IP Cannabis Show # 3
Participation in the segment and what investors look for

This is Investor Perspectives, I'm the host of Investor Connect, Hall T Martin, where we connect startups and investors for funding.

In our new Investor Perspectives series entitled "How to Solve the Cannabis Problem", you'll hear about participation in the cannabis sector and what investors look for.

As the COVID pandemic passes, we emerge into a new world. The cannabis space is now undergoing tremendous change as we shift back to a normal way of life. Every state is reviewing its regulations and accelerating legalization across the board. We have investors and startup founders describe the changes coming up.

I hope you enjoy this episode.

Our guests are:

William Muecke, Co-founder & Managing Director, Artemis Growth Partners, 00:56
Codie Sanchez, Managing Director, Entourage Effect Capital, 04:32
Michael Boniello, Managing Director, Poseidon Asset Management, 07:55
Sherri Haskell, Founder & CEO, Canna Angels LLC, 19:30

Our first guest is William Muecke, Co-founder & Managing Director at Artemis Growth Partners. Artemis Growth Partners are a team of professional investors, operators, and advisors who have built and run successful, award-winning domestic and international impact funds. They started in cannabis in 2015, and since then have been working to bring the principles of ESG and impact investing to the cannabis industry on a global basis. William, thank you for joining us.

William, thank you for joining us.

[00:07:36] **Hall Martin:** And what is your participation in the cannabis segment so far?

[00:07:40] **William Muecke:** So we have been investing, I mean, our team has really been in cannabis since 2015. We are all ex-bankers, so we come from the finance side of the world – two of us out of Goldman Sachs and the Global Healthcare Group out of New York. I was managing director and global co-head of our healthcare services practice, before stepping out into private equity. We have a former JPMorgan, 25-year veteran in capital markets. We also have an M&A specialist Mesoamerica, which is a Latin American bank, formed by the partners of Bank Capital. And we have been focused on deploying capital into those unmet needs, and so, currently, we have about 320 million, a little bit more than that deployed into global cannabis. The lion's share of that is in North America. But we are, hopefully, at the cornerstone of helping this industry move forward, in our view, which is an ESG, environmental, social, and governance focus on investing to basically make sure that the companies are not only taking care of their investors, but are taking care of their customer or patient in this matter, their vendors, their employees and their community. And so, that’s where we've been spending our time, with the teams that, frankly, complete that mission for us.

[00:08:51] **Hall Martin:** So in addition to ESG, what specifically do you look for in a company in order to invest in it, what's your criteria?

[00:08:58] **William Muecke:** I mean, for us, the size that we are now, we're not as focused on seed stage companies, as we may have been three plus years ago. So for us, it's more of a growth capital game, which means that the company, from a profile perspective, should have at least revenues, hopefully, with our investment, they will be at or through their cash flow breakeven inflection point. We'd like to obviously back leaders in the space. We're in the number one edibles category in Kiva. We're in the number one concentrates category in Raw Garden. We are almost, in a way, a GE related pick, number one, two or three category owner and back that company through its growth curve, ultimately, to a monetization event, whether that's an IPO or resale of the company.

[00:09:44] **Hall Martin:** Great. So what else should we know about the cannabis segment that we haven't covered so far?

[00:09:50] **William Muecke:** Well, I think the biggest effect right now is there are many people who are just discovering cannabis, even though the industry itself has been, at least in California, legal since 1996-97. That was when the compassionate medical care access laws came into effect. That allowed a large segment of the population to have access to cannabis as a medicinal. And that became a very important jumping off point for the entire industry. So there are plenty of folks that are just coming to the cannabis space right now, and I think the one thing I would say is that the growth isn't over, like, there are a lot of people that are afraid that they missed the peak, there was this craziness of hyper growth early on. I’d say that the volatility is coming down, but the long term growth is stabilizing. So for those that are coming to the space right now, this is a great time to be reviewing opportunities. As we say, we like the private side, we think that there's a large benefit in being in the private side of the investment structure, but the public markets are just as robust, there's some great companies out there. And I guess, my message would be, it's absolutely not too late. We're maybe in the second inning of a nine inning ballgame with cannabis, and this is a great time to be investing.

Our next guest is Codie Sanchez, Managing Director at Entourage Effect Capital. Entourage Effect Capital is a private cannabis fund disrupting the rapidly evolving cannabis industry. EEC's mission is to actively leverage their sector and investment experience, networks, and investment process, and to identify, invest and accelerate high-quality emerging growth companies. Codie, thank you for joining us.

