Pullback Presents Favorable Investment Opportunities in US Cannabis

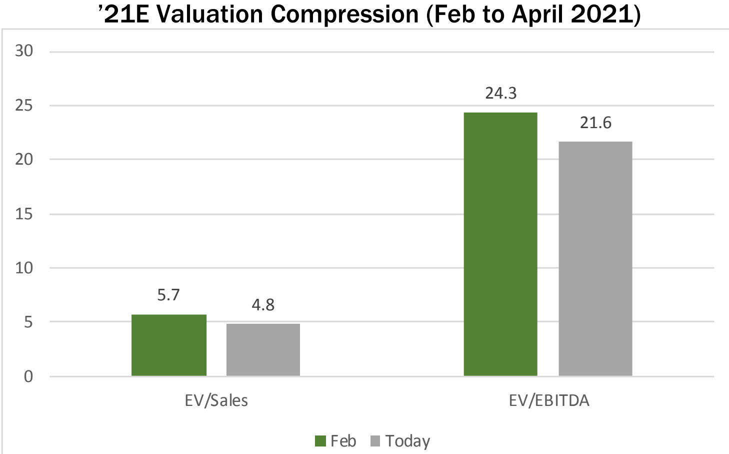
April 14, 2021

Last Saturday (4/10) marked two months since the YTD peak for US cannabis stocks as reflected by the Alternative Harvest ETF. Since that time, cannabis stocks are down 33% (vs. a positive 6% return for the S&P 500 and a 2% decline for the Russell 2000). The two-month underperformance can be chalked up to a correction on overexuberance at the start of the year (cannabis stocks still outperforming YTD) and the fact that a broader improved economic outlook driven by stimulus initiatives and vaccine progress in the US has made other industries more attractive.

While explainable, we believe the underperformance presents a favorable buying opportunity for cannabis investors. US cannabis stocks are currently valued at a 4.8x EV/Sales multiple relative to 2021 estimates and 3.4x 2022. On EV/EBITDA, stocks are valued at 21.6x 2021 and 10.6x 2022. Current 2021 multiples compare with EV/Sales of 5.7x and EV/EBITDA at 24.3x from early February. The multiple compression comes despite significant positive macro news in the past two months.

Since the February peak, New Mexico, New York and Virginia each passed legislation to permit recreational cannabis sales while Arizona commenced initial sales (to strong demand). Legislation in additional states including Connecticut and Pennsylvania continues to progress on the recreational side while multiple sizable states including Texas and Minnesota are considering expanding medical programs. Meanwhile, lawmakers in New Jersey and South Dakota work toward initial recreational sales after voters passed legislation last year. All told, we continue to expect as many as nine states will pass legislation this year and commence recreational sales in 2022. Beyond state legislation, state sales have continued at record levels in existing markets with many operators seeing a meaningful incremental boost in sales from stimulus payouts last month. Meanwhile federal legislation related to banking is progressing and improved capital access for cannabis operators continues as reflected by recent capital raises and a return of IPOs. Importantly, companies too are executing on operations as reflected in the reporting of Q4/20 earnings results and the closure of acquisitions announced last year.

'21E Valuation Compression (Feb to April 2021)



Source: Viridian Cannabis Deal Tracker

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Investment Highlights

- 2 month pullback presents attractive investment opportunities in US Cannabis.
- Canadian companies outperform US peers in Q1/21.
- Disconnected valuation favors market cap over growth. In our view, smaller operators present best opportunity for upside.
- Well-run operators including AYR, Cansortium, Driven by STEM, GAGE, Lowell Farms, Jushi and TILT all favorably valued.
- 2022 valuations do not tell full story for some including: 4Front, Planet 13 and Vireo.
- Unfollowed operators present potential upside.

