LEARNING MADE EASY

Investing in Cannabis

for dummies®
A Wiley Brand

Be a pioneer and invest in cannabis

Understand the risks and rewards of investing in cannabis

Discover the hottest investment categories

Steven R. Gormley
Cannabis Investing Expert

Investing in Cannabis

by Steven R. Gormley

for dummies®
A Wiley Brand

Investing in Cannabis For Dummies®

Published by: **John Wiley & Sons, Inc.,** 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002. For technical support, please visit https://hub.wiley.com/community/support/dummies.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at http://booksupport.wiley.com. For more information about Wiley products, visit www.wiley.com.

Library of Congress Control Number: 2020952057

ISBN 978-1-119-67476-4 (pbk); ISBN 978-1-119-67478-8 (ebk); ISBN 978-1-119-67474-0 (ebk)

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1

Contents at a Glance

Introduction 1

Part 1: Getting Started with Cannabis Investing 5

CHAPTER 1: Taking the Nickel Tour 7
CHAPTER 2: Exploring Cannabis Business Types 23
CHAPTER 3: Understanding the Political, Cultural, and Regulatory Landscape 39
CHAPTER 4: Sizing Up the Risks and Rewards of Cannabis Investing 57

Part 2: Doing Your Homework 71

CHAPTER 5: Exploring Your Investment Options 73
CHAPTER 6: Digging Up Cannabis Investment Opportunities 89
CHAPTER 7: Researching Cannabis Businesses and Stocks: Fundamental Analysis 103
CHAPTER 8: Analyzing Market Trends: Technical Analysis 125

Part 3: Buying and Selling Cannabis Stocks, ETFs, or Mutual Funds 147

CHAPTER 9: Choosing a Broker or Advisor 149
CHAPTER 10: Using Screening Tools 161
CHAPTER 11: Placing Buy and Sell Orders for Cannabis Stocks and ETFs 177
CHAPTER 12: Exploring Advanced Trading Techniques 191

Part 4: Exploring Cannabis Investment Strategies 201

CHAPTER 13: Following the Money: Momentum Investing (aka Speculating) 203
CHAPTER 14: Investing in Canadian Cannabis Companies 213
CHAPTER 15: Investing in Countries Where Marijuana Is Legal 221
CHAPTER 16: Minimizing Risks While Maximizing Gains 237

Part 5: The Part of Tens 247

CHAPTER 17: Ten Ways to Profit When the Market Drops 249
CHAPTER 18: Ten Reasons Not to Invest in Marijuana Stocks 255
CHAPTER 19: Ten (Plus One) Criteria for Choosing a Cannabis Investment 261
CHAPTER 20: Ten Mistakes to Avoid 267

Index 273

Table of Contents

INTRODUCTION 1
- About This Book. 1
- Foolish Assumptions 2
- Icons Used in This Book 3
- Beyond the Book 4
- Where to Go from Here 4

PART 1: GETTING STARTED WITH CANNABIS INVESTING 5

CHAPTER 1: **Taking the Nickel Tour** 7
- Weighing the Pros and Cons of Investing in Cannabis. 8
  - Pros 8
  - Cons 9
- Deciding Whether to Invest in Businesses That Touch the Plant or Those That Don’t 11
- Exploring Your Investment Options 12
  - Starting your own business 12
  - Investing in cannabis real estate 13
  - Buying and selling stocks 14
  - Diversifying with exchange traded funds and mutual funds 15
  - Considering private investment opportunities 15
- Finding Investment Opportunities 16
- Researching Investment Opportunities 17
- Planning Your Investment Strategy 19
- Investing in a Cannabis Business 20

CHAPTER 2: **Exploring Cannabis Business Types** 23
- Choosing Sides: Medical or Adult-Use? 24
  - Investing in medical marijuana 24
  - Investing in adult-use marijuana. 25
- Recognizing Different Cannabis Business Types 26
  - Cultivation. 27
  - Manufacturing 28
  - Processed product brand. 30
  - Retailers/dispensaries. 30
  - Device makers 31
- Considering Ancillary Businesses 31
  - Breweries 32
  - Banking, payroll, and other cash management services 32
  - Blockchain and other technologies. 34

Delivery services 34
Grow equipment manufacturers and suppliers 35
Marketing, public relations, and advertising firms 35
Professional employer organizations 36
Pharmaceutical and biotech companies 36
Real estate 37
Security services and security equipment suppliers 38
Software companies 38

CHAPTER 3: **Understanding the Political, Cultural, and Regulatory Landscape** 39

Recognizing the Impact of Laws on the Industry 40
Getting up to speed on U.S. federal law and enforcement 40
Brushing up on state cannabis laws 44
Considering local laws, too 45
Examining cannabis laws in other countries 46
Riding the Waves of Politics and Culture 46
Checking the nation's pulse 47
Debunking misconceptions of cannabis and users 49
Examining activism 50
Tuning into cannabis culture 52
Accounting for the High Costs of Doing Business 53
Regulatory and compliance costs 53
Federal, state, and local taxes 54
Security costs 55

