

State Legislation Presents Investment Opportunities with Early Entrants

Following news last month that Virginia lawmakers passed recreational cannabis legislation, we highlighted Connecticut, Maryland, Missouri, New Mexico, New York and Pennsylvania as the next most likely states to pass legislation (“[Legislation Progressing in Key States](#)”). As we have previously noted, we expect economic hardship for state economies and the potential to raise new tax revenues and create jobs will motivate passage of recreational laws in the near term.

Whether through initiatives passed this year or in early 2022, we expect initial recreational sales to come in each of these markets next year. While not yet factored into our sales forecasts for 2022, we believe additional states could surprise in the near term with the passage of recreational laws but with a longer out initiation of sales (as was the case in Virginia where sales will kick off in 2024). We are following state initiatives across the country with a focus on Arkansas, Minnesota, North Carolina, Ohio, Oklahoma and West Virginia where legislation is progressing, and, in some cases, neighboring state rollouts are likely to motivate.

Of near term expansion states, New Mexico and New York appear to be making the most progress with potential legislation expected in the next few weeks.

- **New Mexico:** In New Mexico, a recreational cannabis initiative got to the final stages of debate in the state’s Senate before the legislative session ended on Saturday (3/20). Governor Grisham will call a special session debate specifically focused on cannabis legislation within the next two weeks to iron out final details with passage anticipated by the end of April.
- **New York:** Governor Cuomo included cannabis legislation in his 2021-22 budget proposal. The Senate took out cannabis language however there was nearly \$40M in funding approved to create a recreational cannabis regulatory authority. We believe the regulatory funding is an important next step in opening the market and anticipate legislation to come this spring.

Early entrants in expansion markets present attractive investment opportunity

To date, in each expansion market the opening of recreational sales offers significant and sustainable competitive advantages for existing medical license holders. The competitive advantages can translate to inflated retail volumes, high margin wholesale sales and takeout opportunities from larger multistate operators. In the past six months alone most of the industry’s top MSOs including Ascend, AYR Wellness, Cresco, Curaleaf, Green Thumb, Jushi, Trulieve and Verano have all completed acquisitions of limited scale operators in expansion markets at high valuations.

Looming legislation in expansion states presents attractive opportunities for investors through finding the operators which have existing positions within these states which can be leveraged for growth and enhanced profitability or to become takeout candidates. We believe underfollowed companies should be most considered given discounted valuation and greater opportunity for upside. Additionally, given improved capital market access, these companies are just as capable of raising capital to fund growth as larger peers. Underfollowed names with expansion state exposure include Bell Rock Brands (MD exposure), Body & Mind (AR & OH), Consortium (PA), Driven by STEM (OK), Marimed (MD), Terrascend (CT & PA) and TILT (OH & PA).

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Viridian Capital Advisors

www.viridianca.com

Jonathan DeCoursey

Director Equity Research

jdecoursey@viridianca.com

(781) 724.6869

Investment Highlights

- Recreational cannabis legislation continues to progress.
- New Mexico and New York appear most likely to become next rec states.
- Early mover advantages for existing operators in new recreational markets.
- Bell Rock Brands, Body & Mind, Consortium, Driven by Stem, Marimed, Terrascend and TILT each present opportunities for upside on rec market openings.
- Vireo Health appears poised for transformative growth given numerous looming recreational state expansion opportunities.

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Vireo Health, a potential direct beneficiary from rec legislation

As previously referenced, we believe many companies are poised for accelerating growth and outperforming results based on the passage of state recreational laws where they have exposure. In fact, twenty-one different companies, including some of the largest in the industry have exposure to the twelve states we have discussed with looming recreational opportunities. With that said, no other operator appears to be in a better position for transformative growth from the passage of recreational legislation with existing operations than Vireo Health. Vireo is a vertically integrated operator with modest scale. To date the company has focused on the development of best in class medical grade cannabis products and operations in limited license medical markets.

