

## Token Risks

### Rolling the dice on rolling the doobies – speculative risk.

In 1983 I was living in California on a volunteer assignment, and became good friends with an entrepreneur – a computer manufacturer of all things. His name was not Steve, but he was convinced that he was on the verge of surpassing Steve's very successful Apple IIe. A prosperous engineer by trade, but a dreamer at heart, he was putting a good chunk of his life savings, and that of a few business associates, friends and family on the line. He even enthusiastically offered me a few ground floor shares, but at the time I could scarcely afford lunch. His model, he argued, could do everything the Apple IIe could do, but faster, and cheaper. He already had a few orders as his factory was getting close to launch just as I was heading back home to Canada in May 1983. I never heard of him again, but just a few months later, and a few miles north of where I had been living in California, Steve Jobs brought the world the first Macintosh computer, and the rest, as they say, is summed up in that swirling, flushing sound.

#### **This Tuition is Expensive:**

If they are honest, nearly every successful entrepreneur will admit to having broken off the rough edges of their business over the years by the rough and tumble experience of making a go of it. Even if the initial excitement of a new concept is still as intoxicating to them as it was decades before, they will still vividly remember the trials of starting up, and grant some space for reflection over the dreams that mightn't have come true.

The decidedly boring truth is that the best filter for risk is a history of having successfully navigated it. The adjudication of this is not resident in some government bureau, but rather in the undeniable profit/loss numbers, proven over time. There is no short-cut for a track record. Speculation in its dearth is sometimes richly rewarded, but more often punished. Those very few lottery winners are funded by whole bunches of lottery losers, and investing in start-ups is quite simply a risky concept.

#### **Up in Smoke:**

Take the budding business of recreational Marijuana production for example. Now that our political leaders are about to sprinkle ferry dust on Pot Inc., there is a sense that profits will fly high. But viewing this, or any business as a sure thing is a puff of pure millennial magic. It is said that potheads can tend toward paranoia. A dose of that emotion would be useful here.

Legalization of pot is not a free pass around the usual business risks, but a ticket headlong in to them, rolled and licked tightly around its very own special set of jeopardies. As a general rule, take bigger bets on smaller risks, and smaller bets on bigger risks and you might be okay.

#### **But Consider the Unknowns:**

- Political and regulatory risk: What is the yet-unwritten pot legislation going to look like? Will it severely restrict distribution? Will it be popular at the next Federal election? Will it be repealed? Will it be subject to sin taxes down the road?
- Competitive risks: What will the all the other suppliers be up to? Will they be better at this than the company you have invested in? Will entry in to the sector be open wide or restricted?
- Operational risk: The day-to-day putting together of things that make operations work well.
- Weather: Yes, weather. Where agricultural commodities are concerned, the usual risks apply. When weather is conducive to a successful crop, supply goes up, pressuring prices to go down. When the opposite is true the opposite is true. Sometimes being on the right side of this equation is a matter of sheer luck, and international growers might have better growing conditions.
- Financial Risks: Is there a proven history of positive cash flow from operations? Is there access to additional capital from shareholders or lenders? Is the company carrying too much debt amidst a downturn in business volumes? Is management getting involved in large contracts they are ill-equipped to meet? (In new ventures most of this is speculative risk).
- Also consider management quality, environmental risks, and many other issues not listed here.

Eventually, if the political environment remains consistently accommodative (by no means a sure thing) there will be some winners and some losers. It is a roll of the dice at this point to know with confidence who the winners might be. Unfortunately, given that markets are forward-looking, the share prices of most marijuana suppliers who might make a go of it are already inflated to reflect the sum of their hoped-for future profits. So we there is no getting in on the ground floor here.

You might argue that many of these same barriers to success existed with Samsung, Apple, or Microsoft, or Amazon. This is true, but it also conveniently ignores the fact that hindsight is selective. Looking back there is also a long train of has-been competitors we no longer mention (Polaroid, Commodore, Blackberry, Nortel...) But ignoring all that, is this an industry you would be proud to show your children you profit from? They might just become a customer someday, and argue that they were just trying to play a bigger role in the family business.

And that would stink.

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