CHAPTER 4: **Sizing Up the Risks and Rewards of Cannabis Investing** 57

Weighing the Risks 58
Falling victim to con artists 58
Investing in an overvalued company 60
Accounting for dilution risks 61
Weighing the risks of potential commoditization 62
Recognizing the possibility of changes in how federal marijuana laws are enforced 63
Considering the impact of state and local regulation and enforcement 64
Evaluating risks associated with obtaining banking and financial services 65
Anticipating the impact of possible supply and demand imbalances 65
Considering the possibility of business failure 67
Assessing the Potential Rewards 67
Deciding Whether Investing in Cannabis Is Right for You 68
Considering your investment goals 68
Assessing your own risk tolerance 69

PART 2: DOING YOUR HOMEWORK 71

CHAPTER 5: **Exploring Your Investment Options** 73
Comparing Public versus Private Investment Options 74
Understanding how companies raise capital 74
Investing in private companies 76
Investing in public companies 78
Investing Domestically or Abroad? 79
Investing in Cannabis or Ancillary Businesses? 81
Buying and Selling Cannabis Stocks 83
Going mainstream with listed stocks 83
Bargain hunting with unlisted, over-the-counter stocks 84
Diversifying with exchange traded funds 84
Betting on an index with exchange traded notes 86
What about mutual funds? 86
Buying and selling shares of Canadian cannabis companies 87
Investing as a Venture Capitalist 88

CHAPTER 6: **Digging Up Cannabis Investment Opportunities** . . . 89
Using Online Investment Tools and Apps 90
Cannabis Stock Trades 91
Yahoo! Finance 91
Morningstar 92
FINVIZ 92
ETFdb.com 93
FeeX 93
FRED 93
The Marijuana Index 94
Marijuana Stocks 94
Barchart 94
Apps 95
Staying Abreast of Cannabis Industry News 96
Scoping Out Opportunities in Exchange Traded Funds 100
Finding Private Equity and Venture Capital Funds and Firms 101
Getting Investment Leads from a Broker 102

CHAPTER 7: **Researching Cannabis Businesses and Stocks: Fundamental Analysis** 103
Grasping Fundamental Analysis Basics 104
Researching Any Company You're Thinking of Investing in 106
Assessing the management team 106
Evaluating the company's financial health 109
Evaluating startups and investments in licenses 111
Looking at the company's business strategy 112

Checking out the company's competitive position 115
Checking any insider buying or selling 116
Looking into warrants and convertible securities. 117
Following analyst coverage and conference calls. 119
Digging up dirt 120
Evaluating Cannabis Cultivation Businesses 121
Sizing up the grow master 121
Checking a grower's cost per gram. 122
Comparing cost per gram 123
Considering the cultivator's clientele 123

CHAPTER 8: **Analyzing Market Trends: Technical Analysis** 125
Comparing Technical and Fundamental Analysis. 126
Grasping the principles of technical analysis 126
Weighing the pros and cons of technical analysis 128
Combining the best of both worlds 129
Gathering your tools 130
Spotting and Monitoring Trends 131
Examining different trends 131
Gauging a trend's length. 134
Following trendlines 134
Looking for resistance and support 135
Referencing Technical Charts 136
Getting to know the different chart types .136
Identifying chart patterns. 138
Interpreting Technical Indicators 143
The Relative Strength Index. 143
The Money Flow Index 144
Moving averages 144
Moving average convergence divergence .144
Bollinger Bands 145

PART 3: BUYING AND SELLING CANNABIS STOCKS, ETFS, OR MUTUAL FUNDS 147

CHAPTER 9: **Choosing a Broker or Advisor** 149
Defining the Broker's Role 150
Distinguishing between Full-Service and Discount Brokers 150
At your disposal: Full-service brokers. 151
Just the basics: Discount brokers 153
Deciding Whether to Fly Solo or Consult a Broker or Advisor 154
Finding a Cannabis-Savvy Broker or Advisor. 155
Evaluating Brokers and Advisors. 155
Comparing costs 156

Comparing quality and service 156
Checking credentials 157
Comparing online brokers 158

CHAPTER 10: **Using Screening Tools** 161
Searching the Marijuana Stock Universe 162
Getting Up to Speed on the Different Exchanges and Markets 165
Browsing through the Daily Marijuana Observer's List of OTC Cannabis Stocks 167
Checking Out Other Stock Screeners 168
Screening Cannabis Investment Funds 170
What to Screen for 172
First up: The major categories 172
The main event: Specific filters 173
Valuation measures 175
Financial Highlights 176
A Few Final Points to Keep in Mind 176

