121,358	—	—	—
Other	4,778	(4,246)	532	2,428	(1,744)	684
Total finite-lived intangible assets, net	359,716	(62,151)	297,565	223,025	(29,099)	193,926
Indefinite-lived intangible assets:						
Trade name	2,801	—	2,801	120,773	—	120,773
Other	—	—	—	120	—	120
<b>Total Intangible assets, net</b>	<b>\$ 362,517</b>	<b>\$ (62,151)</b>	<b>\$ 300,366</b>	<b>\$ 343,918</b>	<b>\$ (29,099)</b>	<b>\$ 314,819</b>

Amortization expense related to intangible assets was \$33,308 and \$10,354 for the years ended December 31, 2022, and 2021, respectively. Amortization expense includes the impact from intangible assets recorded in connection with five acquisitions completed during the year ended December 31, 2021. The following are the estimated useful lives and the weighted-average amortization period as of December 31, 2022, for the major classes of finite-lived intangible assets:

	Useful lives	Weighted-average amortization period
Computer software	5 years	3 years
Customer relationships	7 to 18 years	11 years
Technology, formulations and recipes	8 to 12 years	10 years
Trade names and trademarks	15 to 20 years	18 years

The estimated aggregate future amortization expense for intangible assets subject to amortization as December 31, 2022, is summarized below:

Year ending December 31,	Estimated Future Amortization Expense
2023	\$ 24,525
2024	24,418
2025	24,348
2026	23,968
Thereafter	200,306
<b>Total</b>	<b>\$ 297,565</b>



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**5. EARNINGS (LOSS) PER COMMON SHARE (“EPS”)**

Basic EPS is computed using net (loss) income divided by the weighted-average number of common shares outstanding during each period, excluding unvested restricted stock units (“RSUs”).

Diluted EPS represents net (loss) income divided by the weighted-average number of common shares outstanding during the period, including common stock equivalents. Common stock equivalents consist of shares subject to warrants and share-based awards with exercise prices less than the average market price of the Company’s common stock for the period, to the extent their inclusion would be dilutive. Regarding RSUs subject to a market condition, before the end of the contingency period, the number of contingently issuable shares (i.e., RSUs) to be included in diluted EPS would be based on the number of shares of common stock issuable under the terms of the arrangement if the end of the reporting period was the end of the contingency period, assuming the result would be dilutive. Those contingently issuable shares would be included in the denominator of diluted EPS as of the beginning of the period, or as of the grant date of the share-based payment, if later.

The following table presents information necessary to calculate basic and diluted EPS for the years ended December 31, 2022, and 2021:

	Years ended December 31,	
	2022	2021
<b>Net (loss) income</b>	<b>\$ (285,415)</b>	<b>\$ 13,416</b>
Weighted-average shares of common stock outstanding	44,974,856	39,991,809
Dilutive effect of warrants using the treasury stock method	—	1,395,393
Dilutive effect of restricted stock units using the treasury stock method	—	1,068,984
Dilutive effect of stock options using the treasury stock method	—	533,009
<b>Diluted weighted-average shares of common stock outstanding</b>	<b>44,974,856</b>	<b>42,989,195</b>
<b>Basic EPS</b>	<b>\$ (6.35)</b>	<b>\$ 0.34</b>
<b>Diluted EPS</b>	<b>\$ (6.35)</b>	<b>\$ 0.31</b>

The computation of the weighted-average shares of common stock outstanding for diluted EPS includes the following potential shares of common stock using the treasury stock method for the weighted-average period during which the shares were outstanding:

	Years ended December 31,	
	2022	2021
<b>Shares subject to warrants outstanding</b>	—	1,899,435
<b>Shares subject to unvested performance based and restricted stock units</b>	—	1,311,914
<b>Shares subject to stock options outstanding</b>	—	831,517

The computation of the weighted-average shares of common stock outstanding for diluted EPS excludes the following potential shares of common stock as their inclusion would have an anti-dilutive effect on diluted EPS:

	Years ended December 31,	
	2022	2021
<b>Shares subject to warrants outstanding</b>	<b>17,669</b>	<b>17,817</b>
<b>Shares subject to unvested performance based and restricted stock units</b>	<b>1,088,879</b>	<b>71,871</b>
<b>Shares subject to stock options outstanding</b>	<b>670,026</b>	<b>10,641</b>

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**6. ACCOUNTS RECEIVABLE, NET AND INVENTORIES**

Accounts receivable, net comprised the following:

	December 31,	
	2022	2021
Trade accounts receivable	\$ 18,204	\$ 35,511
Allowance for doubtful accounts	(1,556)	(1,156)
Other receivables	579	7,129
<b>Total accounts receivable, net</b>	<b>\$ 17,227</b>	<b>\$ 41,484</b>

Inventories comprised the following:

	December 31,	
	2022	2021
Finished goods	\$ 83,134	\$ 145,298
Work-in-process	5,403	5,967
Raw materials	38,558	41,399
Allowance for inventory obsolescence	(15,697)	(3,530)
<b>Total inventories</b>	<b>\$ 111,398</b>	<b>\$ 189,134</b>

The allowance for inventory obsolescence increased during the year ended December 31, 2022, primarily a result of a reserve for certain lighting products. Inventories are stated at the lower of cost or net realizable value, and the Company maintains an allowance for excess and obsolete inventory that is based upon assumptions about future demand and market conditions. The allowance for excess and obsolete inventory is subject to change from period to period based on a number of factors including sales of products, changes in estimates, and disposals.

**7. LEASES**

The Company leases its distribution centers and manufacturing facilities from third parties under various non-cancelable lease agreements expiring at various dates through 2033. Also, the Company leases some equipment under finance leases. Certain leases contain escalation provisions and/or renewal options, giving the Company the right to extend the leases by up to 10 years. However, these options are generally not reflected in the calculation of the right-of-use assets and lease liabilities due to uncertainty surrounding the likelihood of renewal. The Company recognizes operating lease costs over the respective lease periods, including short-term and month-to-month leases. The Company has operating subleases which have been accounted for by reference to the underlying asset subject to the lease, primarily as an offset to rent expense within SG&A.

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Total ROU assets and lease liabilities were as follows:

		December 31,	
		2022	2021
<b>Balance Sheet Classification</b>			
<b>Leased assets</b>			
Operating ROU assets	Operating lease right-of-use assets	\$ 65,265	\$ 45,245
Finance lease assets	Property, plant and equipment, net	2,005	2,365
<b>Total leased assets</b>		<b>\$ 67,270</b>	<b>\$ 47,610</b>
<b>Lease liabilities</b>			
Current:			
Operating leases	Current portion of lease liabilities	\$ 9,099	\$ 7,198
Finance leases	Current portion of long-term debt	704	739
Noncurrent:			
Operating leases	Long-term lease liabilities	56,299	38,595
Finance leases	Long-term debt	1,200	1,628
<b>Total lease liabilities</b>		<b>\$ 67,302</b>	<b>\$ 48,160</b>

Total lease income and costs were as follows:

		For the years ended December 31,	
		2022	2021
<b>Classification</b>			
Operating lease costs	Selling, general and administrative	\$ 11,484	\$ 6,664
Finance lease costs:			
Amortization of lease assets	Selling, general and administrative	285	291
Amortization of lease assets	Cost of goods sold	327	—
Interest on lease liabilities	Interest expense	61	33
Sublease income	Selling, general and administrative	(1,533)	(277)

In addition to the operating lease costs above, short-term and month-to-month lease expense was \$341 and \$2,268 for the years ended December 31, 2022, and 2021, respectively, and other costs associated with operating leases were \$2,573 and \$1,957, respectively, for non-lease components such as common area maintenance and other miscellaneous items. These costs were included within SG&A in the consolidated statements of operations.

