

ANALYSIS

Will private equity aim high on European cannabis?

As experts predict the region will become the world's largest legal cannabis market over the next five years, some growth equity firms are rushing to get in there first



Europe's biggest markets for medical use are Germany, France, Italy and the UK — Getty Images

By Elisângela Mendonça

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Unlike other sectors of the investment industry, private equity has largely sat on the sidelines when it comes to investing in cannabis over the past decade - especially in Europe's small, fragmented market. But the evolving legal landscape and maturity of the sector are finally pushing the industry to show some signs of life.

By the spring, Kingsley Wilson, investment partner of Chrystal Capital, a London-based boutique firm, wants to seal the first deals of its newly launched Verdite Capital fund, which is set to become Europe's largest cannabis-focused private equity capital pool.

The vehicle is on track to reach a \$100m first close next month and double its size at final close by the end of the summer, Wilson predicts.

The veteran dealmaker, who built his two-decade career in both the public and private arena, told *Private Equity News* he decided to focus on cannabis investments to meet the demand of family offices and ultra-high net worth individuals, Chrystal Capital's main clients.

“A lot of cannabis companies have been funded by friends and family, by small venture capital firms or have gone to the public markets to access hedge fund money. But, in the middle, there is this big void of growth funding because the big PE firms, institutions and banks have not come to the space yet. Verdite will plug this gap in the market,” he says.

Last year, he put together a 11-people-advisory board with “deep cannabis and private equity experience”, who have already assessed 500 companies with growth potential. The idea, he says, is that the fund will start to deliver returns to investors in its fourth year.

Its geographically diverse approach is expected to reduce the risks. Verdite will allocate 30% of its capital in European business, 40% to North American cannabis companies and the remaining 30% to the rest of the world.

The vehicle, regulated in Guernsey, will take stakes in 10 to 15 businesses, writing equity cheques from \$5m to \$20m each. With a growth equity focus, the main segments will be health and wellness and medical and pharmaceutical, leaving recreational use out of its scope to avoid more complex regulatory issues.

Fertile ground

Chrystal Capital wants to establish itself early in the European medical cannabis market, which even by the most conservative estimates, is expected to be worth billions in about five years

“We recognise that the cannabis sector is a new asset class and it’s evolving. There are complications around legality and regulatory frameworks. But we know that there is a global industry that can become \$300bn a year and a lot of that demand is flowing into the black market,” Wilson says.

The dealmaker cites figures of Washington-based research group New Frontier Data, which said in a recent report that demand for cannabis stands at about \$344bn globally, of which only \$15bn is currently legal and regulated.

Estimates of how much the legal market could be worth, though, vary depending on who you ask.

Another recent study by lobbying group Prohibition Partners says Europe’s marijuana market could be worth as much as €123bn by 2028, split between medical (47%) and recreational cannabis (53%).

With a population of around 743 million and total healthcare spend of €2.3tn, Europe could be the “largest medical cannabis market in the world,” the Prohibition Partners report states. “The market could be worth as much as €58bn once proper legislation and infrastructure are in place in all markets.”

Last year, though, the European medical cannabis market was valued at only €330m, according to market intelligence firm Brightfield Group. The market for CBD, a cannabinoid that is not classified as a drug and can be sold over the counter in many countries, was valued at €1.4bn in the same year, according to Hanway Associates.

For private equity, that is a “once in a lifetime opportunity”, as Chrystal Capital’s Wilson calls it.

The lack of clarity, he adds, may have historically put institutional investors off, making it difficult for cannabis companies to have access to capital. But loaded with cash and with a long-term view, private equity is well-positioned to give the sector the necessary push, providing scale and lobbying for the relaxation of rules around medicinal cannabis use.

This idea is part of the strategy of US-based private equity Artemis Growth Partners. The fund’s partners have a large portfolio of companies that sell and advocate the use of cannabis for different purposes, including for medicinal use. Last year, the firm, with more than \$300m in assets under management, backed the \$80m acquisition of Bridge Farm, a UK-based low-cost cultivation platform for cannabis.