CHAPTER 11: **Placing Buy and Sell Orders for Cannabis Stocks and ETFs** 177
Understanding the Bid-Ask Spread 178
Placing an Order to Buy or Sell Shares 179
Choosing an Action 182
Buy 182
Sell 182
Sell all shares 182
Understanding the Different Order Types 183
Market orders 184
Limit orders 184
Stop orders 185
Trailing stop orders 186
Specifying a Timeframe 187
Day 187
Good till canceled 188
Fill or kill 188
Immediate or cancel 188
Market on open 189
Market on close 189

CHAPTER 12: **Exploring Advanced Trading Techniques** 191
Buying on Margin 191
Registering to buy on margin 192
Examining marginal outcomes 193
Striving for success on margin 194

Shorting a Stock 195
Setting up a short sale 196
Taking a hit when the stock price keeps rising 197
Responding when you feel the squeeze 198
Recognizing the ups and downs of shorting cannabis stocks 198

PART 4: EXPLORING CANNABIS INVESTMENT STRATEGIES 201

CHAPTER 13: Following the Money: Momentum Investing (aka Speculating) 203
Spotting Opportunities to Buy: Upward Momentum 204
Watching for Signals to Sell: Downward Momentum 207
Following the Smart Money 208
Avoiding Some of the Risks Inherent in Momentum Investing 209
Watching out for the short squeeze 209
Steering clear of pump-and-dump scams 210
Avoiding cannabis stock and industry bubbles 211
Knowing when momentum investing works and when it doesn't 211

CHAPTER 14: Investing in Canadian Cannabis Companies 213
Deciding Whether to Invest in Canadian or U.S. Cannabis Businesses 214
The pros and cons of the Canadian cannabis market 214
The pros and cons of the U.S. cannabis market 216
Scoping Out the Four Leading Canadian Cannabis Companies 217
Canopy Growth Corporation 217
Cronos Group 218
Aurora Cannabis 218
Aphria 219

CHAPTER 15: Investing in Countries Where Marijuana Is Legal 221
Argentina 222
Australia 223
Brazil 224
Chile 224
Colombia 225
Czech Republic 226
Ecuador 226
Germany 227
Greece 227
Ireland 228

Israel 228
Italy 229
Jamaica 230
The Netherlands 230
New Zealand 231
Norway 232
Peru 232
Poland 233
Portugal 233
Switzerland 233
Thailand 234
United Kingdom 234
Zambia 235

CHAPTER 16: **Minimizing Risks While Maximizing Gains** 237
Staying Plugged in to the Industry 238
Investing in the People, Not the Plant 239
Performing Your Due Diligence 239
Trading Cannabis Stocks on Private Markets 240
Investing in the Biggest Markets 241
Diversifying Inside and Outside the Industry 241
Investing in Multi-state Operators 242
Keep an Eye on the ETFs 243
Invest in Innovative Companies 244
Use Different Stock Order Types to Your Advantage 245
Don't Get Greedy 246

PART 5: THE PART OF TENS 247

CHAPTER 17: **Ten Ways to Profit When the Market Drops** 249
Be Patient, But Vigilant 250
Review Your Portfolio 250
Cut Your Losses 250
Buy More Shares 251
Focus on Value Stocks 251
Short Bad Stocks 251
Find Potential Treasures with Bond Ratings 252
Rotate Sectors 252
Buy a Call Option 252
Write a Covered Call Option 253

CHAPTER 18: **Ten Reasons Not to Invest in Marijuana Stocks** 255
Marijuana Is Still Federally Illegal in the U.S. 256

Marijuana Investment Scams Are Rampant 256
Earning a Profit as a Cannabis Business Is a Huge Challenge 257
Illegal Operations Undermine Demand for Legal Products 258
The Industry Is Very Fragmented 258
Oversupply Is More Likely Than Not 258
Bad News Is Just Around the Corner 259
Marijuana Laws Are Slow to Change 259
Company Shares Are Being Diluted 260
Demand Is Unpredictable 260

CHAPTER 19: **Ten (Plus One) Criteria for Choosing a Cannabis Investment** 261
Experienced and Successful Management Team 262
Steady Revenue Growth 262
Consistent Profit Growth 263
Comparatively Low Price-to-Earnings Ratio 263
Positive Money Flow Indicator 264
Expanding Free Cash Flow 264
Operations in Other States or Countries 264
Growing Market 265
Increasing Market Share 265
Positive Reputation in the Industry 266
Manageable Debt 266

CHAPTER 20: **Ten Mistakes to Avoid** 267
Failing to Diversify Sufficiently 267
Relying Solely on Online Information 268
Not Performing Due Diligence 268
Believing Federal Legalization Will Happen Soon 269
Failing to Account for Regulations 269
Failing to Consider the Possibility of Bad News 269
Buying or Selling Too Late or Too Early 270
Ignoring Business Fundamentals 270
Expecting All Marijuana Stocks to Be Winners 271
Buying a Stock Just Because It's Cheap 271

INDEX 273

Introduction

Based on a report published in 2020 by Grand View Research, the global legal marijuana market, valued at US$17.7 billion in 2019, is expected to expand at a Compound Annual Growth Rate (CAGR) of 18.1 percent, to be worth US$73.6 billion by 2027. That represents incredible growth and explains why the push by many entrepreneurs and investors to capitalize on this growing market is often referred to as the "Green Rush" (comparing it to the California Gold Rush, which lasted from about 1848 to 1855).

