

Canada's new psychedelics sector will have better governance than early cannabis, sector advisors say

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- Higher quality directors interested in serving on company boards
- Investors will view companies with greater scrutiny

The corporate governance practices that marred the start of Canada's legal cannabis sector will likely not be as bad in Canada's nascent legal psychedelic drugs sector, said three sector advisors.

In 2020, Health Canada began issuing permits allowing ill people to legally use psychedelics, mainly for palliative care. Many companies planning to legally sell psilocybin (the active ingredient in "magic mushrooms"), ketamine, MDMA or designer molecules have since gone public.

"You've seen interest in the psychedelic industry, particularly in the last couple of months, explode," said Ian Robertson, the president of Kingsdale Advisors, which works with psychedelic and other companies.

When Canada's first cannabis companies started going public, sophisticated businesspeople stayed off their boards because of cannabis's stigma, which resulted in many boards being full of friends and family members of the founders, said Victor Liu, a lawyer at Goodmans who started cannabis work in 2013. Such directors were less likely to insist on proper governance practices and more likely to be involved in conflicts of interest, he explained.

"I don't see that for psychedelics, because people have learned from the cannabis industry," Liu said. "A lot of sophisticated people are already jumping on the bandwagon for psychedelics, so you will get lots of high-quality directors interested in serving on the boards of these companies."

As well, he noted that the high public interest in psychedelics has led to higher scrutiny by shareholders who "are not going to be as receptive to a very incestuous board or governance structure because people are already focused on it, unlike cannabis in the early days."

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Teresa Tomchak, a lawyer at Farris with cannabis-sector clients, agreed that the directors of psychedelic companies now are generally more experienced and independent than those on cannabis company boards a few years ago. "I would not put them at the level of the Fortune 500 companies, but they're better," she said.

Another factor is that the sector has fewer very small companies compared to the early days of cannabis, mainly because psychedelic firms are more expensive to start, she added. "They're more established, which does help with corporate governance," she said.

Because there are fewer psychedelic companies than there were cannabis companies, Tomchak expects less M&A and thus less M&A-related shareholder activism.

Psychedelic leaders will learn from the cannabis experience, Kingsdale's Robertson said. "I have seen overlaps both in terms of some of the investors as well as some of the names that are funding and participating in the industries in board and management roles." After referring to CannTrust, a Canadian cannabis firm which suffered a scandal three years ago which led to its CEO and other executives being charged with fraud, Robertson said, "The lessons of the last couple of years in the cannabis industry ... will be applied at the psychedelic companies."

Governance and overall ESG metrics are becoming an increasing part of the screen that institutional investors apply to measure risk, he said. "If you're a cannabis or psychedelic company that doesn't have its governance house in order, that leads institutional investors to say, well, if they don't have this in order, I wonder what else they're missing on. So good governance is often a leading indicator for a company and a board that's paying attention."

Another lesson that psychedelics have learned from cannabis is that "skin in the game is important," he concluded. "The experience of the cannabis space was you had one or two [directors] who had a bunch of stock and then the rest of the board had nothing, and shareholders often took odds with that."

A "very, very, very big concern" for shareholders and directors in the psychedelics sector is that many companies have an extreme focus on promotion, Tomchak warned. The very high amounts of money spent purely

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on psychedelic stock promotion raise concerns of illicit practices and has led to close scrutiny by regulators, she said.

Tomchak also pointed out that governance in the cannabis sector has improved and is no longer Canada's worst, with today's "bad boys" of governance being mostly small mining companies.

by Mark Coakley in Toronto

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