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The aggregate future minimum lease payments under long-term non-cancelable operating and finance leases with remaining terms greater than one year as of December 31, 2022, are as follows:

Year ending December 31,	Operating	Finance
2023	\$ 11,463	\$ 760
2024	11,043	634
2025	10,466	481
2026	9,180	63
2027	8,941	69
Thereafter	25,016	—
<b>Total rental payments</b>	<b>76,109</b>	<b>2,007</b>
Less portion representing interest	10,711	103
<b>Total principal</b>	<b>65,398</b>	<b>1,904</b>
Less current portion	9,099	704
<b>Long-term portion</b>	<b>\$ 56,299</b>	<b>\$ 1,200</b>

The following table summarizes the weighted-average remaining lease term as of December 31, 2022, and 2021, as well as the weighted-average discount rate on long-term leases for the years ended December 31, 2022, and 2021:

	December 31,	
	2022	2021
<b>Weighted-average remaining lease term in years:</b>		
Operating leases	7.1	6.8
Finance leases	3.1	3.5
<b>Weighted-average discount rate:</b>		
Operating leases	4.00 %	3.32 %
Finance leases	3.63 %	4.62 %

Cash paid for amounts included in lease liabilities in 2022, and 2021 were:

	For the years ended December 31,	
	2022	2021
<b>Cash paid for amounts included in lease liabilities:</b>		
Operating cash flows from operating leases	\$ (9,035)	\$ (5,675)
Operating cash flows from finance leases	(61)	(33)
Financing cash flows from finance leases	(756)	(302)

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**8. PROPERTY, PLANT AND EQUIPMENT, NET**

Property, plant and equipment, net comprised the following:

	December 31,	
	2022	2021
Machinery and equipment	\$ 27,832	\$ 25,177
Peat bogs and related development	10,761	8,686
Building and improvements	9,920	9,510
Land	6,107	6,120
Furniture and fixtures	3,921	2,867
Computer equipment	3,337	3,197
Leasehold improvements	4,177	3,207
<b>Gross property, plant, and equipment</b>	<b>66,055</b>	<b>58,764</b>
Less: accumulated depreciation	(14,920)	(8,291)
<b>Total property, plant and equipment, net</b>	<b>\$ 51,135</b>	<b>\$ 50,473</b>

Depreciation, depletion and amortization expense related to property, plant, and equipment, net was \$8,219 and \$4,580 for the years ended December 31, 2022, and 2021, respectively.

**9. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities comprised the following:

	December 31,	
	2022	2021
Accrued compensation and benefits	\$ 2,522	\$ 3,713
Freight, custom and duty accrual	1,022	2,094
Goods in transit accrual	1,172	3,473
Income tax accrual	451	729
Contingent consideration	—	17,034
Other accrued liabilities	8,041	6,953
<b>Total accrued expenses and other current liabilities</b>	<b>\$ 13,208</b>	<b>\$ 33,996</b>

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**10. DEBT**

Debt is comprised of the following:

	December 31,	
	2022	2021
Term Loan - net of unamortized discount and deferred financing costs of \$5,142 and \$6,025 as of December 31, 2022, and December 31, 2021, respectively	\$ 118,608	\$ 118,975
Other	2,064	2,805
<b>Total debt</b>	<b>\$ 120,672</b>	<b>\$ 121,780</b>
Current portion of long-term debt	\$ 2,011	\$ 2,263
Long-term debt - net of discount and deferred financing costs of \$5,142 and \$6,025 as of December 31, 2022, and December 31, 2021, respectively	118,661	119,517
<b>Total debt</b>	<b>\$ 120,672</b>	<b>\$ 121,780</b>

***Term Loan***

On October 25, 2021, the Company and certain of its direct and indirect subsidiaries (the "Obligors") entered into a Credit and Guaranty Agreement with JPMorgan Chase Bank, N.A., as administrative agent for the lenders, pursuant to which the Company borrowed a \$125,000 senior secured term loan ("Term Loan"). The Term Loan bears interest at LIBOR (with a 1.0% floor) plus 5.50%, or an alternative base rate (with a 2.0% floor), plus 4.50%, and is subject to a call premium of 2% in year one, 1% in year two, and 0% thereafter, and matures on October 25, 2028 ("Maturity Date"). Deferred financing costs totaled \$6,190 at the inception of the Term Loan and are being amortized to interest expense over the term of the loan. For the year ended December 31, 2022, the effective interest rate was 8.30% and interest expense was \$10,331, which includes amortization of deferred financing costs of \$883.

The principal amounts of the Term Loan are required to be repaid in consecutive quarterly installments in amounts equal to 0.25% of the principal amount of the Term Loan, on the last day of each fiscal quarter commencing March 31, 2022, with the balance of the Term Loan payable on the Maturity Date. The Company is also required to make mandatory prepayments in the event of (i) achieving certain excess cash flow criteria, including the achievement and maintenance of a specific leverage ratio, (ii) selling assets that are collateral, or (iii) upon the issuance, offering, or placement of new debt obligations. There were no such mandatory prepayments made since inception of the Term Loan. As of December 31, 2022, and 2021, the outstanding principal balance on the Term Loan was \$123,750 and \$125,000, respectively.

The Term Loan requires the Company to maintain certain reporting requirements, affirmative covenants, and negative covenants, and the Company was in compliance with all requirements as of December 31, 2022. The Term Loan is secured by a first lien on the non-working capital assets of the Company and a second lien on the working capital assets of the Company.

***Revolving asset-backed credit facilities***

***JPMorgan Revolving Loan Facility***

On March 29, 2021, the Obligors entered into a Senior Secured Revolving Credit Facility (the "JPMorgan Revolving Loan Facility") with JPMorgan Chase Bank, N.A., as administrative agent, issuing bank and swingline lender, and the lenders from time to time party thereto. The JPMorgan Revolving Loan Facility is due on March 29, 2024, or any earlier date on which the revolving commitments are reduced to zero.

The three-year JPMorgan Revolving Loan Facility originally had a borrowing limit of \$50,000. On August 31, 2021, the Obligors entered into an amendment (the "First Amendment") to increase their original borrowing limit to \$100,000. In connection with the First Amendment, the Company's previously acquired subsidiaries became party to the JPMorgan Revolving Loan Facility as either borrowers or as guarantors. On October 25, 2021, the Company and its subsidiaries entered into a second amendment (the "Second Amendment"), with JPMorgan Chase Bank, N.A., pursuant to which the parties consented to the Term Loan described above, and made certain conforming changes to comport with the Term Loan provisions.

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The JPMorgan Revolving Loan Facility was further amended by a third amendment and joinder dated August 23, 2022, (the “Third Amendment”) pursuant to which several previously acquired subsidiaries became parties to the JPMorgan Revolving Loan Facility and granted liens on their assets. On December 22, 2022, the Company entered into a fourth amendment (the “Fourth Amendment”) pursuant to which the maximum commitment amount under the JPMorgan Revolving Loan Facility was reduced from \$100,000 to \$75,000, a sale-leaseback transaction was permitted, and certain other changes were made, including changing the LIBOR based rates to SOFR based rates. The Loss on debt modification of \$145 for the year ended December 31, 2022, resulted primarily from the write-off of unamortized deferred financing costs associated with the modification of the JPMorgan Revolving Loan Facility entered into during the fourth quarter of 2022.

The unamortized debt issuance costs were \$580 as of December 31, 2022, and are included in Other assets in the consolidated balance sheet. Debt issuance costs are being amortized to interest expense over the term of the JPMorgan Revolving Loan Facility.

The JPMorgan Revolving Loan Facility is an asset-based facility that is secured by a first lien on the working capital assets of the Company and a second lien on the non-working capital assets of the Company (including most of the Company’s subsidiaries). The borrowing base is based on a detailed monthly calculation of the sum of (a) a percentage of the Eligible Accounts at such time, plus (b) the lesser of (i) a percentage of the Eligible Inventory, at such time, valued at the lower of cost or market value, determined on a first-in-first-out basis, and (ii) the product of a percentage multiplied by the Net Orderly Liquidation Value percentage identified in the most recent inventory appraisal ordered by the Administrative Agent multiplied by the Eligible Inventory, valued at the lower of cost or market value, determined on a first-in-first-out basis, minus (c) Reserves (each of the defined terms above, as defined in the JPMorgan Revolving Loan Facility documents).

The Company is required to maintain certain reporting requirements, affirmative covenants and negative covenants, pursuant to terms outlined in the agreement. Additionally, if the Company’s Excess Availability (as defined in the JPMorgan Revolving Loan Facility documents) is less than an amount equal to 10% of the Aggregate Revolving Commitment (currently \$75,000), the Company will be required to maintain a minimum fixed charge coverage ratio of 1.1x on a rolling twelve-month basis until the Excess Availability is more than 10% of the Aggregate Revolving Commitment for thirty consecutive days. In order to consummate permitted acquisitions or to make restricted payments, the Company would be required to comply with a higher fixed charge coverage ratio of 1.15x, but no such acquisitions or payments are currently contemplated. As of December 31, 2022, the Company is in compliance with the covenants contained in the JPMorgan Revolving Loan Facility.

The JPMorgan Revolving Loan Facility provides for various interest rate options including the Adjusted Term SOFR Rate, the Adjusted REVSOFR30 Rate, the CB Floating Rate, the Adjusted Daily Simple SOFR, the CBFR, the Canadian Prime Rate, or the CDOR Rate. The rates that use SOFR as the reference rate (Adjusted Term SOFR Rate, the Adjusted REVSOFR30 Rate, the Adjusted Daily Simple SOFR and the CBFR rate) use the Term SOFR Rate plus 1.95%. Each rate has a 0.0% floor. A fee of 0.25% per annum is charged for available but unused borrowings.