When announcing the deal in May, Artemis said it expected the huge financial pressures on governments around the world after the coronavirus pandemic could see cannabis legalised to make it taxable.

Will Muecke, co-founder of Artemis, added in a later interview with the Daily Telegraph: “We’re going to find budgets around countries to have giant gaps, and the economics are overwhelmingly in favour of governments jumping ahead and legalising cannabis and finding near-term revenue there.”

A legal roadmap

Ellen Gielen, partner at the global law firm and consultancy CMS, believes the European cannabis market is not far from a turning point. The Netherlands-based expert in life sciences regulatory issues, says European countries are moving towards legalisation and a clear regulatory landscape, but at very different paces.

She expects, however, these changes might take less than five years to be implemented, accelerating the creation of investment opportunities.

For Gielen, science is the key to market expansion now. “If there is more scientific evidence, then healthcare insurers, for example, will be far more willing to reimburse the use of cannabis and it will certainly be of help”.

Currently, more than 50 countries have adopted medicinal cannabis programmes while Canada, Uruguay and 15 US states have legalised its recreational use, with Mexico and Luxembourg having

political debates as to whether to follow that path, according to the United Nations.

In Europe, some form of medical cannabis (or cannabis-based medicine) is now legal in at least 22 countries and the biggest markets for medical use are Germany, France, Italy and the UK.

American cash

Although North America is by far the largest cannabis market in the world today, New York-headquartered private equity firm Orkila Capital has decided to look for investments overseas.

Last month, the buyout group launched Semdor Pharmaceuticals, a German medical cannabis company serving the European pain therapy sector. The transaction, one of the region's largest private equity deals in the sector so far, is worth \$65m.

The growth equity firm, with \$500m under management across three funds, typically targets media, technology, and special situations investments. But it is also attracted to disruptive businesses, Jesse Du Bey, Orkila's founder and managing partner, told PEN via Zoom from his office in Hamburg - to where he moved in 2018.

The decision to move from the US to Germany and invest in the country was not a difficult one to make, he says. "I believe that Germany will be the largest medical cannabis market in the world by far," he says.

And he has reasons to think so. While the German cannabis industry is still in its infancy, it is already the third-largest market globally behind the US and Canada for medical use.

Germany amended its regulations on the therapeutic use of cannabis products in March 2017. Since then, the population of patients receiving medical cannabis products has increased from roughly 1,000 people to more than 60,000 last year, latest official figures show.

Independent research by growth-focused investment bank Bryan, Garnier & Co says Germany's medical cannabis market is expected to grow to €4.9bn by 2029, from €210m in 2019.

Paralysing uncertainty

So, why is private equity not diving into cannabis yet?

According to Tom Whelan, a London-based private equity solicitor with McDermott Will & Emery, cannabis is not "fully bought into by the investor market yet". Until regulations are clearer, the asset class is likely to remain in a wait-and-see position, he expects.

The task is not simple either. Orkila's Du Bey says: "This is the largest black to white market conversion moment in the history of Europe. Private equity guys are intrigued by that, but they're going to need to see more signs [before they flock into the sector].

“In the private equity world, we tend to always take a careful approach,” he adds.

In the past five years, only nine small PE-backed deals in the cannabis sector were completed in Europe, according to data provider PitchBook. But two of them, including Orkila’s Semdor, were closed in the first months of 2021.

More needs to be done to secure a stable foundation to attract larger private equity players, market insiders agree. Changing attitudes to cannabis are increasingly apparent, though (*see below*), such as the United Nations last year reclassifying it for its medical benefits.

“I have friends who are GPs across Europe at long-standing, very successful firms, and they are definitely thinking about cannabis investments. We may see a lot more activity in this segment soon,” Du Bey adds.

>> Cannabis regulatory highlights in 2020<<

December: UN reclassification of cannabis given its medical benefits; US House of Representatives passed the ‘MORE Act’ to legalise cannabis.

November: EU Court of Justice declares that Cannabidiol (CBD) should not be considered a narcotic.

September: UK Financial Conduct Authority clarifies the UK listing requirements for medical cannabis and CBD companies.

Mark Latham contributed to this article.

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