Green Thumb Industries (GTII.CSE)

Leading Cannabis MSO w/ 250% Upside As Headwinds Subside

Green Thumb Industries (GTII.CSE) is the United State's leading cannabis Multi-State Operator (MSO) with 13 state licenses. The company owns six consumer packaged goods (CPG) cannabis brands ranging from premium flowers to pre-rolled joints, edible gummies, and beverages.

GTII has grown revenue at a 222% 4YR CAGR from $16.5M in 2017 to $556M in 2020. Not only has the company grown like a weed, but they're doing so profitably, generating $180M in EBITDA last year (32% margin).

As Alex discussed the other week in his note *(H)Asch(ish) Paradigm...* GTII has grown despite playing with both its arms and legs tied. There are a few reasons for this handicap. First, selling marijuana remains a federal crime in the United States. This means that despite state legalization across its 13 existing markets, GTII cannot bank with a US bank nor list on a US exchange.

Second, most states have yet to legalize cannabis, siphoning GTI's potential addressable market in the short term. Additionally, in the 13 markets that GTII operates, legal cannabis sale and consumption remain taboo for most of the state's potential consumer base.

Third, GTII just started implementing an omnichannel sales strategy where customers can shop fully online or buy online and pick up in-store (BOPIS).

Finally, US investors can only access the stock two ways: MSOS ETF or buying directly from the CSE exchange. This means most investors can't buy the company's shares outright. Think of the millions of Robinhood traders that would want their hands on this company. And US banked institutions/funds that are prevented from buying as well. That's *a lot* of pent-up shareholder demand.

Here's the exciting part. Cannabis is a potential $100B industry set to grow 20% per year for the next **decade.** Doing so would put cannabis above the spirits and wine industry and only $10B behind beer.

GTII's revenues should expand rapidly as more states open their doors to legalized marijuana sales. Moreover, its vertically integrated business model allows it to control production, distribution, and retail within each location.

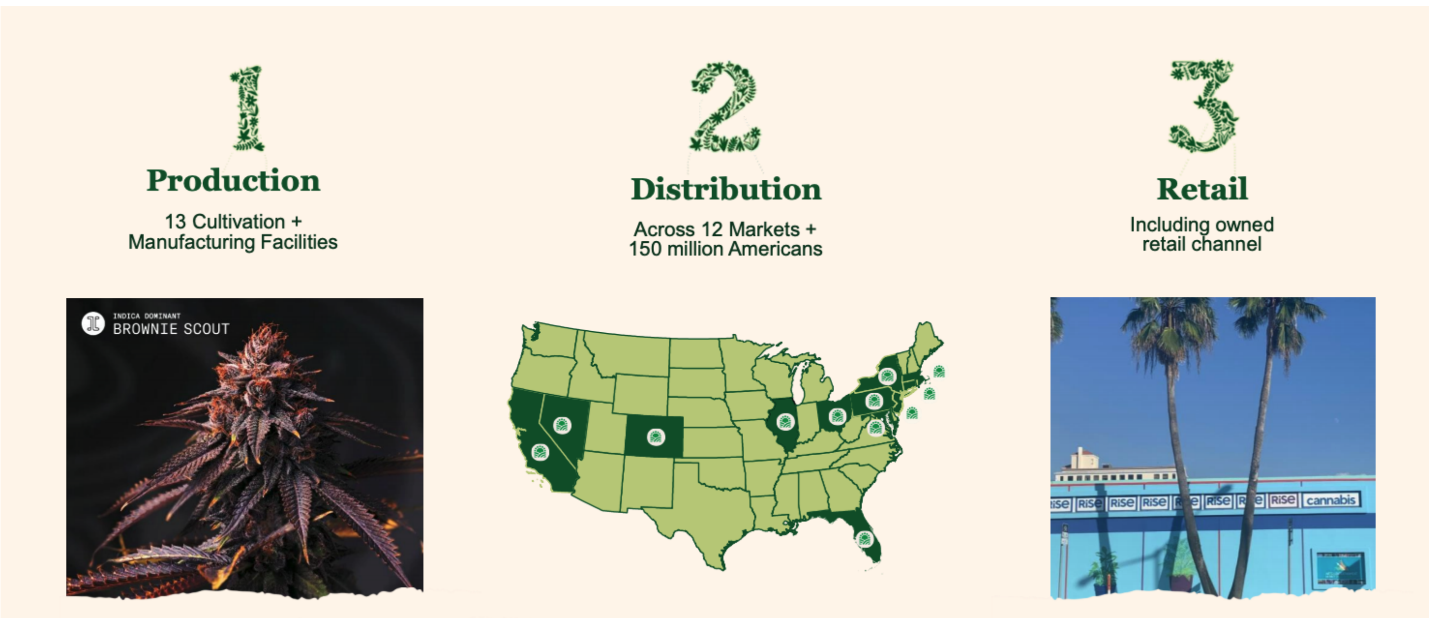
> **Our Variant Perception:** Most investors view cannabis as a commodity product without pricing power and consumer preference. Through its six CPG brands, GTII is making the opposite bet. The company believes that brands *will* matter. New consumers, afraid of the potential ramifications of ingesting cannabis, will anchor to the brand/product that makes them feel the best. In turn, GTII's industry-leading vertical integration allows the company to control product quality and distribution better than any other MSO.

