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TOKYO SMOKE: Building a retail cannabis brand (B)

R. Chandrasekhar wrote this case under the supervision of Eric Janssen solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In September 2018, Alan Gertner could not believe all the events that had transpired since he had quit his job with Google Inc. and returned to Toronto in June 2014. He had sold his business, which he had renamed Hiku Brands Company Ltd. (Hiku Brands) in January 2018 to Canopy Growth Corporation (Canopy), Canada’s leading licensed producer (LP) of cannabis. After the sale, he had also joined Canopy as its chief retail officer, with a mandate to develop the company’s retail footprint.

In acquiring Hiku Brands, Canopy had made a bold bet on retail cannabis in an environment where the outlook for the industry continued to be uncertain. No one was sure what the future of retail cannabis held. To establish Canopy’s dominance in Canada and the world, Gertner would need to build on the industry knowledge he had acquired from the ground up during the last four years and the work he had done building four cannabis brands. “What should I do now to position Canopy as a world leader in retail cannabis?” he wondered.

HIKU BRANDS

Gertner had opened a store in Toronto in June 2014, and he had mobilized some seed funding by early 2015. Subsequently, in canvassing for series A funding starting in May 2015, he had approached the chief executive officers (CEOs) of many of the existing LPs. He told each of them that they should concentrate on manufacturing—where they had built up their competence—and leave the matter of building relationships with customers to Tokyo Smoke (later Hiku Brands) because his company was good at this. He recommended they license the cannabis brands he was going to create from Tokyo Smoke and pay Tokyo Smoke a royalty—a percentage of each sale that Tokyo Smoke steered their way on each brand. He said he also wanted some cash up front to meet the newly formed company’s working capital needs.

In August 2015, Tokyo Smoke signed a deal for medical cannabis with Aphria Inc. (Aphria), one of the leading LPs at the time. Recreational cannabis had not yet become part of the liberalized regime. As part of the deal, Tokyo Smoke would generate the demand, and Aphria would execute the sale. The demand would be generated via Tokyo Smoke’s coffee shops and community events. People would come to events, understand what medical cannabis was all about, learn about cannabis brands, and say, “Hey listen, where can I get this brand?” Tokyo Smoke would direct the customers to the Aphria website, through which the company had to complete the sale, and Aphria would deliver the product by mail. Tokyo Smoke would get a royalty on each sale. In lieu of up-front cash, however, Aphria would give Tokyo Smoke about CA$100,000[[1]](#footnote-1) worth of its shares.

Series A funding was beginning to trickle in—often conditionally. For example, one casual investor wrote a cheque in August 2016 for $250,000 and added the stipulation that Tokyo Smoke could cash it only when it had raised $5 million in funding. By January 2017, Tokyo Smoke had raised $3 million from 30 different investors. The market was warming up, there was general excitement about cannabis, and people were starting to listen to Tokyo Smoke’s pitch. Gertner had three people on the payroll by then.

One of the first things Gertner did with the funding was acquire a company called Van der Pop. The acquisition gave Tokyo Smoke a window into the niche market of women who were using medical cannabis as part of their self-care practices. He also spent a large part of the funding on building a team and scaling up. By November 2016, Tokyo Smoke had three stores open and three more in the pipeline. It was acquiring customers, receiving revenues, and counting about $5 million in the bank. The team was made up of 15 full-time employees at the corporate office and another 10 people in each store.

In October 2017, Tokyo Smoke closed its series B funding of $7 million. The series was led by Aphria and Green Acre Capital, a fund that specialized in cannabis properties. The funds were meant to be allocated to store expansion and strategic acquisitions. By then, Tokyo Smoke had launched four strains of cannabis—Go, Relax, Balance, and Relief—for Canadians with medical cannabis prescriptions.

The acquisition of Van der Pop was followed in December 2017 by a reverse takeover of Tokyo Smoke by Doja Cannabis Company Ltd. (Doja), a listed company. Doja was an LP with a 5,000-kilogram production capacity in British Columbia’s Okanagan Valley. After this merger, Hiku Brands Company Ltd. (Hiku), as the new entity was named, took over Doja’s listing. Now headed by Gertner as the CEO, Hiku had a cash balance of $31 million and had soon acquired Maïtri Group Inc. (Maïtri), a Quebec-based cannabis accessory and design brand.

Hiku became a holding company, with four brands under its banner: Doja (producing crafted cannabis), Tokyo Smoke (catering to urban professionals), Van der Pop (focusing on women), and Maïtri (focusing on the Quebecois market). It had seven stores, which served as coffee shops and sold cannabis accessories.

ISSUES BEFORE GERTNER

In July 2018, Hiku had been acquired by Canopy, and Gertner had become the chief retail officer of Canopy. Within weeks, recreational cannabis would be deregulated by the federal government as promised in its election manifesto. Gertner was riding high. He had an opportunity to make Canopy the “Starbucks of cannabis,” and he was looking for a roadmap.

1. All currency amounts are in Canadian dollars unless specified otherwise. [↑](#footnote-ref-1)