As of December 31, 2022, and 2021, the Company had zero borrowed under the facility, and would be able to borrow approximately \$40 million under the JPMorgan Revolving Loan Facility, before we would be required to comply with the minimum fixed charge coverage ratio of 1.1x.

***Encina Credit Facility***

On July 11, 2019, the Company and certain of its direct and indirect subsidiaries (the “Encina Obligors”) entered into the Encina Credit Facility through a certain Loan and Security Agreement whereby the Encina Obligors obtained a revolving asset-based loan commitment in the maximum amount of \$45,000 (inclusive of a limit of up to \$15,000 of borrowings for the Canadian borrowers and a swingline facility of up to \$2,000), subject to applicable borrowing base availability, through Encina Business Credit, LLC. The Encina Credit Facility was due on the earlier of July 11, 2022, or 90 days prior to the scheduled maturity date of the Brightwood Term Loan. The Encina Credit Facility was secured by working capital assets and a second lien on non-working capital assets.

Interest was calculated at LIBOR or a base rate, plus an applicable margin ranging between 3.75% to 5.50% per annum determined based on the fixed charge coverage ratio calculated over an applicable time period. A fee of 0.50% per annum was charged for available, but unused borrowings as defined. An additional 200 basis points was added to the interest

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rate for any period during which the loan was in default. Deferred financing costs were amortized over the term of the Encina Credit Facility.

The Encina Credit Facility was subject to numerous amendments since its origination generally in connection with modifications to available borrowings, financial covenants, permitted indebtedness and permitted capital expenditures. Certain amendments required payments of fees. All amendments were accounted for as debt modifications.

The Encina Credit Facility was replaced in March 2021 by the JPMorgan Revolving Loan Facility. For the year ended December 31, 2021, the Company recognized interest expense of \$82. The unamortized deferred financing costs and early termination fees totaling \$680 were recognized as a loss on debt extinguishment in the consolidated statements of operations for the year ended December 31, 2021.

***Other debt***

Other debt as of December 31, 2022, was primarily comprised of \$1,904 in finance lease obligations and \$160 in a foreign subsidiary's other debt which constitutes an immaterial revolving line of credit and mortgage. Other debt as of December 31, 2021, was primarily comprised of \$2,367 in finance lease obligations, \$438 in a foreign subsidiary's other debt which constitutes an immaterial revolving line of credit and mortgage.

***Aggregate future principal payments***

As of December 31, 2022, the aggregate future principal payments under long-term debt, excluding payments due under finance lease obligations presented in Note 7 - *Leases*, are as follows:

	<u>Debt</u>
Year ending December 31,	
2023	\$ 1,307
2024	1,269
2025	1,269
2026	1,269
2027	1,270
Thereafter	117,526
<b>Total principal payments under long-term debt</b>	<b>\$ 123,910</b>

The following is a reconciliation of payment due:

	<b>Finance lease obligations</b>	<b>Debt</b>	<b>Total</b>
Current portion of long-term debt	\$ 704	\$ 1,307	\$ 2,011
Long-term debt	1,200	122,603	123,803
<b>Total payments due</b>	<b>\$ 1,904</b>	<b>\$ 123,910</b>	<b>\$ 125,814</b>

**11. STOCKHOLDERS' EQUITY**

***Common stock***

Each holder of common stock is entitled to one vote for each share of common stock. Common stockholders have no pre-emptive rights to acquire additional shares of common stock or other securities. The common stock is not subject to redemption rights and carries no subscription or conversion rights. In the event of liquidation, the stockholders are entitled to share in corporate assets on a pro rata basis after the Company satisfies all liabilities and after provision is made for any class of



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capital stock having preference over the common stock. Subject to corporate regulations and preferences to preferred stock, if any, dividends are at the discretion of the Board. As of December 31, 2022, there were 45,197,249 shares outstanding and 300,000,000 shares authorized.

***Warrants***

On July 19, 2021, the Company completed the redemption ("Redemption") of certain of its outstanding warrants (the "Investor Warrants") that were issued in connection with a private placement of units (the "private placement"), each consisting of a share of common stock and a warrant to purchase an additional one-half (1/2) shares of common stock.

The Company was entitled to redeem all of the outstanding Investor Warrants for a redemption price of \$0.00033712 per Investor Warrant ("redemption price") if (i) there was an effective registration statement covering the resale of the shares of common stock underlying the Investor Warrants, and (ii) the volume-weighted average price of the Company's common stock for the twenty consecutive trading days prior to the date of the notice of redemption was at least \$25.28, of which both requirements were met. Investor Warrants were exercisable at a price of \$16.86 per share until July 19, 2021 (the "redemption date"). Any Investor Warrants that remained unexercised immediately after the redemption date were void and no longer exercisable, and the holders of those Investor Warrants were entitled to receive the redemption price.

Prior to the redemption date, 3,367,647 Investor Warrants were exercised, generating total gross proceeds of \$56,778. The Company redeemed 1,491 Investor Warrants at the redemption price.

In connection with the private placement, the Company agreed to engage the placement agent (the "Placement Agent") as the Company's warrant solicitation agent in the event the Investor Warrants were called for Redemption. The Company agreed to pay a warrant solicitation fee to the Placement Agent equal to five percent of the amount of net cash proceeds solicited by the Placement Agent upon the exercise of certain Investor Warrants following such call for Redemption. For the year ended December 31, 2021, warrant solicitation fee expense totaled \$1,949 and was included in SG&A in the consolidated statements of operations.

As of December 31, 2022, the following table summarizes the outstanding warrants:

	<b>Number of Warrants</b>	<b>Exercise Price</b>
Placement agent warrants	<b>11,662</b>	<b>\$ 8.43</b>
Placement agent warrants	<b>6,007</b>	<b>\$ 16.86</b>
<b>Total</b>	<b>17,669</b>	<b>\$ 11.30</b>

As of December 31, 2021, the following table summarizes the outstanding warrants:

	<b>Number of Warrants</b>	<b>Exercise Price</b>
Placement agent warrants	<b>11,810</b>	<b>\$ 8.43</b>
Placement agent warrants	<b>6,007</b>	<b>\$ 16.86</b>
<b>Total</b>	<b>17,817</b>	<b>\$ 11.27</b>

**12. STOCK-BASED COMPENSATION**

***Stock-based compensation plan overview***

The Company maintains three equity incentive plans: the 2018 Equity Incentive Plan ("2018 Plan"), the 2019 Employee, Director and Consultant Equity Incentive Plan ("2019 Plan") and the 2020 Employee, Director, and Consultant Equity Incentive Plan ("2020 Plan" and collectively, "Incentive Plans"). The 2020 Plan serves as the successor to the 2019 Plan and 2018 Plan and provides for the issuance of incentive stock options ("ISOs"), stock grants and stock-based awards to employees, directors, and consultants of the Company. No further awards will be issued under the 2018 Plan and 2019 Plan. As of December 31, 2022, a total of 1,340,129 shares were available for grant under the 2020 Plan.

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The Incentive Plans are administered by the Company's Board of Directors. Notwithstanding the foregoing, the Board of Directors may delegate concurrent responsibility for administering each plan, including with respect to designated classes of persons eligible to receive an award under each plan, to a committee or committees (which term shall include subcommittees) consisting of one or more members of the Board of Directors (collectively, the "Plan Administrator"), subject to such limitations as the Board of Directors deems appropriate.

In November 2020, the Board of Directors and stockholders approved the 2020 Plan and reserved an aggregate of 2,284,053 shares of common stock for issuance under the 2020 Plan. Pursuant to the 2020 Plan, the number of shares available for issuance under the 2020 Plan may be increased on January 1 of each year, beginning on January 1, 2021, and ending on January 2, 2030, in an amount equal to the lesser of (i) 4% of the outstanding shares of the Company's common stock on such date or (ii) such number of shares determined by the Plan Administrator.

The 2020 Plan provides for the grant of ISOs, nonqualified stock options, stock grants, and stock-based awards that are based in whole or in part by reference to the Company's common stock.