GTII is priced like a value stock. Despite its 200%+ revenue CAGR and net profitability, the company trades at ~25x NTM EBIT and 7x NTM sales. **The current stock price offers 250%+ upside,** assuming a ~36% revenue growth CAGR and 36% EBITDA margins over the next five years.

Green Thumb's Vertical Integration Explained

GTII is a vertically integrated Cannabis Multi-State Operator (MSO) founded by Ben Kovler in 2014. The company makes, processes, and distributes its cannabis products throughout the United States. As of May 2021, the company operates in 13 states with 56 retail stores and 101 retail licenses. The company's mission is to promote well-being through the power of cannabis.

Vertical integration is a critical factor in GTII's success and requires excellence in three categories: **Production, Distribution,** and **Retail.** Let's break each down.



On the production side, the company sports 13 cultivation and manufacturing facilities throughout its 13 existing markets. **Owning production** is essential because it normalizes quality, flavor/taste, and experience across each retail market. We'll explain why this matters later.

Distribution is arguably the most crucial aspect of any CPG company. Those that can get their product into the most hands win. So far, GTII commands a dominant distribution channel in the US market.

The company distributes its product through 13 states (California, Colorado, Connecticut, Florida, Illinois, Maryland, Massachusetts, Nevada, New Jersey, New York, Ohio, Pennsylvania, and Virginia), reaching 150M+ US consumers.

GTII currently sells its product through two main channels: own-brand retail stores and third-party retailers. Its own-brand stores include *Rise* and *Essence.* As of May 2021, GTII had 56 retail stores. The company experienced 35% same-store sales (SSS) growth YoY and has a licensed pipeline to more than double its current store count.

It's easy to see how the combination of in-house production, industry-leading distribution, and a 56+ physical retail presence explain GTII's rapid revenue growth.

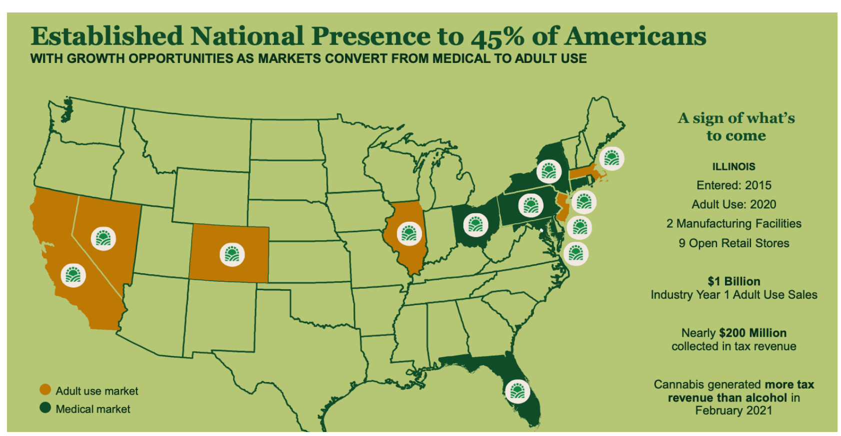
Here's the kicker, though. GTII's leading distribution and retail presence wouldn't matter if they can't convince customers to buy *their* brand. But before we dive into GTII's brand power, it's essential to understand the regulatory dynamics at the local (state) level.

A Simple Way To Understand The Cannabis Regulatory Barriers To Entry

Federal and state regulatory law is an overwhelming topic. Left unattended, most investors can miss the flower from the trees when analyzing these dynamics. The point remains that current state and federal laws have strategically limited GTII's potential competition at the state level. They accomplish that through a limited number of available cannabis business licenses. Let's use California as an example.