[00:19:19] **Hall Martin:** What is your participation in the segment so far?

[00:19:24] **Codie Sanchez:** Meaning what exactly?

[00:19:27] **Hall Martin:** How much have you invested, what have you invested in, and what other actions have you done for cannabis?

[00:19:32] **Codie Sanchez:** Yeah, so we have a $200 million fund in the cannabis space, we're one of the largest small fund in any other industry in cannabis. That's quite a hefty sum. We've invested in 68 companies to date, lots of transactions around the space. I've had, I don't know, 27 different companies exit, lots of big companies actually return capital which is nice. There have been companies in there that are 3xs, and companies in there that are 30xs. And so, it's always fun to play in a space that has that kind of velocity of return in. And then, I sit on the board of a couple of our companies, including Arcview Capital, and also focused pretty heavily on growth within cannabis companies in the space, and helping them to think about how do they take that branding and their financial stability, which we hopefully give them to the next level.

[00:20:24] **Hall Martin:** Great. You talked about what makes a successful company, but can you talk about what exactly you look for to invest in a startup, what's the criteria?

[00:20:33] **Codie Sanchez:** Sure. So we invest in companies that are $10 to $50 million in revenue, so it's almost starting to get more to like $20 to $60 to $70 million in revenue, so growth equity companies. These are companies that have some sort of strong traction, they already have the product market fit. We have done some turnarounds, but typically, we're looking for companies that are really steady, that need an infusion of capital and perhaps better financial structuring and some add-ons in that space, and then we take those companies and we package them together. The goal for us is that these companies need to get to $50 to $100 million in assets under management, I'm sorry, in revenue, because the big strategic players are going to come in and eventually buy some players in the space. But they're not going to buy people that are doing $2, $5, $10 million in revenue, they're really going to go after the largest players in the space, and so, we want our portfolio companies to be prepped and ready for that.

[00:21:27] **Hall Martin:** So what else should we know about the cannabis segment at this time?

[00:21:32] **Codie Sanchez:** I mean, I think the most important thing to know is just that it is an asset class that is having, in our opinion, a generational wealth opportunity within it. I've never seen an industry that has double digit, it's a 24% CAGR industry right now. So that has such strong growth on an annualized basis, but simultaneously is trading at a discount to the rest of the market on an earnings per share basis, on a sales basis, on a margin basis, on almost any segment. They have this very strong growth behind them, but they're undervalued, because it is still a federally illegal substance. And so, I think the most important thing is if you're like I am, and if you believe in investing in companies that are undervalued to some degree, that have a lot of strong upside potential and have traction already realized, then I think it makes a lot of sense to have cannabis allocation in your portfolio.

Our next guest is Michael Boniello, Managing Director at Poseidon Asset Management. Poseidon Asset Management was founded by siblings Emily & Morgan Paxhia in 2013, making their first fund one of the longest-running dedicated cannabis investment funds. The Poseidon team has focused on a diversified strategy covering a range of company stages and industry subsectors across the capital spectrum. Now in the eighth year of conducting due diligence, deploying capital, and serving on multiple company boards of directors, the team is considered a leader in the cannabis industry. Michael, thank you for joining us.

[00:13:30] **Hall Martin:** So what's your participation in the cannabis segment so far, what investments have you made, and what have you done?

[00:13:37] **Michael Boniello:** Sure. When we launched in 2014, we were originally focused on the ancillary businesses. Even for us, investing in the plant touching business was a little early on. We wanted to see how the Feds and the Treasury were going to take to the industry. And so, we were really focused on the infrastructure of the industry. We saw this industry that was going to be a multi-billion dollar industry that had very little to no infrastructure. And so, originally, when we launched our first fund, we're focusing on ancillary businesses and made investments around data analytics, around point of sale software, HR and compliance software, some hardware devices. We also made investments in plant touching companies as well, vertically integrated operators who control their whole supply chain, meaning, vertically integrated, meaning they cultivate, they manufacture or process that either into a finished good, meaning the flower or into a new finished good meaning an edible product or a gel cap or a topical or concentrate, whatever it may be. And then they also control retail. They have retail stores, and so they control their own supply chain and are able to get, first and foremost their own products and brands on their shelf. And so, that is something that we invested in our first fund.

