



When the ground
beneath your feet
starts shifting,
will you stand still
or leap forward?

Key cannabis sector questions to ask now



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Key cannabis sector questions to ask now

If you're not ahead of trends in the cannabis sector, you may feel you're already falling behind. But this evolving global industry is still in its first inning. Companies that will lead this space 10 years from now have not yet been decided. Organizations that dive deep to understand cannabis' transformational market opportunities – and focus accordingly – can proactively make strategic decisions today to position themselves as sector leaders over the long term.

What's shaping the sector right now? Adjacent industries such as tobacco, alcohol, consumer health and pharmaceuticals are paying increasing attention to this space as their markets are becoming disrupted and as new high-growth opportunities emerge. Regulatory reform is sweeping the globe. New potential entrants are considering opportunities. Cannabis is becoming less of a niche market, and increasingly accepted by the mainstream. And the industry itself is proving to be much bigger than many first projected.

While the market has typically focused on CBD and THC – the two most common cannabinoids, which make up the cannabis plant's active constituents – there are actually more than 100 cannabinoids and other compounds to research and explore with potentially versatile applications. Cannabinoids may one day make their way into our daily health regimens, as well as different experimental and social settings such as bars and restaurants. The next generation of cannabis-focused products will be substantiated by validated data and integrated into our daily lives and ubiquitously woven into the fabric of society, especially as new form factors, formats and new consumption occasions come to fruition.

Not only is cannabis becoming a part of the cultural zeitgeist, leading cannabis companies show an estimated annual median gross margin of 41% and an estimated median annual revenue growth rate of 63%, respectively.¹ This is significantly higher than traditional, established consumer products, which have historically grown at 2% to 3% each year.

Taken together, these factors are generating viable opportunities worth exploring – many of which simply may not have existed even a few short years ago.

Asking these questions now can help you build on this environment to carve out a prominent role in tomorrow's cannabis industry:

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A currently estimated \$300-billion, primarily illicit, global market is moving into the regulated and taxable realm. This market consists primarily of dry flower and doesn't account for the oncoming market of diverse consumer packaged goods. As more regulated markets open up, consumption rates should significantly grow as new consumers are exposed to cannabinoids in different form factors (extracted CPG products) and across new distribution networks.



Todd Harrison

Chief Investment Officer,
CB1 Capital

- 1 Is our view of the addressable market broad enough?
- 2 What critical innovations will create new market opportunities for us?
- 3 How can we proactively build optionality into our strategy?

¹ Estimated gross margin and one-year revenue growth outlook for leading companies in the global cannabinoid industry varies by: geography, segment business model, value chain participation, level of vertical integration, channel, brand, operating efficiency, product differentiation, route to market strategy and level competition. Gross margins could also be affected by regulation on an on-going basis. Source: Capital IQ, EY analysis

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The cannabis consumer is evolving every day. Initially, it was the cannabis connoisseur, who moved into the legal market from the illicit market. Nowadays, cannabis brands are targeting themselves towards ‘intenders’ customers who are looking at the space for the first time through low-dosage edibles and beverages. This is the key to crossing the chasm and unlocking mass-market appeal for the sector.

**Narbe Alexandrian**

Chief Executive Officer, RIV Capital



Is our view of the addressable market broad enough?

Even in the few short years since Health Canada laid out the path to cannabis legalization, much has changed. The stigma around cannabis has started to fall away, and research and stakeholder education has increased. More than 40 countries and counting have legalized cannabis, medical cannabis or specific formats for qualifying medical purposes. There are an estimated [190 to 250 million cannabis consumers worldwide](#). The total addressable market is attractive to adjacent industries looking to expand into new market segments, geographies, product and consumer segments.

Research is beginning to show a [host of potential clinical interventions](#) spanning everything from modulating immunity, inflammation, neuroprotection and pain, to hunger, feeding and metabolism. The [100 or so lesser-known cannabinoids](#) like CBG, CBN, THCV; 150 terpenes (aromatic compounds) and other potentially therapeutic compounds could amplify those future market opportunities further. Some compounds may be non-intoxicating or more efficacious when combined with other compounds, but more fulsome research is required. This could lead to significant innovation in the industry, as forward-looking investors seek to unlock the benefits of the plant in forms that could ultimately become as common as a vitamin or all-natural sleep aid.