There are three separate cannabis-specific licenses businesses need in California (from GTII's 10-K):

- **Cultivation:** Permit commercial cannabis cultivation activity involving the planting, growing, harvesting, drying, curing, grading, or trimming of cannabis
- **Processing:** Authorize manufacturers to process marijuana biomass into certain value-added products using volatile or non-volatile solvents, depending on the license type.
- **Retail:** Permit the sale of cannabis and cannabis products to both medical patients and adult-use customers.



Companies obtain these licenses by either state-granted awards (like winning a lottery) or buying a company with an existing license.

Also, there are inherently more licenses for recreational use than medical use. Over time, recreational licenses will dominate the available pie and increase local competition.

Again, it's easy to drown in the legality of state cannabis licenses. As investors, there is one critical takeaway from these laws: **Barriers To Entry.**

It's *tough* for a start-up company to obtain the necessary operating licenses. Even if a start-up made it through preliminary screening, why would state legislators choose them over GTII?

GTII is the *logical* choice to obtain new licenses. They're operating in 13 other states with a public history of growth and profitability. The company benefits from a flywheel where each incremental license makes the next one easier to obtain.

Of course, it's irresponsible to guess how many licenses GTII will obtain over time. But what we can estimate with decent probability is that the company will win more licenses (on average) than its competition.

GTII will use these barriers to entry to build a top-of-mind consumer brand portfolio. Here's how.

Our Variant Perception: New Users Will Anchor To Specific Brands

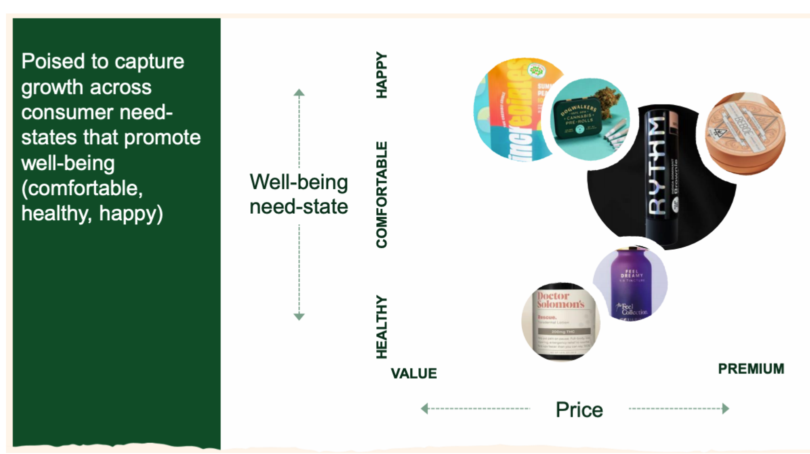
McDonald's is an excellent example of production dominance. It doesn't matter where you are in the world; a Big Mac tastes like a Big Mac.

This matters significantly in cannabis because you're dealing with THC, the active ingredient that gets people buzzed. Psychoactive drug users, whether serious or casual, experience two types of high: good and bad (*Alex here with a short interjection. It's obvious reading this that Brandon is not part of GTII's target market. There are in fact <u>many</u> layers and variations of "highs" [heady, somatic, chill, pick me up, heavy, light, sleepy, wired, etc…] which is why quality and consistency matter so much in production. End side rant*) . New cannabis users will anchor to the product that gives them a "good high" feeling. After that, there's no incentive for recreational/social users to experiment with new products.

Cannabis is different than any other consumer product in this regard. The risk of trying Pepsi over Coke isn't detrimental. Sure, you might not like the taste. But you don't suffer any psychoactive ailments. Cannabis consumption has *real* psychoactive consequences. As such, the Risk/Reward of switching products (read: brands) is significantly higher.

GTII has six CPG brands to attract consumers:

- **Rhythm:** Premium flower product
- **Dogwalkers:** Cannabis pre-rolled joints
- **incredibles:** Cannabis-based chocolate bars, gummies, and tarts
- **Beboe:** Vape pens and edible pastilles
- **Dr. Solomon's:** Lotions, balms, and inflammation-reducing drops



- **The Feel Collection:** Essential-oil infused cannabis tinctures

The company also announced a distribution partnership and equity investment with Cann, the cannabis-infused beverage manufacturer. Cann makes micro-dosed social tonics that are low-calorie and made with all-natural ingredients.

