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The Cannabis Manifesto

Imagine an opportunity to invest in a mythical \$100 billion market on its way to \$200 billion in which capital is scarce, institutional participation is tiny and where many publicly traded companies involved are not listed in any major index or traded on any major US exchange.

Now imagine that these publicly traded companies have defensible moats, strong management teams and possess ten years of growth and re-investment opportunities ahead.

Then imagine that this magical sector has crazy inefficiencies where similar companies trade at wildly different multiples for no apparent reason and where you can buy industry leading companies growing at over 50% while trading for single digit cash flow multiples with little if any leverage.

This is the reality of the US cannabis industry. Thanks to the conflict between state legality and Federal illegality, a US company that “touches the cannabis plant” cannot trade on any major US exchange and instead trades on secondary and tertiary Canadian exchanges. Add in concerns regarding custody issues with major brokerages and prime brokers, and you are left with little institutional involvement (estimated at a measly 4%), no index involvement and thus a wonderful opportunity.

And it is for this reason, I’m launching the Mindset Value Cannabis Fund, which will be solely dedicated to investing in publicly traded cannabis companies that are focused on the US cannabis market.

The Health and Wellness Benefit to Society is Massive

Cannabis is not just a great investment but is fundamentally a big positive for society. Specifically, we are attracted to the enormous health and wellness benefits of cannabis. Consumers of cannabis have been shown to binge drink less, use less opioids and use less powerful prescription drugs. The medical benefits are numerous including the ability to quit opioid addiction, tolerating powerful cancer medications, migraine pain relief, pain relief in general without the risk of addiction, and helping with insomnia and post-traumatic stress disorder.

Studies show that cannabis users are surprisingly active and recover from injury more quickly. Athletes have long used cannabis and are now becoming more vocal about the surprising anti-inflammatory

properties of cannabis and the ability to heal quicker and bounce back faster. It's interesting to read how ultramarathoners are running faster and longer with cannabis and how cannabis edibles are taking over the running world.

All of this is well documented and might be a shock to most people who grew up in the reefer madness era in which people believed that cannabis led to decadence or worse sitting on your couch and wasting your life away. Cannabis has been falsely demonized mainly for racial reasons, first as a tool to fight Mexican immigration into the U.S. and later to discriminate against African Americans.

But all of that is coming to an end as state after state legalizes either medical marijuana or full adult use and as the benefits to consumers, society and the economy become too powerful to ignore. Cannabis already exists as an illegal market, so why not just tax and regulate it in a safe and efficient manner? This is leading to soaring tax revenue and job creation in every state that legalizes cannabis. An estimated 321,000 Americans now work in the cannabis industry, with growth of 80,000 new jobs in 2020 alone. Many cities and states are seeing cannabis tax revenues make up budget shortfalls. Cannabis taxes are easy targets and take much less effort to enact than other forms of taxation that are deeply unpopular with voters.

Maybe the craziest data point in favor of cannabis legalization is that worker compensation claims go down in states after they legalize cannabis. Why would that be? When cannabis is illegal, people turn to other more powerful, more dangerous drugs such as opioids to self-medicate their ailments and these drugs have significantly harsher consequences to job performance. And finally worries about soaring teenage use are now confirmed to just be worries as teenage use has proven to fall in states that have legalized cannabis.

So, if the benefits are real both to health and to the economy, why not legalize it? In this regard, states are moving faster than the Federal government, but even faster is how cannabis is being normalized. Almost 70% of all Americans believe cannabis should be legalized.

Personally, I've benefitted as well. I have suffered from insomnia at different points in my life. It is awful and I wouldn't wish it on my worst enemy. Now with a cannabis tea or a low dose gummy, I can reset my sleep system and sleep soundly. And that pales in comparison to the relief that some of my relatives who use cannabis creams and other products to help with knee, back and migraine pain feel. We are eternally grateful that cannabis helps so effectively with so few side effects.

Cannabis is Reminiscent of the Beginnings of the Single-Family Rental Industry

The investment opportunity in cannabis is reminiscent of the opportunity in single-family rentals. In 2009, I launched a small fund to buy single-family foreclosed homes, fix them up and rent them out. I started with 16 and ended up buying 2,500 homes. We sold the company in 2015 to a publicly traded real estate investment trust, in what was then the largest single transaction of homes ever in the US.

My investment thesis on buying foreclosed homes was that the US could not continue to produce only 400,000 homes a year, and instead needed to be constructing more than 1 million homes a year. If the country continued to produce such few homes, it would eventually find itself with a massive shortage of homes. The only question was when this would occur. I also quickly realized that this was not a trade

but an industry. Yes, scattered site was more expensive to manage, but the turnover was less than multi-family, so the result was similar overall margins to apartment buildings.

It's fun to watch the whole investment world now recognize and invest in single-family as an asset class when ten years earlier people looked at me as if I had a third eyeball or told me it would never work as an ongoing business.

And the same thing is happening in cannabis. For many reasons, professional investors are ignoring the cannabis space, just like they ignored single-family homes. I hear either indifference or comments that cannabis is an agricultural commodity or even more bizarre is when investors lump it into the same bucket as crypto currencies (maybe this is because there is uncertainty around the regulations of both?).