- The Plan Administrator may grant options designated as incentive stock options or nonqualified stock options. Options shall be granted with an exercise price per share not less than 100% of the fair market value of the common stock on the grant date, subject to certain limitations and exceptions as described in the plan agreements. Generally, the maximum term of an option shall be 10 years from the grant date. The Plan Administrator shall establish and set forth in each instrument that evidences an option the time at which, or the installments in which, the option shall vest and become exercisable.
- The Plan Administrator may grant stock grants and stock-based awards, including securities convertible into shares, stock appreciation rights, phantom stock awards or stock units on such terms and conditions which may be based on continuous service with the Company or related company or the achievement of any performance goals, as the Plan Administrator shall determine in its sole discretion, which terms, conditions and restrictions shall be set forth in the instrument evidencing the award.

***Restricted Stock Unit ("RSU") Activity***

RSUs granted to certain executives, employees and members of the Board of Directors expire 10 years after the grant date. The awards generally have a time-based vesting requirement (based on continuous employment). Upon vesting, the RSUs convert into shares of the Company's common stock. The stock-based compensation expense related to service-based awards is recorded over the requisite service period. During the year ended December 31, 2022, the Company granted RSU awards that are expected to vest either (i) one year on the anniversary of the grant date, (ii) ratably over a three-year period on each anniversary of the grant date, or (iii) with three vesting tranches, the first of which occurred on the grant date, and the following two tranches on each subsequent anniversary of the grant date.

The award granted to a former member of the Board (the "former Board member") in July 2020, and modified in November 2020, contained a market-based vesting condition based on the traded value of shares of the Company's common stock following the IPO over a specific time frame. For this award, the market condition was factored into its fair value. The fair value of the award, at the modification date, was \$3,180, all of which was recorded as stock-based compensation expense upon the IPO. In July 2021, the market-based vesting condition for this award was satisfied and 148,315 RSUs of the former Board member vested. The total shares under the unvested RSUs subject to time-based vesting conditions were zero and 111,236 for the years ended December 31, 2022, and 2021, respectively. For the years ended December 31, 2022, and 2021, there were no performance awards with market-based conditions granted.

The Company recognized \$7,638 and \$4,566 of total stock-based compensation expense for RSUs for the years ended December 31, 2022, and 2021, respectively. For the year ended December 31, 2022, the Company withheld 247,979 of the 818,489 of common stock issued upon vesting of RSUs to meet employees' payroll tax withholding requirements. The tax withholding payments of \$2,461 were made in 2022 in addition to a tax withholding obligation of \$9 from 2021.

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The following table summarizes the activity related to the Company's RSUs for the year ended December 31, 2022. For purposes of this table, vested RSUs represent the shares for which the service condition had been fulfilled during the year ended December 31, 2022:

	Number of RSUs	Weighted average grant date fair value
Balance, December 31, 2021	1,087,608	\$ 9.71
Granted	785,486	\$ 9.62
Vested	(824,846)	\$ 9.25
Forfeited	(55,615)	\$ 35.54
<b>Balance, December 31, 2022</b>	<b>992,633</b>	<b>\$ 8.57</b>

The total fair value of RSUs vested for the years ended December 31, 2022, and 2021, was \$7,628, and \$6,090, respectively.

As of December 31, 2022, total unamortized stock-based compensation expense related to unvested RSUs was \$5,920 and the weighted-average period over which the compensation is expected to be recognized is 1.28 years. As of December 31, 2022, there were 6,357 RSUs which had vested, but were not yet issued due to the recipients' elections to defer the awards.

The tax benefits recognized in the consolidated statements of operations for stock-based compensation arrangements for the years ended December 31, 2022, and 2021, were not material to the financial statements.

***Performance Stock Unit ("PSU") Activity***

During the year ended December 31, 2022, the Company granted PSU awards that are subject to a one-year vesting requirement (based on continuous employment) and contain performance conditions based on certain performance metrics. The following table summarizes the activity related to the Company's PSUs for the year ended December 31, 2022:

	Number of PSUs	Weighted average grant date fair value
Balance, December 31, 2021	—	\$ —
Granted	116,113	\$ 15.74
Forfeited	(19,867)	\$ 15.74
<b>Balance, December 31, 2022</b>	<b>96,246</b>	<b>\$ 15.74</b>

As of December 31, 2022, total unamortized stock-based compensation cost related to unvested PSUs was \$101 and the weighted-average period over which the compensation is expected to be recognized is less than one year. For the year ended December 31, 2022, the Company recognized \$355 of total stock-based compensation expense for PSUs.

***Stock Options***

The vesting of stock options is subject to certain change in control provisions as provided in the incentive plan agreements and options may be exercised up to 10 years from the date of issuance.

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The following table summarizes the stock option activity for the year ended December 31, 2022:

	Number	Weighted average exercise price	Weighted average grant date fair value	Weighted average remaining contractual term (years)
Outstanding as of December 31, 2021	720,549	\$ 9.57	\$ 2.21	7.37
Granted	4,250	\$ 13.12	\$ 12.95	
Exercised	(8,283)	\$ 9.01	\$ 2.12	
Cancelled	(8,720)	\$ 9.33	\$ 3.27	
Forfeited	(37,770)	\$ 11.42	\$ 7.20	
<b>Outstanding as of December 31, 2022</b>	<b>670,026</b>	<b>\$ 9.50</b>	<b>\$ 2.05</b>	<b>5.25</b>
<b>Options exercisable as of December 31, 2022</b>	<b>599,439</b>	<b>\$ 8.90</b>	<b>\$ 1.46</b>	<b>5.00</b>
<b>Vested and expected to vest as of December 31, 2022</b>	<b>670,026</b>	<b>\$ 9.50</b>	<b>\$ 2.05</b>	<b>5.25</b>

The following table summarizes the unvested stock option activity for the year ended December 31, 2022:

	Number	Weighted average grant date fair value
Unvested as of December 31, 2021	202,515	\$ 5.04
Granted	4,250	\$ 12.95
Vested	(98,408)	\$ 3.14
Forfeited	(37,770)	\$ 7.20
<b>Unvested as of December 31, 2022</b>	<b>70,587</b>	<b>\$ 7.02</b>

The weighted average grant date fair value of stock options granted was \$12.95 and \$25.58 for the years ended December 31, 2022, and 2021, respectively. The total fair value of stock options vested for the years ended December 31, 2022, and 2021, was \$309, and \$412, respectively.

Since stock options represent equity awards of the Company, such awards are fair valued as of the grant date for the purposes of measurement and recognition under U.S. GAAP. To measure the fair value of an option, the Black-Scholes valuation model was utilized. The valuation model requires the input of highly subjective assumptions. For inputs into the Black-Scholes model, the expected volatility is based on historical implied volatility from recent stock option transactions at the time of grant. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury implied yield at the date of grant. The Company has elected to use the “simplified method” to determine the expected term which is the midpoint between the vesting date and the end of the contractual term because it has insufficient history upon which to base an assumption about the term. The expected dividend yield is 0.0% as the Company has not paid and does not anticipate paying dividends on its common stock. Inputs to the model were as follows for the periods indicated:

	Years ended December 31,	
	2022	2021
Weighted average exercise price of common stock underlying the options	\$13.12	\$59.03
Volatility	200%	45%
Risk-free rate	2.8%	0.85%
Dividend yield	Nil	Nil
Expected term in years	6.0	6.0

For the years ended December 31, 2022, and 2021, respectively, the Company recognized \$361 and \$440 of total stock-based compensation expense for stock options. The total intrinsic value of options exercised was \$82 and \$7,448 for the

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years ended December 31, 2022, and 2021, respectively. As of December 31, 2022, the total compensation cost related to unvested awards not yet recognized was \$407 and the weighted-average period over which the compensation is expected to be recognized is 1.29 years.

