



Cannabis:

A turning point for society,
an industry quickly maturing

Cannabis: An overview

The growth of the cannabis industry is accelerating at a rapid pace. As more governments legalize medical and recreational cannabis, increased opportunities have prompted entrepreneurs and multinational companies to jump into the fray. The regulatory environment is also evolving, with significant changes underway or being contemplated around the world.

In addition to cannabis for recreational and medicinal purposes, there is a broad range of cannabis-related consumer products that includes drinks (from soft drinks, coffees, and sleep-inducing teas, to cannabis-infused non-alcoholic “beers” and “wines”), edibles (such as chocolate and snacks), and topical creams. Producers of tobacco and pain relievers are also watching these markets closely.

As we noted in Deloitte’s 2018 report on cannabis, “A society in transition, an industry ready to bloom,” current cannabis consumers expect to purchase most of their products at physical retail locations. Knowledgeable staff and clearly displayed prices are expected to play a key role in the success of cannabis retailers’ brick-and-mortar stores. In winning over customers, retailing fundamentals such as convenience, customer experience, product choice, and product and location safety are likely to matter just as much to these retailers as those in more traditional segments.

Cannabis is one of the few products to have fostered an entirely new consumer category, and is ripe for forward-thinking companies in the Consumer Packaged Goods (CPG) and retail-consumer market.

A young but strong market

The total cannabis market in Canada, including medical, illegal, and legal recreational products, is expected to produce up to \$7.17 billion in sales in 2019—up to \$4.34 billion of which will come from the recreational market legalized in October 2018.ⁱⁱ

A number of US states have legalized recreational cannabis, which has provided informative data into how cannabis has advanced in the consumer retail space. In Colorado and Washington, recreational cannabis sales enjoyed a 24 percent compound annual growth rate within the past four years.ⁱⁱⁱ

It's important to note that while some state programs have legalized cannabis in the US, cannabis is still a Schedule 1 drug under the US Controlled Substances Act and is federally prohibited.^{iv}

The CBD value-prop

Although cannabis is known for the trademark “high” it produces, there are many consumers who do not wish to consume cannabis products due to their psychoactive effects, but still want to experience the reported therapeutic benefits of cannabis. Accordingly, the demand for cannabidiol (CBD)-based products is also on the rise, both in North America and around the world.^{vi} CBD is a non-psychoactive component of cannabis, which means that unlike tetrahydrocannabinol (THC), it is reported to deliver therapeutic effects without producing the highs.

Consumer demand for CBD is so great that out-of-stock rates for CBD-based products in Canada have been higher than any other product available post-legalization.^{vii} The unique compound is poised to be a game-changer in the cannabis space.

Disrupting markets

Cannabis-infused beverages is a fast-growing sub-category within the cannabis edibles space. In US states where recreational cannabis is legal, cannabis-infused beverages enjoyed a 61% boost in year-over-year sales growth between September 2017 and September 2018. However, in the US, because alcohol is regulated both federally and within each state, the Tax and Trade Bureau announced in 2018 that it “will not approve any formulas or labels for alcohol beverage products that contain a controlled substance under Federal law, including marijuana.”^{ix}

Despite interest within the medical community in the potential benefits of CBD, this substance will still be under federal scrutiny, as with any other pharmaceutical. In December 2018, the US Food and Drug Administration wrote that they “treat products containing cannabis or cannabis-derived compounds as we do any other FDA-regulated products—meaning they’re subject to the same authorities and requirements as FDA-regulated products containing any other substance.”^x

The Canadian market differs from the US market significantly in that Canada allows for federal scale. Canadian draft regulations released in December 2018 indicated that no THC will be allowed to be mixed with beverages containing alcohol.^{xi} This specification could create an opportunity for the production of CBD-infused alcohol throughout Canada.

The market is diverse, and consumers are driving growth in retail areas that are newly emerging as significant cannabis categories. Vape pens, topicals, tinctures, and edibles had the highest year-over-year sales growth in US states where recreational cannabis has been legalized.^y



From cookies to coffee

Cannabis-infused edibles may be one of the most nascent sub-categories within the cannabis space, but it is quickly gaining attention, especially among cannabis consumers who prefer non-inhalable options. Taste is key to consumers, and our 2018 report shows a strong expected preference for baked goods, chocolate, sweets, and drinks. While edibles only make up a small portion of the overall cannabis market, when analyzing the current development of legal markets, we expect six out of 10 likely cannabis customers will choose to consume edible products.^{xii}