Vireo generated a modest \$13M in Q3/20 revenues from operations in seven states (Arizona, Maryland, Minnesota, New Mexico, New York, Ohio and Pennsylvania). Since quarter-end, the company sold off its Ohio and Pennsylvania exposures in order to invest elsewhere in the business and shore up the balance sheet. The remaining states include some of the most likely recreational expansion markets in the US and Arizona which commenced initial recreational sales last month.

With on-going expansion initiatives as well in Massachusetts and Nevada, it is likely that Vireo will transform from having no recreational sales in 2020 to recreational sales from seven different states in 2022 through legislative openings.

Furthermore, of states where the company is exposed, we note that Vireo is one of only two licensed operators in Minnesota, one of just ten licensed operators in New York and has the largest wholesale operation in Maryland. In Minnesota, in addition to the opening of recreational sales the company may as soon as next month benefit from allowance of flower sales in the state. To date, Minnesota has been one of the most restrictive medical markets in the country however an on-going debate to expand the market to permit flower sales is underway and could as much as double the opportunity for Vireo.

Valuation may present opportunity

As with many operators, the opportunity for Vireo appears overlooked at current levels. Relative to 2022 consensus estimates, based on EV/EBITDA, Vireo is priced at 19.8x which is a significant premium to the average for the broader peer group (13.5x). The premium may be justified given comparable M&A activity from the past few weeks in potential expansion markets based on a sum of the parts analysis.

AYR Wellness spent \$75M to acquire Blue Camo an operator in Arizona with three dispensaries and a cultivation facility under development. For its part, Vireo has one dispensary and a cultivation facility operating. In New York, Ascend acquired 87% of MedMen's assets for \$63M. Vireo and MedMen both have the maximum allotted four dispensaries in the state. These transactions could put the value of Vireo's assets in Arizona and New York at nearly \$150M or more than 40% of the company's current market cap before even considering other state opportunities where Vireo has a more established presence and leadership position.

Meanwhile, in considering the current valuation based on anticipated growth, it does not appear that the opportunity for growth through legislation is sufficiently baked into 2022 consensus estimates. Current estimates have Y/Y growth for Vireo decelerating in 2022 from 2021 (26% growth vs. 69% for 2021). This seems unlikely given multiple chances for recreational market openings (and the looming Minnesota flower legislation).

The 2021 growth is based on expansion initiatives including new store openings and cultivation capacity expansion that have been completed. Building on that, rather than considering modest growth for 2022 if revenues double from 2021 estimates and adjusted EBITDA margins stay flat to existing estimates then the stock would be valued at a discount to the peer group at current levels (12.6x). The doubling of revenues could even prove to be conservative given that a historical rule of thumb for retailers is that the difference in sales from a recreational licensed store from medical only is ~3x. Meanwhile, we would also suspect Vireo would be poised for significant margin upside with the opening of recreational opportunities particularly given its position as the largest wholesaler in Maryland, a leading retailer in Minnesota and one of few anticipated operators in New York. Vireo reports Q4/20 earnings results later this week (3/25) and we will be looking for additional color on growth opportunities during the call.

Company Exposure to Potential Upcoming Rec Markets

	AR	CT	MD	MN	MO	NM	NY	OH	OK	PA	WV	Total
Acreage												12
AYR Wellness												7
Bell Rock Brands												5
Body & Mind												4
Cansortium												4
Columbia Care												12
Cresco Labs												8
Curaleaf Holdings												13
Green Thumb												10
Harvest Health												5
iAnthus Capital												12
Jushi Inc.												3
MariMed												6
MedMen												7
SLANG Worldwide												13
TerrAscend Corp												5
TILT Holdings												4
Trulieve Cannabis												6
Verano												
Vireo Health												6
Total	2	5	10	1	5	3	8	9	3	14	1	

Source: Company Reports

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			IB Services in Past 12 months	
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Buy (Buy)	6	100%	0	0%
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