**13. INCOME TAXES**

(Loss) income before tax was as follows:

	Years ended December 31,	
	2022	2021
United States	\$ (235,215)	\$ (9,262)
Foreign	(56,643)	3,541
Loss before tax	<u>\$ (291,858)</u>	<u>\$ (5,721)</u>

Significant components of income tax (benefit) expense consist of the following:

	Years ended December 31,	
	2022	2021
<b>Current:</b>		
Federal	\$ —	\$ —
State	100	72
Foreign	2,767	1,787
Total current expense	<u>2,867</u>	<u>1,859</u>
<b>Deferred:</b>		
Federal	(8,689)	(18,275)
State	(2,980)	(1,962)
Foreign	2,359	(759)
Total deferred benefit	<u>(9,310)</u>	<u>(20,996)</u>
<b>Total income tax benefit</b>	<u>\$ (6,443)</u>	<u>\$ (19,137)</u>

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The reconciliation of income tax computed at the U.S. federal statutory tax rates of 21% to income tax benefit consists of the following:

	Years ended December 31,	
	2022	2021
<b>Effective rate reconciliation</b>		
U.S. federal tax benefit at statutory rate	\$ (61,290)	\$ (1,201)
State income taxes, net	422	68
Permanent items	3,785	542
Goodwill impairment	23,170	—
Global intangible low-taxed income	—	972
Foreign rate differential	(443)	1,032
162(m) officers compensation	1,010	6,969
Share-based compensation	26	(8,118)
Deferred adjustments	770	67
Transaction costs	—	2,290
Other, net	2,410	(973)
Valuation allowance	23,697	(20,785)
<b>Total income tax benefit</b>	<b>\$ (6,443)</b>	<b>\$ (19,137)</b>

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Deferred income tax assets and liabilities consist of the following:

	December 31,	
	2022	2021
<b>Deferred tax assets</b>		
Lease liabilities	\$ 17,079	\$ 11,714
Accrued expenses	1,453	1,215
Share-based compensation	865	460
Intangible assets	2,110	—
Net operating loss	31,425	19,543
Inventories	6,346	4,948
Interest expense	4,183	2,154
Other	1,130	1,243
<b>Deferred tax assets</b>	<b>64,591</b>	<b>41,277</b>
Valuation allowance	(39,293)	(14,892)
<b>Total deferred tax assets</b>	<b>25,298</b>	<b>26,385</b>
<b>Deferred tax liabilities</b>		
Intangible assets	—	(17,526)
Property, plant and equipment	(10,216)	(2,518)
Operating lease right-of-use assets	(17,767)	(11,579)
<b>Total deferred tax liabilities</b>	<b>(27,983)</b>	<b>(31,623)</b>
<b>Net deferred tax liability</b>	<b>\$ (2,685)</b>	<b>\$ (5,238)</b>
Other long-term assets - deferred tax assets	\$ —	\$ 393
Long-term deferred tax liabilities	(2,685)	(5,631)
<b>Net deferred tax liability</b>	<b>\$ (2,685)</b>	<b>\$ (5,238)</b>

As of December 31, 2022, the Company had federal and state net operating loss (“NOL”) carryforwards of approximately \$107,100 and \$80,800, respectively. The federal and state NOL carryforwards, if not utilized, will begin to expire in 2037 and 2027, respectively, and \$93,400 of the federal losses are indefinite. As of December 31, 2021, the Company had federal and state NOL carryforwards of approximately \$74,900 and \$56,900, respectively. Foreign NOL carryforwards were approximately \$15,900 and \$1,000 at December 31, 2022, and 2021, respectively. The majority of the foreign NOLs have a 20 year carryforward period.

The Company determined the amount of its valuation allowance based on estimates regarding the timing and amount of the reversal of taxable temporary differences, expected future taxable income by jurisdiction, and the impact of tax planning strategies. As of December 31, 2022, and 2021, the Company believes it is more-likely-than-not that it will not be able to realize its U.S. deferred tax assets and therefore has maintained a full valuation allowance against its U.S. deferred tax assets. The Company has also provided valuation allowances against certain foreign deferred tax assets.

The Company's effective tax rate differs from the U.S. federal statutory rate primarily due discrete tax benefits relating primarily to measurement period adjustments associated with 2021 acquisitions, the impairment of goodwill for certain 2021 acquisitions which was not deductible for U.S. tax purposes, increases in the Company's valuation allowance on U.S. deferred tax assets, and the establishment of a valuation allowance for Canadian deferred tax assets. In connection with the measurement period adjustments associated with 2021 acquisitions, the Company recorded a net deferred tax liability which provided an additional source of taxable income to support the realization of the pre-existing deferred tax assets. The Company's income tax benefit was partially offset by income taxes from certain foreign subsidiaries.

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**(In thousands, except share and per share amounts)**

Carryforwards of NOLs are subject to possible limitation should a change in ownership occur, as defined by Internal Revenue Code Section 382. An ownership change is generally defined as a greater than 50% increase in equity ownership by 5% stockholders in any three-year period. The Company experienced an aggregate ownership change which exceeded the 50% threshold in connection with the Company's IPO, and future changes in stock ownership may occur. To the extent that the Company earns net taxable income, the Company's ability to use NOLs to offset such taxable income may be subject to limitations. The annual limitation resulting from the IPO ownership change is not expected to result in the expiration of the NOL carry forwards before utilization.

In 2022 and 2021, the Company did not record any liabilities related to uncertain tax positions. The Company does not have any tax positions for which it is reasonably possible that the total amount of gross unrecognized tax benefits will significantly change within 12 months of December 31, 2022, and 2021. The Company recognizes interest and penalties relating to unrecognized tax benefits as part of its income tax expense. The Company's major filing jurisdictions are the United States and Canada. Due to the Company's net operating loss carryforwards, the Company's income tax returns remain subject to examination by federal, foreign and most state taxing authorities for all tax years.

#### **14. COMMITMENTS AND CONTINGENCIES, AND RELATED PARTY TRANSACTIONS**

##### ***Purchase commitments***

From time to time in the normal course of business, the Company will enter into agreements with suppliers which provide favorable pricing in return for a commitment to purchase minimum amounts of inventory over a defined time period.

##### ***Contingencies***

In the normal course of business, certain claims have been brought against the Company and, where applicable, its suppliers. While there is inherent difficulty in predicting the outcome of such matters, management has vigorously contested the validity of these claims. Based on available information, management believes the claims are without merit and does not expect that the outcome, individually or in the aggregate, would have a material adverse effect on the consolidated financial positions, results of operations, cash flows or future earnings.

##### ***Related party transactions—Hydrofarm Distribution Center***

The Company leased a distribution center in Petaluma, California from entities in which a related party was a stockholder. For the year ended December 31, 2021, rent expense for the month-to-month lease totaled \$639.

#### **15. FAIR VALUE MEASUREMENTS**

Contingent consideration, as described in Note 3 – *Business Combinations*, is measured at estimated fair value on a recurring basis and based on Level 3 fair value measurements. The fair value of the contingent consideration for the Heavy 16 and Aurora acquisitions was \$200 and \$16,834, respectively, as of December 31, 2021. The fair value of the contingent consideration for the Heavy 16 and Aurora acquisitions were both zero as of December 31, 2022, as the liabilities were paid during the year. The change in the fair value of contingent consideration during the years ended December 31, 2022, and 2021, was a benefit of \$1,560 and \$2,610, respectively, and was recognized in SG&A on the consolidated statements of operations for all periods presented. The valuation methodology and inputs used in the fair value measurement were disclosed in Note 3 – *Business Combinations*.

Nonrecurring fair value measurements include the Company's goodwill impairment recognized during the year ended December 31, 2022, as determined based on unobservable Level 3 inputs. Refer to Note 4 – *Goodwill and Intangible Assets, Net*, for further discussion. The note receivable, as described in Note 2 – *Basis of Presentation and Significant Accounting Policies*, was measured at fair value on a nonrecurring basis. During the year ended December 31, 2022, the Company measured an impairment on the note receivable based on the estimated fair value of the collateral, which was considered a Level 3 fair value measurement. The Company recorded an impairment loss of \$2,636 during the year ended December 31, 2022, recognized in Impairments on the consolidated statements of operations. The carrying value of the note receivable was



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\$475 and \$3,111 as of December 31, 2022, and 2021, respectively. As of December 31, 2022, the note receivable was included in Other assets on the consolidated balance sheet.

The following table summarizes the fair value of the Company's liabilities which are required to be remeasured to fair value on a recurring basis, as described above:

	Fair Value Hierarchy Level	December 31, 2022		December 31, 2021	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Liabilities</b>					
Contingent consideration:					
<i>Heavy 16 Acquisition</i>	Level 3	—	—	200	200
<i>Aurora Acquisition</i>	Level 3	—	—	16,834	16,834

**Other Fair Value Measurements**

The following table summarizes the fair value of the Company's assets and liabilities which are provided for disclosure purposes:

	Fair Value Hierarchy Level	December 31, 2022		December 31, 2021	
		Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets</b>					
Cash and cash equivalents	Level 1	21,291	21,291	26,607	26,607
Restricted cash	Level 1	—	—	1,777	1,777
<b>Liabilities</b>					
Debt facilities					
<i>Term Loan</i>	Level 2	123,750	105,188	125,000	121,250
<i>Other debt</i>	Level 3	2,064	2,064	2,805	2,805

The fair value of the Term Loan was estimated based on Level 2 fair value measurements and was based on bank quotes. The carrying amount of the Term Loan reported above excludes unamortized deferred financing costs and discount. The carrying amount of Other Debt was \$2,064 and \$2,805 as of December 31, 2022, and 2021, respectively, and was primarily comprised of finance lease obligations. The estimated fair value of Other Debt approximated its carrying value given the applicable interest rates and the nature of the security interest in the Company's assets, which were considered Level 3 fair value measurements. Refer to Note 10 – *Debt*, for further discussion of the Company's debt facilities.

