Floyd Advisory

Deals, Dollars, and Disputes

MAXIMIZING VALUE
MINIMIZING RISK

A Summary of Private Equity Transactions for the Quarter Ended June 30, 2014

CONTENTS

Introduction and Our Objective

We are pleased to present you with our *Deals, Dollars, and Disputes* report for the quarter ended June 30th, 2014. Our analysis involves a study of the merger and acquisition transactions involving private equity firms ("PE firms") during the recent quarter.

Our objective in preparing this report is to provide a general overview of the volume and value of transactions during the quarter along with an analysis of trends when compared to prior quarters. We also hope to present useful information on select topics related to valuation concepts and recent acquisition disputes in our *Featured Transactions and Insights* section.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding business and valuation matters to assist our clients in today's fast-paced and demanding market. This report is just one example of how we intend to fulfill this commitment.

We appreciate your comments and feedback and welcome requests for any additional analysis that you might find helpful.

Floyd Advisory
JULY 2014

Our Process and Methodology

We studied financial data for transactions involving PE firms, both as buyers and sellers, during the most recent quarter for companies headquartered in North America.

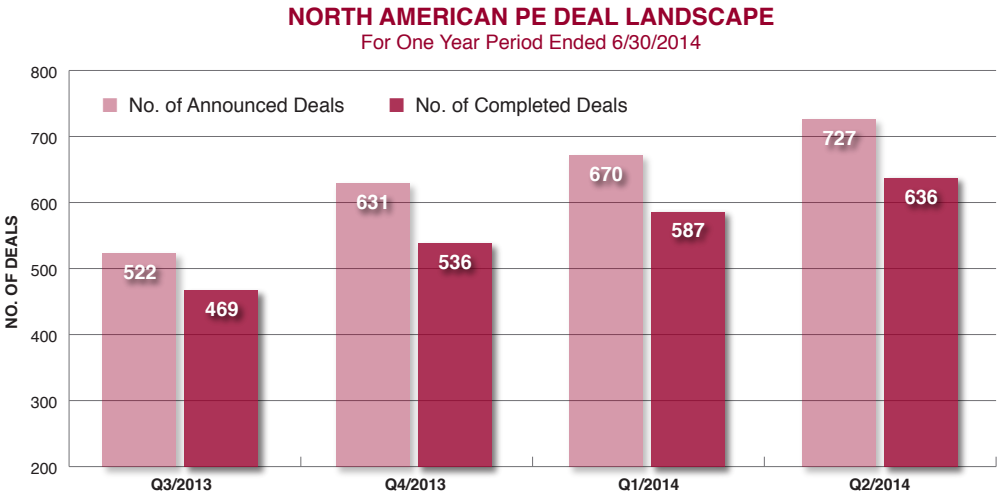
As part of our review, we gathered and analyzed relevant transaction information and data such as industry sector, equity interest, and deal structure, and created a database for our further analyses. From this information, we analyzed market trends by industry, by common attributes, by valuation premiums, and by other characteristics. Applying our professional judgment to these observations, we have prepared this report. Within our*Featured Transactions and Insights* section, we have highlighted one transaction and one noteworthy emerging market as recommended reading.

For the purposes of this report, the transaction data we have analyzed is limited to publicly available information. Beginning with the Q4 2013 report, our third-party source has provided us with an expanded data set to include a broader set of private equity deals. Data throughout this report will be comparable to last quarter's report, but may not be comparable to our Q3 2013 report.

While reported deal volume increased in Q2 for both announcements and completions, the total value of the top 25 deals fell by 35% compared to Q1.

Summary of Q2 2014 PE Firm Transaction Activity

Volume of PE Deals Announced and Completed



Source: Zephyr

Note: Includes data for which transaction details were reported and available.

For the 3rd consecutive quarter we note an increase in deal activity. Compared to Q1 2014, there was a 9% increase in announced deals and 8% increase in completed deals. Over the last four quarters there has been an average of 14% more deals announced than completed.

Numerous factors explain the variance between deals being announced and completed, including regulatory approval, break-ups, terminations, and other causes. The variance can also be partially explained by the difficulties surrounding the confirmation of completions involving privately-held companies.

