An Insider’s View on the Future of the Cannabis Industry

Description

Constellation Brands (NYSE:STZ) caused a wave of excitement in August when it announced an additional $5 billion investment into **Canopy Growth** (TSX:WEED)(NYSE:CGC), raising its stake in the cannabis leader to 38%. This deal has set the cannabis industry ablaze, pushing shares of many cannabis companies to all-time highs in recent days.

To learn more about the ramifications of this deal for the future of the cannabis industry, we talked to a cannabis industry insider, Vahan Ajamian, who has boots on the ground in this fast-growing category. Ajamian is the managing director of analyst relations at **MedMen** (CNSX:MMEN), which operates dispensaries in several states in the U.S.

What does this deal mean for the industry?

Ajamian: I think this is great news for the cannabis industry as a whole. You have a Fortune 500 company taking a $5 billion stake in a cannabis business, the biggest investment ever in our young industry. It doesn’t get more mainstream than that, when an established company like Constellation Brands decides it is time to enter this space in a such a big way. For our part, MedMen has approached marijuana as a mainstream consumer product since the inception of our enterprise nearly a decade ago.

We see that playing out every day in California, the world’s largest legal cannabis market, where adults can shop for cannabis products much the same way they shop for a bottle of wine. So Constellation’s investment into Canopy did not come as surprise. It was a matter of time, and we are sure you will see others follow suit.

Why are beverage companies the first to be pushing these initial large-scale partnerships into the cannabis category?

Ajamian: Alcoholic beverages and cannabis speak to similar demographics. Whether it’s Chardonnay moms or weekend backyard barbecues, marijuana is a natural substitute for alcohol, and the data supports that. Alcohol consumption is down in states that have legalized adult use of cannabis. Cannabis offers fewer calories and no hangover. So it makes sense the alcohol industry would hedge on cannabis.

I think Constellation Brands' CEO Rob Sands has incredible foresight. Back in November 2016, he was already talking about how there are going to be beverages containing cannabis, and how this would be big business. I always had the view that even its primary investment in Canopy a year ago was primarily a defensive move – not so much that Constellation was hugely interested in capturing a large market share of the Canadian cannabis drink market.

Rather, I believed their primary objective was to defend their main alcohol market and take advantage of growth in cannabis. There is some natural synergy between alcohol and cannabis as consumers enjoy both products in similar fashion, but cannabis has the added facet of being a nutraceutical. That said, we have had conversations with companies across the alcohol, CPG and tobacco sectors. Everyone is looking into cannabis. If you are in those sectors it would be almost derelict not to.

How does this deal impact the competitive landscape of the cannabis industry?

Ajamian: In Canada, I believe this transaction will serve to accelerate tie-ups between large mainstream alcohol or CPG companies and cannabis firms. We saw **Molson-Coors** enter into a joint venture with **HEXO**. There are already reports that **Diageo**, **Coca-Cola** and **Pepsi** are out meeting with cannabis companies for some sort of collaboration. Everyone is looking for a dance partner and the early movers will have the best picks.

I think the Constellation-Canopy transaction changes the landscape in the U.S. as well. The companies' joint press release discussed the potential to enter new markets including the U.S. and the U.S. was discussed repeatedly on the conference call. Canopy's CEO Bruce Linton reconfirmed that Canopy would not enter the U.S. until cannabis becomes federally legal – but that this was likely to be sooner than people realize.

Competition will heat up among the top players in the sector, and that's a good thing for the industry as a whole. Everyone will be forced to up their game.

What should investors watch for over the next three years?

Ajamian: There is still a lot of noise in this industry but the fundamentals do not change just because it is cannabis. It still boils down to understanding the business you are in and executing. We are in the consumer goods business and we are in the "land grab" phase. MedMen is the largest player in California, the biggest legal cannabis market in the world, with 6 percent market share and our stores are averaging triple the revenue of the average dispensary in the state.

Retail is where the rubber meets the road as cannabis reaches new consumers. It is where people learn about the products and build brand loyalty. Although we are vertically integrated in every market, retail is key to our business thesis. We have two dispensaries open in Las Vegas, with a third coming, and four locations open in New York – including our flagship on 5th Avenue in Manhattan. We also have states we are building out, such as Florida, where we plan to open 25 to 30 stores in the next 18 months.

Over the next three years, you will start to see the emergence of some dominant brands in this industry and that dominance will be based on location, location, location. Where you build your brand will be key. Are you in the most important markets? Are you in the trend-setting markets?

The end of the federal Prohibition in the U.S. is just a matter of time. It won't happen overnight, it won't be an event, but marijuana will be progressively more legal than illegal. Medical marijuana is already legal in the majority of the states. With Canada starting adult use sales in October and states like New York and New Jersey lining up to fully legalize in the near future, this industry is here to stay. In the next three years you will see clear winners emerging, and like with any other industry, it will boil down to business fundamentals.

You now have a cannabis company, Canopy, with billions of dollars in hand and a partner who understands consumer brands. This is good for the sector and ups everyone else's games.

How can smaller/mid-size companies compete with the Constellation/Canopy juggernaut?

Ajamian: This is not an either-or proposition. This is $70 billion plus market, there is space for everyone to play in. It is not so much a question of size, but again business fundamentals. You have to have something to offer; you need to add value.

CATEGORY

1. Investing

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2. NYSE:STZ (Constellation Brands Inc.)
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