Cash, cash equivalents, and restricted cash included funds deposited in banks, and the carrying values approximated fair values due to their short-term maturities. The carrying values of other current assets and liabilities including accounts receivable, accounts payable, accrued expenses and other current liabilities approximated their fair value due to their short-term maturities.

The Company did not have any transfers between Levels within the fair value hierarchy during years ended December 31, 2022, and 2021.

**16. SUBSEQUENT EVENTS**

In January 2023, Gotham Properties LLC, an Oregon limited liability company and a subsidiary of the Company ("Seller"), consummated a Purchase and Sale Agreement with J & D Property, LLC, a Nevada limited liability company ("Purchaser") pursuant to which certain real property located in the City of Eugene, County of Lane, State of Oregon (the

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“Eugene Property”) was sold to Purchaser for \$8,598 and then leased back by Seller (the “Sale-Leaseback Transaction”). The new lease has a term of 15 years with annual rent starting at \$731 and fixed increases to the final year when annual rent is \$964. The Company is accounting for the transaction as a failed sale and leaseback which requires retaining the asset associated with the property and recognizing a corresponding financial liability for the cash received. The Eugene Property serves as the manufacturing and processing site for certain of the Company’s grow media and nutrient brands. The Company intends to reinvest the net cash proceeds into certain permitted investments in 2023, such as capital expenditures.

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**Item 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation and supervision of our Chief Executive Officer and our Chief Financial Officer, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this Annual Report on Form 10-K. Based upon that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective for the period covered by this Annual Report on Form 10-K.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost benefit relationship of possible controls and procedures.

**Management's Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2022 based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As a result of this assessment, management concluded that, as of December 31, 2022, our internal control over financial reporting was effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Deloitte & Touche LLP has independently assessed the effectiveness of our internal control over financial reporting and its report is included in Item 8 of this Annual Report on Form 10-K.

**Changes in Internal Controls over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the period covered by this Annual Report on Form 10-K that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. OTHER INFORMATION**

None.

**Item 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS**

Not applicable.

## PART III

### Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item will be included in the 2023 Proxy Statement and is incorporated herein by reference.

The following table sets forth the name and position of each of our executive officers and directors as of March 9, 2023.

<b>Name</b>	<b>Position</b>
William Toler	Chairman of the Board and Chief Executive Officer
B. John Lindeman	Chief Financial Officer
Kevin O'Brien	Chief Accounting Officer
Mark Parker	Executive Vice President
Patrick Chung	Director
Susan P. Peters	Director, Chairperson of Compensation Committee
Renah Persofsky	Director, Chairperson of Nominating and Corporate Governance Committee
Richard D. Moss	Director, Chairperson of Audit Committee and Mergers and Acquisitions Committee
Melisa Denis	Director

#### *William Toler, Chairman of the Board and Chief Executive Officer*

Mr. Toler has served as our Chairman of our board of directors and Chief Executive Officer since January 1, 2019. Prior to joining Hydrofarm in 2019, Mr. Toler was the Chief Executive Officer of Hostess Brands, Inc. (Nasdaq: TWNK) ("Hostess"), a food and beverage company, from May 2014 to March 2018. Under his leadership, Hostess successfully re-established the iconic Hostess brand as a leader within the sweet baked goods category, returned the company to profitability and transitioned Hostess from a private to public company. Mr. Toler has over 35 years of executive leadership experience in supply chain management and consumer packaged goods, including previously having served as Chief Executive Officer of AdvancePierre Foods, from September 2008 to August 2013, and President of Pinnacle Foods. He has also held executive roles at Campbell Soup Company, Nabisco and Procter & Gamble. Mr. Toler served on the board of directors of Collier Creek Holdings from September 2018 to September 2020, Hostess Brands from May 2014 to March 2018, AdvancePierre Foods from 2008 to 2013 and Pinnacle Foods from 2007 to 2008. In addition, Mr. Toler has also served as a senior advisor at Oaktree Capital Management, an investment management firm, from September 2013 to April 2014. Mr. Toler holds a B.A. in Business Management and Economics from North Carolina State University.

#### *B. John Lindeman, Chief Financial Officer*

Mr. Lindeman has served as our Chief Financial Officer since March 2020. From August 2015 until assuming his current role at Hydrofarm in March 2020, Mr. Lindeman served as Chief Financial Officer and Corporate Secretary at Calavo Growers, Inc. (Nasdaq-GS: CVGW) ("Calavo"), a global avocado-industry leader and expanding provider of valued-added fresh food, where he was responsible for the finance, accounting, IT and human resource functions. Prior to joining Calavo, Mr. Lindeman held various leadership positions within the finance and investment banking industries, including serving as managing director at Sageworth Trust Company, a family office and private trust company, from March 2015 to July 2015, managing director and co-head of the consumer and retail group at Janney Montgomery Scott from August 2009 to March 2015, managing director at Stifel, Nicolaus & Co., Inc. from December 2005 to August 2009 and principal at Legg Mason from October 1999 to December 2005. Prior to joining Legg Mason, he was a Manager at PricewaterhouseCoopers LLP from August 1996 to October 1999. Mr. Lindeman has also served as a director of Utz Brands, Inc. (NYSE: UTZ) since September 2020. Mr. Lindeman is a Chartered Financial Analyst and holds a B.S. in Business Administration from the University of Mary Washington.

#### *Kevin O'Brien, Chief Accounting Officer*

Mr. O'Brien has served as our Chief Accounting Officer since March 2022. Prior to joining Hydrofarm, Mr. O'Brien served as the Chief Accounting Officer of CPI Card Group Inc. (Nasdaq: PMTS) since April 2018. Mr. O'Brien previously

served as the Director of Corporate Accounting and SEC Reporting at the same company from March 2016 until April 2018. Mr. O'Brien has 20 years of accounting experience, including serving as a Senior Audit Manager at Deloitte & Touche LLP. Mr. O'Brien is a Colorado Certified Public Accountant and received a Bachelor of Science in Business with an Emphasis in Accounting from University of Colorado and a Master of Science with an Emphasis in Accounting from the same institution.

*Mark Parker, Executive Vice President*

Mr. Parker has served as our Executive Vice President since February 2022. Mr. Parker has over 30 years of experience in sales and marketing, and leading complex integration projects in multiple industries, in particular with consumer packaging goods. From May 2019 until February 2022, Mr. Parker served as our Senior Vice President of Business Development. Prior to joining Hydrofarm Mr. Parker was the founder and Chief Executive Officer of iQ Solutions, where he spent nine years assisting organizations in commercialization efforts focused on sales and marketing. Mr. Parker also previously served as Senior Vice President of Trade Marketing, U.S. Soup Division, for Campbell Soup Company (CPB, NYSE), where he introduced innovative initiatives as "Soup to Go" (convenience in a package) and iQ Shelf, an in-store approach to simplify consumer shopping experience and drive mutual share growth. Mr. Parker holds a B.S. in Economics from Wingate University.

*Susan P. Peters, Director*

Ms. Peters has served as our director since November 10, 2020. Previously, she was the Senior Vice President of Human Resources for General Electric Company ("GE") from July 2013 until December 2017 after which she retired following 38 years of service. In her role as Chief Human Resource Officer ("CHRO"), Ms. Peters was a member of GE's senior leadership team. From 2001 to 2007 Ms. Peters served as GE's Vice President of Executive Development and served as Chief Learning Officer since 2007. In her role as the CHRO, Ms. Peters oversaw all aspects of the Human Resource function for GE's workforce of approximately 325,000 employees in 175 countries. She was responsible for all of GE's talent acquisition, talent development, learning, compensation and benefits, payroll, union relations, and security. Approximately 5,000 human resource employees worked under her leadership. Ms. Peters was first appointed as an officer at GE in 1997. Ms. Peters was a founding member of the GE Women's Network and was also a member of the GE Foundation Board and the GE Pension Board. Ms. Peters also served on the National Board of Directors of Girl Scouts of the USA from 2008 until 2017. She is currently a member of the Loews Corporation (NYSE) board of directors. Ms. Peters received her B.A. from St. Mary's College, Notre Dame and her Masters in Education from the University of Virginia. Ms. Peters was selected to serve on our board of directors because of her expertise in leadership and development and her experience serving as an officer of a global industrial company.