Top 25 PE Firm Transactions by Deal Value Completed During Q2 2014

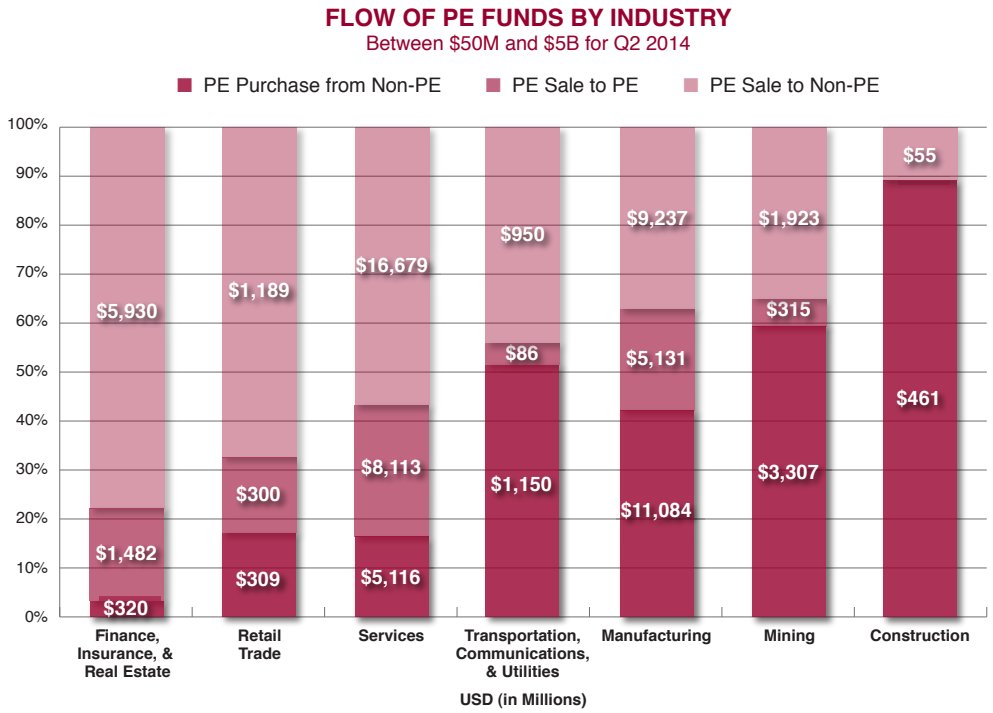
	Deal Value USD (in millions)	PE Role(s)	Target	Seller	Deal Type*	Acquiring Entity (Advisors)	Target Primary US SIC Description
1	$4,150	Buyer	Ortho-Clinical Diagnostics Inc.	Johnson & Johnson	MAJ	Carlyle Group LP	In vitro and in vivo diagnostic substances manufacturing
2	$3,200	Buyer, Advisor	Industrial Packaging Group Inc.	Illinois Tool Works Inc.	MAJ	Vault Bermuda Holding Company LTD (Carlyle Group LP)	Metal shipping barrels, drums, kegs and pails
3	$2,450	Seller	MFI Holding Corporation	Goldman Sachs Capital Partners Thomas H Lee Partners LP Shareholders	MAJ	Post Holdings Inc.	Chicken eggs
4	$2,350	Seller	Sheridan Healthcare Inc.	Hellman & Freidman LLC	MAJ	Amsurg Corporations	Offices and clinics of health practioners, not elsewhere classified
5	$2,328	Seller	Hilton Worldwide Holdings Inc.	Blackstone Group LP	MIN	Shareholders	Hotels and motels
6	$2,300	Seller	Oculus VR Inc.	Matrix Management Corporations Shareholders Spark Capital Partners LLC Andreesen Horowitz LLC Formation8 Partners LLC	MAJ	Facebook Inc.	Commercial physical and biological research
7	$2,300	Buyer	IMG Worldwide Holdings Inc.	Forstmann Little & Company	MAJ	Silver Lake Partners LP William Morris Endeavour Entertainment LLC	Professional sports clubs and promoters
8	$2,200	Buyer, Advisor	Jones Group Inc.	Shareholders	MAJ	Jasper Parent LLC (Sycamore Partners LP)	Women's, misses' and juniors' outerwear not elsewhere classified
9	$2,000	Seller	Sterling Financial Corporation	Warburg Pincus LLC Thomas H Lee Partners LP Shareholder	MAJ	Umpqua Holdings Corporation	State commercial banks
10	$1,800	Buyer, Advisor	Encana Oil and Gas (USA) Inc.'s (Wyoming Natural Gas Properties)	Encana Oil & Gas (USA) Inc.	MAJ	Jonah Energy LLC (TPG Capital LP)	Crude petroleum and natural gas
11	$1,650	Seller	Mercury Payment Systems Inc.	Silver Lake Partners LP Shareholders	MAJ	Vantiv Inc.	Functions related to depository banking, not elsewhere classified
12	$1,570	Advisor	Calpine Corporations's Six Power Plants in the Southeast Region	Calpine Corporation	MAJ	Natgen Southeast Power LLC (LS Power Equity Advisors LLC)	Electric services
13	$1,400	Buyer, Seller	Hillman Companies Inc.	Oak Hill Capital Management Inc.	MAJ	Management, CCMP Capital Advisors LLC	Bolts, nuts, screws, rivets and washers
14	$1,300	Buyer, Seller	DFC Global Corporation	Shareholders Springowl Asset Management LLC Royal Capital Management LLC	MAJ	Lone Star Funds	Functions related to depository banking, not elsewhere classified
15	$1,300	Seller	IMS Health Holding Inc.	Leonard Green & Partners LP Canada Pension Plan Investment Board TPG Capital LP	IPO	Public offering	Management consulting services
16	$1,150	Seller	Cetera Financial Group Inc.	Lightyear Capital LLC	MAJ	RCS Capital Corporation	Security brokers, dealers, and flotation companies
17	$1,100	Buyer, Seller	Renaissance Learning Inc.	Permira Advisers LLC	MAJ	Management, Hellman & Freidman LLC, Google Capital	Computer processing and data preparation and processing services
18	$1,100	Buyer, Seller	Hearthside Food Solutions LLC	Wind Point Partners LP	MAJ	Goldman Sachs Group Inc., Vestar Capital Partners Inc.	Flour and other grain mill products manufacturing
19	$1,055	Seller	Allison Transmissions Holding Inc.	Carlyle Group LP Onex Corporation	MIN	Shareholders	Motor vehicle parts and accessories manufacturing
20	$1,000	Buyer	Electronic Funds Source LLC	FJ Management Inc. First Data Transportation Services Inc. CTP Holdings LLC	MAJ	Warburg Pincus LLC	Computer processing and data preparation and processing services
21	$950	Seller	Maker Studio Inc.	Singtel Ventures (PTE) LTD, Shareholders, Time Warner Investments, GreyCroft LLC, Northgate Capital LLC, Astro Overseas LTD, Ms Elisabeth Murdoch, Societe D'Edition De Canal Plus SA, Daher Capital, Mr Ynon Kreiz, Downey Ventures, Fuel: M+C, Ms Rachel Lam, Mr Jon Landau, Uprfont Ventures, Lakestar Advisors GMBH	MAJ	Walt Disney Company	Motion picture and video tape production
22	947	Seller	Victor Technologies Holdings Inc.	Irving Place Capital Inc.	MAJ	Colfax Corporation	Machine tools, metal cutting types
23	930	Buyer, Seller	Travelclick Inc.	Genstar Capital LLC Shareholders Bain Capital Venture Partners LLC	MAJ	Thoma Bravo LLC	Computer processing and data preparation and processing services
24	925	Seller	Parsley Energy Inc.	NGP Energy Capital Management LLC Shareholders	IPO	Public offering	Oil and gas field services, not elsewhere classified
25	915	Buyer, Seller	Medpace Inc.	CCMP Capital Advisors LLC	MAJ	Cinven Ltd	Commercial physical and biological research

