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**A director's guide to governance  
in the cannabis industry**



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## Boards: key to preparing for the future of cannabis

After a challenging 2019, the cannabis industry is focusing on learning from recent experiences and moving into a somewhat warier future—one in which boards of directors will need to play a more central role. They'll need to step up and renew their attention on key governance matters to ensure the resiliency of their companies at a time of ongoing uncertainty. Which matters are most critical?

To gain insight into what cannabis boards should keep top of mind this year and beyond, we convened an industry roundtable in February 2020, which drew nearly 40 directors from across the sector as well as other industry advisors and observers. The roundtables highlighted numerous important and pertinent observations and recommendations, which we've collected here.

## Money flows amid rising valuations, but M&A to slow

Cannabis multiples have returned to high levels after the industry's rough 2019, but they are likely still too high. Given the slow rollout of retail outlets, particularly in Ontario, there's a belief that 2020 estimates are somewhat too bullish, and companies and investors alike should expect to see both estimates and multiples drop as the year progresses.

Merger and acquisition activity is expected to continue in the year to come, albeit at a slower pace and with lower purchase prices. The industry should see more consolidation in the market in the near future, as companies focus on improving both production and cash flow. There is also likely to be an uptick in restructuring activity and insolvencies as some cannabis companies struggle to meet the challenges of an industry in constant flux.

Encouragingly, investment continues to flow into the cannabis sector, although more of this money is coming from different sources. Institutional investment is strong from a flow perspective, and there's an increase in investment from hedge funds and non-traditional investors like family offices. However, there is much less long money in play. The sector is instead seeing an influx of fast money, and higher short interest than is seen in other consumer packaged goods (CPG) categories.

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## Board priorities for 2020 and beyond

The cannabis industry will remain in flux as it continues to mature. To be successful through this process, boards must maintain constant vigilance and take careful, deliberate steps to adapt and evolve. Their top concerns should include:

### Professionalizing the board and management

Boards should identify the skills, experience, and next-level competencies they and their management team will require in the next five years. This is likely to mean many company founders will step aside and allow more seasoned, professional managers from CPG and other sectors to take the leadership reins. Boards should look for individuals who have experience growing smaller enterprises into large, well-run companies. They should consider those who have dealt with the ugly realities of business and demonstrated resilience in tough times and crises. Recruiting individuals with standard corporate functional backgrounds isn't enough; boards will need members with entrepreneurial backgrounds and more varied experiences, such as with restructurings. In searching for candidates with technical skills—those with IT, artificial intelligence, and analytics skills, for example—boards should be open to applicants who lack direct experience in the cannabis industry.

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### Improving board diversity

Participants in our roundtables called for greater gender, age, racial, and other forms of diversity on cannabis boards to better reflect the consumer base of their companies. More diversity will bring the breadth of experience and perspective that cannabis companies need to compete on the global stage. And in the absence of formal rules or guidelines on diversity in the boardroom, directors themselves must act to make it happen.

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### Getting a better handle on risk

In light of some industry missteps in the last year, boards should take immediate steps to make sure they have someone with a deep grounding in risk management and compliance on the team. This will help ensure the board asks management the right questions about the risks the company faces, and how these risks are being managed and mitigated. Boards should also devote time to clarifying which management decisions require their input and approval—and which don't—to allow management the freedom to act while maintaining appropriate oversight.

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Have someone with a deep grounding in risk management and compliance on the team

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It's incumbent on boards to insist their companies make sufficient investment in regulatory compliance

### **Investing in regulatory compliance**

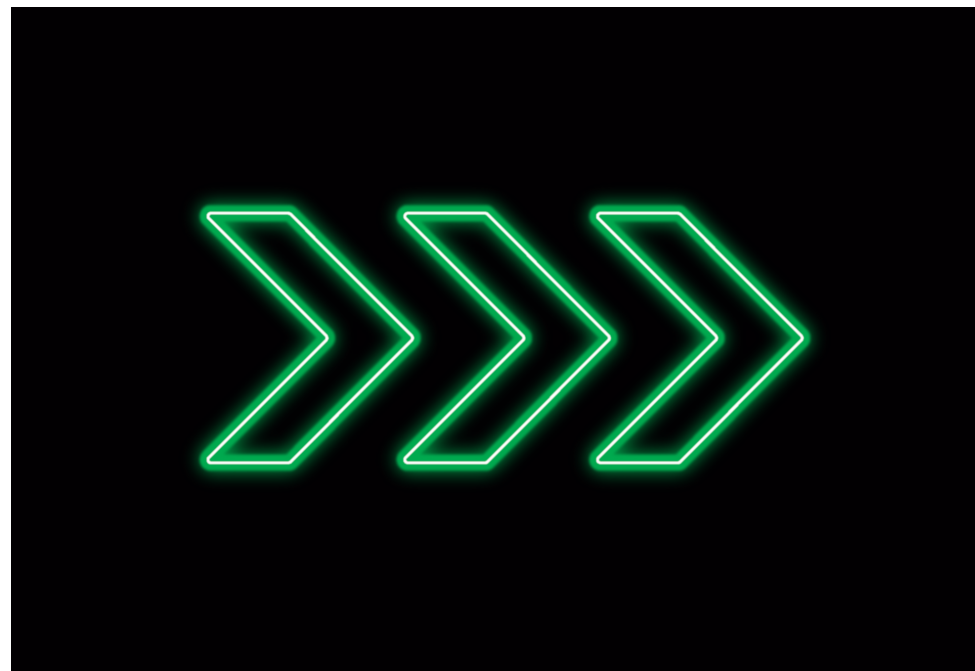
Cannabis companies have tended to under-invest in regulatory compliance, which, in a highly regulated industry, has in some cases proven an unwise and costly decision. It's incumbent on boards to insist their companies make sufficient investment in this critical area, even to the extent of appointing a Chief Regulatory Officer. A company's ability to do business may depend on it.

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It's time to introduce more rigorous focus and discipline regarding disclosures

### **Improving investor relations and disclosures**

There's a lot of noise in the cannabis space, and that's making it difficult for companies to differentiate themselves in the marketplace. In the current market, cash flow is emerging as the key differentiator, and companies with robust cash flow would do well to tell that story loud and clear. It's also time to introduce more rigorous focus and discipline regarding disclosures. Boards should ensure that effective disclosure guidelines and processes are in place and that management follows them. Boards should also make sure management receives proper coaching in how to communicate effectively and appropriately with investors to ensure the right message gets out as clearly as possible.



## **Prepare for a fast-changing future**

Following the chastening experiences of 2019, the cannabis industry is poised to begin a new, more mature phase of development. It's a time of rapid change, great opportunities, and potentially significant risks—and boards will play a pivotal role in helping their companies successfully navigate what's to come. They must now focus on developing a strategy and plan to help their company overcome tomorrow's challenges to grow and thrive.

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Focus on developing a strategy and plan to overcome tomorrow's challenges

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