*Patrick Chung, Director*

Mr. Chung has served as our director since November 10, 2020. Mr. Chung currently serves as the Vice President of Finance at Serruya Private Equity Inc., which he joined in March 2018. In his role as Vice President, Mr. Chung oversees financial reporting and asset management for the fund, leads the real estate investments team, and plays a strategic role in the growth of investee companies. Previously, Mr. Chung was the Director of Finance for Inside Edge Properties Ltd. from March 2017 to March 2018. From January 2015 to March 2017, Mr. Chung served as the Assistant Manager of Finance Advisory for Deloitte. Prior to January 2015, Mr. Chung served as an Associate of Risk Assurance Services at PricewaterhouseCoopers Canada. In December 2015, Mr. Chung was designated as a Chartered Professional Accountant ("CPA") by the Chartered Professional Accountants of Ontario. Mr. Chung received his Bachelor of Accounting and Finance and Minor in Economics from the University of Waterloo in December 2011 and his Masters of Accounting from the University of Waterloo in August 2012.

*Renah Persofsky, Director*

Ms. Persofsky has served as our director since November 10, 2020. Ms. Persofsky has over 40 years of business experience. Ms. Persofsky has served as the Chief Executive Officer of Trajectory Corp. since 2010 and as an executive consultant of Canadian Imperial Bank of Commerce since 2011. Ms. Persofsky served as the Chairwoman of BookJane Inc. from October 2016 to December 2021, a director of Tilray Brands, Inc. (f/k/a Aphria Inc.) since October 2017 and the Vice Chairwoman and Lead Director since October 2019, the Chairwoman of Green Gruff Inc. since July 2019, a director of Alkemy since April 2021 and a director of Greenlane Holdings (Nasdaq: GNLN) since April 2022. Ms. Persofsky has also previously served as an executive consultant to many iconic brands including Tim Hortons, Canadian Tire, Canada Post and Interac, and was an executive officer of the Bank of Montreal. Ms. Persofsky previously co-chaired the Canadian Minister's Advisory Committee on Electronic Commerce, as well as served as a special advisor to the Minister of Foreign Affairs and Trade. Ms. Persofsky received her degree from the Rotman School of Management at the University of Toronto.

*Richard D. Moss, Director*

Mr. Moss has served as our director since November 10, 2020. Mr. Moss served as Chief Financial Officer of Hanesbrands Inc., a leading Fortune 500 apparel company, from October 2011 until October 2017, after which he served in an advisory role at Hanesbrands until his retirement on December 31, 2017. Prior to his appointment as Chief Financial Officer, Mr. Moss led several key financial functions, including treasury and tax, at Hanesbrands from 2006 to 2011. From 2002 to 2005, Mr. Moss served as Vice President and Chief Financial Officer of Chattem Inc., a leading marketer and manufacturer of branded over-the-counter health-care products, toiletries and dietary supplements. Mr. Moss also previously served as a senior advisor to Nexo Capital Partners from January 2018 until December 2020. Mr. Moss has served as a director of Winnebago Industries, Inc., a leading U.S. recreational vehicle manufacturer since February 2017, and has served as a director of Nature's Sunshine Products, Inc. since May 2018. Mr. Moss received a B.A. and an M.B.A. from Brigham Young University.

*Melisa Denis, Director*

Ms. Denis has served as our director since November 20, 2020. Ms. Denis is currently President of Miracle Pointe Development, a real estate development company. Ms. Denis previously served as a partner at KPMG from 1998 to October 2020, including as National Tax Leader for Consumer Goods and as the leader of the Consumer and Industrial Market for Dallas. Ms. Denis has served as a member of the Board of Regents for the University of North Texas System since January 2020, an advisory board member of Women Corporate Directors since 2011, and a board member of Enactus, a global non-profit, since 2019. Ms. Denis is a Certified Public Accountant and received her degree in accounting and her Masters of accounting and tax from the University of North Texas.

**Item 11. EXECUTIVE COMPENSATION**

The information required by this Item will be included in the 2023 Proxy Statement and is incorporated herein by reference.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item will be included in the 2023 Proxy Statement and is incorporated herein by reference.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item will be included in the 2023 Proxy Statement and is incorporated herein by reference.

**Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item will be included in the 2023 Proxy Statement and is incorporated herein by reference.

**Item 15. Exhibits, Financial Statement Schedules.**

**(1) Consolidated Financial Statements**

See Index to Consolidated Financial Statements at Item 8 herein.

**(2) Financial Statement Schedules**

See Index to Consolidated Financial Statements at Item 8 herein.

**(3) Exhibits**

The following is a list of exhibits filed as part of this Annual Report on Form 10-K.

<b>Exhibit</b>	<b>Description</b>
2.1+	Stock Purchase Agreement, dated as of May 21, 2021, by and among House & Garden Holdings, LLC, House & Garden, Inc., Humboldt Wholesale, Inc., Allied Imports & Logistics, Inc., South Coast Horticultural Supply, Inc., the Sellers (as defined therein), and Steven Muller, as Sellers' Representative (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on May 26, 2021).
2.2+†	Securities Purchase Agreement, dated as of June 17, 2021, by and among Hydrofarm Holdings Group, Inc., Gotham Properties LLC, Aurora Innovations Inc., an Oregon corporation, Aurora International, Inc., and certain equity holders party thereto (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on June 21, 2021).
2.3+†	Share Purchase Agreement, dated as of August 3, 2021, by and among Hydrofarm Holdings Group, Inc., Greenstar Plant Products Inc., GSPP Investments Inc., Funance Productions Corp., Michael Nemirow, and 13213684 Canada Ltd. (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on August 3, 2021).
2.4	Amended and Restated Agreement and Plan of Merger, dated August 28, 2018, by and among Hydrofarm Holdings Group, Inc., Hydrofarm Merger Sub, Inc. and Hydrofarm Investment Corp. (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
2.5+†	Stock Purchase and Contribution Agreement, dated as of October 25, 2021, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Bruce Zierk and Christopher Mayer (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on November 3, 2021).
2.6	Amendment No. 1 to Stock Purchase and Contribution Agreement, dated as of November 1, 2021, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Bruce Zierk and Christopher Mayer (incorporated by reference to Exhibit 2.2 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on November 3, 2021).
3.1	Amended and Restated Certificate of Incorporation of Hydrofarm Holdings Group, Inc. (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Hydrofarm Holdings Group, Inc. (incorporated by reference to the Company's Registration Statement on Form S-1/A (File No. 333-250037), filed with the SEC on December 1, 2020).
3.3	Certificate of Designations, Preferences and Rights of the Series A Convertible Preferred Stock of Hydrofarm Holdings Group, Inc. (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
3.4	Amended and Restated Bylaws (incorporated by reference to the Company's Registration Statement on Form S-1/A (File No. 333-250037), filed with the SEC on December 1, 2020).
4.1	Specimen Common Stock Certificate of the Hydrofarm Holdings Group, Inc. (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
4.2*	Description of Capital Stock.
10.1	Credit Agreement, dated March 29, 2021, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, and JPMorgan Chase Bank, N.A. (incorporated by referenced to Exhibit 10.38 to the Company's Annual Report on Form 10-K filed with the SEC on March 30, 2021).

