

NEWS ANALYSIS

VCs and cannabis: A new union could be in the making

Founders Fund has made waves by becoming the first significant institutional firm to make a cannabis-focused investment. Will others make a similar leap?

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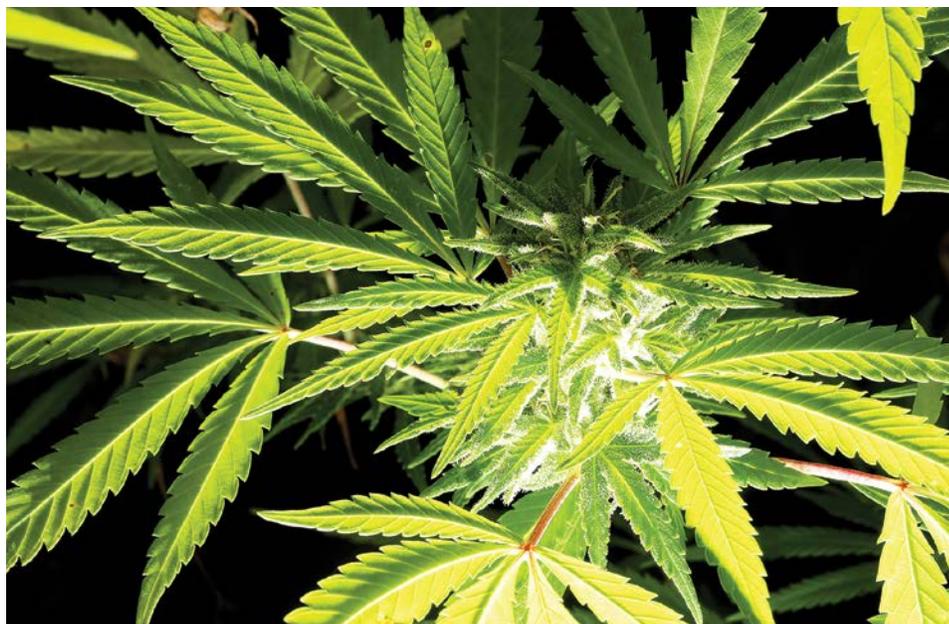
The revelation that **Founders Fund** participated in a recent \$75 million Series B round for Seattle-based **Privateer Holdings**, a cannabis-focused private equity firm, could change the stakes in an industry that up until now has had to rely on private investors due to its legal hurdles.

Although there are 23 states and Washington, D.C., in which medical marijuana is legal—and four states where recreational use is permissible—marijuana use is still federally illegal. As a result, most banks will not do business with legal cannabis firms, which are forced to become all-cash operations while still expected to pay taxes to the IRS.

But the Founders Fund investment, believed to be in the multi-million-dollar range, could open the door to an industry previously shunned by the VC community by giving it a legitimacy it previously lacked. The question is whether this will induce other VCs who might have been skittish about entering this still very polarizing space, to back cannabis companies?

That's what **Brendan Kennedy**, CEO and co-founder of the four-year-old Privateer is hoping.

"We believe we're past the tipping point on the road to legalization," said Kennedy, a Yale MBA who formerly worked at **Silicon Valley Bank** before co-launching Privateer in 2011. "But one of the remaining obstacles has been the legitimization of the industry in the finance world. As the first institutional investor in the industry, Founders Fund is changing that and giving other institutional firms permission to



REUTERS/ALESSANDRO BIANCHI

analyze and enter the space."

Possibly. But here's the rub: Although the Founders Fund investment marks a pivotal milestone in the history of the sector, as it emanates from the same firm that also backed **Spotify**, **SpaceX**, **Airbnb**, **Facebook** and **Lyft**, there's no guarantee that other VCs will follow suit.

For instance, **Ron Heinz**, founder and managing director of Salt Lake City-based **Signal Peak Ventures**, which focuses on life sciences and IT, said that his firm won't be investing in cannabis startups anytime soon, Founders Fund's support of Privateer notwithstanding. Heinz said that his chief objection is the market's federal illegality.

"We have a really strict set of guidelines regarding areas where we'll invest and where we won't invest," he said. "A cannabis-focused investment would fall outside those parameters. It's as simple as that."

But cannabis is also an industry rife with potentially lucrative exit opportunities. MMJ Business Daily, an online cannabis trade publication, recently reported that overall revenue projections for the

cannabis industry in 2015 are estimated to be between \$3.1 and \$3.7 billion in total sales, encompassing recreational and medical use. That number is expected to rise by 2018 to range from \$7.4 to \$8.2 billion in sales.