Click the Link to Subscribe to the Viridian Cannabis Deal Tracker

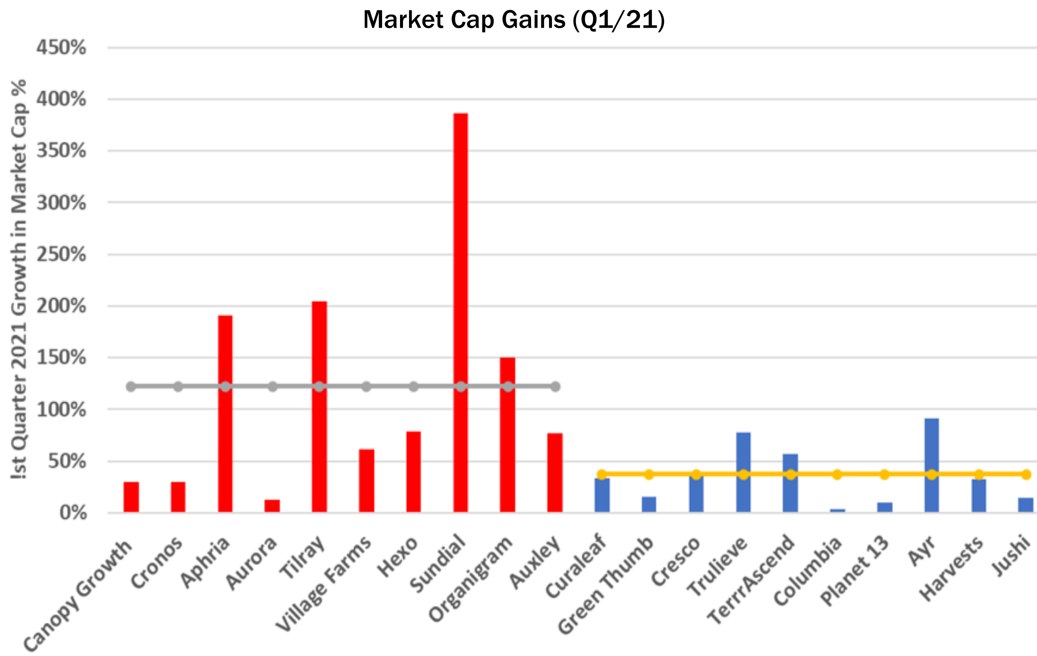
Canadian market cap gains

Further solidifying our positive view of opportunities for US cannabis companies is the fact that Canadian companies are growing in value.

As highlighted in this week's Viridian Capital "Chart of the Week", Canadian LPs have not experienced the same market correction as their US peers and have outperformed significantly this year despite lower growth expectations. The outperformance highlights the fact that cannabis is still very much in favor. The ten largest Canadian LPs increased in size by 122% on average in Q1/21 while the top ten US operators grew by 37% on average. The Canadian outperformance comes despite lower anticipated revenue growth for companies (+45% Y/Y in 2022E vs. 57% for US).

We believe that the Canadian LP outperformance stems from the belief that US access is coming for these operators in the near term. As we have previously mentioned, we do not believe this to be true and expect the current regulations regarding interstate commerce and international investment will remain in place for the foreseeable future. For state and local legislators looking to utilize cannabis as a means of generating tax revenues and create new jobs, the current format presents the best opportunities.

We believe an eventual pushback will come on any significant openings to the market from the federal government. We expect a rotation from Canadian operators is forthcoming as this reality becomes clearer and particularly as banking regulations open US operators for greater investment from institutional investors.



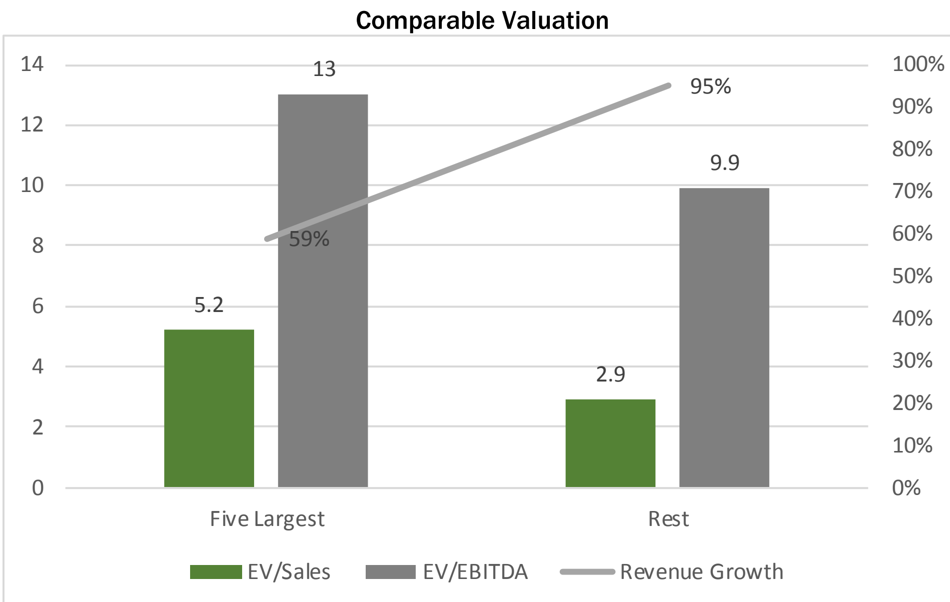
Source: Viridian Capital "Chart of the Week"

Disconnected valuation favors market cap over growth

We believe the recent valuation compression presents opportunities across the US market. As we have previously discussed, we continue to believe the best investment opportunities are for smaller cannabis operators with outperforming growth expectations. A disconnected valuation persists in favor of the largest market cap companies in the space through which these companies have a premium valuation based on size despite lower growth expectations. We note that enhanced capital access for larger operators may have justified the premium valuation previously, however with capital access having improved for all in recent months we believe that should no longer be a factor.