To get ahead:

- ▶ Explore the emerging form factors, formats, consumption occasions and intended effects for cannabinoid-focused products.
- ▶ Consider how what you do best connects to where the industry is going next. The nature of your operations, products and existing consumer base may already be well positioned to take advantage of the industry shift.
- ▶ Look for synergies from your existing assets and capabilities to enter the cannabinoid market and consider where alignment of the two can identify high-growth opportunities.



The future cannabinoid consumer or patient will consume cannabinoids for many purposes, ranging from general wellness and symptom management to targeted ailments, all backed by data and research.



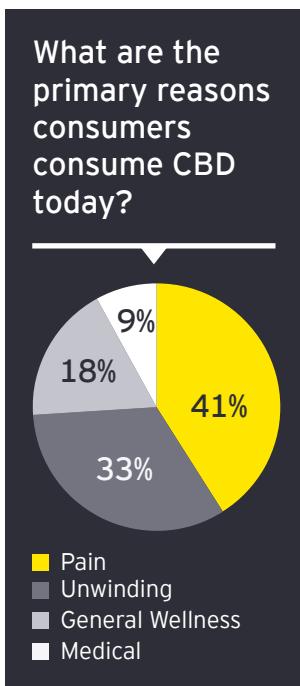
Deepak Anand

Chief Executive Officer,
Materia Ventures

Which conditions could cannabinoids potentially address?

	Ailment	CBC	CBD	CBDa	CBG	CBN	THC	THCa	THCv
 Pain/Sleep	Cramps, Migraine	○	●	○	○	○	●	○	○
	Insomnia	●	●	○	○	●	●	○	○
	Pain	●	●	○	○	●	●	○	●
	Arthritis, Inflammation	●	●	●	●	●	●	●	○
 Gastro-Intestinal	Appetite loss	○	○	○	○	○	●	○	○
	Nausea	○	●	○	○	○	●	○	○
	Diabetes	○	●	○	○	○	○	○	●
	Crohn's disease	○	●	○	○	○	●	●	○
 Mood/Behaviour	Anxiety	○	●	○	●	○	○	○	○
	ADD/ADHD, Stress	○	●	○	○	○	●	○	○
	Bipolar disorder, OCD, PTSD	○	●	○	●	●	●	○	○
	Depression	●	●	○	●	●	●	○	○
 Neurological	ALS	●	●	○	●	●	●	●	○
	Parkinson's, Alzheimer's	●	●	○	●	○	●	●	○
	Multiple Sclerosis	○	●	○	○	●	●	●	○
	Epilepsy, Seizures	○	●	○	○	●	○	●	●
Other	Cancer	●	●	●	●	●	●	●	○
	Fatigue	○	○	○	●	●	●	○	○

Source: Leafly



Source: New Frontier Data 2020 U.S. CBD Survey

According to Euromonitor, legal cannabis can be tailored to cater to the broad spectrum of mental wellbeing and mood enhancement need states. Cannabinoids and other compounds could be included in functional food and beverage products, disrupting adjacent industries. As cannabis consumption becomes more commonly accepted, and broader audiences recognize its opportunities outside of medicinal and adult-use/recreational markets, consumers will represent broader demographic and socioeconomic groups with a variety of need states.



We are continuing to see new form factors emerge every day with branding that is better aligned with the consumer target in mind. The winners of tomorrow will be the hyper-focused brands that don't rely on budtenders to sell, but instead have an easy-to-understand, frictionless value proposition targeted to their end consumer (e.g., premium quality, creative edge, sleep aid).



**Narbe
Alexandrian**
Chief Executive
Officer, RIV Capital

What critical innovations can create new market opportunities for us?



Those already shaking up the cannabis industry are taking a holistic view of the sector and using innovation to accelerate research, product development and consumer understanding. On the one hand, dried cannabis flower has been the dominant cannabis format to date and will continue to be an important category. But as the industry matures, first movers are already researching and developing other novel and non-combustible form factors.

Federal legalization in the US would greatly impact the perception of the industry, demand for new products, capital that would flow into the industry and the level of research and innovation that would fuel the acceleration of product development and consumer acceptance.

