We’re In a Cannabis Recession
How did we get here and what can we do about it?

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We’re in a Cannabis Recession*

- A recession is defined as two consecutive quarters of decline in GDP

*But total national cannabis sales are not in decline

- Instead we are seeing a serious multi-quarter decline in cannabis stock prices resulting in billions of dollars of loss for the largest operators

- This distinction is important to consider and helps to explain our current predicament
State of the Markets

American Cannabis Operator Index

43.32 -0.64 | -1.46%

January 3, 2020 4:00 PM EST  Volume: 6,650,402
USD | CANNABIS STOCK INDEX | REAL-TIME PRICE | MARKET CLOSED

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<th>Last</th>
<th>43.32</th>
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<td>$ Chg</td>
<td>-0.64</td>
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<tr>
<td>Open</td>
<td>43.76</td>
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<tr>
<td>High</td>
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<td>Year Low</td>
<td>38.22</td>
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<td>Year High</td>
<td>121.87</td>
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<tr>
<td>Volume</td>
<td>6,650,402</td>
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Exchange: NCV IND...
It’s Happening in Canada as Well
Creates Real Costs for Cannabis Businesses

- Increases capital costs for public and private companies
- “The recent downturn in cannabis stocks has spilled over to the private-equity and debt markets. We have seen a 1-2 percentage point increase in borrowing rates.”
  - Tony Cappell, Green Ivy Capital, as reported in the WSJ
Companies Turn to Real Estate Sales

- Cannabis companies need capital for expansion and debt financing is getting more expensive.
- Many large operators turn to Real Estate Investment Trusts (REITs) to provide a financing in exchange for long term facility leases.
- Innovative Industrial Properties (NYSE: IIPR) – Q3 2019 Report:
  - Over $500 million in cannabis real estate investment.
  - Investments across 13 states, 41 properties, and 2.8 million square feet.
  - Large MSOs: Ascend Wellness, Cresco Labs, Grassroots, Green Thumb Industries (GTI), Pharmacann, The Green Solution, Trulieve, Vireo Health.
How Did We Get Here?

There is not a problem with demand for cannabis
A Variety of Compounding Factors

- Cannabis business went public early on second tier stock exchanges
- Media and investor expectations do not equal the reality of a new regulated industry
- Slow and overly complex implementation reduces the ability to compete with the unregulated market
- Other factors such as bad management and missed revenue projections
The Rush to Go Public

- Federal illegality limits the availability of institutional capital
- Multi-state operators (MSOs) rush to acquire licenses and build a national brand larger and faster than their competitors
- Limited license programs artificially inflate the value of the license itself
- Media and retail investor excitement to cash in on the next big thing
- Without interstate commerce MSOs need lots of capital for new cultivation and manufacturing operations in each state

So growing MSOs go public on the Canadian Securities Exchange
Media and Investor Expectations

- The media and cannabis companies looking to get headlines set unrealistic growth expectations for the industry
- Initial adult-use markets ≠ new adult-use markets
- Most cannabis stockholders are risk adverse retail investors
- When stocks started to decline, the media turned to the dotcom bubble as an analogy and retail investors fled
Slow Implementation and the Illicit Market

- Less than a third of sales in California and Massachusetts are within the legal market.
- Slow licensing, expensive regulations, and high taxes make competition with underground market difficult.
- Major cities such as Boston and Los Angeles still without access.
- Americans prioritize convenience.
- Frequent consumers are the most important but also have the deepest connections to the illicit market.
So What Can We Do About It?

Focus on streamlining operations in states with robust markets rather than quickly building out a national empire in unprofitable places.

Be cautious of operators whose value is largely based off holding undeveloped licenses in states with limited markets.

Build up cash to avoid additional financing rounds just to pay off current operations.

Focus on expanding the law and market opportunity in existing states.

Re-center the industry around the purpose of legalization - serving consumers and reducing the power of the unregulated market.
Focus on Robust Markets

Oklahoma’s MMJ Program:
Sales & Patients Compared to Other MMJ & Adult-Use Markets in the U.S.

Sales of MMJ & Adult-Use Cannabis by State in the Third, Sixth and Ninth Month After Launch

Percentage of Population Registered as a MMJ Patient

Source: Illinois Medical Cannabis Program, Ohio Medical Marijuana Control Program, Maryland Medical Cannabis Commission, Oklahoma Medical Marijuana Authority, Headset
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Focus on Operating Costs

- If profitability is only sustainable at $2,000 wholesale pounds or $250 dollar ounces, the business will be in serious trouble in 3-5 years.
- Some companies seek to be early movers to take advantage of high prices, but operational inefficiencies wipe away potential gains.
- Focus on profitability because now investors are less interested in a speculative national empire.
Focus on the Purpose of Legalization

• It should not be this hard to start a cannabis business
• It should not be difficult to purchase legal cannabis
• Legal cannabis should cost less than the illicit market
Questions?
Thank You!

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