Such high figures do little to sway Heinz and Signal Peak, however, from their resolve not to fund this space.

"For us, it would not be at all about the return," he said. "It would be all about what we consider to be responsible social investing and for the greater good. That would fall way outside our comfort level."

Signal Peak's reluctance to back this space does not surprise **Geoff Lewis**, a partner at Founders Fund.

"I'm sure the investment has piqued the interest of other investors," he said. "But I don't anticipate many entering the space until recreational cannabis is federally legal in the United States."

Lewis was responsible for sparking Founders Fund's interest in the sector after he found out about **Leafly**, a Yelp-like cannabis review site that is also a Privateer portfolio company. Lewis contacted Privateer about 18 months ago, Kennedy

estimated. From then on, meetings were held between Founders Fund and Privateer at various venues, including the medical cannabis research and production facility at **Tilray**, a Canadian cannabis brand that is also owned by Privateer.

In addition to Leafly and Tilray, Privateer also has backed **Marley Natural**, a cannabis brand that the firm launched last November with the consent of the late reggae great **Bob Marley's** family.

Besides Privateer, Lewis also met with other companies in the legal cannabis space to consider them for potential

tality and lacked the expertise and long-term vision needed to build a successful company.”

He said only Privateer with its “strategy, talent, expertise and potential for growth” impressed Founders Fund.

As far as the possibility goes of Founders Fund being Privateer’s only significant institutional investor for now, Lewis is not only fine with that, it meshes perfectly with the venture firm’s history of backing startups poised on the cusp of becoming trailblazers for their respective industries.

“We look for companies that will define

number of previous VCs and institutional investors that Privateer met with in the past about funding have pinged him back for further talks. Although Kennedy won’t disclose details about these ongoing conversations, he remains optimistic. Yet he tempers that with a realistic outlook.

“Founders Fund has been studying the industry for 15 months, and has a strong understanding of the operational, legal, social and political nuances of this industry,” relates Kennedy. “Other VCs now have to scramble play catch-up.”

Lewis agreed, noting the firm spent



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investments. In comparison to Privateer, all came up alarmingly short.

“Half had been in the industry so long that they’d operated illegally up until just a few years ago, which, of course, immediately ruled them out as potential investments,” he said. “The other half demonstrated a kind of gold-rush men-

the most important industries in the world,” Lewis said. “We believe that legal cannabis will become an incredibly important industry within the next decade, and Privateer Holdings is positioned to be the leader in this space.”

Since the announcement of Founders Fund’s investment, Kennedy admits that a

time looking at the sector before making the decision to invest in Privateer.

“I wouldn’t advise anyone to get involved until they’re taken the time to learn about the complexities of the industry,” he said.

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Select venture-backed startups in the cannabis industry

Company	Location	Description	Founded	Total funding raised to date (\$M)	Investors
Bhang Chocolate Co.	Oakland	Makes chocolates, including those with cannabis.	n/a	\$34.00	Mentor Capital
CannaBuild	Denver, Colo.	Provides budtending services online.	2014	\$0.23	ArcView Group
Coastal Compassion	New Bedford, Mass	Provides patient access network to medical marijuana.	2012	n/a	Dutchess Opportunity Fund
Dixie Elixirs	Denver, Colo.	Provides cannabis products and edibles.	2009	n/a	Dutchess Opportunity Fund
Eaze	San Francisco	Provides delivery of medicinal marijuana.	n/a	\$1.50	Fresh VC
Foria		Provides cannabis oil for sensual lubricant	2013	n/a	Dutchess Opportunity Fund
GrowLife	Gardena, Calif.	Develops products that serve the legal cannabis growing and retail industry.	1987	\$34.00	Undisclosed.
Leafly	Seattle	Operates an online review site for strains of cannabis and dispensaries.	2010	n/a	Privateer Holdings
Marley Natural	New York	Cultivates cannabis.	2014	n/a	Privateer Holdings
MassRoots	Denver, Colo.	Operates a digital hub for the cannabis industry.	2013	\$0.50	ArcView Group, Dutchess Opportunity Fund
Palliatech Inc	Sea Cliff, N.Y.	Producer of marijuana-based pain medication.	2010	\$10.00	Gruppa Sputnik 000, undisclosed investor
Tilray	Nanaimo, British Columbia	Supplies medicinal marijuana	2014	n/a	Privateer Holdings
WeedMaps	Denver, Colo.	Operates an online community for cannabis users.	2008	n/a	Undisclosed.

Source: Thomson Reuters data and VCJ research.
Note: Data is continuously updated and is therefore subject to change.