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The Emerging Frontier: A Pivot Toward Colombian Cannabis

The cannabis industry is now prioritizing fundamentals, self-sufficiency, and cost-reduction to ensure long-term growth and profitability. Some companies have leveraged international supply chains by gaining a foothold in Latin America. While the broader region will benefit from recent drug policy reforms, no country is better positioned than Colombia to become the “grower” of choice for international cannabis trade.

Growing Pains in a Maturing Industry

At the outset of legalization, the cannabis market entered a period of explosive growth.¹ But by late 2019, cannabis was in bear territory, with some major stocks posting up to 90 percent losses for the year.² The final months of last year brought major layoffs at some of the most high-profile firms. And that was before the COVID-19 pandemic.

The industry writ large is now, more than ever, feeling the pinch of skittish investors, delayed deliveries, new layoffs, and looming civil litigation.³ With less than 10 months of cash on hand, many of the most high-profile cannabis companies could face liquidity challenges and potential insolvency by early next year.⁴ More than a dozen special-purpose acquisition companies formed last year (with \$3 billion pooled from shareholders) to purchase distressed cannabis assets.⁵

This turbulence is a sign that the global cannabis industry is beginning to mature. Companies are now prioritizing fundamentals, self-sufficiency, and cost-reduction to ensure long-term growth and profitability. That analysis includes the evaluation of secure and efficient supply chains. To that end, many global cannabis leaders will direct their strategic investments to the new frontier of cannabis production: Colombia.

1 <https://www.forbes.com/sites/katiesola/2016/04/19/legal-u-s-marijuana-market-will-grow-to-7-1-billion-in-2016-report/#78e69bda568d>

2 <https://www.fool.com/investing/2020/04/05/there-are-big-changes-coming-to-the-cannabis-indus.aspx>

3 <https://www.msn.com/en-ca/money/topstories/cannabis-companies-pen-letter-seeking-government-help-amid-covid-19/ar-BB11Ayj8>

4 <https://www.fool.com/investing/2020/02/14/10-pot-stocks-that-could-run-out-of-money-in-10-mo.aspx>

5 <https://www.law360.com/articles/1262625/investors-prep-3b-lifeline-for-distressed-cannabis-assets>

The Emerging Frontier of Cannabis Production

While predictions for the global cannabis trade in 2020 vary widely, industry leaders largely concur that legalization efforts will continue across the globe.⁶ As of April 2020, medical cannabis is legal (to some degree) in upwards of 50 countries.⁷ As a result, marijuana-related business (MRBs) are beginning to leverage international supply chains in pursuit of lower production costs, with a view to Latin America.

Some countries in the region are positioning themselves to compete in the global cannabis market through regulatory reforms and partnerships with established North American and European players. While their competitiveness will be hampered by persistent political and macroeconomic hurdles, no country is more prepared than Colombia to differentiate itself from other countries in the region to become the industry's grower of choice.

Early Moves toward Legalization

The Colombian government sees cannabis production as a viable alternative to coca growing for farmers in conflict-ridden areas. During the 2016 peace negotiations between the administration of former President Juan Manuel Santos and the Revolutionary Armed Forces of Colombia (*Fuerzas Armadas Revolucionarias de Colombia* or *FARC*), a left-wing guerilla group, coca production saw exponential growth following a ban on aerial spraying in favor of manual eradication. Accordingly, the current administration of President Iván Duque hopes that cannabis production will provide an attractive legal alternative for rural communities, which have historically had few economically viable options beyond cooperating with illegal armed groups in the production of coca.

Colombia thus began to take legalization seriously very early on and has sought to promote business opportunities for domestic and foreign companies seeking to capitalize on global shifts in attitude away from prohibition.⁸ As early as



2016, the Colombian Congress passed Law 1787, granting legal access to cannabis for medical and scientific use.⁹ The following year, the executive branch passed Decree 613, creating a legal framework to eliminate the cannabis black market by allowing commercial cultivation, processing and export of medical cannabis products.¹⁰

In recent years, Colombia has markedly improved its regulatory framework, streamlined approval processes, improved public security, and lowered production costs across myriad industries, cannabis included. The country also has natural competitive advantages, as its fertile soils and favorable weather conditions are ideal for cannabis cultivation. Colombia's cannabis and hemp plantations receive an average of 12 hours of sunlight per day, bypassing the need for costly greenhouse facilities that are commonplace in many North American grow operations.¹¹ Colombian grow operations also benefit from low production costs of around \$0.50/gram of cannabis flower, compared to approximately \$2.10/gram in Canada.¹² Collectively, these regulatory, geographic and economic advantages buttress Colombia's potential role as a world leader in cannabis production.¹³ Some major investments are already trickling in.