“ Federal legalization in the US would make banking easier and would change the dynamic of the availability of credit and capital in the industry. Cannabis is not something most adjacent industries can afford to ignore.



Trina Fraser
Partner,
Brazeau Seller Law

To capitalize on new innovation, consider:

- ▶ Non-combustible form factors could introduce new consumers to the cannabis industry. Substantive and validated data for next-generation cannabinoid-based products and devices will inform company decisions and act as a source of differentiation as regulations continue to transform.
- ▶ Taking down organizational silos that impede innovation can accelerate the speed and impact of your progress. Innovation thrives when it's deeply embedded in organizational culture.
- ▶ Creating a collaborative innovation ecosystem through incubators, accelerators and co-innovation spaces. This can provide high-growth potential companies with access to resources, infrastructure, product development and commercialization expertise.

What are the most notable areas of industry innovation?

Top 10 innovation areas		Notable areas of innovation		
	Human biology, medicine and data	Endocannabinoid system research	Biomarker identification and person-to-person variability	Drug development, clinical trials and safety data
	Genetics	Genome editing	Selective breeding	Stabilized feminized auto-flowering seed lines
	Production	Biosynthesis and chemical synthesis	Yield optimization	Post-harvest and derivative production
	Business	Monetization	Distribution	Branding and marketing
	Capital equipment	Automated industrial scale planting, maintenance and harvesting	Extraction, isolation and purification	Finished goods manufacturing
	Digital	Precision agriculture	Supply chain and product provenance	Product development and formulation
	Product form factor and format	Nano-emulsion and encapsulation	Flavour, palatability and formulation	Function or use occasion
	Performance	Consistent/controlled onset and duration	Bioavailability and solubility	Enhanced pharmacokinetic profile
	Devices and delivery systems	AI-enabled metered dosage	Nasal inhalation	Non-combustible route of administration
	Customer	Education, engagement and activation	Experiences	Services

Down the road, individuals may consume cannabis as a supplement with their morning breakfast for a boost of energy, apply cannabis-infused topicals to soothe localized pain from a round of golf, or drink a beverage before bed to promote relaxation. Creating such substitutes and investing in resources to develop these new markets are attractive propositions for adjacent industries already making their way into the space.

The industry could be further segmented by composition, format or route of administration, mirroring similar regulation in adjacent industries. Industry participants will have to gain a better understanding of consumer behaviour to develop new products that address various functions and need states as the industry itself evolves.

“ Most institutional investors and high-net-worth investors are prohibited from investing in the cannabis space due to legal or regulatory impediments. As these legal and banking barriers resolve, and the cannabis space opens, institutions will likely chase growth. With all potential use cases added together, an approximate \$1-trillion potential global annual revenue market is visible on the horizon vs. an approximate estimated \$140 billion in aggregate current public cannabis-related market cap.



Todd Harrison
Chief Investment Officer, CB1 Capital

How can we proactively build optionality into our strategy?



So much of the market opportunity ahead will only accelerate as major regulatory breakthroughs and scientific milestones are met. Valuation premiums for good operators, additional investments and industry participation are likely to increase as additional countries, like the US, embrace federal legalization. Waiting for the industry to cement itself can mean missing out on the opportunities already proliferating across the global industry.

Still, it can be hard to know where to make your mark, and which scenario will map to optimal results. Early entrance into this emerging industry typically requires significant infrastructure investments. However, late entrants may miss out on opportunities that are accessible only through established and trusted partnerships. Optionality can be built into strategy by taking an iterative approach to scanning the market, developing adaptive commercial strategies, conducting scenario analysis and engaging in pilots that are structured in a way that reduces risk while enabling active participation.

“ Developing a strategy for getting into the industry is one thing, and then actually executing is another. In some respects, the cannabis industry has already gone through a lifecycle, and in some respects the industry is incredibly immature or commoditized. You can't just speak in broad generalizations.



Trina Fraser
Partner,
Brazeau Seller Law

Create greater optionality by:

- ▶ Using flexible and innovative investment and partnership structures to mitigate risks and compete effectively over the long term. Given the many unknowns and dynamic changes in the industry's future, the traditional “build, buy or joint venture” market entry framework may need rethinking.
- ▶ Decreasing risk through structuring contingencies into minority investments with the option to convert to majority/controlling interest upon certain market conditions, economic milestones or regulatory reform.
- ▶ Creating a portfolio of diversified bets, similar to venture capital that, allow companies to cast a wide net of strategic investments or structure tranche capital disbursements.

