
NEW CANNABIS LICENSEES: **SETTING YOURSELF UP FOR A SUCCESSFUL JOURNEY**

5 critical drivers for continued growth

MAXIMIZE YOUR CHANCES OF SUCCESS

You've won your cannabis license. (Congratulations!)

You've invested hundreds of thousands of dollars to get to this point. You're about to invest (or already investing) hundreds of thousands or even millions more in building your retail store or cultivation or processing facility. How can you maximize your chances of success?

Pay special attention to these five critical drivers to help you build a business that's positioned to grow, and to maximize its value when you're ready to exit.

1



Real Estate

Understand the intricacies of zoning regulations and identify multiple options early in the licensing process.

2



Operational Management

Build or curate operational expertise in both cannabis and relevant traditional industries, such as retail or manufacturing.

3



Compliance

Dedicate adequate resources to evolving state and local regulatory compliance.

4



Exit Planning

Know your value, and be prepared to entertain a sales offer at any moment.

5



Financing

Look beyond initial startup capital: Consider ongoing capital requirements as well.



Plus, special bonus section:

A deep dive into setting and managing investor relations



Success Driver #1:

REAL ESTATE

Secure a lease or acquire property as soon as is practical. Even in states that don't require a lease before you submit your application, it's essential to identify your real estate options early in the process. Be mindful of these key factors, particularly in newer-to-cannabis states where municipalities are still figuring out their zoning regulations:

1 Stay ahead of zoning laws

To avoid submitting an application only to find out that the local municipality had decided to opt out or pass exclusionary zoning regulations, you must make connections and work your local network from the outset. Stay involved, and show local leaders why you're an asset to the community. Go to town council meetings and advisory commissions, and consider retaining an attorney who does community lobbying work.

2 Leaseholder beware

Do thorough due diligence on the property and landlord before signing a lease. Ask explicitly:

- Does the bank holding the mortgage know that you will lease to a cannabis operator?
- Have you done your due diligence to make sure that we won't have any zoning issues?
- Is there any reason why you can't lease to us?

Success Driver #2:



OPERATIONAL MANAGEMENT

Success in the cannabis industry requires both knowledge of the cannabis product and experience in relevant business operations. It will be important to balance the two as you build your team and operations.

Hire interim operational leaders (e.g., CFO)

It is critical for cannabis applicants to put a management team in place many months before the business is operational. In some cases, the license application requires bios of key managers. In most cases, investors and lenders will expect resumes of the people running the operations.

During these early stages, consider outsourcing critical operational functions. For example, some outsourced CFOs work on an interim basis, taking on a handful of early-stage clients before helping each client transition to a full-time CFO.

Build a cash flow model

Although it's a well-worn trope, the saying "cash is king" holds true for cannabis companies. Since success depends on accurately forecasting sources and uses of cash, one of the essential jobs for the interim CFO will be building a realistic cash flow projection. Top factors to incorporate will include any price compression as markets mature, supply chain inflation, and tax costs related to 280E.

Invest in inventory management

Cannabis inventory is highly regulated in terms of how much companies can keep and have available for sale at any given time. Given this complexity, inventory management is a crucial area of operations that is best handled by someone with inventory management experience in the retail or manufacturing sector. Make sure you have adequate technology in place to provide that person with accurate, real-time inventory data.



Success Driver #3:



COMPLIANCE

The one aspect of the cannabis industry that most sets it apart is that it is highly regulated at the state and local/municipal levels. You should have at least one person whose primary focus is state and local regulatory compliance, whether you hire an experienced compliance officer, develop that expertise in-house, or seek out an outsourced compliance solution.

Corp, S-Corp, or LLC?

If you haven't already, choose a corporate structure as soon as possible. Identify attorneys and accountants who have worked in the cannabis space and understand the state regulatory environment. The interim CFO should be familiar with the structure of cannabis companies and the factors that impact the decision, such as your license (or licenses) and your investor demographics.

Success Driver #4:



EXIT PLANNING

Be prepared to entertain a sales offer when your business is operational – or even during the application process.

1 Be ready to sell

While a sales offer might not happen right away, you could miss out on a potentially lucrative opportunity if you're not ready when it arrives. Be constantly prepared for a buyer's due diligence checklist. Keep your loan documents, capital table, and financial statements organized and readily accessible.

2 Prioritize working on (rather than in) your business

As much energy as you direct into your operations, the same amount of energy should go into the business side. While your customers might appreciate a beautiful, well-designed dispensary, potential investors or acquirers will want to see clean, organized, and readily accessible financials.

3 Build your ecosystem

Remember, amid all these best practices, that part of the fun and the challenge of cannabis is that it is an emerging growth industry where it often feels like we're making up the rules as we go. Thankfully, plenty of resources exist to help you learn and navigate the industry's complexities. Consider attending national, state, and local industry events to network with industry capital providers and professional advisors.





Success Driver #5:

FINANCING

As a successful licensee, you may have already discovered that startup capital requirements are often far more significant than initial projections. The same can be said for operating capital. Keep these three best practices in mind:



Always be fundraising

A business needs ready access to cash in order to thrive, and the journey to positive cash flow can be filled with unpredictable twists and turns. Continuously foster relationships with potential investors to keep that pipeline full and protect against a possible funding shortfall.



Set and manage realistic investor expectations

In the cannabis industry, your investors are likely to be a diverse mix: Along with high-net-worth individuals with sophisticated investment acumen, you likely also have friends and family who are new to investing. These inexperienced investors may have unrealistic expectations about how much and how quickly their investments will generate returns. It's your responsibility to understand your investors and provide the information and education they need. (We'll take a deeper dive into this in the next few pages.)