The trouble with any rush, whether green, gold, or no color at all, is that it's often accompanied by chaos, uncertainty, and failure — what former U.S. Federal Reserve Board Chairman Alan Greenspan called "irrational exuberance." Sure, some people got rich during the Gold Rush, as will some people during the Green Rush, but most prospectors during the Gold Rush went from boom to bust, many without experiencing the boom. Likewise, until the cannabis market stabilizes, many businesses will fail, many investors will lose their shirts, and many con artists will scam unsuspecting investors and business owners out of millions, if not billions, of dollars.

To profit from cannabis as an investor, you really need to know what you're doing. You need to know the industry, know how to find leads on potentially profitable investments, be able to size up a business's potential for earning a profit, and have the knowledge and skills necessary to reduce your exposure to risk.

About This Book

Welcome to *Cannabis Investing For Dummies*, your personal guide to investing in the cannabis industry profitably and without losing your shirt. Of course, I can't guarantee either of those outcomes (making gobs of money or not going broke), but as an expert in the legal marijuana sector, I can show you how to find and research cannabis investment opportunities in a way that increases your chances of earning a profit while reducing your chances of investing in a lousy business or getting scammed by savvy con artists.

To make the content more accessible, I divided it into five parts:

- **Part 1, "Getting Started with Cannabis Investing,"** brings you up to speed on the basics of investing in cannabis, introduces you to the different types of businesses you can invest in, and discusses numerous factors that can impact a business's ability to turn a profit. Here, I also lead you through the process of weighing the pros and cons of investing in cannabis, so you know what you're getting into before getting into it.
- **Part 2, "Doing Your Homework,"** provides guidance on how to find leads on potentially profitable cannabis companies, and then research those companies and their management teams before investing in them. Unless you're going to base your entire investment strategy on luck, this part is essential reading.
- **Part 3, "Buying and Selling Cannabis Stocks, ETFs, or Mutual Funds,"** gets down to the basics of trading securities in cannabis businesses. If you're already an experienced investor who has bought and sold securities on the stock market or you're working with a qualified broker, this may be optional reading for you.
- **Part 4, "Exploring Cannabis Investment Strategies,"** presents different strategies for earning a profit by investing in cannabis businesses. Buy low and sell high, right? Well, generally speaking, that's certainly the goal, but this part breaks down that overarching strategy into more practical steps.
- **Part 5, "The Part of Tens,"** features four "top ten" lists: ten ways to profit when the market drops, ten reasons not to invest in cannabis, ten criteria for choosing a cannabis business to invest in, and ten common mistakes to avoid when you're just getting started.

In short, this book serves as your guide to investing in cannabis profitably without getting scammed by clever con artists or overhyped investment leads.

Foolish Assumptions

All assumptions are foolish, and I'm always reluctant to make them, but to keep this book focused on the right audience and ensure that it fulfills my purpose in writing it, I had to make the following foolish assumptions about you:

- You're interested but a little hesitant to invest in the new and growing cannabis industry, knowing it's risky but wanting to profit from it in some way.

- You're willing to invest your time to properly research a cannabis business before investing in it. (If you're not, don't waste your time reading this book; just forge ahead, speculating in businesses you know little or nothing about.)
- You're looking for guidance on how to increase your chances of earning a profit by investing in cannabis while reducing your exposure to risk.
- You don't expect me to give you recommendations on specific companies or sectors of the industry to invest in. The cannabis industry has a high turnover rate in terms of new companies coming on the scene and old companies disappearing. Even if I did recommend a company to invest in, by the time you picked up this book and started reading it, I may have changed that recommendation.

Other than those four foolish assumptions, I can honestly say that I can't assume much more about you. The vast number of people who invest in cannabis or express some interest in doing so represent a diverse demographic. You may be 21 or 90 years old or somewhere in between, a white-collar or blue-collar worker, a housewife or househusband, a doctor, a lawyer, rich or poor. Regardless of the demographic, I applaud you for being open minded and willing to explore what I believe is a great opportunity for earning big returns in an exciting, new, and fast-growing industry.

Icons Used in This Book

Throughout this book, icons in the margins highlight certain types of valuable information that call out for your attention. Here are the icons you'll encounter and a brief description of each.

REMEMBER

I want you to remember everything you read in this book, but if you can't quite do that, then remember the important points flagged with this icon.

TIP

Tips provide savvy insight from an industry expert (me). When you're looking for a better, faster way to do something, check out these tips.