What are the steps to building optionality into your strategy?



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Licence-holders will act as the gateway into all of these new opportunities. The main advantage of forming a strategic partnership with an existing licence-holder is speed to market and bringing together complementary strengths. Whether it's CPG or pharma, they'll bring their brand-building, technical expertise and asset base to the table to complement a licence-holder's infrastructure, licence to operate and experience to produce products or conduct research.



Trina Fraser
Partner,
Brazeau Seller Law

Where do we go from here?

With the right alignment, just about any company competing in a mature adjacent industry can uncover a route into the sector, tapping into new growth. Right now, the industry represents a wealth of possibilities to explore. Making smart investments today can secure optionality as legalization expands, regulations evolve and innovation unlocks new product, market and customer opportunities. Exploring what investments, partnerships, joint ventures or transactions could make the most sense for you now means building agility and alignment with your longer-term strategy. With an industry moving this rapidly, that's critical.

Key takeaways

- ▶ Cannabis is evolving from a misunderstood industry to a mainstream product. Next-generation cannabinoid-focused products and devices will be substantiated by data and accessible to the mass market.
- ▶ New form factors, formats and versatile applications will address a wide array of need states, intended effects and consumption occasions that will change the way individuals interact with and incorporate cannabis into their regular routines.
- ▶ The fast pace of innovation requires establishing strategic relationships and an ecosystem of cross-industry stakeholders to stay ahead and adapt to industry trends and changes.
- ▶ New opportunities are emerging every day. Companies need to understand their core competencies and how to quantify the risk and return for various scenarios or opportunities. Success requires constant iteration, and continuous incorporation of lessons learned.
- ▶ Companies entering the industry must be adaptive to the shifting landscape and understand how to differentiate their strategy, products and brands.
- ▶ Market entry and investment strategy require a tailored and multi-pronged approach. Successful execution entails active participation.



At-a-glance case study: Cannabinoids moving mainstream

Background:

2018

Molson Coors forms a joint venture called Truss Beverages with HEXO, a Canadian cannabis licence-holder, to diversify their business and pursue non-alcoholic beverage opportunities.

- ▶ The JV developed CBD- and THC-infused ready-to-drink beverages in various flavour profiles and dosages (high-THC, low-THC, 1:1 THC:CBD and CBD-only). Truss also developed a house of brands to introduce its new cannabinoid ready-to-drink assortment to the Canadian market, including Veryvell, one of Truss's more notable brands.

2020

Molson Coors launches its new corporate logo and identity as part of the company's expansion strategy into beverage categories "beyond beer."

2021

Molson Coors announces a new joint venture, Truss CBD USA, majority owned by Molson and operated in partnership by HEXO. The new JV launches Veryvell in Colorado.

- ▶ Veryvell's non-alcoholic, zero-calorie and zero-sugar sparkling water CBD-only formulation was reformulated to include adaptogens, targeted at health-conscious consumers. Colorado was chosen as a pilot state in the US to test the market, create new retail relationships, leverage existing key account relationships and build out Truss's direct-to-consumer channel.

Key takeaways

The joint venture gives Molson greater flexibility and optionality down the road as the company explores new products, geographies, markets, customers and brands. Molson brings years of operating experience, branding and marketing capabilities, global distribution network and key account relationships, while HEXO, being a vertically integrated license holder, brings its established infrastructure, licence to operate and cannabis industry knowhow to the table.

Molson curated its ready-to-drink product assortment with the long-term view of introducing new consumers to the non-combustible cannabinoid beverage category. Once Molson developed its proof-of-concept and tested its products in market, it was able to gather feedback before expanding adjacently into new geographies, channels and customer segments.

Leaders in this market will:

- ▶ Create an environment to de-risk entry and accelerate research, product development and speed to market
- ▶ Secure omni-channel distribution and market access
- ▶ Thoughtfully segment consumers (current and future) and understand their evolving purchase drivers and preferences
- ▶ Invest in the right innovations to consistently offer diverse and differentiated products
- ▶ Constantly assess new market opportunities

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