Source: Zephyr

Deal types: MAJ = Majority Stake Aquisition, MIN = Minority Stake Acquisition, IPO = Initial Public Offering

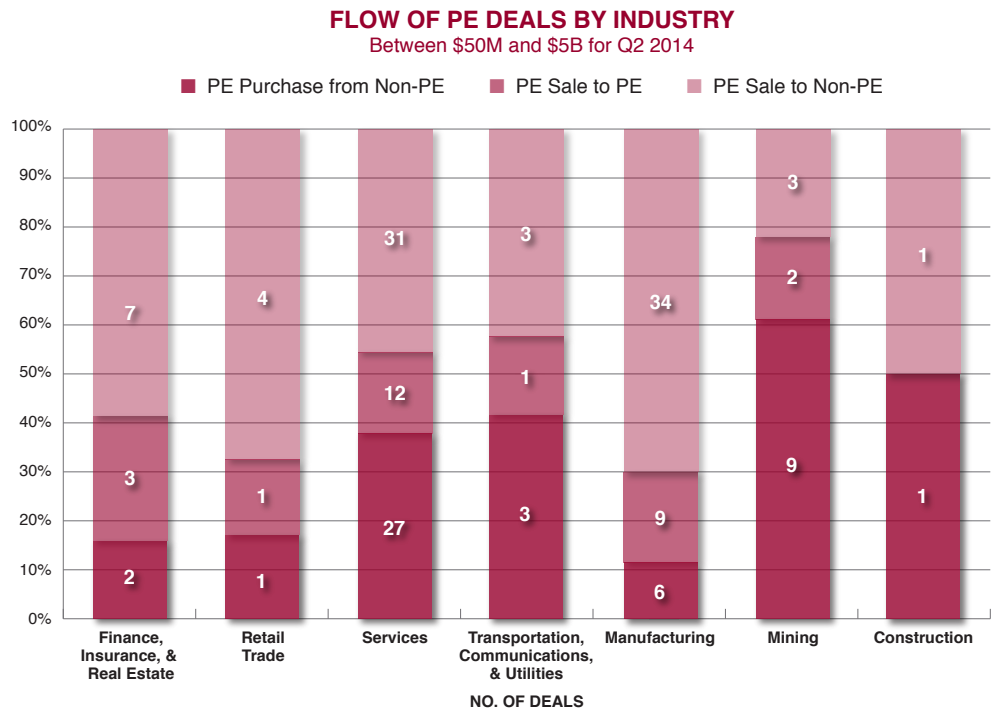
Industry Sector Transaction Analyses

The improving economy and bullish markets have buttressed a steady flow of private equity exits in 2014. Such an environment has also made the search for value increasingly challenging for private equity firms.



Source: Zephyr

Note: Includes data for which transaction details were reported and publicly available.



Source: Zephyr

** Retail Trade, Agriculture, Public Administration and Forestry & Fishing Industries are excluded due to nominal activity.*

Note: Includes data for which transaction details were reported and publicly available.