WARNING

"Whoa!" Before you take another step, read this warning. I provide this cautionary content to help you avoid the common pitfalls that are otherwise likely to trip you up (and lose you money).

Beyond the Book

In addition to the abundance of information and guidance related to cannabis investing that I provide in this book, you get access to even more help and information online at `Dummies.com`, including a Cheat Sheet that serves as a quick reference guide to this book. To access this book's online Cheat Sheet, go to `www.dummies.com` and search for "Investing in Cannabis For Dummies Cheat Sheet."

Where to Go from Here

You're certainly welcome to read this book from cover to cover, but I wrote it in a way that facilitates skipping around. For a quick tutorial on cannabis investing that touches on all the key topics, turn to Chapter 1. To get up to speed on the types of businesses that constitute the cannabis industry, check out Chapter 2. Turn to Chapter 3 to get to know the various factors outside the industry that can impact the industry (and your investments), and to Chapter 4 to figure out whether cannabis investing is even something you want to get into.

All the chapters in Part 2 are essential reading. Before you invest a single penny in a cannabis business, you should carefully vet that business. Otherwise, you're not investing, you're speculating, and you may not even be doing that very well. The chapters in Part 2 guide you through the process of digging up leads on potentially profitable businesses, researching a business and its management team, and conducting fundamental and technical analysis, so you have a pretty good idea of what you're getting in exchange for your investment.

If you're new to investing in general, head to Part 3, and if you're a seasoned investor looking for more advanced information on different investment strategies, turn to Part 4.

Consider the chapters in Part 5 bonus material. These chapters are all quick reads that are chock full of tips and guidance on how to invest profitably in cannabis . . . or decide not to invest in cannabis after you consider the risks.

1 Getting Started with Cannabis Investing

IN THIS PART . . .

Getting a quick primer on cannabis investing — from identifying investment opportunities and researching them to buying and selling investment securities.

Distinguishing between cannabis business types — medical versus adult recreational, and plant-touching versus ancillary businesses.

Understanding how politics, laws, regulations, and the high costs of doing business in the cannabis industry can impact investments.

Weighing the pros and cons of cannabis investing to determine whether it's the right move for you.

IN THIS CHAPTER

» Deciding whether you really want to invest in cannabis

» Investing in businesses that touch the plant or those that don't

» Scoping out different ways to invest in cannabis

» Digging up leads on potential investments and researching them

» Creating and executing your investment strategy

Chapter 1

Taking the Nickel Tour

Whenever you're getting started on a new topic or trying to develop a new skill, you can benefit from having a general understanding of what's involved. It's sort of like reading the plot or synopsis of a movie or book before starting to watch or read it . . . or seeing the finished product before you start following the instructions to assemble it. You get the gist of what you're about to encounter, which serves as both a framework on which you can hang the details, and the context for more quickly and easily understanding those details.

The purpose of this chapter is to bring you quickly up to speed on the topic of investing in cannabis and to provide the framework and context for understanding topics covered in subsequent chapters.

REMEMBER

This book is structured in a way that facilitates skipping around, so feel free to skip this primer if you think you don't need it or if you're looking for more detailed information and guidance about a specific aspect of investing in cannabis. On the other hand, if you're a quick learner with an intuitive mind, you might read this primer and start investing right away based solely on the general directions it presents (not recommended, but it's certainly an option).

Weighing the Pros and Cons of Investing in Cannabis

I don't try to sell anyone on the idea of investing in cannabis, except, of course, prospective investors with lots of cash who want to invest in the cannabis company *I* run. Even then, I want them to invest with eyes wide open, knowing the potential for both profit and loss. In fact, I actually spend more time *discouraging* people from investing in cannabis, because I can usually tell quickly from talking with someone who's eager to invest in this industry whether they're too eager and ill-informed or simply won't perform the due diligence necessary to invest wisely.

I don't know you, so I'm not going to try to encourage or discourage you from investing in cannabis businesses. Instead, I present some of the most important pros and cons you should consider and leave the decision up to you.

Pros

The biggest motive people have for investing their money in any venture is profit. Chances are good that you, too, are curious about investing in cannabis because you want to profit from it. The industry is growing in leaps and bounds, and you want in on the action. Nothing wrong with that, but consider other benefits. Here's a complete list (or as complete as I can think of at the moment):

- Profit (which I already mentioned) is the biggie.
- Getting in at or near the bottom of a new and exciting industry is always a thrill. By investing in cannabis, you become a participant, not merely an observer, in the green rush.
- Being able to tell people you know that your investment portfolio or retirement account includes cannabis stock. This may sound silly, but being invested in cannabis says something about who you are and may help you engage in conversations you would otherwise be excluded from.
- If you consume marijuana, you get to invest in a product you enjoy and help to make it more available to others.
- If you invest in medical marijuana, you're investing in medical research and helping to bring those new medicines to market, potentially alleviating some of the world's physical and perhaps even mental suffering.