And to give you an idea of kind of how we've participated over the years, our first fund, because of how early it was in the industry, was a hybrid hedge fund and venture capital model. And at any given time, we are running approximately 80% private companies and 20% public companies in that fund, which we still are to date. That fund's done incredibly well over the years. That fund is running at around a 45% IRR since inception. We've returned about 60% of invested capital back to investors. And we have a lot of great companies in that fund that are going to have opportunities when we have things like the capital markets open up in the United States, and we get access to banking. Fast forward a few years, we launched our second fund and raised about $60 million in that fund to be a Series A focus fund, so we're looking at later stage growth companies. And in that fund, we've invested in 10 companies to date. We're still in the allocation period that ends June 30 of this year, but happy to say, we just recently had our first IPO from that fund, a company called Ascend Wellness they IPOed up on the Canadian Stock Exchange. But that being said, they went through a full gap and SEC audit, and are going to have the ability to uplift, when we do have the capital markets in the United States. I don't know when that's going to be, it could be in a year, it could be in two years. But they're ready to go, and I think, as an investor, that's important, because there's a lot of companies in cannabis that couldn't pass a gap audit right now that wouldn't have that opportunity. And so, I don't think there's going to be a rush of US companies that are going to be able to get on exchanges like the NASDAQ and the New York Stock Exchange.

And finally, we launched our third fund about a month and a half ago, and this is a fund, a smaller fund, we're targeting $25 to $50 million, and closed on just under 6 million in our first close. So we feel good about that, especially on the lower end of the range, where we feel like we will hit that higher end of the range, and that is a fund that's focused on late seed stage companies. So we're going back and looking at earlier stage companies again, and the reason we're doing that was very similar to why we launched our second fund to focus on Series A. We saw a portion of the market that investors were not flocking to, and we were talking to companies that were having trouble raising capital, because investors currently are focused on later stage, and focused on pre-IPO and the public markets. And this is such an early industry, and there's so much opportunity around so many segments in the industry and no clear cut leader. We still don't have interstate commerce. We still only have maybe 30 to 35% of the country that has access or will have access to adult use when New York and New Mexico and Virginia open up to announce that earlier this year. But all that being said, there has been a capital crunch for early stage companies. And so, we decided to launch a fund to focus on that, and ultimately brought on the team who were running funds at CanopyBoulder, which is an accelerator in the cannabis space and hemp space since 2014, to help manage that fund. So we're excited about that fund, but overall, we have allocated a lot of money to this industry since 2014, and we are still bullish and feel like we are still in the early innings of this industry. And though you have some big players in the industry, when you look at overall market share, it is miniscule. And the other thing is when you think about technology solutions and infrastructure, there's a long way to go in this industry, which gives great opportunities for young up and coming companies.

And I'll say, lastly, our participation also has been very important to us, has been around corporate governance. We are big believers in governance in this industry. We feel that you have to be involved in as much governance as possible, and on the flip side of that, also on policy. This is an industry that you have to be as close to the regulators as you possibly can as the regulations and laws are ever changing, and it really gives us, I don't want to say crystal ball by any means, but we start to see shifts in the industry both from our board access and our policy involvement. That allows us to make longer term investment decisions. And being a young industry in an ever changing industry, it's important, I believe, and I think most people believe that it's important to not be a passive investor and to either be personally active or be investing through an organization that is a believer in governance and that has their finger on the pulse of the regulators at any given time.

[00:19:41] **Hall Martin:** Great. So when you make an investment, what were you looking forward to invest in, what was the criteria that drew you to a company that you funded?

[00:19:50] **Michael Boniello:** Sure, I think that's very similar to some of the things I mentioned around the people making realistic or having realistic expectations. We see a lot of pro forma financials that are kind of the hockey stick or companies that are going to go from a million in revenue to 25 million to 200 million, not to say, they can't do that, but the expectation and execution around that makes it very challenging. And frankly, I don't think there's any reason to be reaching for those types of valuations as it's such a high growth emerging industry, where you can build a good company, and have the opportunity to grow that company and raise future rounds of capital. Because I like to say, if you're going out for a round of capital, and you're valuing yourself at $100 million at your Series A round, when you get to your Series B round, you're going to have to justify that Series A, you're going to have to show execution and show actual financials that allow you the ability to go out and raise more capital at a higher valuation, and that's been very difficult for a lot of companies to do who have gone for these nosebleed valuations early on. And so, getting back to the answer to your question, it comes down to good people, understanding industry, a good product, if there's IP around the product, that's, you know, we love that as anyone in any industry would do. But most importantly, being aligned in terms of expectation, in terms of exits, these are conversations we have very early on with founders. We run funds that have a fixed timeline. So if a company is planning to IPO in 10 years, and our fund ends in six to eight years, in terms of exit strategy, we might not be aligned, and that could cause problems down the road, as you can imagine. So being aligned is very important, and it's something that we've heard from a lot of cannabis companies over the years, who took money not knowing and understanding their investors as much as they should, and have ended up in some tough situations.