VALUE AND NUMBER OF DEALS BY INDUSTRY
For Q2 2014

Industry*	Median Deal Value (In Millions)	Average Deal Value (In Millions)	Sum of Completed Deals (In Millions)**	Count of Completed Deals**
Agriculture, Forestry, And Fishing	$1,228	$1,228	$2,456	2
Transportation, Communications, & Utilities	$210	$419	$3,775	9
Finance, Insurance, & Real Estate	$133	$468	$8,421	18
Mining	$130	$330	$5,607	17
Retail Trade	$119	$206	$1,856	9
Construction	$100	$166	$664	4
Wholesale Trade	$95	$243	$972	4
Manufacturing	$52	$261	$26,105	100
Services	$33	$183	$31,781	174
Public Administration	$1	$1	$1	1

Source: Zephyr

** Industries are based on main divisions defined in the United States Department of Labor's Standard Industrial Classification (SIC) System*

*** Calculations based on our third party data include only deals that list values*

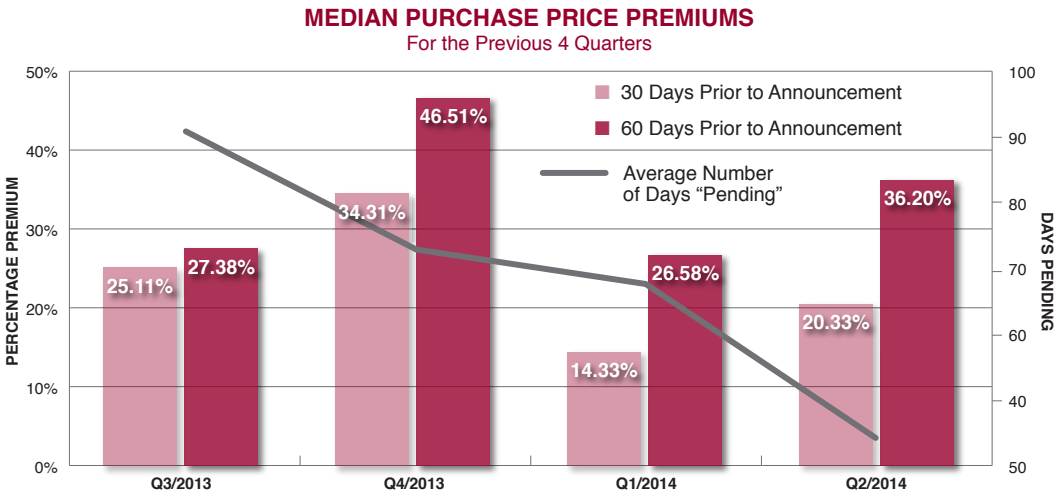
Note: Includes data for which transaction details were reported and publically available.

Analysis of the sub-sectors within Manufacturing and Services reveals that "Pharmaceutical Preparations" deals represented the greatest volume (10%) in Manufacturing, while the bulk of deals in Services can be attributed to "Computer processing and data preparation" (51%).

INDUSTRY FOCUS: SERVICES

Q2 2014 featured a number of high-value deals related to technology, media, and entertainment in the services industry including Facebook's $2.3 billion purchase of virtual reality technology pioneer Oculus VR and Walt Disney's $950 million acquisition of multichannel network company Maker Studios. An increasing number of deals spotlight younger companies with an entrepreneurial bent; Oculus, for example, raised over $2 million solely through the crowdfunding website Kickstarter. The deals in this quarter show that more established companies are willing to take acquisition risks to ensure that their investments give them an edge in the fast-paced high-tech arena.

Purchase Price Premium for Transactions Involving Controlling Stakes



Source: Zephyr

Note: Includes data for which transaction details were reported and publicly available.

The median purchase price premium over share price 30 days and 60 days prior to announcement for the trailing four quarters was equal to 22.72% and 31.79%, respectively. The decline in the average number of days spent "pending" may be attributed to the large volume of minority stake deals as compared with the previous quarters.

"The more successful private equity investors are likely to separate the noise from the trend because they spend more time monitoring their investments from the ground up and are able to change management when performance falls below expectations."

Wiley Finance, Rawley Thomas, Benton E Gup, *The Valuation Handbook: Valuation Techniques from Today's Top Practitioners*

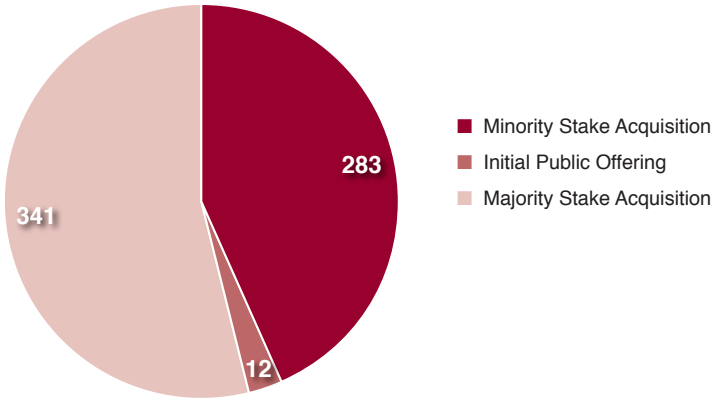
PE Acquisition Type Analyses

We broke down the transactions by the following categories based on characteristics of the acquirer and the stake acquired:

Deal Type	Definition
Majority Interest	Stake acquired is equal to a 50% or greater interest in the target entity.
Minority Interest	Stake acquired is equal to less than 50% interest in the target entity.
Initial Public Offer	A transaction where a percentage of ownership is offered and sold to public investors.

