

The more the marijuana industry changes, the more it looks like the alcohol industry all over again...

Alphonse Kerr could easily have been writing about the nascent marijuana industry when he penned, "The more things change, the more they stay the same". The past month has brought change, legislative announcements, rumours and wild fluctuations in share prices: in other words, it's the same as it ever was.

Plus ça change, plus c'est la même chose.

Recently police in Toronto raided and arrested illegal distributors of marijuana. (Notice how often the word "raid" gets used when the police go a'knocking.) The illegal distributors are easy to find: they idiotically advertise in their storefronts and dare the police to arrest them.

The distribution and sale of marijuana in Canada, absent having a government issued licence to do so, is illegal. Full stop. Whether you agree with the legislation or think it is stupid, it is the law.

We do get to pick which laws we will follow and which we will deliberately ignore, but there are consequences to such decisions. Choose to hide taxable income from Canada Revenue Agency, and there are consequences. Choose to drive while impaired, and there are consequences. Set up a store that advertises the sale of a prohibited substance, and there will be consequences.

Such choices in this industry will continue to be shaped by the occasionally complementary forces of legislation and

demand.

Concerning demand, the number of Canadians registered to use medical marijuana has soared from 30,000 to nearly 130,000 since the federal election in October, 2015. While this represents over a 400% per cent increase it is nowhere near the 450,000 users predicted by the feds for 2017. The Canadian demand is there, but the court decisions of Smith and Allard increased the number of permitted grow-at-home users, and that had the effect of reducing the number of users requiring a third party provider.

On the legislation front, medical marijuana has been legislated into legality on a limited basis, as refined by Smith and Allard, with the market expecting some kind of announcement this month concerning a path to decriminalization.

The Liberals, firmly in power federally, have long said they would not decriminalize marijuana without also introducing new legislation to regulate its production, sale and distribution. There will be rules to be followed, with the threat of some form of government sanction for a failure to follow those rules.

The hot 'news' is that the federal Liberal party might announce the new legislation on April 10, 2017, with a view to implementing the legislation on July 1, 2018. Note that this is not the official position of the government. This 'news' came from "a senior government official who spoke to CBC News on condition of anonymity".

The politics here become fascinating. The media have largely reported this target date as a fact, with minimal credit to the questionable reliability of the source. Did Prime Minister Trudeau authorize that official to leak the news? Is this a trial balloon looking to see how the voting public reacts? Was this a true leak, which could jeopardize the timetable? Is it

even an accurate rumour? If the leak wasn't an official unofficial leak, why did that person choose to talk to the media about this?

Time will tell. The market had a small pop in reaction to this rumour, then settled back into normal trading patterns. Expect the same responses when the government formally releases the actual timetable. We still think April 20 is the most logical choice for the day of the announcement.

Even if this anonymous tip turns out to be roughly accurate, the government still has to deal with three pesky international laws that restrict Canada's ability to make unilateral legislative decisions on marijuana. The federal government's position on these is here and it adds to the uncertainty surrounding the market. Do not assume that Canada will be able to decriminalize while those three international agreements apply, and as we've said before, do not assume Canada has a solution to this part of the challenge.

For a preview of what the legislated recreational cannabis industry could look like, look at the current mess that is the alcohol industry in Canada. Canada nationwide prohibited the sale of alcohol (other than for medicinal purposes) after World War I. The restriction was lifted in 1920, leaving each province to regulate the production, distribution, importation and sale of recreational alcohol. Quebec with its liberal (and organized crime controlled) system became a drunken tourist destination for Americans in the north, much as Las Vegas later drew tourists from California.

Ontario the Good kept its prohibitions in place until 1927, although certain export exemptions allowed Carling and Labatts to thrive. "Public drinking" was illegal in British Columbia until 1925. Prince Edward Island maintained prohibition until 1948.

The bizarre patchwork of regulation province by province

continues to this day. Microbreweries suffer from different rules from vineyards from stores. The mighty Liquor Control Board of Ontario with its near-monopoly had over \$5Billion in revenue in FY2015, with net profit of over one billion dollars. That revenue went to the provincial government, since the LCBO is a Crown corporation. There's no room for entrepreneurs when going up against the Crown – almost every bar and restaurant in Ontario must purchase all inventory from the LCBO, which gives the LCBO massive power in determining which brewer will succeed and which will go bankrupt.

In 2012 the federal government eliminated a ban on inter-provincial direct-to-consumer sales. A winery in Manitoba could for example legally sell directly to an internet purchaser living in Alberta.

But just because the feds allowed it in theory did not mean it would happen in practice. Each province still retained the right to govern over whether it would allow its residents to enjoy the lifting of the ban. Provincial regulations impede the implementation of what the feds have permitted, and there is always a fear from smaller producers that the monopolistic government distribution arms like the LCBO could punish them for selling into Ontario.

And this brings us to what the marijuana industry in Canada will likely look like. Everything above about the alcohol industry can be applied to marijuana. The feds will propose to remove marijuana from the *Criminal Code* and related statutes, and will maintain a system that federally regulates the production of marijuana for medical and recreational purposes.