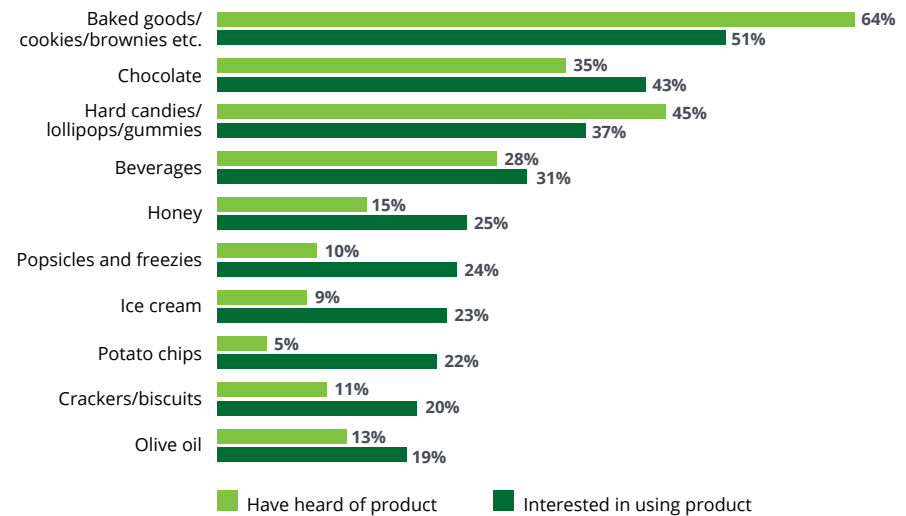
Innovation and brand recognition matter

Scaling an edibles business requires robust knowledge of a rapidly maturing market. Such an undertaking may be expensive if proper planning and extensive research aren't top priorities. Many edibles manufacturers and distributors are taking their cue from craft beer brewers, who disrupted the beer industry with more artisanal approaches to building sustainable brands.

Establishing a reliable brand by delivering a consistent product is seen to be of vital importance to leaders in this business. Cannabis is unlike many other retail categories in that consumers have to be convinced to stop purchasing from a well-established black market.

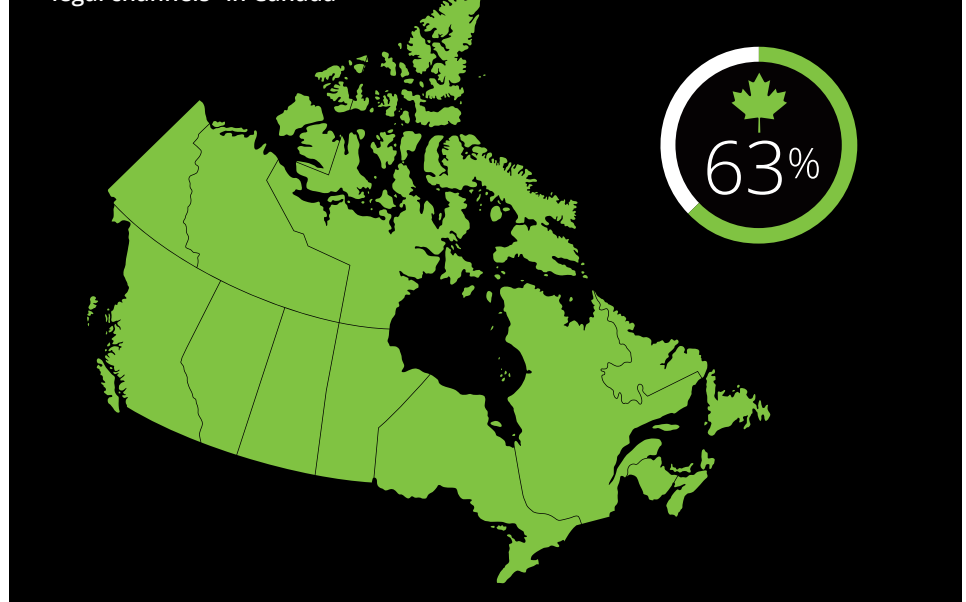
More than half of current cannabis consumers say that offering better quality products and a range of price points would help them move away from the illicit market.^{xiii}

Graph of Deloitte report's potential cannabis-edibles products



Source: Deloitte Cannabis Report 2018.

Proportion of cannabis products likely to be purchased through legal channels^v in Canada





Regulation and legalization

Generally, where cannabis has been legalized, we find governments have concurrently created regulations and policies laying down where and how cannabis can be consumed. Such a shift in legislation doesn't happen overnight, but retail players are sometimes slow to move with the changing tide of public sentiment and government regulation. Due diligence is essential for any business seeking to position itself within the cannabis industry.

Thanks to more studies being green-lit to analyze the science of cannabis and its consumption, the health impact of this plant is undergoing trials in Canada and the US to give consumers a more well-rounded understanding of how cannabis might affect both body and mind. While we're all generally aware of the harm smoking cannabis might cause, do we know exactly how cannabis oils and tinctures affect us? Are we aware of how cannabis and CBD-based products interact with the many popular medications used to combat other conditions unrelated to cannabis use? Better understanding of the pros and cons of using cannabis in its many forms will hopefully offer a better and more 360-degree view of this new product category.

Mandating where and how cannabis can be consumed has been a top priority for legislators and public-safety advocates. For example, establishments dedicated to cannabis consumption have not yet been legalized in Canada, despite some rogue players setting up shop with vapour lounges. It remains to be seen how the cannabis industry and public-safety personnel will work together to address the hurdle of where cannabis can be consumed.

Questions arising from the challenges facing cannabis-industry participants:

- How will government policy on cannabis affect how cannabis is sold?
- Are there regulations restricting the marketing and promotion of cannabis?
- Which legal professionals should be consulted to ensure regulation compliance?
- Who are the key stakeholders, including non-legal specialists, to consult?

