ACG® New York

Association for Corporate Growth

TresVista FINANCIAL SERVICES

In April, we attended ACG New York's "Cannabis - The New Investing Frontier" event. Here are five of our top takeaways from the event, which focused on, "Trends & Challenges in Cannabis Industry."

Prepared by *TresVista Financial Services*

5 THINGS YOU MISSED LAST WEEK –

1 **Legalization and Regulation:** Recreational marijuana is legal in nine states and medical marijuana is legal in 29 states. First introduced by Rep. Maurice Hinchey in 2001, the Rohrabacher–Blumenauer amendment became law in December 2014, prohibiting the Justice Department from spending funds to interfere with the implementation of state medical cannabis laws. This amendment gave states the liberty to pass their own regulations without the interference of the federal government. The regulatory environment in the cannabis industry is dynamic and continuously evolving as the industry grows. The panel mentioned that companies should operate on the right side of the regulatory evolution, adhere to the best practices laid out by the regulatory authorities, and adapt to any upcoming regulations.

2 **Banking Systems:** After the rescission of the Cole Memorandum in January 2018, which stated that the Justice Department would not enforce federal marijuana prohibition in states that legalized marijuana, banks pulled out financing, which has made it difficult for companies to handle their finances. As a result, the majority of cannabis businesses struggled to open bank accounts, which led to a lack of credit for these affected companies. Cannabis businesses needed twice the capital as compared to startups in other industries. Additionally, these businesses now have to transact in cash only, which requires the business owners to carry duffle bags of cash when they need to buy equipment or supplies. The only banks supporting such enterprises are credit unions and community banks, which charge significant compliance fees ranging from $1,500 to $ 15,000 every month.

3 **Taxation:** Taxation laws are stringent for the cannabis industry. One of the prime examples of this is IRS 280E, under which licensed cannabis businesses end up paying much more in federal taxes than other companies do. As 280E explicitly bans any tax deductions beside the cost of goods sold, any cannabis business that tries to deduct any other business expenses, like any other regular business entity typically would, faces a potential audit. The panel estimated that the companies end up paying 70% or more taxes on their top line. In total, this is a considerable amount of money in taxation and compliance fees, which makes it difficult for the companies to operate and sustain their businesses.

4 **Lack of Professionalism:** The cannabis industry suffers from a dire need in professionalism and institutionalism. The panel observed that the industry is still filled with business owners who are "Dead Heads" or opportunist lawyers who want to leverage the loopholes in the regulations. Also, many businesses often sell to illegal operators, though dealing with such businesses can be avoided by analyzing their historical financials.

5 **Valuation:** The panel had repeatedly stressed the importance of due diligence in this industry, as there are many regulations to which the businesses need to adhere. There is a lot of misinformation in the market, and any critical thinker can avoid risky deals by performing in-depth due diligence and homework in the industry. Skip Motsenbocker, President at Floris Capital Management, noted that out of every 100 potential deals, 80 are straight rejects, 15 are not legal, and then only four businesses have high valuations primarily. The valuations in the Canadian cannabis industry have lead to extraordinarily high valuations in the American market, which is still at a booming stage. Jeff Finkle, Portfolio Manager at Viridian Ventures Cannabis Fund, believes that there should be clear-cut exit strategy when one is looking to invest in this space, as in most of the cases it is difficult to see an exit five years down the line.

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