REMEMBER

Life offers us few choices to invest in a new industry in its infancy. I like to think of investing in cannabis as what it would have been like to invest in alcohol three to five years before prohibition was repealed. How often do you get to participate in an industry at the dawn of legalization? Investing in cannabis also reminds me what investing in the dot-com era was like. I got into the technology boom shortly after graduating college and learned a great deal about new industries. Cannabis is a new industry. It presents an opportunity for an investor to be a pioneer.

Cons

As you may have guessed from my reluctance to encourage people to invest in cannabis, I can come up with more reasons *not* to invest in cannabis than *to* invest in it. Here's a list of reasons not to invest in cannabis that you should seriously consider before investing in this industry (see Chapter 4 for more details):

- Cannabis attracts money, and money attracts thieves. In addition, many novices eager to invest in cannabis are easy marks because they're eager, naïve, and have money — just the combination of traits a con artist is looking for.

  REMEMBER

  Many of the successful entrepreneurs in cannabis got their start in the black market, which attracts a very particular personality type. Leopards don't change their spots. Some savvy former black marketers have simply chosen a different crime — instead of dealing in illegal marijuana, they're now on the prowl for unsuspecting investors they can fleece. And they're not the only thieves that pose a threat to cannabis investors, as illustrated in the sidebar, "Crooks in law enforcement."
- With lots of money flowing into the industry from eager investors, even legitimate cannabis stocks are overvalued. The more overvalued a stock is, the further the potential fall. Short sellers often target overvalued stocks just for this reason; then, when the stock price drops, they cash in and everyone else loses. (See Chapter 12 for more about short selling.)
- Cannabis businesses struggle to be profitable due to numerous factors, including the high costs of complying with federal, state, and local marijuana laws; increased security costs; increased bank fees; and the cost of specialized software.
- Cannabis stocks have an increased susceptibility to *dilution* because cannabis companies have a tougher time getting bank loans in the U.S. (due to federal laws that discourage banks from doing business with cannabis companies). Companies issue and sell more shares to raise money, but that dilutes the value of existing shares.

- Companies that grow cannabis are at risk of cannabis becoming a commodity, and if (when) that happens, prices and profits drop.
- Laws, and enforcement of those laws, are susceptible to change, and if they change in a direction that hurts cannabis businesses, their investors suffer as well.
- Supply-and-demand imbalances are common in the cannabis industry. These imbalances not only disrupt the supply chain but also negatively impact profits by creating market gluts (which drive down prices) or shortages (which increase costs and reduce demand); either way, profits suffer.
- Cannabis still has a healthy black market, even in states where it's legal, and black-market growers and dealers don't pay taxes, so they can afford to sell their product for less. If state and local authorities don't crack down on illegal production and sales, legal businesses have a tough time competing.

TIP

Don't rule out investing in cannabis just because of this long list of potential drawbacks. You can considerably reduce your exposure to risk by doing your homework and investing in well-run companies. See Part 2 for guidance on how to properly research businesses and their management teams, and keep up on what's happening in the industry.

CROOKS IN LAW ENFORCEMENT

Corrupt law enforcement officers pose a threat to both legitimate cannabis operations and their investors. These bad cops have been known to raid lawfully operating cannabis operations and take cash and product. Operators have little recourse. What are they going to do, call the cops? Likewise, operators get little sympathy and support at the judicial level.

An unjustified raid can be fatal to a business. I was a partner in a dispensary in Los Angeles that was raided by the police. They took cash and damaged the on-site cultivation facility, causing hundreds of thousands of dollars in losses, not to mention the loss of revenue that occurred as a result of the closure of the business. It took months to recover from the raid, and the city eventually dropped the charges.

Incidents like that still happen and likely will until federal prohibition of marijuana is repealed.

Deciding Whether to Invest in Businesses That Touch the Plant or Those That Don't

One of the first decisions to make before investing in cannabis is whether to invest in businesses that have contact with the plant or those that don't (often referred to as *ancillary* companies):

- **Plant-touching:** These businesses come into contact with the plant at some point during the growth, manufacturing, distribution, or sale. They include grow operations, manufacturers of infused products (MIPs), shipping firms, dispensaries, and licensed delivery services. Plant-touching businesses stand to profit most from cannabis, and they're also at the greatest risk of suffering losses when the industry takes a hit.

  TIP

  If you decide to invest in a plant-touching business, consider a *vertically integrated company,* which means the business does its own cultivation, manufacturing, distribution, and sales. Vertically integrated companies are less susceptible to supply chain disruptions because they control their entire supply chain.

- **Ancillary:** These businesses serve the plant-touching businesses in some way. Perhaps the best-known ancillary business is The Scotts Company, which provides fertilizer, pesticides, and disease control products, primarily for lawn care but also for agricultural operations, including cannabis cultivation companies. Other ancillary companies include manufacturers and dealers of equipment for cultivation operations; legal and accounting services that specialize in cannabis; software companies that develop point-of-sale and supply-chain managements systems; security equipment and service providers; and real estate groups that buy, sell, and rent land and buildings for cannabis businesses.

