

Interview with Mitch Baruchowitz @ Merida Capital Partners

Introductions

- **Who are you?**
 - Hi, I'm Mitch Baruchowitz, Managing Partner of Merida Capital Partners, a cannabis-focused private equity firm. Merida was founded in September of 2016 to focus primarily on investing in highly scalable ancillary businesses that have asset-light models and are led by experienced, professional management teams.
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- **What's your Background?**
 - I was a lawyer
 - Started out in the HFC trading. Built a 35 person company with his brother. This was the beginning of this cannabis experience
 - All publicly traded securities and ETNs
 - One of the partners was hit by a car and paralyzed, moved out to Colorado and explored Cannabis to help with the pain
 - Electronic trading until 2007
 - "Less formal environment"
 - Revolutionize electronic trading for bonds
 - The ability to trade quickly and provided the validation services.
 - The data around bond trading was opaque. We were deconstructing this process and showing a much more disclosed bond market
 - "As I got into the Family Office world, I saw cannabis as the biggest opportunity of our lifetime"
 - My background in winning some of the most restrictive cultivation licenses in the country
- **How'd you get started in private equity / venture capital?**
 - "I think people get people pools of capital"
 - Here at Merida, we are a PE fund, but we also invest in publicly traded securities
 - We're agnostic whether it's debt, structure notes
 - If there is alpha, we want to be there
 - The excess return you make based on the perceived risk

- Alpha is the difference between expected return and return.
- There are VCs investing in development deals
 - We'll do a deal that is completely pre-revenue
 - It's not our preference, but you gotta go where the money is
 - "We're looking for risk adjusted returns"

The Opportunity

- **What is the cannabis industry? (The Mega Trend)**
 - I would look at cannabis as having 3 different eras
 - **<2013: The west coast market**
 - **2013-2015: this is the beginning of licensing that started in the east coast**
 - The beginning of the MSOs
 - Legal markets where capital could be deployed with some legal certainty
 - MICHIGAN
 - "When I went out and did a bunch of due diligence on caregivers, it told me the market was uninvestable"
 - **2015 - 2017 (early maturity / infrastructure growth change)**
 - Capital markets open up
 - Canadian markets open up
 - A lot of individualized pitches to a broader audience
 - Supply chain begins to open up
 - **2018 - 2020**
 - This was a real heady time. Stocks were going crazy in 2018.
 - You can really see the groundwork being laid for massive growth in places like IL and MI
 - Most of the groundwork that needs to be laid for growth was put down years before.
 - OHIO Wreck initiative
 - Was the lowest scoring MJ initiative on the ballot
 - "Too much easy money led to too much SG&A"
 - Too many hungry people showed up
 - Needed to have more "real" deals
 - People started to tire of the aspiration quality of earning releases

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- 2020 is the beginning of the normalization of institutional investing in cannabis
 - COVID hardened some of the softer things, like delivery and curbside.
- **What is your investment thesis?**
 - “We’re on our third fund”
 - Our first fund was an offshoot of winning state licences.
 - In a highly regulated industry, you have to bring your cost down.
 - We thought it was going to be clear over time that supply chain was going to self evolve so quickly.
 - “Companies that have less friction across their ecosystem will have superior returns for their investors”
 - **We started to develop a more holistic approach to cannabis space**
 - The Adoption Score (113 point system) - how in the is the investment with our goal for the investment.
 - Companies that remove friction from other operators
 - This is easy to find
 - Companies that naturally lack friction
 - Much harder to find, and over the years, we’ve developed a very pinpoint way of finding them.
 - Fund III has been the best at articulating this strategy.
 - Early on, one of the scores we gave huge credence too...
 - “How many investor meetings are you doing per week?”
 - How much time are you wasting raising capital vs running their business.
 - We would look at how the operators were using their time in the business. It helped us look at early businesses and make sure we weren’t missing a gem or a dog.
 - EXAMPLE: GrowGen
 - Had a high adoption score
 - Dedicated consumer base
 - Almost no friction acquiring new stores
- **How did you come to this conclusion?**
 - Early on, we talked about supercharging great business models through sophistication and ecosystem development
 - Things you’d normally do in the real finance world
 - Brining those skills to cannabis operators where everywhere they turned there was friction
 - **Fragmentation Gap**