6 <https://www.forbes.com/sites/katiesola/2016/04/19/legal-u-s-marijuana-market-will-grow-to-7-1-billion-in-2016-report/#78e69bda568d>

7 <https://www.fool.com/investing/2020/04/05/there-are-big-changes-coming-to-the-cannabis-indus.aspx>

8 <https://www.msn.com/en-ca/money/topstories/cannabis-companies-pen-letter-seeking-government-help-amid-covid-19/ar-BB11Ayj8>

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10 <https://www.elanbiz.org/the-legalization-of-medicinal-marijuana-creates-great-opportunities-in-colombia>

11 <https://www.cannabisbusinesstimes.com/article/colombia-medical-cannabis-exports-rising/>

12 <https://www.cannabisbusinesstimes.com/article/colombia-medical-cannabis-exports-rising/>

13 <https://www.cannabisbusinesstimes.com/article/colombia-medical-cannabis-exports-rising/>



Foreign Investors Blazing the Trail in Colombia

Total investment in medical cannabis farms and laboratories in Colombia is at approximately \$600 million to date.¹⁴ This amount includes roughly \$100 million invested by Canadian firms, which are among the first movers in the sector.¹⁵ The most prominent vertically integrated cannabis outfits operating in Latin America include Toronto-based Khiron Life Sciences Corp., which in March 2020 was granted authorization to manufacture high- and low-THC prescription medicinal products in Colombia. Khiron now treats over 120,000 patients in Colombia and recently opened a 15,000 sq. ft. facility in Bogota known as Zerenia,¹⁶ where it produces oil distillates for sale both domestically and abroad.¹⁷

In January, PharmaCielo Colombia Holdings SAS (the Colombian subsidiary of publicly listed Canadian firm PharmaCielo Ltd) signed an agreement to deliver 30,000 kg of medical-grade extracts to be sold in Germany,¹⁸ the largest cannabis market in Europe.¹⁹ Similarly, Ecomedics SAS (a/k/a Clever Leaves) expects to produce 85 tons of dried flower in Colombia for use in capsules, creams, ointments, patches and other products destined for export to the German market.²⁰

Other MRBs have followed suit. Verdemed, a Toronto-based pharmaceutical cannabis company, has large industrial indoor cultivation and extraction facilities in Cali (through its interest in local producer Greenfarma SAS).²¹ Ontario-based Aphria Inc. plans to build grow operations in Colombia in order to supply the domestic market and “[to] develop low-cost export opportunities across the Latin America region.”²² The Colombian government has also granted cultivation, processing, and export licenses to several other operators including Cannavida SAS (in Barichara), Kunna SAS/Cannalivio (in Medellín) and Pideka SAS (in Bogotá).²³

A Word of Caution

Despite the reasons for optimism, Colombia’s inchoate cannabis sector still faces uncertainty. Legalization is deeply intertwined with the local peace process negotiated between former President Santos and the FARC, which culminated in a peace agreement in 2016. The agreement has been the target of some criticism in Colombia, and even its partial collapse could throw the cannabis industry into disarray as militants and splintered factions of rebel groups might seek to reclaim control of agricultural regions.

The FARC might also coerce or incentivize small-scale farmers to take up coca farming instead (by law in Colombia, cannabis firms must source 10 percent of their inventories from small growers).²⁴ The threat of violence and coercion

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22 <https://aphriainc.com/wp-content/uploads/2019/09/Aphria-Annual-Report-2019.pdf>

23 <https://www.elanbiz.org/the-legalization-of-medical-marijuana-creates-great-opportunities-in-colombia>; <https://www.prnewswire.com/news-releases/cannavida-one-of-first-in-colombia-to-be-granted-full-licensing-for-commercial-cannabis-extraction-and-cultivation-300543867.html>

24 <https://cci.substack.com/p/cci-march-2020>



also emanates from criminal bands (*bandas criminales* or BACRIM) or other armed militant groups with which the government has yet to pursue formal peace negotiations. As in other sectors such as mining and energy, cannabis production in rural areas will present major challenges stemming from the persistent threat of resurgent violence. Nevertheless, the government will persist with the peace deal with the FARC and will attempt to strike a ceasefire with the country's second largest leftist guerilla group, *El Ejército de Liberación Nacional* (ELN). Not only is peace the sharp preference of the Colombian people, but economic pressure being exerted on the government by low oil prices and COVID-19 will require state resources to be focused on areas such as the medical sector, education and general welfare rather than on the ongoing civil war. The appetite of voters for continued conflict will be diminished in light of the looming economic downturn and will cause high-profile peace proponents, such as Bogotá mayor Claudia Lopez, to gain popularity in the run up to the 2022 Presidential elections. Beyond the unique challenges they will face in Colombia, MRBs will also encounter many of the same operational challenges present in more mature markets. Investors in

this burgeoning market must do their homework to identify suitable sites of operation, gauge the reputations and professional track-records of local investors and business partners, and understand the relevant stakeholders and communities where their cultivation and production facilities are located. By the same token, regular audits should be performed to detect irregularities in inventory, vendor payments, cash reconciliation, and other operational procedures. Successful operators in Colombia, particularly in high-risk industries such as cannabis, must seek to mitigate the elevated risk of fraud, third-party vendor integrity, anti-bribery and corruption (FCPA) issues, intellectual property theft, embezzlement, asset theft, and undisclosed related-party transactions.

Notwithstanding the risks outlined above, it seems likely that major cannabis players will come to view Colombia as the industry's grower of choice in the Americas, making this once war-torn country a central node in the international supply chain. Companies that proactively mitigate operational risks and invest strategically in burgeoning markets like Colombia will be well-placed to benefit in the years to come.

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