‘Buying’ an Arizona medical marijuana dispensary...

ARIZONA DISPENSARY M&A TRANSACTIONS—*not your typical M&A*

Janet E. Jackim
Sacks Tierney P.A.
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Cannabis ‘M&A’: Purchasing Control of the Dispensary Licensee

- Asset acquisitions
- Stock (corp) purchase
- Membership interest (LLC) purchase
Cannabis Dispensary ‘M&A’ ≠
• Purchase of dispensary or certificate to dispense
• Sale of board of director or officer positions

Transfer of MMJ certificate is prohibited by Ariz.Admin.Code R-9-17-306 (A)
Ownership and Operational Regimes in MMJ M&A’s:

• Seller ≠ dispensary; seller is an affiliate
• Dispensary = a non-profit corp or LLC managed by a board, members and officers
• 6+ levels of players involved:
  • (1) buyer and principals (owners, employees)
  • (2) dispensary and principals (board, officers)
  • (3) manager(s) and principals (owners, employees)
  • (4) cultivator and principals (owners, employees)
  • (5) landlords and vendors of (2) – (5)
  • (6) lenders and other stakeholders of (1) – (4)
MMJ M&A Similarities to Other Arizona Business Sales

• Typically not *Fortune 500* buyers or sellers
• Typically good books and records and business practices lacking
• Often not represented regularly by counsel
• Organic growth based upon hard work, sweat equity
Evolving M&A Environment

• Opportunity junkies
• Limited historical precedents multiply risk, legal and operational uncertainties
• TONS of cash, banking non-existent, limited financing
• Securities laws disregarded
• Adult use coming soon!
• Betting on the come/who cares about profitability?
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<th>TERMS</th>
<th>TYPICAL M&amp;A</th>
<th>CANNABIS M&amp;A</th>
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| Buyer | • Desires growth, diversification or compatible offerings  
• Needs to invest excess $$  
• Entrepreneurial | • Out of state acquirer desiring high growth in new States  
• Positioning for IPO  
• Recent private placement offering  
• Positioning for passage of recreational initiative 2020 |
| Seller | • Principals ill, dead or retiring  
• Divorce or partnership split  
• Wants liquidity or diversified wealth  
• New or increasing competition | • Tired 2012 founders  
• Expense, commitment and psychological toil of litigation  
• Receivership order  
• Partnership dispute resolution  
• Capital needed, not obtainable  
• Opportunity to capitalize on past efforts, maximize wealth |
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| **What’s being sold?** | • Business assets  
• Corp stock or LLC member interests  
• Associated real estate (fee or leasehold)  
• Board, shareholder or member control | • Assignment of management contract(s)  
• Assignment of stock or member interests in manager  
• Resignation of board members, officers in control  
• Appointment of new board, officers assuming control of dispensary and/or manager |
| **What’s not being sold?** | • Payables, receivables  
• Contingent liabilities  
• Cash on hand, in accounts  
• Seller’s designated personal property | • Dispensary certificate  
• Right to cultivate, extract, infuse marijuana, marijuana products  
• Board seats and officer positions  
• MMJ-related ATO’s |
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<td><strong>Purchase price</strong></td>
<td>• Appraisal, market study&lt;br&gt; • EBITDA or multiple of revenues&lt;br&gt; • Compilation of personal, real property and non-compete values&lt;br&gt; • Debt, equity</td>
<td>• Revenues/profits may be less relevant&lt;br&gt; • Recreational use in 2020&lt;br&gt; • $8 – $10 million -- ‘hairy’&lt;br&gt; • $10 million -- ‘paper’&lt;br&gt; • $15 – $30+ million -- clean&lt;br&gt; • Stock in established cannabis business, convertible debt&lt;br&gt; • Limited availability</td>
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<td><strong>Due diligence</strong></td>
<td>• Title searches&lt;br&gt; • Phase I and other inspections&lt;br&gt; • Analyses of financials, material contracts, permits and licenses&lt;br&gt; • Employees and benefits</td>
<td>• Certificate, ATOs and use permits&lt;br&gt; • Management contracts, leases&lt;br&gt; • Agent cards&lt;br&gt; • State audits, NODs and responses, auditors’ exams, audited financials&lt;br&gt; • Policies and procedures&lt;br&gt; • ‘Reasonableness’ per R-9-17-310 (A) (13) – (17)</td>
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<td>Due diligence (cont’d.)</td>
<td>• Entity structure, ownership&lt;br&gt;• Intellectual property ownership, licenses, protections</td>
<td>• Revenue underreporting and 280(e) noncompliance, tax liens&lt;br&gt;• Follow flow of cash, seed to sale&lt;br&gt;• Conflicts of interest, self-dealing, commingling&lt;br&gt;• Affiliates and more affiliates! &lt;br&gt;• Enforceability of material contracts&lt;br&gt;• Poorly documented, non-existent contracts, books, records&lt;br&gt;• Cash payments, ‘out the back door’&lt;br&gt;• Intellectual property ownership by principals, affiliates</td>
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| **Unique Cannabis Provisions** | • Termination for ‘special events’:  
  • Federal or State enforcement activities  
  • Termination of key contracts (dispensary lease, cultivation contract or lease)  
  • Material audit deficiencies  
  • Material change of State or Federal law  
  • Federal law is not a defense to breach of contract  
  • Dispensary is sole owner of all cannabis, wherever located, in whatever form, the dispensary license and ATO’s  
  • Appointment of new board, resignation of old board, qualification of new board and other principals as dispensary agents with AZDHS  
  • Reasonableness standards apply  
  • Cash, bank and merchant accounts, security measures |
'Buying’ a dispensary?

1. There are numerous, material differences between typical and cannabis M&A’s

2. Tax payments, tax liens, books and records are central due diligence inquiries. Hire experienced CPA and auditing firms

3. New management likely means: (a) improved recordkeeping, (b) adoption of tax management policies and procedures, and (c) timely payment of taxes