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- If it's small, and all you need to do is jump across a moat, and you can operate in a normal environment, that's what we look for.
- "A lot of operators would tell us they were wasting half of their waking hours raising capital"
- **What forces are driving the Mega Trend?**
 - "There's never been a more frequently or bigger volume of something that is illegal on a massive scale like cannabis"
 - \$250 billion that is illegal on a global scale
 - It is inevitable that it will be largely legal in 5 years.
 - **If you are a newer investor to cannabis, you have no idea how hard this was 5-7 years ago**
 - "The Green Closet" - None of us were allowed to talk about what we did for a living.
 - This leads to stress across the entire ecosystem
 - "You couldn't even talk to people to build your network"
 - How can you raise capital when you can't talk about the thing you're doing?
 - **We were able to deliver great returns in fund one because we saw the liquidity events.**
 - We've already returned all of the capital to investors and still hold 80% of the assets.
 - GrowGen is one of the real winners. We got in at \$6m valuation, it's now at \$800m
 - New Frontier Data is one of the tent poles of consumer data that feeds the space
- **Other People's Opinions**



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- There's other people like Josh Wolf from Lux who is great

- “We’ve always been this highly curious but focused investment team”
 - The inefficiencies in the cannabis ecosystem are still there.
 - We understand how those work and how to solve those problems.
- When we talk to management teams...
 - We look at how they deal with change, stress, and uncertainty.

The Problem

- **What are the major problems in the industry you focus on?**
 - **Illegality**
 - This is a feature, not a bug.
 - One of the best things in life is investing when you have almost no competition from institutional investors.
 - Retail investors just aren’t gonna be able to compete with professional investors like Merida
 - The retail investor needs a vehicle
 - Detroit vs New York (cars)
 - Detroit had 70% of all accidents. Why? Cause NY drivers were largely chafurrs and already knew how to handle it. Detroit was unsophisticated drivers.
 - You really do have to have a sense of the regulatory
 - **Information Opaqueness**
 - It’s hard to find out everything you need to know and get due diligence
 - That’s why people do public investments. They feel like they have more information.
 - At Merida, we treat our investors like public investors.
 - Part of the reason we do this is more transparency = more investor interest (typically)
 - “We find out 90% of what we know through our networks and competitors of the investment we’re looking for”
 - Have people heard of this company?
 - What is their reputation in the market?
 - **Supply Chain**
 - Now, we’re talking about capital lite models
 - You don’t need to build a grower. Those have already been made.
 - The Return on Capital is so much quicker.
 - It’s different from spending \$25 million to build the grow

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- If you're taking larger durational risk, you have to understand what that means for returns.
 - What we excel in is finding companies that lack a lot of this friction, given the upfront spend.
- **Legitimacy of Company**
 - Early on, we were talking about adoption of the technology to other companies or to consumers
 - We called it the "AD" Score originally.
 - "Fund I was supply chain. Our question was "is someone going to adopt your solution"
- "The Fragmentation Gap"
- **What are the major problems investors face in this industry?**
 - "Shooting the Money Gun"
 - Economic Carpetbaggers drive up valuation
 - Capital floods in and you can un-dilute the money
 - Once you break the capital stack, you become problematic in future rounds.
 - Flat rounds and down rounds
 - Nothing destroys capital faster than a downround.

The Catalyst

- **Readjustment of Valuation**
 - Never been a better time in terms of setting sensible valuations
 - "We were penalized early on because we weren't built to pull the money gun out fast enough. We had a slower, more methodical approach to investing"
 - 2018 was so frustrating because of this crazy dynamic.
- **Transition from Illicit to Legal**
 - We believe the transition from illegal market to legal market is the largest and most underappreciated construct we've seen in any market
 - Look at the fundamental tentpole companies in tech (like NVDA)
 - When you look at cannabis, we've done so much work understanding what the transition entails, what opportunities in Cannabis, in a normalized world, will disproportionately benefit
 - \$80B illegal / \$10B legal
 - 2020 is the first year where the 3% growth in the consumption of cannabis, the legal market will outstrip the illegal market.

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- The legal market is capturing huge swaths of the illicit market every year.
- It's not just an existing shift from illegal to legal, it's new entrants into the market.

