



# Investors bet on legal marijuana as others warn of 'green rush' burn

**Ed Beeson/The Star-Ledger**

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For nearly two decades, Troy Dayton has been on the front lines, pushing for marijuana legalization.

Now, the Somerset County native is ready for the next step of his career: Pioneering the legal pot industry.

A former fundraiser for the Marijuana Policy Project, Dayton is chief executive officer of ArcView Group, a California-based organization that connects well-to-do investors with entrepreneurs in need of funding for projects in the cannabis industry.

Medical marijuana is now legal in 20 states including New Jersey as well as Washington D.C., and two states – Colorado and Washington – have approved sales of the drug for recreational use. Meanwhile, other states including New York have unveiled plans to allow medical marijuana sales.

So as efforts to legalize pot gain momentum, people like Dayton are searching for footholds in the nascent industry. The promise of pot is not just in selling the drug – which by some estimates is a \$40 billion a year underground industry – but also in building businesses around it, from consulting firms to packaging companies to device makers to security providers.

"Never for a second did I think that my desire to change the world would create the next big industry," said Dayton, a 36-year-old who grew up in Hillsborough.

Yet some warn the industry isn't primed for take-off, and it still could be grounded. The risks are hard to understate: Marijuana is still illegal under federal law. Banks have been skittish about accepting deposits from legal pot sales. Deep-pocketed institutional investors are on the sidelines. And potential scams and investment bubbles could be lurking in the form of penny stock schemes.

Others think legalizing marijuana to turn it into a money-making enterprise is simply bad public health policy.

"This is big tobacco redux," said Kevin Sabet, director of the Drug Policy Institute at the University of Florida and a former Office of National Drug Control Policy official. "They know the only way to make money is to create addicts."

From where Dayton sits, combining capitalism with cannabis and strict regulation could deliver the policy change that a majority of Americans say they want. A Gallup poll last fall found that 58 percent of the nation favors legalizing marijuana for recreational purposes, and an even larger share approve of it for medical purposes.

"If you want to get something done in this world, you figure out how to make it profitable," he said.

Seeds of that change may sprout from ArcView's quarterly pitch sessions. Here, companies seeking backing for their business plans go before a group of angel investors, who have paid ArcView a \$3,500 to \$5,000 annual fee for the opportunity and expect to invest at least \$50,000 in the cannabis industry over the next year.

Dayton says he doesn't advise investors on whether to back a certain company. But in recent months, he said, ventures have secured some \$4 million in financing out of ArcView meetings. He expects fund-raising this year to hit double-digits. That's a far cry from two years ago, he noted, when the group nearly closed for lack of investor interest.

What changed that was the good vibrations sent by Colorado's and Washington's ballot initiatives and, later, the Obama administration's response, Dayton said.

On Jan. 1, the Rocky Mountain state became the first in modern times to allow marijuana sales for recreational purposes. Washington is set to follow in the coming months.

Helping them along is the U.S. Department of Justice. Last August, the agency said it won't interfere with retail sales in Colorado and Washington, so long as the states strictly regulate the industry. And on Friday, the Financial Crimes Enforcement Network, a unit of the U.S. Treasury Department, issued guidance to outline how banks can do business with legal pot operations, though bank lobbies said they were still cool to the idea.

These developments have given some the view that America's long prohibition on pot is winding down, and that an underground industry will finally come to the surface. ArcView estimates that the legal marijuana industry generated just over \$1.4 billion in sales last year, and will drum up more than \$2.3 billion this year. Over five years, the market value should rise to \$10.2 billion, the group said.

Others are less sanguine about pot's immediate potential, even if they support legalization.

"The door is slightly ajar, but it isn't enough to let the horse gallop out," said Jeffrey Miron, an economist at Harvard University and a senior fellow at the Cato Institute who favors decriminalizing marijuana.

While Miron thinks a pot industry would resemble the beer market, he said the drug's legal status is an impediment. It would take a lot of effort – namely, an act of Congress – to revise marijuana laws, but comparatively little to start cracking down on legal pot sales again, he said.

"A new administration could just undue everything the Obama administration has done at the stroke a pen."

And like that, a high-flying industry could go up in smoke.

Investors who have already rolled the dice on marijuana say they aren't deterred.

Brendan Kennedy, the 41-year-old CEO of a private equity shop called Privateer Holdings, said one belief has kept him invested in the cannabis industry despite years of uncertainty: Inevitability.

"The inevitability of the end of prohibition. The inevitability of legalization," he said. "It's not just about creating a new company, but building a new industry."

And building this new industry is not just about growing pot and opening dispensaries.

"There's a whole world of product-making that goes beyond selling plants," said Taylor West, deputy director of the 430-member National Cannabis Industry Association. She points to markets for pot-infused food and drinks, cannabis oil and butters. Regulatory demands will spark other opportunities, such as labs to test for purity and contaminants and systems to track inventory from seed to sale.

Privateer, based in Seattle, Wash., sees its role in developing these ancillary businesses.

"What we look for are holes in the marketplace, where no one is thinking about the opportunity," said Kennedy, who through Privateer raised \$7 million from investors last year and expects to raise at least another \$50 million by April.

Take, for example, pot cultivation. Many would-be entrepreneurs focus on becoming growers, Kennedy said, but they've had trouble securing leases that meet their various requirements. So Privateer, under a company it owns called Arbormain, began buying up warehouses in Washington with the aim of subdividing the space for growers, he said.

As interest in the cannabis market continues to heat up, some investors could end up getting burned, one financial regulator has warned.

On the less-regulated, thinly traded parts of the U.S. stock market, shares of purported medical-marijuana companies have been trading up a storm since the beginning of the year. Some companies, listed on venues such as the OTC Bulletin Board, have quadrupled or more in value.

The price spikes have caught the eye of the Financial Industry Regulatory Authority, which has warned that some of these companies appear to be employing the tactics of penny stock pump-and-dump schemes.

This includes issuing a flurry of rosy press releases touting the company's earnings potential, despite it having only a record of losses and no business plan, the regulator said in an investor bulletin.

FINRA doesn't accuse any specific companies of wrongdoing, and a spokesman said the alert wasn't in response to any complaints. But the regulator said it found a number of red flags among public cannabis companies, including one whose former CEO has been indicted for a Ponzi scheme and another whose current head had served nine years in prison for a drug-smuggling operation.

Dayton of ArcView and Kennedy of Privateer say they too are concerned by these listings.

Above all, investors before putting money in should closely evaluate a company's financial data and other factors such as its management, auditing firm and experience in its field, said Gerri Walsh, head of FINRA's senior vice president of investor education.

"It's easy to get caught up in the hype and that's something we caution investors about," she said.