[00:22:04] **Hall Martin:** So what else should we know about the cannabis segment that we haven't talked about yet?

[00:22:10] **Michael Boniello:** Well, I think one thing to know about this industry is it is not a get rich quick scheme, by any point in time. In any emerging market, you're going to have those types of players that come in, that are trying to get companies go public as fast as they possibly can, trying to get these nosebleed valuations, and trying to monetize their investment as quick as possible. This is not the industry for that. There's a reason why we run funds that are six years, eight years, 10 years, there's a lot of regulations to be rolled out. There's a lot to come for this industry. We don't even have banking and capital market access yet in the United States.

There are challenges around the tax code in the United States, the tax code that the industry runs on is called 280E which ultimately forbids businesses from deducting expenses from their gross income, because cannabis is a Schedule I substance. And until it's removed from being a Schedule I substance, which is in line with, I think, meth and heroin, I think, cocaine is Schedule II, and then alcohol and tobacco is _________ completely, which we'd like to see cannabis there.

But anyway, what it really means is that cannabis entrepreneurs are forced to pay taxes on all of their business income, so they're more or less prohibited from writing off business expenses to minimize their taxable income. So that is very material for business. Some cost of goods sold is the only exception that you can write off. But when you think about this industry, and you think about where this industry is today, and how you do have profitable companies in this industry, or companies that are close to being profitable or breakeven, they're dealing with things like the inability to access most banking services. So what that means to a company is that your access to capital is a lot more expensive; you can't go to a bank and get a small business loan in the 6 to 10% range, you have to go to private investors. A lot of cannabis companies have been borrowing money more in the 12 to 20% range. It is coming down, there's no doubt, as more banks are willing to work with the industry, but that's very material. The tax code I mentioned is very material. When that changes, think about what that means ultimately for business income and being able to write off those expenses.

And then lastly, not having access to the capital market, so again, it makes it very, very difficult to raise capital when you can't go public, when you don't have access to banking, when you don't have access to the SBA, so that all being said, I think there's going to be a lot of torque for growth and profitability in this industry, once those things change. I don't know if they're going to change this year. Again, that's another thing that it takes a crystal ball to make that bet. But businesses can focus on their core markets in building a strong business, possibly being profitable now, while they wait for these things to change.

Our final guest is Sherri Haskell, founder & CEO at Canna Angels. Canna Angels is the leading angel investment consortium dedicated to the cannabis industry in the U.S. They are in their 5th year with over 50 stellar companies in their portfolio. With 5 exits (four as acquisitions, one as public issue to the CSE) in less than three years, their track record of identifying rising stars is solid. Sherri, thank you for joining us.

[00:09:47] **Hall Martin:** So tell us more about your participation in the segment so far, how many investments have you guys made and what looks like it'd be the next one?

[00:09:58] **Sherri Haskell:** Okay. As I said, in total, I think there are 50 or 51 companies now. We very much play down the middle through the technologies. If you go to our website, cannaangelsllc.com, you will see the complete portfolio, and it's segmented among verticals. So anyone that's interested can go and can look and see exactly what we've invested in, and what category of company they fall in. In other words, are they an Agritech, or a biotech, that kind of thing. We are working with one specific company right now, that's an infrastructure company that is just knocking it out of the park. They're doing really, really well. I'm very proud of them. But another thing, Hall, that we're seeing, and I'm starting to get very involved with, and I'm excited about is a new sort of expansion to the cannabis industry. It's a related industry, but nascent still, and very, very new and would be very interesting for prudent investors to start looking at. And that is what I call, industrial hemp. Actually, within the industry, we call it true hemp. And what I'm referring to here is hemp that is utilized for its fiber, its hurd, its stock, its seeds and other properties of the plant, rather than just being concentrated at the very top, where we get the flour that's taken for CBD. Now that the farm bill was passed in 2018. I don't want to get into the politics of how primitive we are here in the US, but, as an example, in Europe, and in China, they're decades ahead of us. They've been using true hemp for years, and we unfortunately, in the US, have been importing any derivatives of that, which has made it a little prohibitive for that product to really be accepted, because of the prices that have to be charged for imports. Now that the government passed the 2018 farm bill, now our farmers in North America – well, they've been doing it in Canada, but now in US – are starting to cultivate true hemp to be used for building materials, plastics, textiles, and animal bedding. I mean, there are actually 25,000 uses for this product. I know, people are just not aware and you can't blame that, because we really haven't had the information and education in the US to help investors know about this, but we are just now getting in the supply chains created, getting the special equipment that is necessary to harvest this very particular kind of plant. It's difficult to harvest because it's so meaty, and we need special equipment, but it's happening. And we're going to be producing these products here in the US very shortly. We already have a pipeline of business for some of the companies that I'm working with.