Regardless, if an investor has patience, you can see what is coming, which is some form of legalization. When that happens, companies will trade at wildly different multiples than where they currently trade, on what will be a much larger industry than it is now.

Consider Verano Holdings (Canada: VRNO, OTC: VRNOF). This company should earn approximately \$1.3 billion in revenue and close to \$600 million in EBITDA in 2022. At slightly less than \$4 billion in market cap, Verano trades at 3x revenue and less than 7x EBITDA unlevered. That is with a company with a 3-year CAGR (compounded annual growth rate) of over 50% with over 40% EBITDA margins and in a net cash position. It's possible that if the growth Verano is experiencing continues that the company could be trading at 4x 2024/2025 EBITDA.

When Verano is allowed to list on US exchanges, it could easily go up more than five times in value. There are other companies that are similarly well run and undervalued that could go up even more, such as AYR Wellness (Canada: AYR.a, OTC: AYRWF).

Prominent consumer goods companies and alcohol companies are lucky to be seeing 3-4% growth and trade north of 20x EBITDA.

An even better example is sports betting. Once illegal, publicly traded sports gambling companies trade at absurd multiples. Draftkings (NASDAQ: DKNG) for example sports a market cap of over \$20 billion and trades at more than 40x 2024 EBITDA. When investors get access and are excited about a sector, valuations can go sky high.

The Longer Legalization Takes the Better for the Top Cannabis Companies

To the patient investor, the longer legalization takes, the better it is for the leading US public cannabis companies. Why? Because they have access to capital that their smaller competitors do not. This means they can grow, solidify their footprint, invest in their infrastructure, acquire smaller competitors, and gain size and scale advantages.

I estimate that there are only a dozen or so publicly traded companies that have access to capital. The longer legalization takes, the more time these companies have to establish themselves, to create footprints and moats and the more valuable they become. Anyone trying to follow them will either be shut out, will have to partner with them or buy them.

Consider all the barbarians at the gate, like Big Tobacco, leading alcohol companies or consumer packaged goods companies are holding off on entering the industry due to fears of reprisal from the Federal government. British Tobacco has a strategic plan called “Beyond Nicotine” and tens of billion in free cash flow in the next five years to invest. Pray tell, what in the world is after nicotine other than cannabis?

When I was buying foreclosed homes on the Gwinnett County, Georgia courthouse steps in 2011, it was a dream. I would compete against mom-and-pop investors, and we would buy homes left and right at prices that seem silly now, like \$45,000 for a safe suburban 3-bedroom home. That all changed seemingly overnight when Colony Capital and Blackstone entered in May and June of 2012. Prices increased over 50% overnight. The minute the institutional investors believe it is safe to enter the industry, valuations and prices will change overnight.

Partnering with Doug Brien, CEO of Mynd, to Launch the Mindset Value Cannabis Fund

I’m excited to announce that I’m launching the Mindset Value Cannabis Fund with Doug Brien, who was one of the first investors to go after the single-family rental opportunity when he started Waypoint, which later became publicly traded as Starwood Waypoint. We met when he was CEO of Starwood Waypoint, and he almost bought my company, but was unfortunately not the highest bidder.

Doug is now the CEO of Mynd, a next generation property management company that is absolutely killing it. Mynd just secured a massive \$5 billion partnership/investment from Invesco to further expand on the opportunity in single-family homes. <https://www.bloomberg.com/news/articles/2021-06-01/invesco-backs-mynd-to-spend-5-billion-on-single-family-rentals?sref=DGfbsOzc>

I will be running the portfolio day to day and leading research and due diligence, while Doug will assist with portfolio review and helping to grow the fund.

Doug was a kicker for the San Francisco 49ers (he has a Super Bowl ring!) and is a big believer in the health and healing aspects of cannabis as well. Both Doug and I think this is just the beginning of a ten plus year run in an industry about to take flight.

Fund Strategy and Structure

Mindset’s strategy will be to conduct deep research on the best US cannabis companies and own them for the long term. We will not worry about short-term volatility, but will instead focus on a company’s business model, management team and capital structure. We expect Mindset to hold 10 to 20 investments and not employ leverage.

Mindset’s fee structure will be a 1% annual management fee and 20% of the profits with a high watermark. The fund will prime broker at Interactive Brokers, will use Spicer Jefferies as its auditor and HC Global as its hedge fund administrator.

Risks

There are many risks associated with investing in cannabis. The greatest is obviously that it is currently illegal federally to sell cannabis or to touch the plant in anyway. So, even though the IRS collects federal taxes (excessive taxes due to rules like 280e) from cannabis companies, the federal government still considers it illegal. This is the reason most institutions won't touch US cannabis companies.

Beyond that risk, the other risk is one of timing. It may take much, much longer than expected for the industry to become legalized. It could also be legalized in a way that is very detrimental to the industry or the stocks the fund owns.

We plan to base our investments on deep research and to run a concentrated portfolio. Analysis of which companies could benefit could be wrong, which could lead to inferior returns.

