

# Investing in the marijuana industry and Risks

Emerging sectors like the marijuana industry have often attracted investors hoping to be among the first to capitalize on the potential growth and high returns of what they believe are untapped markets or products that may be popular in the future.

While some new sectors have been successful for some investors, the chase for the next big investment can lead investors to speculate on trends and bet on industries and products with no proven record or history of success.

The marijuana industry has grown quickly in recent years as a number of jurisdictions, including Canada and certain U.S. states, have explored new laws around the sale and use of marijuana. In Canada, this initially began with the legalization of marijuana for medicinal purposes, which prompted a number of companies to express interest in entering the market and approaching investors who were keen to get in on what they believed was the next big thing.

Marijuana regulation in Canada may continue to evolve over time as the federal government plans to legalize its recreational use. Because of this, many marijuana companies are promising investors the opportunity to capitalize on an opportunity for considerable future growth. A number of companies are looking to expand into the U.S. where some states have authorized sale and use of marijuana for medicinal or recreational purposes. However the sale and use of marijuana remains prohibited at the federal level in the U.S.

**Update: (January 12, 2018) – The US Attorney General recently canceled the Cole Memorandum, which suggests that the US federal government may enforce federal laws against marijuana activities even in states where marijuana is legal.**

**There remains a large amount of uncertainty in this emerging sector, especially as laws and business models continue to evolve. Investing in a marijuana company comes with a number of risks that could negatively affect an investment at any time.**

There are now a number of businesses operating under the umbrella of the marijuana industry, even if their business does not actually grow or sell marijuana products directly, making it possible to invest in a marijuana company without investing in the cultivation or distribution of marijuana itself.

Some examples of businesses operating within the marijuana industry include:

- **Agriculture technology:** Businesses that support the innovation and development of equipment required to cultivate marijuana, such as automated fertilizer systems, greenhouse technologies and improved lighting systems.
- **Ancillary products and services:** Businesses that offer products that complement the marijuana industry as a whole, which can include products like a marijuana breathalyzer to laboratories that test cannabis products. This also includes companies that provide insurance to cultivators as well as those that create consumer packaging for products.
- **Biotechnology:** Businesses that focus on the pharmaceutical applications of marijuana by developing treatments to target illnesses and diseases.
- **Consulting services:** Businesses that respond to the complexity of rules and regulations around marijuana between different jurisdictions. They may provide services to assist with licensing, zoning or advising on operational processes.

- **Consumption devices:** Businesses that create products that people use to consume marijuana.
- **Cultivation and retail:** Businesses that grow and sell marijuana, and are often the types of businesses that most people think of when discussing the marijuana industry.
- **Cannabis products and extracts:** Businesses that sell cannabidiol products, edibles, topicals, drinks and other products.
- **Holding companies:** Businesses that typically own a considerable number of voting shares in a variety of marijuana companies, allowing them to influence the management and affairs of the companies held.
- **Industrial hemp:** Businesses that provide products using industrial hemp, which is different than marijuana and may have numerous applications and uses, including creating consumer products like paper and clothing, as well as building materials, fuel and foods.
- **Organic farms:** Businesses that provide organically-grown marijuana to other companies or sell to consumers directly, relying on the increasing demand for organic products and services to drive the business's growth.

## Investing risks

All investments come with some amount of risk. Generally, the higher the potential return of an investment, the higher the risk. There is no guarantee that you will actually get a higher return by accepting more risk.

When you invest in the marijuana industry, you're exposed to different types of risk that can affect your potential return. Some common risks include:

### No guarantee of success

Despite the rapid growth of companies in the marijuana sector, there remains no guarantee that their businesses are profitable or will be in the future. Many marijuana companies' expectation for success is based on the future distribution and sale of their product, despite the fact that many rules and regulations around distribution and sale are still in the process of being established.

As with any investment, there is no guarantee that an investment in the marijuana industry will provide any return or income.

### Government regulation

The governments and regulators in many of the jurisdictions that are exploring new marijuana laws have yet to fully establish the framework for how and where marijuana products can be sold. For example, there may be some restrictions on the stores that are permitted to sell marijuana, as well as rules about branding and advertising that could affect a consumer's ability to find and purchase products. These sorts of challenges can affect a company's ability to sell its products and make a profit, which in turn could reduce the value of your investment in the company.

