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# Valuations and Investments: How to Value and Invest in a Cannabis Business Part 1

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# Agenda

- About GreenGrowth CPAs
- Valuation 101
- Discounted Cash Flow Method
- Time Value of Money
- What to look for in a good cannabis business investment
- Things to consider before making any investment

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# GreenGrowth CPAs



## About Us:

- Tax Preparation: completed over 500 Annual Tax Returns for cannabis operators spread across all verticals: dispensary, distribution, cultivation, manufacturing, delivery and testing.
- >300 clients based in California, Colorado, Michigan, Oregon and Washington
- Performed over a dozen audit related projects in the last year
- Expected to hit 7-digits in revenues in our second full business year (2018).
- Thorough and deep understanding of tax, compliance and assurance related requirements for the cannabis industry

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# Valuation 101

- Valuations are done to estimate the value of companies and assets. It is also used to assess whether or not an investment or an acquisition is attractive.
- Depending on the company, its assets and the industry it falls under, there are several financial methods that are used to determine its value.
- There is the Discounted Cash Flow Method, the Guideline Public Company Method and the Guideline Transaction Method for mergers and acquisitions.
- The best and most effective method to use when valuing cannabis companies is the Discounted Cash Flow method since there are very few publicly traded companies to use the Guideline Public Company valuation method.

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# Discounted Cash Flow Method (DCF)

- Analyses future free cash flow projections and discounts them using a required annual rate to arrive at present estimates.
- The present value estimate is used to evaluate the potential for an investment. If the present value estimate is higher than the current cost of the investment, then the investment could be a good one.

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# Discounted Cash Flow Method

- Other factors that should be taken into consideration while computing valuations are:
  - Risk
  - Actual Cash on Hand
  - Existing debts, liens and assets
  - Ownership
  - Projections

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# Disadvantages of DCF

- This method is only as good as its input.
- In the case of cannabis businesses, the input will be coming from the company itself.
- Every assumption has the potential to increase or decrease the the estimate's accuracy.

# Example of Discounted Cash Flow Method

- Start-ups VS Mature Companies

STARTUP ENTITY								
PROJECTED INCOME STATEMENT								
		PROJECTED RESULTS						
	STARTUP YEAR	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022	Fiscal Year 2023		
Revenue								
Flower	\$	-	\$ 2,000,000	\$ 4,000,000	\$ 7,000,000	\$ 12,000,000	\$	21,000,000
GROSS SALES	\$	-	\$ 2,000,000	\$ 4,000,000	\$ 7,000,000	\$ 12,000,000	\$	21,000,000
REVENUE GROWTH RATE				100%	75%	71%		75%



# Example of the Discounted Cash Flow Method

MATURE ENTITY								
PROJECTED INCOME STATEMENT								
	ACTUAL RESULTS			PROJECTED RESULTS				
	2016 Actual Results	2017 Actual Results	2018 Actual Results	Fiscal Year 2019	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022	Fiscal Year 2023
Revenue								
Flower	\$ 10,000,000	\$ 11,000,000	\$ 12,100,000	\$ 13,310,000	\$ 14,641,000	\$ 16,105,100	\$ 17,715,610	\$ 19,487,171
GROSS SALES	\$ 10,000,000	\$ 11,000,000	\$ 12,100,000	\$ 13,310,000	\$ 14,641,000	\$ 16,105,100	\$ 17,715,610	\$ 19,487,171
REVENUE GROWTH RATE		10%	10%	10%	10%	10%	10%	10%

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# Time Value of Money

- The Discounted Cash Flow method is dependent on the principle of Time Value of Money.
- The principle states that money in the present moment is more valuable than the same amount of money in the future, because of its potential earning capacity.
- Any amount of money received sooner is worth more than money received later because of its potential to earn.

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# What to look for in a good cannabis business

- Does not have a lot of debt.
- The more mature, the better (i.e. established brand, 5+ years operational...)
- Well developed sales, distribution and procurement channels
- Clear financial reporting
- Independent cash reconciliation

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# What to look for in a good cannabis business

- Depending on the cannabis business type some indicators of a good business investment would be:
  - Good yields and high costs per pound of flower (cultivation operations)
  - Good brand and high sales (manufacturing operations)
  - High average transactions and high frequency of purchase, (dispensary operations)

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# What are the Things to Consider before Investing in a Cannabis Business


1. License
  - Make sure there is a license in good standing associated with the business.
2. Do a background check on entity and investors
  1. Find out and understand the debt and equity arrangements
    - Who owns what?
    - Who does the company owe money to?

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#### 4. Make sure all tax filings are complete and up-to-date.

- Local taxes: income, business tax
- State taxes: income, sales and excise tax, payroll taxes
- Federal taxes: income, payroll taxes

#### 5. Observe operations and its stage of growth

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6. Confirm the cash-on-hand or the cash in the bank.
  7. Confirm receivables
  8. Analyze and confirm the customer list, if any
  9. Analyze projections
  10. Assess compliance with local, state and applicable federal laws

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# Key Takeaways



1. Cannabis Businesses should be valued before making investments
2. The Discounted Cash Flow Method is the most effective way to value cannabis businesses.
3. It relies on the financial principle called Time Value of Money: your money is worth more now rather than later.
4. A viable cannabis business venture is well established and/or mature, with a healthy cash flow, little or no debt and is compliant with local, state and applicable federal laws.
5. Make sure to do your due diligence before investing in any cannabis business.
6. Ask yourself: At what value am I getting the company?



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## Coming up next:



Part 2 is going more in-depth and looking at what to look for when investing in verticals and how to value them:

- Cultivation
- Manufacturing
- Dispensing

There will be a Part 3 that will focus on:

- Delivery
- Testing
- Ancillary Cannabis Businesses

We will talk about looking at business' assets, equipment, facilities, the build-out and other key areas that contribute to successful cannabis businesses and investments.

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**Questions or need help with valuing your  
cannabis business or new investment?**

**Contact GreenGrowth CPAs today!**

**[www.greengrowthcpas.com](http://www.greengrowthcpas.com)**

**(800) 674-9050**