



The Canadian cannabis industry: executing the deal

With October 17 just around the corner, the buildup toward the legalization of recreational cannabis in Canada is in full swing. Across the country, companies are racing to get their hands on additional supply, production capacity, intellectual property (IP), and genetic variety while strengthening almost every aspect of the supply chain that could give them a leg up in this new—and highly competitive—landscape. As a result, we've seen an acceleration in M&A transactions in the marketplace in recent months, mega-deals and mid-sized transactions alike.

With the market expected to generate more than \$4 billion in sales in 2019, this flurry of activity is not unfounded. Our recent report on cannabis, *A society in transition, an industry ready to bloom*, reveals there will be quite a demand for the legal product once it hits the market. Existing consumers are expected to shift 63 percent of their purchases to legal channels, while an influx of new consumers will expand the market even further.

To meet this demand, companies will need to take a disciplined approach to mergers and acquisitions (M&A), particularly when it comes to post-transaction integration. Too often deals fail to capture their stated accretive value because not enough time is spent strategizing or planning. To avoid this—and to increase your organization's chances of lasting industry success—we recommend focusing your pre- and post-transaction efforts on three key areas: operational structure, compliance, and M&A strategy.

A streamlined operational structure

Of the current cannabis users in our recent report who indicated they'll convert to legal consumption channels, more than half cited better-quality products as the key reason for doing so. It therefore appears quality will be paramount in this nascent industry—and the companies capable of offering it will swiftly become market leaders.

With that in mind, it's important to note that the efficient production, distribution, and sale of high-quality cannabis doesn't happen by accident. To deliver the best product to market in the most efficient way, you need to attain a certain level of structure (governance) and operational rigor across your entire organization, both during and following an M&A transaction.

This will require focusing on your existing people, processes, and systems, and asking some key questions throughout the deal process, including:

- What is our overarching vision for the combined companies?
- How will our operating model translate vision into operating reality?
- What operational processes and procedures will enable us to deliver on our objectives and scale our business for future growth?

More specifically, you'll want to focus your structuring efforts on three key areas:

Align talent strategies

The race for talent is fierce right now, so it is important to consider how your talent and skills mix will be able to deliver on your short and long-term objectives. During the post-transaction period in particular, this will involve taking steps to ensure the talent strategies of both companies align—and working together to position the new entity for success.

For instance, while one of the original companies may have invested in hiring agriculture professionals experienced in cultivation—allowing the new entity to produce high-yield products—there may still be some gaps when it comes to ensuring these products meet regulatory compliance standards. In this case, it might make sense to hire a regulatory team familiar with the cannabis compliance landscape, as well as talent from the banking, marketing and brand, and pharmaceutical sectors, to ensure a holistic view of the space.

The strength of the management team is another key component of M&A success. An experienced management team will send a strong signal to potential investors and instill confidence in decision-making at the top. Given the complexity and uncertainty of M&A in an unproven market, the management team will be what sets companies apart in many cases.

Ultimately, it's important to identify your talent requirements early on and get a team in place that will enable your organization to scale and adapt quickly to a rapidly evolving market over the long term.

Establishing repeatable processes

Once you've put in place the ideal team to produce a high-quality cannabis product, you're going to want to maintain that high quality yield after yield. For that, you'll need robust, repeatable processes.

Such processes should be highly automated, efficient, and scalable to future growth. Some key areas you may want to refine include finance and accounting (including financial reporting), cultivation, picking-packing-shipping, seed-to-sale tracking, supply chain management, inventory management, security, and quality assurance.

By taking such steps during the execution stage of an M&A transaction, your new business will not only be better positioned to deliver a consistent, compliant cannabis product, it will also help you establish a robust reputation among consumers.

Using technology to accelerate growth

The earlier you invest in research and development (R&D) and in technology to uncover ways to efficiently automate processes and improve data capture, the faster you'll be able to get to market—and that may position you to become a market leader. That said, not every company is going to have the same technology strategy. In some cases, it may make sense for a company to take a second-mover advantage approach—letting the larger players test out key market categories before investing in their own development. In other cases, it may be wise to make big bets on technological advances or adaptations from other sectors.

To determine which option makes sense for your company, establish a solid strategy in the early days following an M&A transaction. It should take into account how you plan to implement and integrate technology across operational processes, use data to drive decision-making, and scale proven technologies to meet the evolving needs of your business as it grows.

Before M&A: Questions to consider

What are our growth goals?

- Will we serve the medical or recreational market, or both?
- What customer segments and products offer the greatest growth opportunities? How can we better understand unproven customer segments?
- Will we be a pure-play cultivator down the road, or offer downstream products as well, such as beverages and edibles?
- What opportunities exist in international markets? Are we willing to enter the US market and forgo our banking relationships with the large national banks? Have we considered other consequences given the complex and evolving legal framework?
- What are our core capabilities?