- **Consumer Quartet**
 - What are the things driving the consumer market?
 - **Price** – this is something you can't achieve parity in a legal/illegal market until you get scale.
 - **Choice** – If a formerly illicit consumer walks into a dispensary, the choice they see in the legal market is night and day different.
 - More educated staff, better selection of product
 - **Access** – Has there ever been more access than curbside pickup and delivery?
 - COVID helped orient the access components being held back.
 - Colorado had 6 years of the most mature market, with no delivery, until COVID
 - **Quality** – Most illicit growers have in some way become part of the legal market.
 - Early on, they maybe didn't want to share.
 - But now we're seeing the unorthodox methods of growing being adopted by the legal market.
 - The quality of products being grown indoors, a lot of their growers are former CA and CO growers who know what they're doing.
 - **Safety** – This is going back to the vape crisis
 - Before COVID, people were concerned they could die from vape cartridges. But no product was a legal market product.
 - Now that you have a regulated product that is safe, dosed...
 - Edibles
 - Vapes
 - Microdose
 - Tablets
 - Illicit market is largely flower

- **Anyone who is waiting for a federal movement, you are going to miss out. You need to be invested before the frameworks are laid out.**
 - Normalization

- What occurs when consumers can consume, learn about products, find resources, doctors have education and they feel comfortable prescribing it.
 - Medical care
 - Reimbursement
 - It's what happens when you go to buy soda or food. It's the infrastructure and information components that exist.
 - Very rarely do we see a market with so much consumption with no normalization.
- Destigmatization
 - A lot of early cannabis users in our country are people who didn't care about the smell or stigma from using the product.
 - Early on, the early adopter were the self selected group of consumers
 - People are consuming openly, honestly, safely...
 - With moderation, there isn't a depraved feeling of consumption.

The Mechanism

- **What does your investment process look like?**
 - The Adoption Score
- **What makes your process different from what else is out there?**
 - **First – We think we are the most voracious consumers of cannabis in the space.** We feel very strongly we will read and grind through more data, more relentlessly, than anyone else.
 - When you consume this much information, it leads to a whole new level of insights into the due diligence process.
 - “We often think we should be judged by the quality of work we do, that doesn't get monetized immediately”
 - We did work 4 years ago with another fund that gave us the context for an investment we're making now
 - **Second – I think we're more comfortable investing in plant touching companies**
 - We were the first company to bring legal medicine to the market in VA
 - As a fund, the ability to work like an operating company is an advantage that other traditional funds cant

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- Other people are great investors, we are great at building companies
 - A company builder has lower valuation, but you can negotiate other things into the deal.
- **Third – Personality.**
 - We're patient investors. We didn't have tons of capital early on. We've learned to vet hundreds of deals.
 - We are willing to abandon ideas that go stale or get sour, even if we've invested a tremendous amount of time.
 - We have a competitive and robust internal dialogue with each other. When you have too small of a team, your feedback loop can be too small.
 - We challenge each other's ideas in a respectful way, in the pursuit of getting to the core truth.
 - "Big things aren't necessarily"

The Solution

- **How do you work with funds and fund managers?**
 - The fundamental challenge should be first, figure out what you want your investment to represent for you.
 - Are you looking for speculation?
 - Are you looking for income?
 - Be on the lookout for information
 - Who is on the cap tables of deals?
 - If retail investors are looking to spend real money, they absolutely need to be invested in a vehicle.
 - If they are side by side with a fund, it's going to be hard to deliver better returns.
 - "Is the CEO the original, 2.0, or an investor that had to take over"
 - You'd be surprised how many investors had to take over because they wanted to protect their investor
 - "I'd say 10-15% was a former investor who took over"
 - **Invest in things you can handle the risk, and react in a way that adds value.**
- **What kinds of questions should people ask?**
 - Is it "give me the highest return possible?"
 - Is it "I need early liquidity?"

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- Don't create a lot of money stress because your investment goals don't meet the timeline of the fund.
- **Ask questions around process**
 - Do they do large syndicated rounds with other funds?
 - Do you want bleeding edge investments based on asymmetric returns?
 - Find out if they are investing in a diversified platform of investments.
 - I think cannabis works really well with an ecosystem
 - At Merida, we have an entire engine/flywheel of value creation
 - Do you have the ability to get it over the hump with your own ecosystem and base?
 - Companies that are doing one-offs, I don't know if that works well in cannabis.
- **How does the investor add value?**
 - You have to be knowledgeable about governance and how to deconstruct friction in the business