While plant-touching businesses carry the most potential for profit and risk, ancillary companies still stand to profit from the industry, but they have less exposure to risk. For example, if the U.S. federal government decided to crack down on cannabis businesses across the country, that revenue stream would be negatively impacted for The Scotts Company, but the company would still have value as a business selling lawn care products.

REMEMBER

According to a study published by Deloitte in 2016, ancillary businesses are estimated to be 2.5 times the size of the cannabis industry itself, so ancillary businesses stand to profit handsomely from the success of the cannabis industry.

Exploring Your Investment Options

You can profit from legal cannabis businesses in several ways, depending on how directly you want to be involved. The most direct approach is to start your own cannabis business. The least direct approach is to trade cannabis-related securities, such as stocks, bonds, or exchange traded funds (ETFs).

In the following sections, I present different ways to invest in the cannabis industry to make you aware of the wide variety of options.

Starting your own business

One approach to investing in the cannabis industry is to start your own business — either a plant-touching or an ancillary business. Here are some of the more popular opportunities cannabis entrepreneurs pursue.

- **Cultivator:** Cultivators start and grow plants from seeds; harvest the plants; separate the useable portion of the plants and properly dispose of the green waste; dry, cure, and trim the harvested bud; arrange for third-party lab tests to ensure the safety and quality of the product; pack and ship product to manufacturers and dispensaries; and track and report all processes as required by law to government regulatory agencies. Note that cultivation operations are the lowest profit-margin segment of the industry.

  TIP

  Cultivation is a great choice if you have a passion for the plant and a green thumb.

- **Manufacturer of infused products:** MIP is an industry term used to describe a company that makes marijuana-infused products, including concentrates such as wax and shatter; oils and tinctures; and lotions and edibles. This segment of the industry acts as a laboratory as well as a processing plant. It may be even more tightly regulated than other segments of the industry, with additional rules and regulations that extend to manufacturing and commercial kitchens.

  TIP

  MIP is a great choice for those who want to get more into the science of extracting active ingredients from the plant and using those extracts to create a wide variety of consumer products.

- **Processed product brand:** A processed product brand could be an MIP or a combined grow/MIP business that makes products and sells them to numerous retail outlets. For example, you could set up your own grow/MIP business to produce a line of infused chocolates that you sell to a variety of medical and recreational dispensaries in Oregon. Another option is to create your own brand and develop unique products and then farm out the growing, manufacturing, and distribution operations to other businesses that specialize in those areas.

» **Retailer/dispensary owner:** Cannabis retailers run the dispensaries and other retail outlets that sell products directly to consumers. Depending on the rules and regulations in your area, you may be permitted to run a medical dispensary, an adult recreational dispensary, or a dispensary that serves both medical and adult recreational clients. This is like owning a liquor store but with more rules and regulations to follow.

» **Ancillary business:** Ancillary businesses you may want to consider include the following:

- Nursery owner
- Manufacturer or seller of grow lights
- Heating, ventilation, and air conditioning (HVAC) service provider specializing in ventilation and circulation for grow operations
- Packaging and labeling manufacturer/supplier
- Security service, or manufacturer or supplier of security systems and equipment
- Marketing, public relations, or advertising specialist
- Real estate sales, rentals, or management (for more details, see the next section)
- Legal, accounting, or consulting service provider
- Banking and cash management services

WARNING

If you're interested in starting a business that comes in contact with the cannabis plant in any way, don't go it alone, and do be prepared for a high cost of doing business. Especially be sure to consult with a lawyer who has knowledge and expertise in helping businesses comply with state cannabis laws.

Investing in cannabis real estate

An often overlooked way to invest in cannabis is to buy land zoned for cannabis businesses or to buy land and have it zoned for such businesses and then sell or lease the land to cannabis businesses. You can even erect buildings on the land (or buy land with buildings suitable for certain types of businesses) and sell or lease the commercially improved land to businesses.

If you've seen the movie *The Founder*, about Ray Kroc, the founder of McDonald's, you probably remember his lawyer/advisor telling him, "You don't seem to realize what business you're in. You're not in the burger business; you're in the real estate business. You build an empire by owning the land." Kroc followed that advice and made a fortune buying the land on which McDonald's franchises were built and then leasing that land to the franchise owners.

You can take a similar approach to profit off the cannabis industry. However, you really need to know not only the cannabis industry and the real estate market, but also the rules and regulations in place that govern where (and what type of) cannabis businesses can be conducted on differently zoned plots of land.

See Chapter 2 for additional details about investing in the cannabis real estate market.

