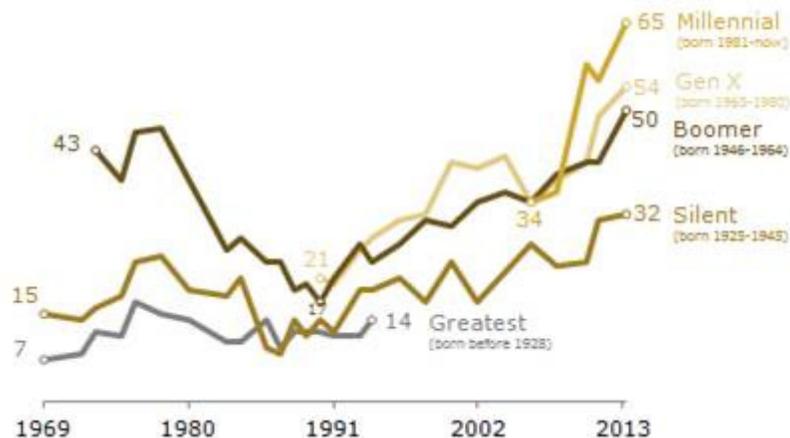


## The Marijuana Industry: Investors See Green

By Brian McCormick and Mike Cornacchioli

Over the past several years, 20 states have legalized marijuana for medicinal purposes, and studies show that more and more Americans support legalization, especially in younger generations (see Figure 1). Washington and Colorado voters have approved marijuana for recreational use, and pro-recreational marijuana initiatives are expected in various other states in 2016.

**Figure 1. Boomers' Support for Legalization Rebounds to 1970s Levels**



Source: Pew Research Center, March 17–17, 2013; 1973–2008 data from General Social Survey; 1969 and 1972 data from Gallup

Whether you agree with legalization or not, the pendulum is swinging in that direction. A huge factor behind the push is the amount of money that's potentially involved. The National Cannabis Industry Association projects \$400 million in sales in Colorado in 2014, and the national market could grow to more than \$10 billion in five years if other states legalize marijuana for recreational use. Clearly, this has the potential to be an incredible growth story. It's not often that a product comes to market with a proven customer base and a very high level of demand. Other states are likely viewing Colorado as an experiment, and if all goes well, it could open the floodgates for broader legalization. Nonetheless, there is still an enormous level of risk for investors in this industry.

**Are the risks too high?** First of all, most marijuana-related stocks are penny stocks trading in the over-the-counter market, which is less regulated and highly susceptible to manipulation. There are virtually no requirements to be listed on these exchanges, and many of the companies in this industry have terrible fundamentals: poor management, high debt, and no cash or earnings to speak of. Some of them don't even have SEC filings, so their financials and revenues are unknown.

Some investors have been throwing money at these stocks simply because of their connection to marijuana, without any understanding of the companies' revenue potential. As a result, valuations of many of these stocks make absolutely no sense, and investors need to be careful. On the other hand, Colorado companies are growing rapidly, and some are positioning themselves as potential acquisition targets for firms in other industries, such as tobacco or alcohol. This could represent an opportunity for investors, but some of the better, more established companies in the marijuana industry are still privately held.

Another risk is that cannabis is still illegal at the federal level. In August of last year, the Justice Department said it wouldn't challenge state laws sanctioning medicinal or recreational use of marijuana as long as drug sales don't impede federal enforcement priorities, such as distribution to minors. So, although marijuana remains illegal, the U.S. government seems to be taking a hands-off approach in states like Colorado.