Dot.com, Pot.com: We’ve Seen This Movie Before

The marijuana laws will change in North America. Inarguable. Case closed. What’s open for discussion is who will survive that change.

We had similar decisions to make during the post-HTML boom of the late 1990’s. Fueled by Alan Greenspan’s liquidity fears of Y2K and investor giddiness, the boom propelled internet companies into the pricing stratosphere. Companies simply added the letter “e” to the front of their corporate names, and then watched their stock prices skyrocket. The industry arrogantly looked down on anyone who wasn’t in a dotcom deal – we just didn’t get it, from their perspective.

Here’s an example. I attended an investor meeting in 1998 for yet another medical advisor site. The company, with an idea, three employees, no code written and no marketing plan, valued itself at $900M. Couldn’t help myself – I had to ask how they got to that number. “Well, the market will someday be a $9Billion market and we will own 10% of it.” They threw me out when I, uh, challenged the logic of that model.

As with all booms, after a short hysterical expansion the dot-com bubble popped.

Early 2000 saw the tech-heavy NASDAQ plunge from its high of roughly 5100 to 1100. Then the strong companies continued and the weak got the death they deserved. That medical advisor site never saw the light of day.

Who else failed during the bust period? Here’s a walk down BankruptcyMemory Lane: Pets.com, Nortel, Boo.com, BooksaMillion, FreeInternet, ToySmart, Inktome, WebVan, Open.com, Pixelon, Worldcom. All gone.

In retrospect, none of them had a viable defensible business plan. All of them spent like the money bucket had no bottom. It’s easy to see now why they failed.

Who survived? The companies with a long term vision, fiscal discipline, governance and an executable strategy. Yahoo, eBay, Apple, Microsoft, Google, Cisco, Amazon, SalesForce, Yandex. Again, looking back, it’s easy to see why they won.

Today the NASDAQ composite is back trading over 5000.

Look at this 2 year chart from MarijuanaIndex.com for its global marijuana composite index. The irrational high of roughly 3000 was hit in September, 2013. Since then it’s been a nauseating drop to today’s quote of roughly 310, a loss of about 90%.

See where we’re going with this?

In Canada, since the highs were hit in March and April of 2014, the *Allard* injunction in the Federal Court, coupled with the federal government’s structural inability to process the 1400plus MMPR applications, resulted in a loss of investor confidence. When investors lose confidence, stock prices fall.

Hemp and marijuana companies are currently in a bust phase of a longer cycle. This doesn’t mean their business plans are flawed (although some are) nor does it mean management is making mistakes (although, again, some are). It means the regular cycles of capitalism are doing their job, just like during the internet era. After the bust will come an echo.

So if we could get in our DeLorean and go back to 1999, what lessons from the dotcom era can be applied to the potcoms?

Here are my takeaways from this exercise.

The leadership team matters most of all. The dotcoms had cocky inexperienced MBA students drawing up business plans on cocktail napkins and getting funded. They had no idea how to run a company or execute on a plan. Looking back, is it any wonder they failed? This cannabis industry is seeing a wide cast of characters, from weary mining promoters to construction companies to the stereotypical socks-and-Birkenstocks potheads. Avoid the clowns, the fast talkers, the starry-eyed true-believers. If it sounds stupid it probably is. Find a company with a balanced board, an experienced management team, some degree of cynicism, and a commitment to corporate governance. Discipline will go a long way.

Companies in the infrastructure of an industry tend to have less risk with less potential return than the primaries. The MMPR licencees are all still overvalued on a risk / return basis, given the two hurdles of *Allard* and the federal election in October, 2015.

If the Conservatives win a majority in the federal election, expect marijuana to remain criminalized and the medical laws to stay more or less the same. A Liberal majority would likely liberalize both medical and social. An NDP majority would be irrelevant since most of us would flee the country. The political intrigues surrounding minority coalitions make it almost impossible to predict their impact on cannabis laws, except to note that there is a general groundswell supporting some degree of liberalization. (See here for earlier work on that popular support and the tax revenue governments will reap from it.)

Allard could delay the elimination of the MMAR's, in much the same way the Supreme Court of Canada did for Canada's prostitution laws. If the Federal Court of Appeal does anything other than agree with the federal government and outlaw the MMAR's, that would mean a loss of roughly 40,000 core users to the MMPR's and the applicants, a hit that some of the MMPR's simply wouldn't survive. The risk there is massive, especially when one reads the Supreme Court of Canada's recent decision in *Smith* empowering the medical patient.

But the companies targeting the hemp, food, cosmetic, beverage, medical device and CBD markets have spread their risk away from those two uncontrollable events, making their risk / return profiles more palatable and their valuations more defensible.

Those who overspend or who overcharge will die. This seems obvious, but it’s astonishing how many business plans severely misjudge how they will earn revenue and when they will turn that revenue into real cash. Pets.com was one of the poster children for this kind of obliviousness – it had revenue of $619,000 but spent $11.8 million on advertising. Its business plan called for it to hit $300M in revenue in four years based on projected internet penetration rates. In retrospect, it was lunacy.

We’re seeing similar plans today. Look through the MMPR’s business plans. They are all losing money, all have to spend significant marketing money, and all are projecting high growth based on projected penetration rates. That’s the unavoidable stage of the industry they’re in.

The obvious loser in that group will be Hydropothecary and its plan to charge roughly 6 times what other MMPR’s will charge, for essentially the same product. Their theory is, people will pay a lot more for medical marijuana if it comes in a nicer bag with a ribbon. That’s an indefensible business plan, doomed to fail as there will never be enough consumers in their target demographic. They will need a basic change of philosophy to avoid insolvency.

When the cannabis market rebounds, and it’s inevitable it will, one of our picks for who will be left standing is Abattis Bioceuticals Corp. (OTCQX: ATTBF) (CSE:ATT). Go through the website and the press releases. You’ll find a strong management team, an experienced board, product diversification, some exposure to the MMPR’s for potential immediate upside if *Allard* and the election go the right way, a history of accessing capital as needed, and an unwillingness to spend that capital.

Bill “Comet” Fleming, CEO, is attacking the food and beverage markets, including an Aug/15 announcement of selling 10,000 units of “Glacier Hemp Water” through its natural health products subsidiary. The F&B market in North America is huge, and ripe for exploitation. With an emphasis on hemp and CBD’s, Abbatis limits its dependency on political and judicial developments.

All of those elements contribute to Abattis having a strong likelihood of being a market leader when the industry consolidates and re-enters a growth phase.

The NASDAQ composite is back to where it was during the dotcom era. The marijuana composite index will certainly some day return to its highs. Who do you think will be part of the composite then?