<b>Exhibit</b>	<b>Description</b>
10.2+	Unit Purchase and Contribution Agreement, dated as of April 26, 2021, by and among Hydrofarm Holdings Group, Inc., Field 16, LLC, F16 Holding LLC and the members of F16 Holding LLC (incorporated by reference to Exhibit 10.38 of the Company's Registration Statement on Form S-1 (File No. 333-255510) filed with the SEC on April 26, 2021).
10.3+	First Amendment and Joinder to Credit Agreement, dated as of August 31, 2021, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Hydrofarm Investment Corp., Hydrofarm Holdings LLC, EHH Holdings LLC, Sunblaster LLC, Hydrofarm Canada, LLC, Sunblaster Holdings ULC, Eddi's Wholesale Garden Supplies Ltd., Field 16, LLC, House & Garden, Inc., Humboldt Wholesale, Inc., Aurora Innovations, LLC, House & Garden Holdings, LLC, Gotham Properties LLC, Aurora International, LLC, Allied Imports & Logistics, Inc., Aurora Peat Products ULC, Greenstar Plant Products Inc., the lenders party thereto and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K (File No. 001-39773) filed with the SEC on September 7, 2021).
10.4+	Second Amendment to Credit Agreement, dated as of October 25, 2021, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Field 16, LLC, House & Garden, Inc., Humboldt Wholesale, Inc., Aurora Innovations, LLC, Hydrofarm Investment Corp., Hydrofarm Holdings LLC, EHH Holdings LLC, Sunblaster LLC, Hydrofarm Canada, LLC, Sunblaster Holdings ULC, Eddi's Wholesale Garden Supplies Ltd., House & Garden Holdings, LLC, Gotham Properties LLC, Aurora International, LLC, Allied Imports & Logistics, Inc., Aurora Peat Products ULC, Greenstar Plant Products Inc., the lenders party thereto and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q filed with the SEC on November 15, 2021).
10.5	Third Amendment and Joinder to Credit Agreement, dated as of August 23, 2022, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Field 16, LLC, Aurora Innovations, LLC, Innovative Growers Equipment, Inc., Manufacturing & Supply Chain Services, Inc., Hydrofarm Investment Corp., Hydrofarm Holdings LLC, EHH Holdings LLC, Sunblaster LLC, Hydrofarm Canada, LLC, Sunblaster Holdings ULC, Eddi's Wholesale Garden Supplies Ltd., House & Garden Holdings, LLC, Gotham Properties LLC, Aurora International, LLC, Aurora Peat Products ULC, Greenstar Plant Products Inc., Innovative AG Installation, Inc., Innovative Racking Systems, Inc., Innovative Shipping Solutions, Inc., Innovative Growers Equipment Canada, Inc., the lenders party thereto and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q (File No. 001-39773), filed with the SEC on November 09, 2022).
10.6	Fourth Amendment to Credit Agreement and Limited Consent and Waiver, dated December 22, 2022, by and among Hydrofarm Holdings Group, Inc., Hydrofarm, LLC, Field 16, LLC, Aurora Innovations, LLC, Innovative Growers Equipment, Inc., Manufacturing & Supply Chain Services, Inc., Hydrofarm Investment Corp., Hydrofarm Holdings LLC, EHH Holdings, LLC, Sunblaster LLC, Hydrofarm Canada, LLC, Sunblaster Holdings ULC, Eddi's Wholesale Garden Supplies Ltd., House & Garden Holdings, LLC, Gotham Properties LLC, Aurora International, LLC, Aurora Peat Products ULC, Greenstar Plant Products Inc., Innovative Ag Installation, Inc., Innovative Racking Systems, Inc., Innovative Shipping Solutions, Inc., Innovative Growers Equipment Canada, Inc., JPMorgan Chase Bank, N.A. and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K (File No. 001-39773), filed with the SEC on December 29, 2022).
10.7+	Credit and Guaranty Agreement, dated as of October 25, 2021, by and among Hydrofarm Holdings Group, Inc., the other credit parties party thereto, the lenders party thereto and JPMorgan Chase Bank, N.A. (incorporated by reference to Exhibit 10.3 of the Company's Quarterly Report on Form 10-Q filed with the SEC on November 15, 2021).
10.8**	Employment Agreement, dated January 1, 2019, by and between Hydrofarm Holdings Group, Inc. and William Toler (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.9**	Offer Letter, dated February 26, 2020, by and between Hydrofarm Holdings Group, Inc. and B. John Lindeman (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.10**	Hydrofarm Holdings Group, Inc. 2018 Equity Incentive Plan (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.11**	Form of Hydrofarm Holdings Group, Inc. 2018 Equity Incentive Plan Stock Option Grant Notice (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.12**	Hydrofarm Holdings Group, Inc. 2019 Equity Incentive Plan (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.13**	Form of Hydrofarm Holdings Group, Inc. 2019 Equity Incentive Plan Stock Option Grant Notice (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).



<b>Exhibit</b>	<b>Description</b>
10.14	Form of Indemnification Agreement (incorporated by reference to the Company's Registration Statement on Form S-1 (File No. 333-250037), filed with the SEC on November 12, 2020).
10.15**	Form of Restricted Stock Unit Award Agreement under the 2020 Employee, Director and Consultant Equity Incentive Plan.
10.16**	Non-Employee Director Compensation Policy (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q filed with the SEC on August 13, 2021)
21.1*	Subsidiaries of Hydrofarm Holdings Group Inc.
23.1*	Consent of Deloitte & Touche LLP, independent registered public accounting firm.
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*#	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.2*#	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Schema Linkbase Document.
101.CAL	Inline XBRL Taxonomy Calculation Linkbase Document.
101.DEF	Inline XBRL Taxonomy Definition Linkbase Document.
101.LAB	Inline XBRL Taxonomy Labels Linkbase Document.
101.PRE	Inline XBRL Taxonomy Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101).

\* Filed herewith.

\*\* Denotes management contract or compensatory plan or arrangement.

# The certifications attached as Exhibits 32.1 and 32.2 accompany this Annual Report on Form 10-K pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed "filed" by the Company for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall they be deemed incorporated by reference into any filing of the registrant under the Securities Act of 1933, as amended, or the Exchange Act, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

+ Certain schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule and/or exhibit will be furnished to the Securities and Exchange Commission upon request.

† Certain confidential portions (indicated by brackets and asterisks) have been omitted from this exhibit.

## **Item 16. FORM 10-K SUMMARY**

Not applicable.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### Hydrofarm Holdings Group, Inc.

Date: March 9, 2023

/s/ William Toler

\_\_\_\_\_  
William Toler  
Chief Executive Officer  
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the registrant and in the capacities indicated below and on the dates indicated.

Signatures	Title	Date
/s/ William Toler William Toler	Chief Executive Officer and Chairman of the Board <i>(Principal Executive Officer)</i>	March 9, 2023
/s/ B. John Lindeman B. John Lindeman	Chief Financial Officer <i>(Principal Financial Officer)</i>	March 9, 2023
/s/ Kevin O'Brien Kevin O'Brien	Chief Accounting Officer <i>(Principal Accounting Officer)</i>	March 9, 2023
/s/ Susan Peters Susan Peters	Director	March 9, 2023
/s/ Patrick Chung Patrick Chung	Director	March 9, 2023
/s/ Renah Persofsky Renah Persofsky	Director	March 9, 2023
/s/ Richard D. Moss Richard D. Moss	Director	March 9, 2023
/s/ Melisa Denis Melisa Denis	Director	March 9, 2023

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## CORPORATE INFORMATION

### EXECUTIVE OFFICERS

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**William Toler**  
*Chairman and Chief  
Executive Officer*



**B. John Lindeman**  
*Executive Vice  
President and Chief  
Financial Officer*



**Mark Parker**  
*Executive Vice  
President of  
Sales & Business  
Development*



**Kevin O'Brien**  
*Chief Accounting  
Officer*

### BOARD OF DIRECTORS

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**Susan Peters**  
*Director  
Chairperson  
of the  
Compensation  
Committee*



**Rick Moss**  
*Director  
Chairperson  
of the Audit  
Committee*



**Renah Persofsky**  
*Director  
Chairperson of the  
Nominating and  
Corporate Governance  
Committee*



**Patrick Chung**  
*Director*



**Melisa Denis**  
*Director*

### EXECUTIVE LEADERSHIP TEAM

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**Gerard Cantwell**  
*SVP Supply Chain*

**Eric Ceresnie**  
*SVP International Sales  
and Corporate Development*

**Laura Harvey**  
*General Manager - Canada*

**Charles (Rob) Marlow**  
*Chief Information Officer*

**Tais Garcia Martinez**  
*VP Human Resources*

**Chris Mayer**  
*SVP Commercial Sales*

**Elaine Rudolphi**  
*VP Manufacturing Operations*



## TRADING INFORMATION

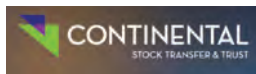
The common stock of Hydrofarm Holdings Group, Inc. is traded on the Nasdaq (symbol: **HYFM**).  
Website: [www.Hydrofarm.com](http://www.Hydrofarm.com)

## ANNUAL MEETING

June 6, 2023 at 11 am EDT  
Live Online Meeting  
[www.virtualshareholdermeeting.com/HYFM2023](http://www.virtualshareholdermeeting.com/HYFM2023)

## TRANSFER AGENT AND REGISTRAR

Information about stock and warrant certificates, address changes, ownership transfers or other related matters can be obtained from:



### Continental Stock Transfer & Trust

1 State Street, 30th Floor  
New York, NY 10004-1561  
[cstmail@continentalstock.com](mailto:cstmail@continentalstock.com)  
[www.continentalstock.com](http://www.continentalstock.com)  
212.509.4000

## INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**Deloitte.**

Deloitte & Touche LLP

## INVESTOR RELATIONS



### ICR, Inc.

Anna Kate Heller  
[ir@hydrofarm.com](mailto:ir@hydrofarm.com)





1510 Main Street  
Shoemakersville, PA 19555  
707.765.9990

[WWW.HYDROFARM.COM](http://WWW.HYDROFARM.COM)