NUMBER OF COMPLETED PE DEALS BY ACQUISITION TYPE

For Q2 2014

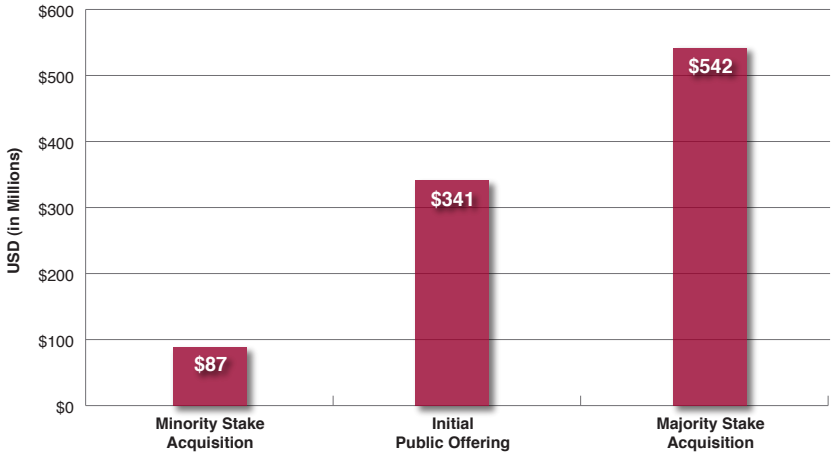


Source: Zephyr

Note: Includes data for which transaction details were reported and publicly available.

AVERAGE DEAL VALUE FOR PE FIRM TRANSACTIONS

For Q2 2014



Source: Zephyr

Note: Average deal value based on transactions for which values were publicly available.

". . . without consortia of private equity firms, there may be fewer bidders participating in auctions for these companies, potentially resulting in significantly lower bids."

Elizabeth M. Bailey, *Are Private Equity Consortia Anticompetitive: The Economics of Club Bidding,* April 2007

Featured Transactions and Insights

Among the transaction activity and related events in the quarter, we select certain deals and market trends that present information we consider especially worthy of further review and analysis by those involved in structuring and negotiating business sales and acquisitions. Our goal is to feature transactions that raise unique considerations from a valuation, deal-structure, or subsequent-dispute standpoint.

This quarter, we feature both a transaction and a viable new industry. First, we examine the market circumstances underlying a parent company's decision to spin off a less productive subsidiary company to a private equity firm and the ensuing shareholder dispute. Additionally, we look at an industry billowing outwards and upwards as attitudes shift and state governments amend their laws regarding marijuana. Medical marijuana might just be the next big cash crop.

"Institutions often play the role of activist investors to affect the policies of companies in which they invest and especially to discipline corporate management."

DePamphilis, Donald M., *Mergers, Acquisitions, and other Restructuring Activities*. Sixth Edition. 2012. Pg 32.

Investor Unrest as Darden Sells Red Lobster to Golden Gate

On May 16, 2014, Golden Gate Capital ("Golden Gate") announced its $2.1 billion purchase of Red Lobster from Darden Restaurants ("Darden"). The sale and acquisition ended significant speculation surrounding the fate of Red Lobster, a buzz that started in December 2013 when Darden initially expressed its intentions to spin off the floundering seafood restaurant chain. In the end, Darden determined that selling Red Lobster to Golden Gate would generate the most value for shareholders. Darden had reportedly considered other plans of either selling Red Lobster to a strategic partner or keeping the restaurant's operations while selling off its real-estate assets.[1] Subsequent to Darden's announcement of the sale, investors rose up in heated dissatisfaction over the decision made by Darden's board with allegations of an inadequate transaction price. Investors currently exclaim that shareholders have been shortchanged by the deal. Are their claims justified? Did Darden fail to maximize the value of Red Lobster?

Pre-Deal Grumblings

Despite operating 706 restaurants across the U.S. and Canada, Red Lobster has been underperforming for a sustained period of time due to steadily rising seafood prices[2] and a consumer shift to fast food over casual dining establishments. Competition in the casual dining industry has become fierce.[3] Darden reported that Red Lobster's U.S. same-restaurant sales were expected to fall from between 5.5% to 6.5% in fiscal 2014, with sales for the quarter ending Feb 23rd down 8.7% from the prior year.[4]

[1] *http://www.forbes.com/sites/samanthasharf/2014/05/22/activists-turn-up-heat-on-darden-red-lobster-deal-unconscionable-board-misleading/*
[2] *http://www.fool.com/investing/general/2014/06/13/did-darden-restaurants-sell-the-wrong-restaurant-c.aspx*
[3] *http://www.restfinance.com/Restaurant-Finance-Across-America/September-2013/Olive-Garden-Red-Lobster-Are-Struggling/*
[4] *Darden 10-Q Q3 2014*

Darden's press release announcing the spin-off emphasized the favorable impact on the restaurant group's balance sheet. The sale netted $1.6 billion in cash (after tax) and Darden's debt will be reduced by $1 billion. The new capital structure will allow Darden to sustain its $0.55 quarterly dividend[5] and use $500-to-$600 million to repurchase the company's outstanding shares. By and large, its newly-found ability to allocate resources towards their other restaurant chains, including Olive Garden, Longhorn Steakhouse, and The Capital Grille, has provided Darden added rationale for the sale.