[00:13:16] **Hall Martin:** Great. Well, what do you look forward to invest in a company, in particular, what revenue level, and what stage do they need to be in to come up on your radar?

[00:13:25] **Sherri Haskell:** Thank you for asking that, I'm glad that you asked that. We really like to see companies that have a differentiator, first of all – is there something uniquely differentiated about this particular company? That could encompass a number of different things. But they really need to be differentiated which is – and this leads me, Hall, to another answer to your question – we are not looking at brands, particularly right now, we are not looking at CBD. There actually are 6000 brands right now on the market. People don't realize that. So I'm not interested in that at all. I'm interested in a company, a product, a service that is distinctly different, and can protect that differentiation. Now, typically, we do look for a company that's got a pipeline of business, or at least a little bit of traction. There can be exceptions. In Biotech, we do see exceptions sometimes – well, they're not revenue generating yet, but they may have patents on their technology, they may have a team that's extraordinary, and we would take a look at that. But we do look at companies that are a little bit more mature than at seed level; and the other thing is, is that in the last year, year and a half, we've expanded that footprint a little bit and now we're funding some into Series A, not just Angel rounds. Angel rounds, we were confined to a $2 million ceiling and now we expanded that, and we can go quite a bit beyond that with the Series A. So that's something that we've been doing, and we find that out of the 50 companies in the portfolio, I have quite a few of them that do circle back after they've got some meat on the bones and say, hey, we're ready for Series A, can we work with you now. And that's worked out to be beautifully, because we all know each other, we trust each other, we know how each other communicate, and that's a really nice situation, when that comes up, and it's happening more and more now. We're starting to see some of those companies that are actually maturing, and I'm thrilled to be working with them.

[00:15:40] **Hall Martin:** Great. So what else should we know about this segment that we haven't covered so far?

[00:15:45] **Sherri Haskell:** Hmm. Okay, for an investor, I will say that the complexion of the structure of some of these opportunities has opened up a little bit, and what I'm talking about there is that some of these companies are more open now to receiving debt, where we didn't see that a few years ago, and that's because they're heavy cash flow now. So some investors that are cash flow investors can get into this. As I said, we're seeing more and more mergers – merger acquisition, I think that's going to be really dominant in the next year or so. Some of the form factors we're starting to see, in other words, we're seeing up until, well, up until really this year or last year when the COVID hit, flower, as far as that consumer product, dried flower was the primary product and very dominant. Now we're seeing all different forms of concentrates, and that really speaks a lot to the medical community as well. Because the medical patients, of course, don't want to inhale. So we're seeing a number of different form factors in the form of capsules, beverages, edibles, patches – and those patches now, we're seeing time dispersed patches that are being created. I have a company in Israel that's doing that. There are some other companies around Europe that are doing that. Whereas, as a matter of fact, for sports applications, and I'm talking high level professional sports, we're seeing them becoming very interested in these time released patches for CBD and pain relief products through them.

Genetics, I mentioned, we're seeing a number of those things. What else can I tell you? Data. Data is another opportunity, and it's explosive – data in this industry. And I see the inquisitive look on your face, and what I'm saying there is we have a number of big data companies that are now very active in this industry, I would say, a half a dozen, that are providing data, everything from manufacturing to point of service, so that we can start knowing behavior of patients, behavior of consumers, so that the manufacturers there can refine even more their product. Something else that just happened Friday, it is really important and good for your investors and everyone to know. The DEA, as of Friday, just granted a number of-applications to be able to research cannabis in the US. Up until last week, there was only one university, one entity that was granted authority to research cannabis. It's insane. It's insane. And there was so much pushback in the industry, and actually through the political structure that the DEA finally last Friday granted approval to three specific companies, but there are hundreds more that have made application and they are under review. This is really fantastic. Now, the general public, the consumers, all of us can really get credible clinical information on what THC is doing and how and when and to what effect. Same thing with CBD, I'm really excited about this.