Today, the top five market cap companies in cannabis are trading at an EV/Sales relative to 2022 estimates of 5.2x and EV/EBITDA of 13x. This compares with all other operators at 2.9x and 9.9x.

Meanwhile, the top five sized operators are expected to have annual sales growth of 59% over the next two years versus 95% for all other operators.



Source: Viridian Cannabis Deal Tracker

Smaller operators can become acquisition targets

Furthering our favoring view of smaller operators in US cannabis based on valuation and growth expectations is the fact that smaller operators can become takeout candidates in the near term either entirely or with specific assets of operators for sale.

With capital access having improved in recent months, many larger operators have raised significant capital to fund expansion initiatives particularly in new and developing state markets. Meanwhile, SPAC investments still loom with several cannabis SPACs approaching looming liquidation deadlines and others simply well capitalized and motivated to complete additional deals. As reflected in the latest ***Viridian Cannabis Deal Tracker***, there have been five completed cannabis market acquisitions this year (with others having been announced and pending regulator approval) versus just one through the first quarter of 2020. The higher YTD activity continues the positive trend of second half 2020.

For larger well-capitalized operators, the quickest and most efficient way to enter a new market is to acquire existing operators. Additionally, by acquiring existing operators, the new entrants to the market are best able to take advantage of the early mover advantages in new recreational markets if/when they become available. We expect this trend to continue in the years ahead particularly in existing medical markets which are expected to pass recreational legislation in the near term.

Attractive opportunities in undervalued operators

In our view, the most attractive companies for investment are well-run operators with opportunities for outperforming growth in the near term which are currently undervalued relative to the peer group. Companies which fit this criteria and present significant upside potential for investors include: AYR Wellness ('22E 2.3x EV/Sales and 5.5x EV/EBITDA), Cansortium (1.9x and 4.5x), Driven by STEM (1.1x and 7.9x), GAGE (1.2x and 3.8x) , Lowell Farms (2.3x and 6.9x), Jushi (3.0x and 9.7x) and TILT (1.4x and 9.5x). On average these companies are expected to have average annual growth over the next two years of 105% versus the broader peer group at 86%.

Of these operators, we believe the discounted valuation for AYR and Jushi is most disconnected as both are true multi-state operators with attractive state footprints and sufficient capital to fund further expansion initiatives. As such, the valuation discount goes against the market cap trends we have previously referenced. Meanwhile, relative to larger MSOs AYR and Jushi are expected to have significantly higher average annual sales growth over the next two years. AYR and Jushi are expected to grow revenues at an annual rate of 116% while other larger MSOs are forecasted to grow at 68% on average.

Comparable Valuation

		Market Cap		EV/Sales		EV/EBITDA	
	Price	($M)	EV ($M)	2021E	2022E	2021E	2022E
Curaleaf	14.75	10,461	10,909	8.7	5.9	29.8	17.1
Green Thumb	27.35	6,422	6,543	7.6	5.7	20.8	14.6
Verano Holdings	19.42	5,890	5,807	7.5	5.0	17.6	11.3
Trulieve	42.90	5,423	5,511	6.5	5.0	14.7	11.2
Cresco Labs	12.49	4,622	4,705	5.8	4.0	18.0	11.1
Terrascend	10.15	2,578	2,623	8.9	6.0	22.1	13.7
Columbia Care	5.98	2,273	2,362	4.7	3.2	24.1	11.2
AYR Wellness	27.50	1,626	1,559	4.9	2.3	12.3	5.5
Planet 13	7.11	1,354	1,275	9.1	6.3	31.1	18.5
Harvest Health	2.92	1,200	1,435	3.7	2.9	17.5	10.0
Jushi Holdings	6.86	1,114	1,124	5.0	3.0	24.1	9.7
4Front Ventures	1.16	864	1,972	12.3	8.7	42.6	26.5
Acreage	4.97	627	452	1.7		20.2	
Gage Cannabis	1.92	406	377	2.2	1.2	8.4	3.8
Lowell Farms	1.30	303	299	4.7	2.3	34.8	6.9
Vireo Health	2.27	289	296	3.9	2.8	29.6	12.2
Cansortium	0.81	243	272	2.8	1.9	9.0	4.5
TILT Holdings	0.50	235	300	1.8	1.4	27.5	9.5
Red White & Bloom	1.19	223	214	0.7	0.4	2.9	1.3
STEM Holdings	0.67	125	131	1.7	1.1	52.5	7.9
Slang Worldwide	0.32	111	109	2.6	2.1	16.0	12.9
Flower One	0.23	63	108	1.4	1.0	8.1	3.8
Plus Products	0.58	26	32	1.2		12.3	
Mean				4.8	3.4	21.6	10.6
Median				4.7	2.9	20.2	11.1