Cannabis-infused beverages have tremendous upside. For example, cannabis beverage category sales grew nearly four times faster than total cannabis market sales between January and December 2020. Concurrently, Cann rose from fifth in market share to first with over 600% growth in sales (BDS Analytics).

> *(Alex again. CANN is a big hit in the states where it's available. Ellen DeGeneres raved about it on her show. Here's a Forbes piece about the company. We think liquid will become a dominant form of THC intake over time. The reason being is that it's social. CANN has the correct strategy in that they keep the THC doses low. So, like beer, people can hang out at a party, drink some CANNs, and only get a slight heady buzz. But, and this is important… there's zero hangovers the next day or worries about the extra calories from alcohol, etc… CANN could very well be the next White Claw in 2-4 years. End rant).*

CEO Ben Kovler is betting big on brand value in the cannabis space. But why should we listen to him?

Ben Kovler: A Jockey Worth Betting On

Kovler comes from a long line of sin-worthy consumption products. Kovler's great-grandfather, Harry Blum, co-founded Jim Beam, the world-renowned bourbon company after Prohibition ended.

As Ben mentions in multiple public interviews, cannabis is Prohibition 2.0. This is important because Ben saw first-hand how the power of brands transformed the alcohol industry, and he thinks the same thing will happen in the cannabis space. He explains this thesis in a mjbizdaily.com interview (emphasis mine):

> ***"Brands are real. They are trusted and authentic relationships with the consumer, and they drive purchasing decisions every day.*** *We believe brands distributed at scale is how to win, and we're investing heavily. We've developed several and will continue to expand, including Rythm, The Feel Collection, Dogwalkers and a female-focused brand that is under development. In the same way that alcohol companies categorize hard liquor, beer and wine, cannabis has those parallel segments with concentrates, vape and flower."*

Listen to a couple of Kovler's public interviews (here and here). He possesses a sharp mind for capital allocation, brand building, and balance sheet conservation. Additionally, we can verify his words with his actions. For example, Kovler's GTII was the first MSO to go public and raise debt financing at sub 10% levels.

Finally, Kovler eats his own cooking. He's the third-largest shareholder owning 1.40% of the company ($76M in stock).

A Future Vastly Different Than The Present

GTII generated $557M in revenue last year. This year they're expected to hit $875M for a near 60% increase. And by 2022, the company should cross $1B in annual revenue. As we mentioned earlier, they're doing all this amidst stiff federal regulation that's drastically restricting the company's potential addressable market.

Here's what we know. The company has a long runway in its existing 13 markets, with New York set to come online in 2022. Over time, most states will legalize recreational and medical cannabis consumption, offering *massive* revenue tailwinds in the highly fragmented $100B industry.

Let's assume GTII grows revenue at a 36% 5YR CAGR until 2025. That gets us ~$2.6B in revenues or ~2.5x current EV. Next, we'll assume the company maintains ~37% EBITDA margins over those five years. We're also assuming EBITDA margins compress from 38% (2022 estimates) to 35%, reflecting increased recreational competition. That gets us ~$920M in 2025 EBITDA or ~7x current EV.

If those estimates materialize, what would a reasonable buyer pay for this business? To recap, you're buying one of the fastest-growing, vertically integrated, CPG-focused cannabis manufacturers with high regulatory barriers to entry. Let's say a buyer would pay between 20-30x EBITDA.

In other words, a reasonable buyer would pay roughly $23B for this business by 2025 (assuming the above figures). Add back another $25M in net cash, and **you get a shade over $23B or ~$102/share in shareholder value.**

Concluding Thoughts: Betting on Lindy

Historically, sin stocks like tobacco and alcohol have generated world-beating market returns. This makes sense as we humans have consumed such products for thousands of years. As Nassim Taleb likes to say, these products are “Lindy.”

Lindy simply means that if something has existed for a long time (say 100 years), it has a high probability of existing for another 100 years.

Cannabis will undoubtedly become the next “Lindy” consumption industry once regulations inevitably change. Humans have consumed cannabis in some form for over 2,500 years. If we apply the “Lindy” concept to cannabis, we can *reasonably* assume humans will continue to consume cannabis for another 2,500 years.

GTII has the best shot at becoming the industry-leader in this space. The company has monopolistic barriers to entry, a strong CPG brand portfolio that consumers love, industry-leading vertical integration, and a long runway for unabated revenue and earnings growth.

Most importantly, you can buy this business for bargain-bin prices.