Buying and selling stocks

The most common way people invest in cannabis is to buy and sell stock in privately or publicly owned cannabis companies. Stocks provide you with a share of the company without your having to get your hands dirty or deal with the complex legal and regulatory issues (and other matters) of starting and running your own cannabis business. Of course, buying shares in an existing business leaves you with less control over the business, leaving the value of your shares in the hands of others. If they're innovative, intelligent, and manage the company effectively, your shares are likely to increase in value, but if they drop the ball, you're likely to lose money on your investment.

REMEMBER

Investing in publicly traded companies has a couple advantages. First, to list their stocks on public stock exchanges, companies must be a certain size and comply with stringent financial reporting standards, which provides a greater level of transparency for investors. In other words, you have more data on which you can base your investment decisions. Second, stock in publicly traded companies is a very liquid investment. You can convert your shares to cash almost immediately by listing them for sale on the exchange, assuming, of course, that someone's willing to buy the shares at a price you're willing to sell them for.

For guidance on how to buy and sell stock in publicly traded companies, see Part 3.

REMEMBER

In this book, I assume you're investing in cannabis by buying and selling securities (stocks or bonds) in public or private companies and not by starting your own cannabis business or investing in real estate, which may be the focus of other books on investing in real estate. The goal of this book is to provide the information and guidance you need to research businesses and their management teams to determine whether they're likely to be profitable and good investments for you. You can then decide whether to invest in the company.

Diversifying with exchange traded funds and mutual funds

Most financial advisors recommend *diversification* as a way to reduce an investor's exposure to risk. A diversified investment portfolio contains both *stocks* (shares of ownership in a company) and *bonds* (like IOUs, short for "I owe you"); investments in numerous companies in a particular industry; and investments in various industries, such as cannabis, automobiles, pharmaceuticals, and energy.

One quick and easy way to diversify is to purchase shares of an exchange traded fund or mutual fund, both of which contain investments in a variety of businesses. The basic difference between the two is that shares of an ETF can be traded throughout the day like shares of stock, whereas shares of a mutual fund can be traded only after the markets close or before they open, because the share value is calculated a couple of hours after the markets close. You can find several cannabis-specific ETFs to invest in. Cannabis mutual funds are a rarer species.

WARNING

The main drawback of cannabis ETFs and mutual funds is that a fund manager chooses the businesses to invest in, and fund managers may not be experts in the cannabis industry, so they may not make the best choices. You're generally better off doing your own research and making your own choices.

Considering private investment opportunities

Investing in private companies (in contrast to publicly traded companies) carries significantly more risk but has more potential for a higher return on investment (ROI). You basically have four options for investing in private companies depending on the business's stage of development.

- **Angel investing:** If you know someone who wants to start a cannabis business, you can bankroll the operation as an *angel investor*, usually in exchange for *ownership equity* (shares of stock) in the company or *convertible debt* (a loan that can later be converted to ownership equity). You can also join a group of angel investors, pooling your money to finance startup businesses.
- **Venture capital investing:** One step up from angel investing is venture capital investing, which involves providing capital and expertise to take a promising startup to the next level. As with angel investing, you can join venture capital groups to pool money and expertise.

- **Mezzanine investing:** One step up from venture capital investing is mezzanine investing, which involves private financing in the form of debt or preferred stock. (*Preferred stock* is a higher class of ownership than that provided by common stock. With preferred stock, you have first claim on any assets and earnings if the company struggles or folds.)
- **Private equity:** Private equity is financing that doesn't appear on public exchanges. It usually comes from funds and investors that invest directly in companies or that engage in buyouts of public companies, which results in those companies being delisted.

REMEMBER

Private investing is usually the realm of high-net-worth individuals — and a perfect example of how the rich get richer.

Finding Investment Opportunities

Before you can invest in a cannabis business, you need to find a business to invest in. Sure, you can Google "cannabis companies to invest in" or head to an online discount brokerage such as Firstrade, Ally Invest, or E*TRADE, and use their tools to track down cannabis companies and ETFs, but those searches are likely to turn up only the biggest, publicly-traded cannabis companies. (And a Google search would be likely to turn up some of the biggest scams.) To get quality leads on cannabis businesses, you have a few options, including the following (see Chapter 6 for details).

- **Word of mouth:** People talk, especially when they're planning something big like starting their own cannabis business. You may hear something from a friend, relative, or casual acquaintance about someone who's interested in starting a cannabis business and is looking for investors.

  WARNING

  Be especially careful in your research of word-of-mouth leads, especially if someone approaches you out of the blue about a great investment opportunity. Head to Part 2 for guidance on how to properly vet businesses and their owners and managers.
- **Online resources:** Dozens of general and cannabis-specific investment websites are available to keep investors informed of opportunities. General sites include Yahoo! Finance (`finance.yahoo.com`) and Morningstar (`www.morningstar.com`). Cannabis-specific resources include The Marijuana Index (`marijuanaindex.com`), Marijuana Stocks (`marijuanastocks.com`), and Cannabis Stock Trades (`www.cannabisstocktrades.com`).