Canada goes legal

One country to watch is Canada, which legalized recreational cannabis and opened the door to hundreds of companies seeking to cash in on this \$7 billion (in 2019 alone) market. Demand has been so high that suppliers in many provinces have been out of stock of the products consumers appear especially eager to purchase, such as pre-rolled cannabis cigarettes and oil-based products high in CBD, the compound widely believed to provide medical benefits for a variety of conditions.^{xv}

Many Canadian companies have brokered partnerships with established leaders in the alcohol, food, and tobacco industries, further cementing cannabis as a product category bound to influence other retail segments.

Canadian licensed producers have also been acquiring their competitors at an increased pace in order to capitalize on an aggressive market.

What's the appeal?

In our 2018 report, respondents informed us why they want to consume cannabis in the first place. According to the survey, when asked about which needs cannabis addresses, roughly two-thirds of the current recreational consumers who responded revealed that they use cannabis to help them relax, sleep, or reduce stress and anxiety.^{xvi}

We also learned that consumers said they would buy cannabis more often after legalization, and that less-frequent consumers expected to spend more. Such a consumer trend suggests that cannabis consumption has or will soon become a normalized activity, far removed from the stigma stamped on it decades ago.

Follow the data

Data-driven cannabis players are expected to emerge as market leaders in CPG/retail. Identifying areas of opportunity, targeting specific customers, estimating competitor market share at the postal-code level, and sifting through sales data to flush out consumer behaviour trends are critical responsibilities. As production innovation continues to drive sales and margin growth^{xvii}, those players will need the ability to navigate the complex cannabis ecosystem in order to take advantage of quickly evolving business models.

Keys to more successfully navigate and prosper in the market for cannabis and related products:

- Research the latest cannabis consumer trends
- Build a strong brand presence
- Deliver a consistent product
- Offer product variety, especially in the edibles space
- Analyze and capitalize on sales data

Opportunity knocks

Those who engage in an early dialogue with consumers, build distribution and retail relationships, and establish a varied lineup of CBD and THC products are more likely to be better prepared to adapt quickly as the regulatory environment evolves and the goalposts shift.

There are many avenues to participation in the cannabis industry—from strategic partnerships and acquisitions, to organic category growth. Identifying the ideal route for industry participants should be carefully considered before executing a game plan in order to win in an area filled with other like-minded firms.

Interested parties that can execute swiftly and aggressively are more likely to be well-suited to achieving a competitive advantage, giving them a solid foothold in this market.

Deloitte is seen as having the skills and experience to assist governments and regulators better develop cannabis policy, and to help businesses as they seek to maximize their potential in this market.

We have supported cannabis industry clients in regulatory applications, consumer advisory and retail analytics, capital advisory, mergers and acquisitions, valuations, IPO readiness, and post-merger integration in Canada.

We believe we are extraordinarily well-positioned to help our clients reach a level of cannabis knowledge and practice where they can more thoroughly identify, consider, and thereby seek to take advantage of the opportunities arising in this nascent industry.

To gain deeper insight into the cannabis industry, you'll want to read [Nurturing New Growth: Canada gets ready for cannabis 2.0](#), released in June 2019.

ⁱ Deloitte Cannabis Report 2018. Pg. 5

ⁱⁱ Deloitte Cannabis Report 2018. Pg. 5

ⁱⁱⁱ Headsight.io November 2018 Cannabis Report. Pg. 2

^{iv} <https://www.dea.gov/controlled-substances-act>

^v Headsight.io November 2018 Cannabis Report. Pg. 7

^{vi} Via a Forbes report on Dec. 12, 2016:

<https://www.forbes.com/sites/deborachardt/2016/12/12/the-cannabis-market-that-could-grow-700-by-2020/#517de634be1e>

^{vii} Cowen Report: Taking a Trip the Online Cannabis Store—Part 3

^{viii} Cowen Report, Pg. 7

^{ix} Via Tax and Trade Bureau report.

<https://www.ttb.gov/newsletters/archives/2018/ttb-newsletter052518.html>

^x Via FDA press release on Dec 20, 2018. <https://www.fda.gov/newsevents/newsroom/pressAnnouncements/ucm628988.htm>

^{xi} Via Health Canada's 'Proposed regulations for additional cannabis products' December 20, 2018, <https://www.canada.ca/en/health-canada/services/drugs-medication/cannabis/resources/proposed-regulations-edible-cannabis-extracts-topicals.html>

^{xii} Deloitte Cannabis Report 2018. Pg. 18

^{xiii} Cannabis in Canada, Deloitte's Boston Cannabis Summit Report 2018. Pg. 11

^{xiv} Via the Globe & Mail. <https://www.theglobeandmail.com/cannabis/article-marijuana-legalization-is-spawning-a-renaissance-in-cannabis-research/>

^{xv} Cowen Report: Taking a Trip the Online Cannabis Store—Part 3

^{xvi} Deloitte Cannabis Report 2018. Pg. 12

^{xvii} Cannabis in Canada, Deloitte's Boston Cannabis Summit Report 2018. Pg. 18

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