This will be a fund concentrated on a single industry, cannabis. We could be wrong about the potential, and it could be that this is just an agricultural product with no margins. The market could outperform the cannabis sector, which could struggle.

There might be other unknown factors that could cause the fund to perform poorly, so know that this fund could be risky.

Summary

When I first identified the opportunity to buy, fix and rent homes, I saw a long-term opportunity to invest in the absolute bottom of housing. My mistake in hindsight was that it would have been much more lucrative and easier to simply research and buy the best housing related stocks like Home Depot (NYSE: HD), Lennar (NYSE: LEN) and others. And that's my plan with the Mindset Value Cannabis Fund.

The opportunity to invest in the cannabis industry is just beginning. This is a generational investment opportunity in an industry with phenomenal growth and limited access to capital. We aim to invest before full legalization occurs and believe that patient capital will be well rewarded in the years to come.

Further links to read that support the Fund's perspective:

<https://www.washingtonpost.com/business/2021/09/24/marijuana-dispensaries-jobs/>

<https://www.marijuanamoment.net/legal-marijuana-states-see-reduced-workers-compensation-claims-new-study-finds/>

<https://jamanetwork.com/journals/jamapediatrics/fullarticle/2718512>

<https://pubmed.ncbi.nlm.nih.gov/30684198/>

<https://www.healthline.com/health-news/after-cannabis-legalization-college-students-binge-drink-less-smoke-more-pot>

<https://news.umich.edu/many-users-prefer-medical-marijuana-over-prescription-drugs/>

<https://www.healthaffairs.org/doi/full/10.1377/hlthaff.2015.1661>

<https://filtermag.org/youth-marijuana-american-medical-association/>

<https://www.chicagotribune.com/marijuana/sns-tft-marijuana-recovery-revolution-for-pro-athletes-20200629-hz6k3ujkrnfkxcnkdsshstzgq-story.html#:~:text=According%20to%20science%2C%20cannabis%20provides,caused%20by%20traumatic%20brain%20injuries.>

<https://www.marijuanamoment.net/seven-in-ten-americans-support-marijuana-legalization-new-gallup-poll-shows/>

<https://www.menshealth.com/health/a37622765/runners-high-cannabis-in-sports/>

<https://www.sandiegouniontribune.com/communities/north-county/vista/story/2021-09-20/sales-surge-at-vista-cannabis-shops-after-city-oks-recreational-use>

<https://www.pbs.org/wgbh/pages/frontline/shows/dope/etc/cron.html>

<https://www.linkedin.com/pulse/legal-cannabis-market-goes-hannibal-lecter-mina-mishrikey-cfa/>

<https://www.cato.org/policy-analysis/effect-state-marijuana-legalizations-2021-update#economic-outcomes>

<https://www.nationalaffairs.com/publications/detail/the-public-health-case-for-legalizing-marijuana>

<https://www.mdlinx.com/article/is-it-healthier-to-smoke-weed-or-drink-alcohol/7bhmtMNdgXlzy2HE69hRPU>

<https://doi.apa.org/doiLanding?doi=10.1037%2Fbn0000701>

<https://www.sciencedirect.com/science/article/abs/pii/S0167629621001223>

https://www.thecentersquare.com/opinion/op-ed-legalization-of-adult-use-marijuana-in-pennsylvania-is-inevitable/article_7c9693a2-253a-11ec-8755-17e6c934ff45.html

Mindset Posts and Writings on Cannabis:

<https://mindsetvalue.substack.com/p/your-margin-in-glass-houses-opportunity>

<https://mindsetvalue.substack.com/p/in-cannabis-it-pays-to-bet-on-mitch>

<https://mindsetvalue.substack.com/p/ayr-wellness-and-the-art-of-the-deal>

<https://mindsetvalue.substack.com/p/turbulence-a-diverted-flight-and>

<https://mindsetvalue.substack.com/p/veranos-puzzling-summer-valuation>

<https://mindsetvalue.substack.com/p/cannabis-endgame>

<https://mindsetvalue.substack.com/p/are-interstate-commerce-restrictions-bdf>

<https://mindsetvalue.substack.com/p/are-interstate-commerce-restrictions>

<https://mindsetvalue.substack.com/p/is-there-enough-legal-cannabis-being>

<https://mindsetvalue.substack.com/p/the-most-valuable-greenhouse-in-america>

<https://mindsetvalue.substack.com/p/cannabis-will-be-normalized-before>

<https://mindsetvalue.substack.com/p/caution-in-cannabis>

<https://mindsetvalue.substack.com/p/update-on-canopy-rivers>

<https://mindsetvalue.substack.com/p/jason-wilds-fund-is-over-70-in-cannabis>

<https://mindsetvalue.substack.com/p/why-are-so-few-money-managers-investing>

<https://mindsetvalue.substack.com/p/is-cannabis-the-new-saas-part-two>

<https://mindsetvalue.substack.com/p/wild-that-so-few-are-following-jason>

<https://mindsetvalue.substack.com/p/is-cannabis-the-new-saas>