The dissenting investors include Barington Capital Group and Starboard Value. In January 2014, Barington expressed concern over shortcomings of Darden's value-creation plan for Red Lobster. This investment firm declared the best viable plan in the interest of shareholders would be a tax-free spin-off of both Red Lobster and Olive Garden while maintaining control of the real-estate assets and establishing a real estate investment trust. The best way for Darden to create value for shareholders, according to Barington, would be through leasing retained real-estate assets, thus allowing Darden to focus on their younger and faster-growing restaurant brands.[6] In late April, in an effort to gain influence over Red Lobster's future, Starboard garnered enough shareholder support to force a special meeting around soliciting a vote regarding a sale or spin-off.[7] Ultimately, Darden asserted that the deal did not require consent from their shareholders, which provoked the ire of the activist investors. Darden summarily sold Red Lobster's real-estate assets to American Realty Capital Partners ("ARCP") for $1.5 billion. Darden's CEO maintained that the deal was in the best interest of the shareholders and the strategic direction of the restaurant group.

"...The number of U.S. casual eateries has grown by 9% since 2006 even as customer traffic has dropped by 9%."

Online.wsj.com

Justifiable Investor Ire?

While investor discontent seems to stem from Darden's apparent disregard for their pre-deal concerns and strategy suggestions, the activists' arguments revolve around two pivotal issues: first, the undervaluing of Red Lobster's real estate and operations and second, around the transaction's purported tax leakage. Starboard and Barington contend that since Darden emerged from the deal with $1.6 billion in cash (after tax), and Golden Gate subsequently sold the acquired real estate for $1.5 billion, Darden effectively received a mere $100 million for the operations of Red Lobster. Additionally, according to their calculation and stripping out the real estate, they contend Golden Gate paid only $600 million for the Red Lobster operations, resulting in a low 5.3x effective pro forma EBITDA multiple (after removing the estimated annual real estate operating income on the leased properties from total EBITDA). Regarding tax leakage, the investors argue that the deal could have been structured on a tax-free basis to avoid the $500 million tax liability.[8]

The table on the next page displays the consideration for each deal. Red Lobster's EBITDA is derived from reports of a 9x multiple in the initial deal. The estimated cash capitalization rate for the real estate in Golden Gate's deal with ARCP was widely reported. We arrive at the Red Lobster pro forma EBITDA by deducting the estimated annual real estate operating income (which Golden Gate will now pay to ARCP) from its EBITDA.[9]

[5] *http://www.fool.com/investing/general/2014/06/08/what-was-darden-restaurants-thinking-when-it-sold.aspx*
[6] *http://dealbook.nytimes.com/2014/01/13/why-barington-still-opposes-dardens-plan-to-spin-off-red-lobster/?_php=true&_type=blogs&_r=0*
[7] *http://online.wsj.com/article/BT-CO-20140422-708950.html*
[8] *http://nrn.com/mergers-acquistions/activist-investor-calls-red-lobster-valuation-grossly-misleading*
[9] *http://www.forbes.com/sites/samanthasharf/2014/05/22/activists-turn-up-heat-on-darden-red-lobster-deal-unconscionable-board-misleading/*

Darden - Golden Gate Deal	**Value**	*a*	$2,100,000,000
	Effective EBITDA multiple		9x
	EBITDA	*b*	$233,000,000
Golden Gate - ARCP Deal	**Value**	*c*	$1,500,000,000
	Reported Real Estate Cap Rate		8%
	Estimated Annual Real Estate Operating Income	*d*	$120,000,000
Effective Red Lobster Operations Deal	**Net Operations Value**	*a-c*	$600,000,000
	Red Lobster Pro Forma EBITDA	*b-d*	$113,000,000
	Effective Pro Forma EBITDA Multiple		5.3x

A Forensic Analysis of the Sales Price

Darden has responded in part by proclaiming that critics of the deal were relying on *"incorrect and unrealistic analysis, which results in misleading conclusions."* While the deal's purchase price allocation is not publicly available, there are indicators of reasonableness that might be assessed based on disclosed facts. One might consider the real estate asset allocation may well have been valued at $1.5 billion (a central assumption for the activist investors). Assuming this were true, a significant portion of the $500 million tax burden would have been attributable to the gains made on these assets over time. With taxable gains being equal to the sales price minus the depreciated value of the asset, Darden's tax liability would be quite substantial given a large number of the assets sold had been owned for many decades. As importantly, and in contrast, Golden Gate could have allocated its assets purchased both across the sales price and without any depreciation. The private equity firm was perfectly placed to extract value from the newly purchased assets while avoiding, or minimizing, any tax burden.

"…the basic proposition for fair sharing is a simple one. Since synergy requires skills and strengths contributed by both the acquiring and target firms for its existence, the acquiring company's share of the synergy will depend upon how unique the strengths it brings to the mix are. In the limiting case, if only the acquiring firm has the components necessary for the synergy firm, it should receive a large share of the synergy benefits."