Tap into the growing cannabis debt market

Growing any business requires a thoughtful balance of debt and equity. Thankfully, the cannabis industry now has a growing number of debt providers finding creative solutions to working with cannabis businesses. While raising capital remains a challenge for emerging operators, solid operational and financial management can help level the playing field. Have a pitch deck and financial model ready, and be prepared to support and explain your financial projections. (Check out our [“Raising capital for the cannabis industry toolkit”](#) for additional considerations and a list of materials to prepare.)





Deep Dive:

MANAGING INVESTOR EXPECTATIONS

For many cannabis operators, fielding the many emails and phone calls prompted by annual K-1s can feel overwhelming. Setting appropriate investor expectations at the outset can help avert this flood. Plus, ongoing, transparent communications will help set the stage for future fundraising, making it easier to go back to the well when it's time to expand to a new location or pursue a license in a second state. In this "Bonus section," we'll explore top tips and considerations for navigating expectations and keeping your investor relationships strong.



3 FACTORS THAT WILL INFLUENCE YOUR INVESTOR RELATIONS NEEDS

When you take on investors, managing their expectations will always be a central part of your job. But there are a few factors that will determine just how much time you will need to dedicate.



Corporate structure

For various reasons, many operators adopt a limited liability company (LLC) legal structure that is treated as a partnership for federal income tax reporting purposes. Entity choice is a complicated decision best made in consultation with tax and legal advisors. If your cannabis business chooses a partnership structure, keep in mind that investors can't file their personal returns until they receive their K-1s – in other words, when your company chooses to extend its corporate return, so must your investors. This fact alone automatically increases the amount of investor communication that is necessary.



Investor demographics

What does your investor pool look like? Is it composed of a few high-net-worth individuals and family offices? If so, you can count on their sophisticated investment acumen; generally, their past experience gives them more realistic expectations and an understanding of the business cycle. But if your investors are primarily friends and family who are new to investing, it's your responsibility to bring them up to speed on investment basics, as well as the fundamentals of the cannabis industry. (We'll talk more about this on the next page.)



Your level of organization

Without accurate and organized documentation, certain things can slip through the cracks – especially when you're rushing to put a deal together. It takes care and precision to track the various transfers of interest, preferred returns, and other special deals that may be required to secure the capital you need to get a cannabis operation off the ground. Plus, keeping your records accurate and up to date will pay off when it's time for another fundraising round.





EDUCATE INVESTORS ABOUT THE CANNABIS INDUSTRY – BEFORE THEY COMMIT

Never assume that your investors know anything about the cannabis industry. It's your responsibility to educate them. Your initial fundraising pitch should cover the fundamentals, such as:

1 Tax treatment

Very few people outside of the industry have even heard of Section 280E, much less understand how it creates phantom income and impacts their personal tax situation. Before they write a check, new investors need to know that they will be allocated income on their personal tax returns without corresponding cash distributions.

2 Background checks for investors

Many states require investors to go through a background check before they can own a piece of a cannabis business. Some investors drop out when they discover that to proceed would mean the state government would have a record of them owning the cannabis business. Make sure you and your investors understand all state regulations that apply to your business and, before you move forward, confirm that your investors' backgrounds won't create an issue.

3 Capital requirements

After investing hundreds of thousands of dollars to obtain a license, most cannabis operators must go back to issue another capital call to build out the facility and get the operation up and running. Investors who aren't prepared to participate in these capital calls need to know they will see dilution in their shares.

4 Realistic timelines for legalization

Not so long ago, we kept hearing that federal legalization was "right around the corner," which created unrealistic expectations for some investors. While we can't be certain when that change may come, you can take control of the narrative by sharing what you know and giving investors your best estimate of when this landmark event may occur. Being honest about what can be reasonably expected and what is unknowable will help build trust. (The same goes at the state level: Keep investors informed on applicable state bills and laws.)



CHECK THE ALIGNMENT: ARE INVESTORS ON BOARD WITH YOUR BUSINESS STRATEGY?

How profits are put to use

You and your various investors need to be on the same page about how cash flow will be put to use. When you start seeing positive cash flow, will you reward investors with hefty dividends? Or will those profits be invested back into the business? While friends and family might expect (or need) their money back, high-net-worth investors are more likely to keep their sights set on the future liquidity event. Trying to maintain a single investor pool with these two very different mindsets practically guarantees that you will end up disappointing one of those factions.



ONGOING COMMUNICATION: KEEP THE LINE OPEN

As in philanthropic fundraising, business investors need ongoing communication to keep them engaged. Radio silence after the first round of fundraising can leave them feeling neglected – or worse, anxious.

So keep in touch with regular updates on your progress, as well as how you're handling any challenges. And to really build a strong, positive relationship, be sure to bring them along for the highs as well as the lows – allow them to share in your success and major milestones.

Here are just a few reasons you might want to reach out to your investors:

- Projections on when facilities and inspections will be complete
- An invitation to tour a recently completed phase of the building
- Groundbreaking or open house of the new facility
- Updates on new strains and how they are selling
- How you are responding to changes in supply and other market trends
- Hiring of a new operational leader



In conclusion

As a still-emerging and ever-evolving industry, cannabis is not without its unique challenges. But you've made it this far; you're ready for this journey. And there are countless benefits and adventures to be found along the path ahead if you know how to plan for them.

For assistance or guidance in validating your financial plans, building your customer communications strategy, or any other piece of this puzzle, feel free to contact our team today.

For more perspectives and timely updates, [subscribe to receive our cannabis industry content](#), including our quarterly newsletter, CannaQuarterly.

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CONTACT



Ira Weinstein

Managing Principal –
Real Estate, Cannabis Industries
410.783.8328



Michael Harlow, CPA

Partner
301.907.2330

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