

# Cannabis and Hemp Valuations: A Market Analysis

By Ryan Cram, CVA, and Ron Seigneur, CPA/ABV, CVA, ASA

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## Table of Contents

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<b>Cannabis and Hemp Valuations: The Market Approach. . . . .</b>	<b>4</b>
<b>Who Are the Hypothetical, or Specific, Buyers of Companies in This Space? . . . . .</b>	<b>5</b>
<b>The U.S. Cannabis Zeitgeist . . . . .</b>	<b>6</b>
<b>The Range and Sustainability of Public Market Multiples . . . . .</b>	<b>11</b>
<b>Select Guideline Merged and Acquired Company Transactions. . . . .</b>	<b>15</b>
<b>Cannabis Emerged at a Time When Private Capital Has Reached Record Levels . . . . .</b>	<b>18</b>
<b>How About Earlier-Stage VC Returns? . . . . .</b>	<b>22</b>
<b>The VC Method . . . . .</b>	<b>23</b>
<b>The VC Method in Action. . . . .</b>	<b>25</b>
<b>Private Equity Minority Investments. . . . .</b>	<b>28</b>
<b>Conclusion . . . . .</b>	<b>29</b>

## Cannabis and Hemp Valuations: The Market Approach<sup>1</sup>

By Ryan Cram, CVA, and Ron Seigneur, CPA/ABV, CVA, ASA

Valuing any early-stage company in an emerging industry is a difficult task, and we would argue that the degree of difficulty involved in valuing an early-stage enterprise in the cannabis and hemp<sup>2</sup> sectors rises even further due to lack of visibility and historical context. Early-stage valuation relies almost entirely on assumptions, or, put another way, best guesses, about future growth and related product pricing structures. Making predictions about more mature cannabis or hemp-focused companies isn't a free pass either due to rapidly evolving economic, technological, and regulatory dynamics that seem to change almost daily. We would argue that any method used to value a cannabis or hemp company results in a best-efforts guess, which could prove drastically different from the business reality that unfolds in such a fast-changing landscape—analysts and investors are not fortune tellers. Such is the environment to which we are all accustomed, but perhaps this dynamic is even more pronounced in the cannabis realm, with its polarized opinions and market prognostications clouded by euphoric undertones that have whipsawed the share price of public facing companies in this space over the last few years. Uncertainty abounds.

Moreover, unprecedented growth in private capital markets and accommodative fiscal policies over the last several decades have tipped the scales in favor of “hot” emerging growth opportunities as investors have become “yield starved” and in search of more meaningful returns. In fact, private market multiples (based on EBITDA) exceed those in the public sector, a phenomenon that has only occurred two other times in history, and both were followed by market collapses.<sup>3</sup> When put in context, it is rational to believe there is a systemic bias toward heightened valuations of growth assets in the current economic environment. Warning signs flashed in the IPO market as companies such as WeWork, Uber, and Lyft have been prevented or penalized for “going public” at wildly optimistic market caps but with zero profits. To paraphrase Alan Greenspan, former chairman of the Federal Reserve Bank from a December 1996

- 1 The *International Glossary of Business Valuation Terms* defines the market approach as: a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold. The *Glossary* was initially a collaborative effort between representatives of the American Institute of CPAs, the National Association of Consultants and Valuation Analysts, the American Society of Appraisers, the Institute of Business Appraisers, and the Canadian Institute of Chartered Accountants.
- 2 While this discussion is focused primarily on using the market approach to value cannabis-related interests, much of the content is directly or indirectly applicable to the valuation of agricultural hemp and CBD-related interests.
- 3 During the “Barbarians at the Gate” era of the mid-1980s and during the exuberant run-up to the great recession. (Source: “Global Private Equity Report,” Bain Capital, 2019.)

speech, “there appears to be some irrational exuberance in the markets.”<sup>4</sup> We believe irrational exuberance must be taken into consideration when assessing the reliability of market multiples in the hemp and cannabis space.

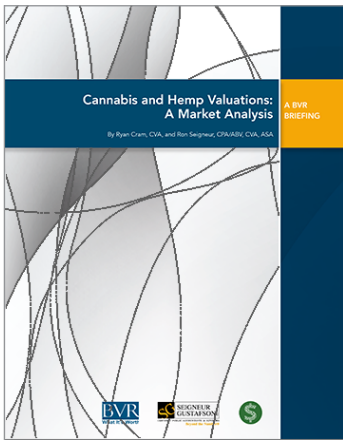
As a counterpoint, cannabis represents one of, if not the, fastest growing industries in the world, so overly pessimistic forecasts do not help the accuracy of valuations in this space either. Furthermore, it is an industry that is both hindered and protected by unique and substantial regulatory hurdles.

As an alternative to a one-size-fits-all solution to the challenge of the market approach in the cannabis industry, this study aims to frame the current market sentiment about cannabis companies and private growth assets, in general, and attempts to make sense of the headline-grabbing deals and stock prices being used as anchors to estimate exit values and therefore market multiples being paid for cannabis assets in today’s environment.

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4 Clearly, sustained low inflation implies less uncertainty about the future, and lower risk premiums imply higher prices of stocks and other earning assets. We can see that in the inverse relationship exhibited by price/earnings ratios and the rate of inflation in the past. But how do we know when *irrational exuberance* has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade? *The Challenge of Central Banking in a Democratic Society*, Dec. 5, 1996.

# New and credible analysis and insight into the evolving cannabis and hemp market



Valuing any early-stage company in an emerging industry is difficult – and that difficulty only intensifies in the nascent cannabis and hemp sectors. There is no better time for the new study by Ryan Cram, CVA, and Ron Seigneur, CPA/ABV, CVA, ASA. The authors pursue an alternative to the “one-size-fits-all” application of market approach in the cannabis industry.

## Highlights of the study include:

- Credible analysis and insight into an evolving market with numerous data sources to present analysis, tables and charts that reveal the industry economics
- Keep current with ongoing – and substantial - regulatory hurdles: Know what to look out for in the market and what to keep on the value driver radar
- Spot current – and future - trends: Stay ahead of one of the fastest growing sectors in the world! This study will help you discern between the verified and non-verified resources that exist or are being developed

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