Damodaran, Aswath

Another measure of reasonableness relies on comparisons to the market. During 2014 within the same casual-dining sector, we saw Chuck E. Cheese sell to Apollo Management for roughly 7.4x EBITDA[10] and, just recently, TGI Fridays sell to Sentinel Capital Partners and TriArtisan Capital Partners at a price press reports put at 7x EBITDA.[11] Taking the 7x EBITDA industry measure and applying it to the Red Lobster's pro forma EBITDA, the consideration for the operations would have been $800 million, while the value of real estate would have been $1.3 billion. Were this price allocation assumed, Golden Gate could theoretically have garnered an additional $200 million selling Red Lobster's real-estate assets to a strategic buyer like ARCP, although the gains on the deal would have been subject to considerable taxation.

Applying this market approach helps us gauge Darden's ability to garner the highest achievable selling price. If Golden Gate did take home a quick gain on Red Lobster's real estate by flipping these assets to ARCP, then based on a fair market value approach where all participants are willing and knowledgeable, one could argue that Darden could have negotiated the deal so that all possible gains were realized in their favor. In theory, the incremental synergistic value of any acquisition should be distributed between buyer and seller based on the unique synergies and other attributes each contributes to the asset. Since the ability to spin off the real estate assets in a tax advantaged manner was not unique to only Golden Gate, did Darden unnecessarily surrender much of its bargaining power and potential gains?

[10] *http://www.thestreet.com/story/12243232/1/apollo-bids-13b-for-chuck-e-cheeses.html*
[11] *http://www.thestreet.com/story/12717277/1/carlson-makes-40-year-exit-from-tgi-fridays.html?cm_ven=RSSFeed*

Upshot for Darden

Beyond the controversial sale to Golden Gate, the value added by offloading all Red Lobster's underperforming assets will depend on the success of Darden's restructuring and future performance in the casual dining sector. Given that these developments will play out over the long term, the short term for Darden will likely be fraught with confronting continued investor outcry. The deal is expected to close in the first quarter of fiscal 2015.

The Medical Marijuana Industry: Pipe Dream or Profitable Concern?

As of July 2014, twenty-three states and the District of Columbia have ratified the use of medical marijuana. Legislation is still pending in Florida, Ohio, and Pennsylvania. Two states, Washington and Colorado, have gone one step further and legalized recreational use of the substance as well. As social acceptance of marijuana use—both medical and recreational—becomes ever more mainstream, many across the spectrum of business interests view nationwide legalization as a waiting game, if not an outright inevitability. Now that legal and governmental agencies are moving towards normalizing a once-taboo lifestyle, private investors and lenders are quickly accommodating its growing and lucrative marketplace.

According to Michael Correia, a federal lobbyist for the National Cannabis Industry Association, the marijuana industry grows at a rate of sixty percent [per annum], making it the fastest-growing industry in the nation—all while illegal under federal law.[12] However, differing state and federal regulations make quantifying the value of the medical marijuana industry difficult. While numerous states have decriminalized or legalized marijuana use, under the Controlled Substances Act, pot is considered a Schedule 1 drug. This means that federal law views marijuana as a dangerous substance with high potential for abuse and limited accepted medical practicality.

Economists, law enforcement agencies, and business advocates estimate that the marijuana market is worth anywhere from $10 billion to $120 billion a year, though this figure includes recreational use.[13] Private equity firms are taking notice. For example, Privateer Holdings is currently seeking to raise at least $50 million in its second round of fundraising. This private equity firm based in Seattle is the country's first devoted entirely to the cannabis industry.[14] The shifting attitude towards medical marijuana appears to be enticing high-level investors to capitalize on this fresh new cash crop, as well as tangential aspects like production, warehousing, security, and paraphernalia.

In January 2014, another private equity firm was launched with hopes of raising $100 million in two years. HT Growth Fund plans to make individual investments ranging from $2 to $5 million in marijuana-related businesses with a focus on "ancillary" fields rather than retailers or cultivators. Although founded by two *High Times* executives, the fund will be separate from the well-known monthly magazine promoting the cannabis lifestyle and cannabis legalization.[15]

"I think there might have been a burst of feeling that what happened in Washington and Colorado was going to be soon replicated across the country. I'm not sure that is necessarily the case. I think a lot of states are going to be looking to see what happens in Washington, what happens in Colorado before those decisions are made in substantial parts of the country."

Attorney General Eric Holder in an interview with the Huffington Post, April 15, 2014

[12] *http://america.aljazeera.com/articles/2014/6/11/marijuana-industrygrowing.html*
[13] *http://www.thedeal.com/content/private-equity/private-equity-firing-up-medical-marijuana-sector.php*
[14] *http://www.kptv.com/story/21198594/groups-waiting-to-cash-in-on-pot-sales-in-washington*
[15] *http://www.denverpost.com/business/ci_24844193/high-times-launches-fund-cannabis-investment*

These are just two firms. To illustrate the degree of interest the industry currently attracts, listed below are other notable funds and firms hoping to capitalize on what they expect will be a robust new market:

- *Emerald Ocean Capital Fund, which plans to focus on cannabis-related software and technology for investments. They are related to Ghost Group, an operating conglomerate that owns various marijuana-related websites and companies.*
- *KindBanking, a California-based firm, offers debt, convertible debt, and equity financing for legal cannabis businesses locked out of the traditional banking system.*
- *ArcView Group, also based out of California, specializes in venture-style financing for medical marijuana companies. They bring together accredited investors and cannabis companies, and in the past year, 14 different companies have received a total of $10 million in investments.*
- *Duchess Capital Management, a hedge fund manager from Boston, makes equity investments in medical marijuana start-ups.*
- *Greenstead Growth Fund is a marijuana mutual fund set to launch in the next 12 to 24 months and was established by New York State Assemblyman Steve Katz.*

"…a lot of private equity companies are getting into the marijuana infrastructure business, even if they're not investing directly in the green stuff. Software, agricultural equipment, pharmaceutical testing, and real estate for warehouses, dispensaries, and cooperatives are all attracting investor interest."

http://buzz.money.cnn.com/2014/05/01/marijuana-investing-stocks/

Waiting to exhale

The upcoming 2016 election could be a game-changer on many fronts. Recent polls indicate that public opinion favors marijuana reform. According to the National Organization for the Reform of Marijuana Laws, 80% of Americans support the medical use of marijuana, 75% support no jail time for recreational users, and 58% support legalizing marijuana altogether.[16] However, an impending election has the potential to change numerous aspects of the industry, and unforeseen legislation may leave investors and fund managers scrambling to adjust.

Meanwhile, the SEC has taken a stand by halting the shares of nearly a dozen marijuana-related companies since March of 2014. Last August, the Financial Industry Regulatory Authority (FINRA) issued a public statement about the risks of investing in medical marijuana stocks, particularly "pump and dump" schemes and fraudulent companies that advertise large gains while having little industry experience. The statement has since been reissued to "warn investors not only about the potential for fraud in this arena, but also to reiterate the risks of investing in thinly traded companies about which little is known."[17]

Unsurprisingly, there are sometimes-veiled legal issues surrounding this developing industry. Due to differing state and federal policies, certain challenges are almost guaranteed to surface even if capital funding is launched in a state where marijuana is legal. Marijuana's federal designation as a Schedule 1 controlled substance means that facilitating the cultivation or distribution of the drug—even in states where it's legal—is a violation of the Controlled Substances Act. Established pharmaceutical giants are understandably reluctant to invest research and development into an illegal substance. Then there's the issue that marijuana itself, as a plant, cannot be patented. For pharmaceutical companies to profit from plant cultivation and processing, they would have to create products derived from marijuana's two key extracts: THC (tetrahydrocannabinol) and CBD (cannabidiol).

[16] *http://www.thedeal.com/content/private-equity/private-equity-firing-up-medical-marijuana-sector.php*
[17] *http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P325352*

Feeling paranoid?

Given the current climate of pending legislation and strong public support, medical marijuana is clearly a booming industry with plenty of room to flourish. However, the risks inherent in any new market are evident, and this particular industry is perhaps more susceptible than others to unexpected legal and regulatory hurdles. These contradictory conditions make valuing almost all marijuana businesses a delicate task. Satisfactory pre-deal due-diligence findings require target companies meet standards related to their brand recognition, loyal clientele, employee expertise, reputational capital, infrastructure, and proper state and local licensing, with an added important stress on clean criminal records for its CEOs and CFOs.

As an additional challenge, even the simplest valuation methods to appraise marijuana businesses find too few data points in a market fraught with conflicting determinants. In the marijuana trade, there are no set industry standards. Basing a valuation on assets can be misleading when, for example, at our current historical conjuncture, the price tag attached to a marijuana license alone can range from $250,000 to $1 million. Or, today, even the more authenticated trademarked marijuana businesses require exorbitant security expenditures.

On the other hand, if a valuation is based on potential earnings, assuming a sensible multiplier to apply to revenue allows ample room for uncertainty because most established cannabis cultivators and retailers have only a short history of viability. With no record of profitability, any appraisal of these emerging cannabis businesses would be based on limited indications of expected future growth in earnings.

"..Federal legal issues remain a key risk factor, but lack of information on statewide customer demand also leads to uncertainty, and both of these risks tend to reduce the multiplier."

http://www.cannalawblog.com/valuation-of-marijuana-businesses-still-an-art-not-a-science

High time to make history?

But, for the private-equity investor or buyer, if aspects of the target cannabis company include an insignificant amount of existing debt, or multiple long-term customer contracts, and if all business is permitted under state law and does not break restrictions or limitations, then an investment or plan to acquire may seem worthwhile. Such a venture might also profit from the number of budding marijuana-related service industries with everything from irrigation systems, customized fertilizers, and indoor horticulture, to financial, legal, and real-estate services. Even the hospitality and tourism sectors are unearthing synergies with the industry. Pot-centric tech start-ups already thrive on creating mobile apps for locating producers and retailers, or by developing software for all operational aspects from general ledgers to barcoding and tracking individual pot plants. Don't forget wholesome hemp clothing and hempseed cereals. As more states adopt legalized medical (or even recreational) marijuana legislation, the federal government may be compelled to amend the Controlled Substances Act itself, as well as the Bank Secrecy Act. A whole economy around this highly-promising, but not-fully-accepted industry is rapidly unfolding. Perhaps opting to partake would not be so radical.

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