### Competition

As regulation continues to evolve and the marijuana industry grows, new companies will enter the industry and compete with existing marijuana businesses. Increased competition may compel a company you have invested in to adjust its business model, adjust the prices of its products, or make other changes in order to stay competitive. This may affect the value of your investment.

## **Legal considerations**

Marijuana companies must abide by all the laws and regulations of the jurisdictions in which they operate, which can vary from country to country. Should laws change, the company may be required to adjust its operations to comply with the law or risk having legal action taken against it. In some cases, this may mean ending its business.

In the U.S., some states have authorized the sale and use of marijuana, but it still remains illegal under federal law. While the federal law may not be strictly enforced in states where there are effective marijuana regulations in place, authorities in the U.S. could choose to enforce federal law at any time, putting any company with marijuana-related activities in any U.S. state at risk of being prosecuted and having its assets seized. Similarly, if the U.S. federal government chooses to change how it enforces federal marijuana laws, this could have a significant impact on any companies with operations in the U.S.

Investing in a company that does business in a place where the law either prohibits marijuana or is unclear about its use, puts your money at risk. If legal action is taken against a company in which you have invested, you could stand to lose your entire investment.

## **Pricing and taxation**

Government-mandated pricing and taxation on marijuana products may also pose a risk to the success of a marijuana company. If the government prices marijuana products too high, or if black market dealers undercut prices of products available in stores, the companies growing and selling the products may not be able to sell enough product to make a profit.

## **Inflated share prices**

Opportunities to invest in new marijuana companies or existing companies expanding their business into the marijuana industry have generated a high level of interest among investors looking to get in on a new trend with the expectation of quick growth. However, these investments can be highly speculative, and the cost of an investment in a marijuana company may be based on the expectation of its future success rather than its current performance.

In some cases, companies that have simply announced their intent to develop a marijuana business have seen an immediate rise in their stock price, before there is even a viable business in place. Investors who buy shares in these companies risk paying an inflated price for an investment that may never increase in value.

## **Dilution**

As the popularity for marijuana-related products grows, companies have to scale up their operations to meet the demand, which may include building larger facilities, buying additional equipment and hiring additional employees. This can cost considerable amounts of money, and if a company doesn't have the funds required to expand its operations, it may choose to raise money by issuing additional shares.

When companies issue additional shares to raise money, it comes at the expense of existing shareholders, whose percentage ownership decreases proportionally to the number of new shares created. This is known as dilution. If you hold shares in a company that continuously raises money by issuing more shares, your investment will decrease in value.

## High operating costs

The costs associated with developing and operating a commercial marijuana company can be considerable. Growing and selling marijuana requires specialized and large-scale agriculture facilities and enormous amounts of power and capital in order to operate. Construction and energy costs can greatly increase a company's overhead, and as companies scale up in order to meet demand, the costs of constructing new buildings may undercut profitability, especially if there are significant cost overruns or construction delays that impact a company's ability to produce and deliver its product.

As an investor, you should understand the company's business plan and how it intends to earn a profit, as well as the related risks, costs of doing business and time it may take for the business to become profitable. There is no guarantee that a company will be successful in generating profits or increasing its stock value.

## Getting information before you invest

If you are considering investing in a marijuana company, you should first take some steps toward researching the investment opportunity and considering how the investment will help meet your financial goals:

- **Review disclosure documents.** Companies offering investors the opportunity to invest are required to provide specific disclosure documents, such as a prospectus, listing statement or an offering memorandum, which contains information about the business, its management, operations and business risks, including the nature of its operations in specific countries and states, as well as how it complies with laws in each jurisdiction in which it conducts business.
- **Read official materials.** Annual reports, management's discussion and analysis, news releases and other official company materials can provide information about whether the company is making or losing money, information about its financial statements and comments from management on how the company has performed, as well as any industry trends or events that may have affected the company's operations.
- **Speak with an advisor.** Advisors can answer questions about particular investment products and assist you with selecting investments that can help you achieve your financial goals. Find out what to expect from an advisor and check their registration at [\[INSERT LINK TO CHECK REGISTRATION DATABASE\]](#).
- **Learn more.** Explore more articles, tools and resources on [\[INSERT LINK TO CSA WEBSITE TOOLS\]](#) to learn more about investing.
- **Contact the Nova Scotia Securities Commission if you have further questions or concerns.**