Source: Viridian Cannabis Deal Tracker

2022 multiples do not sufficiently reflect valuation for some

In some cases, 2022 multiples do not sufficiently tell the valuation story. 2022, for some companies, marks only the beginning of viable near-term growth initiatives. Growth beyond 2022 for these operators is expected based on legislation initiatives, looming acquisition opportunities and the buildout of operations. Three names which fit this category that we have previously highlighted are: 4Front Ventures, Planet 13 and Vireo Health. The three look expensive based on 2022 EV/EBITDA multiples however each has legitimate opportunities for outperforming growth (and profitability) that are not sufficiently baked into estimates for 2022 (and/or will come into play beyond that forecast period).

- 4Front Ventures: 4Front is building out its Illinois cultivation/production facility which will enable the company to become the biggest wholesale operator in the state beginning in late 2022. Given Illinois' attractive pricing dynamics and 4Front's proven expertise as a leading (and profitable) wholesale operator, we believe this will be a game changing initiative for the company enabling significant growth and enhanced profitability.

- Planet 13: Planet 13 has more than $140M in cash and limited capital needs in the near term. The company is a proven developer of leading assets in the industry (including the Las Vegas Superstore and the California dispensary which is set to open in June). We believe it is only a matter of time before Planet 13 puts it cash to work and completes acquisitions to buildout similar facilities in other states. We note that Planet 13's Superstore alone is capable of generating more than $100M in revenues. Given the company's proven track record of success, we expect expansion initiatives to be big contributors to future results. We do not believe the potential upside from acquisitions is baked into estimates.

- Vireo Health: Vireo Health has been a relatively overlooked operator to date. The company is mainly known for its leading position in Minnesota's limited medical market. That exposure presents an attractive opportunity for if/when legislators expand that market. We believe there is legislation in the state which could pass as soon as next month to permit flower sales. Allowing flower could as much as double market sales. We do not believe this is sufficiently factored into estimates for Vireo. Additionally, the company has exposure to markets which recently opened for rec sales or will in the near term in Arizona, New Mexico and New York. Meanwhile, in Maryland, Vireo is the state's leading wholesaler. Maryland too is a market poised for recreational legislation over the next few years, so the company is well positioned if/and when legislation occurs. We expect Vireo to benefit from its growth opportunities in each of these markets or for assets to be sought after (particularly the New York assets) if the company does not wish to buildout these assets.

Attractive opportunities in unfollowed names

With cannabis still, a nascent market and given persistent banking prohibitions, many even well-run cannabis companies are under or fully unfollowed by sell-side research analysts. As with the smaller operators in the space, we believe some un-followed but well-run operators warrant greater investor consideration and can present attractive investment opportunities.

Public, well-run operators that lack investor coverage currently include: Body & Mind, Bell Rock Brands, CLS Holdings, Harborside Inc., Halo Labs, MariMed Inc., MJardin, Schwazze and TerraTech. We believe each has an attractive current footprint of operations which can be leveraged for growth in the near term or sold to operators looking to enter specific markets.

- **1933 Industries**: Branded products company focused on manufacturing hemp derived CBD and cannabis concentrates products.
- **Bell Rock Brands**: Owns a portfolio of leading cannabis and CBD brands including Dixie and Mary's.
- **Body & Mind**: Multi-state operator with exposure to Arkansas, California, Nevada and Ohio.
- **CLS Holdings**: Vertically integrated operator in Nevada market.
- **Harborside**: One of the largest and longest tenured operators in California.
- **MariMed**: Vertically integrated MSO focused on medical markets.
- **MJardin**: Canadian operator with a managed services agreement in Colorado.
- **Schwazze**: Vertically integrated operator in Colorado.
- **TerraTech**: Vertically integrated operator focused on agriculture.

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