- Will we build capacity and capability or purchase it? If purchase, how do we choose the right partner that has a sound reputation and low financial risk?

How can M&A help us create value?

- How does this deal fit into our overall growth strategy?
- Are we looking for a company that will help us diversify geographically?
- Is there a company that can broaden our product portfolio?
- Will this deal improve our upstream or downstream capability?
- Will this deal add immediate accretive value to our organization?

What is our integration plan?

- How can we adapt our operating model to help us improve flexibility, absorb new businesses, and avoid the duplication of shared services (e.g., finance, HR, and technology)?
- Do we have an Integration Management Office (IMO) to oversee the execution and development of Day 1-100 plans and beyond?
- Have we taken a systematic approach to integration?
- Does our integration plan deliver the synergies envisioned when entering the deal? How will we monitor and track the value being delivered from the combination versus our original business plan?

Compliance is non-negotiable

While there are still many uncertainties surrounding the implementation of cannabis regulations, one thing is clear: regulatory compliance is sure to be a huge focal point for the government, both in the early stages of the industry and beyond. That makes it another key priority for organizations.

When establishing a compliance framework, it's important to remember the regulatory intent of cannabis legalization in Canada: to eliminate the black market and get cannabis out of the hands of young people. As a result, our view is that maintaining compliance comes down to perfecting your standard operating procedures so that you're confident in your ability to be 100 percent compliant 100 percent of the time.

This not only includes establishing the operational processes described above, but also developing policies and a clear governance structure that will serve as the ultimate stopgap on compliance. You may also consider bringing in third parties that specialize in the new cannabis legislation to perform audits of your operations.

Planning for take-off

With the current excitement about the cannabis industry, it's easy to get caught up in the race to be the biggest. To be sure, M&A offers companies many benefits, such as the ability to build scale and capacity, establish brand and market awareness, and offer differentiated products, among others. However, it's impossible to realize the true potential of these benefits without setting a focused strategy from the outset and executing that strategy in a disciplined fashion.

For this reason, much of an M&A transaction's success depends on the legwork you put in before signing on the dotted line. One of the main challenges right now is that key customer segments and product categories are unproven. Before considering what deal makes sense for your organization, it's important to define the markets where you want to play, understand what you do best, understand what your target does best, and pursue growth accordingly. Every new deal should be evaluated on the immediate accretive value it brings to the table. And, above all else, a sound post-deal execution plan must be in place to facilitate a smooth integration.

By following these steps—and taking strides to professionalize early, allocate capital strategically, and plan for the future—you'll not only increase your chances of surviving the uncertain road ahead, but make a distinct and longstanding mark on what is sure to be an exciting industry.

Deloitte's Value Creation Services team specializes in cross-functional and cross-industry advisory in high-urgency timeframes. We help solve the complex business and performance challenges our clients face, whether they're in thriving or distressed business transformation situations, or in the cut-and-thrust environment of M&A—or sometimes both. Our main areas of focus are:

- **Performance improvement and turnaround:** We help clients with: rapid revenue and market growth initiatives; cost reduction; working capital optimization; and business model transitions, transformations, and modernization.
- **Pre-deal M&A diligence:** We perform operational, IT, and commercial due diligence to help clients drive informed bids, frame out risk factors, uncover value potential, and get a head start on post-merger integration planning.
- **M&A execution:** We work with clients before and after the deal is signed to design, plan, and execute post-merger integration programs that help maximize the deal value, minimize Day 1 disruptions, and accelerate and de-risk deal closing.

www.deloitte.ca

Deloitte provides audit & assurance, consulting, financial advisory, risk advisory, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries and territories bringing world-class capabilities, insights and service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 264,000 professionals—9,400 of whom are based in Canada—make an impact that matters, please connect with us on LinkedIn, Twitter or Facebook.

Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited. Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

© Deloitte LLP and affiliated entities.

Designed and produced by the Deloitte Design Studio, Canada. 18-5795M

To learn more about how Deloitte's Value Creation Services group can help you reach the next level, contact us.



Heather Blumberg

Partner, M&A Value Creation Services

hblumberg@deloitte.ca



Brittany Trumper

Manager, M&A Value Creation Services

btrumper@deloitte.ca



Darren Gill

Senior Manager, M&A Value Creation Services (Vancouver)

dargill@deloitte.ca



Sean Delsnider

Senior Manager, M&A Value Creation Services (Calgary)

sdelsnider@deloitte.ca



Trang Trinh

Senior Manager, M&A Value Creation Services (Toronto)

ttrinh@deloitte.ca