Each province will then create its own system for the actual sale and distribution of the product to users in that province. Some will opt for a direct to consumer model, some will create a LCBO-type government monopoly, some may prohibit it altogether (PEI?)

Since the provinces haven't yet seen the proposed federal legislation, no province can yet create a plan for regulating the actual sale of the product.

Don't expect the provinces to be eager to be co-operative. As noted on March 27, 2017 by The Toronto Star, "[a] free-for-all system in which anyone could sell marijuana is a non-starter with federal, provincial and municipal officials." There is still a large portion of the population who is against decriminalization, and they appear to be the demographic that is more politically active than the marijuana supporters. Also, the provinces will have to invest a considerable amount of resources into creating the necessary infrastructure to distribute and sell the marijuana.

In Ontario, Premier Kathleen Wynne has said regulating cannabis and limiting access for children and teenagers will be critical as Queen's Park develops its own legislative framework.

A final layer of regulation is on a city by city basis. Municipalities use zoning to control what businesses can be physically located where. It's why you don't see a bar next to a primary school. This means municipalities are the last control on where a marijuana producer or seller can be located. Concerns over organized crime, addiction issues and proximity to schools may lead some municipalities to use the zoning code to effectively ban all sales and production from that municipality.

So the more the marijuana industry changes, the more it looks like the alcohol industry all over again.

One company that has finally adapted is Hydropothecary Corp. We have been highly critical of the company's moronic 2015 business plan that called for Hydropothecary to sell its medical marijuana at \$50 per gram when the rest of Canada was selling for around \$8. Hydropothecary's historic explanation

for this price point was that it would deliver its marijuana in a fine brown paper bag with a lovely red ribbon on it, thereby catering to the luxury end of the market, for the same product.

Times change but business fundamentals don't. Private equity voted on that business plan with its dollars. Hydrothecary could not raise expansion capital on its flawed business model. When recently going public, the company announced its average sale price was now roughly \$11 per gram, at the high end of reasonable.

Over the next few years, stock market pricing will fluctuate wildly as the different legislative pieces are unpacked, digested, enabled and tested. The marijuana industry will have to adapt as the legislation rolls out nationally and provincially, and then is regulated municipally. Those who don't learn from history will be condemned to repeat it.

The marijuana industry in 2016

January 8, 2016 – Peter Clausi, lawyer, investment banker and consultant to the marijuana sector in an interview with InvestorIntel Publisher follows up on his recent Law and Valuation in the Marijuana Market column for InvestorIntel. Discussing 4 different kinds of marijuana companies, he advises Tracy on how to review the wide range of investment opportunities presently in the market. Providing an understanding of the impact of legislation on the marijuana sector and a timeline on when the legalization of recreational marijuana may occur.

Tracy Weslosky: Your column on the law and valuation of the marijuana sector did very well, can you tell us where we are today with the marijuana industry in Canada?

Peter Clausi: The largest driver of value lately for the marijuana sector as a whole was the Throne speech. The majority liberal government followed through on its electoral promise to deregulate marijuana in Canada. They have made it part of their platform and have promised to do so. I don't anticipate that happening for the next three to four years. There'll be consultation needed. There'll be time to draft the statute, draft the regulations and work with the provinces to incorporate them into the process, but it will happen.

Tracy Weslosky: All of us investors out there last year we were hit from so many different directions about which marijuana company we should invest in and which one was going to be the greatest, you know, best stock we'd ever owned. I think a lot of it had to do with licensing. Can you explain to our audience how we should be perhaps evaluating these different types of stocks?

Peter Clausi: Sure. The government of Canada can issue different types of licenses. There's a license to cultivate, which means you can grow it, but as Aurora Cannabis found out, you also need a license to sell otherwise you're just stuck with inventory in your warehouse. There are also licenses to transport and licenses to import. Bedrocan part of its merger with Tweed had a license to import and that was its driver of value. We're now looking at four different kinds of marijuana businesses, companies that have applied for license of any kind and don't have one yet, companies that have a license to cultivate, companies that have a license to cultivate and sell, and then all of the infrastructure companies supporting the growers.

Tracy Weslosky: Of course, there's not that many sales licenses that are out there for instance. I mean, there's

only, what, less than three dozen?

Peter Clausi: Yes.

Tracy Weslosky: Okay. So in order for us to really establish which company we should invest in we need to be looking at licenses obviously.

Peter Clausi: Yes.

Tracy Weslosky: And of course, then we have the additional challenges – right now there's rumors in Canada with Justin Trudeau becoming our new prime minister, that perhaps we will have recreational marijuana being legalized in the next couple of years. What's the reality of this?

Peter Clausi: That will happen in the next three to four years. It will take time and statutes must be drafted. Getting the provinces onside will take a considerable amount of time. Just like with alcohol, every province has its own scheme for distribution. Every province will want to distribute the marijuana within its borders in a different way...to access the complete interview, [click here](#)