

Finding a National Foothold

US Cannabis Market: June 2020 Report

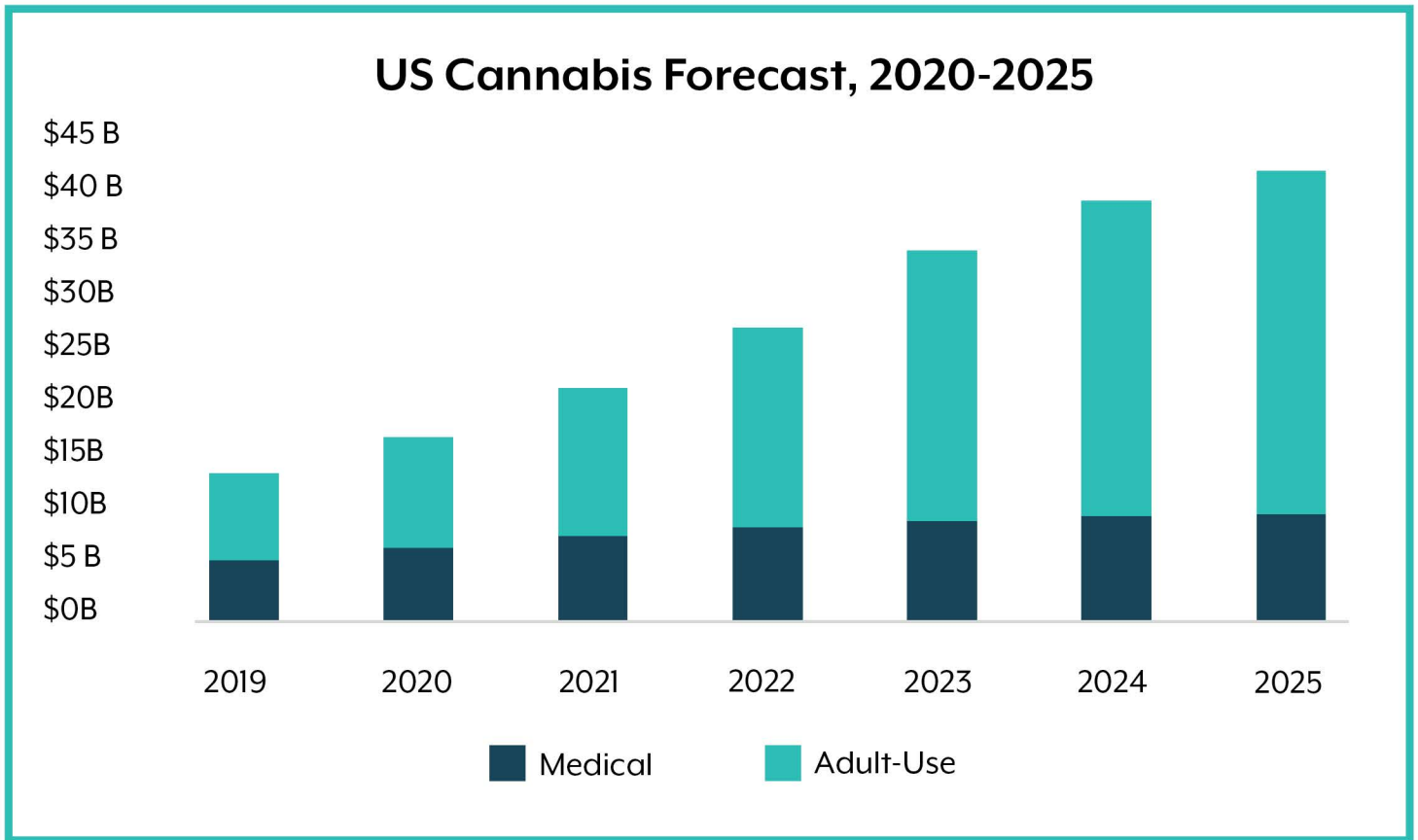
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Introduction

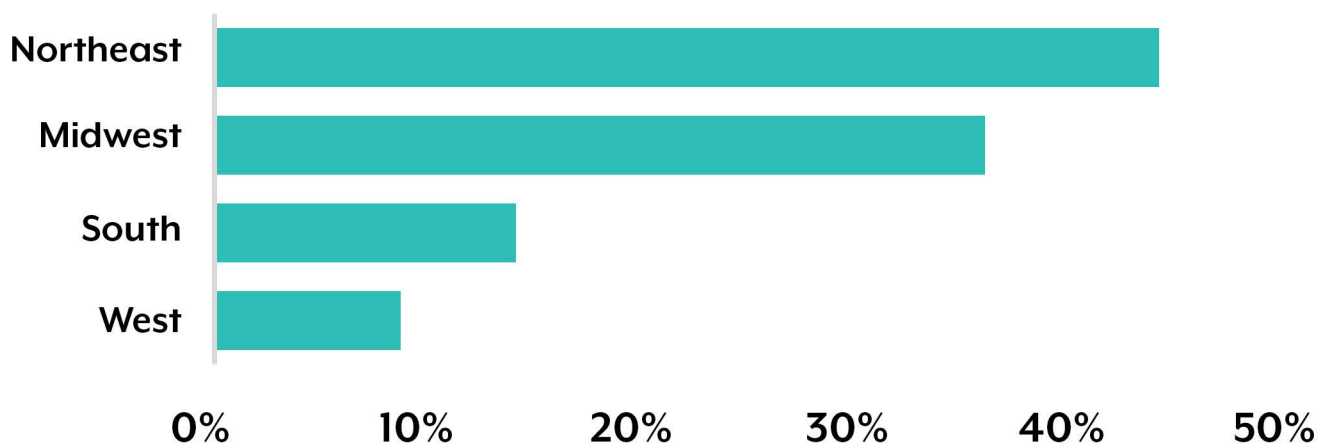
The US cannabis market is expected to grow to \$18 billion by the end of 2020, a 24% increase over 2019. Of this, adult-use will account for 60% of sales. The market is projected to surpass \$43 billion by 2025, representing a 20% CAGR as cannabis nationalizes its presence. This is driven primarily by adult-use, which will comprise 75% of the market by 2025 and will continue to grow significantly due to new market openings, market expansion, and increased consumer interest.



Growth Drivers

Through 2025, the Midwest and Northeast regions will see new openings and be responsible for the greatest portion of market growth. In particular, the Northeast will be the most significant contributor to growth as several large population centers – New York, New Jersey, and Pennsylvania – are expected to legalize adult-use cannabis over the forecast period. With several already large and relatively mature markets, the West will see slower growth than other regions. However, the West will contribute an additional \$6 billion to the industry from 2020 to 2025 as California continues to mature and adult-use markets in Arizona and New Mexico come online. Meanwhile, Illinois will become a large market once regulatory kinks are ironed out, but the Midwest will lag behind the other regions in terms of overall adult-use legalization. Slower growth is expected from the South due to the region's generally restrictive attitude towards cannabis, with the notable exception of Oklahoma.

2020-2025 CAGR by Region, Total Cannabis



Market Trend:

Not All Markets are Created Equally

Regulations Strain Retail

With recent market openings, the cannabis industry has experienced rapidly unfolding and expanding markets operating with a wide range of models. A closer look at several current models, including recently opened adult-use markets in Michigan and Illinois, sheds light on challenges with retail and product access that often constrain growth and limit full market maturity.



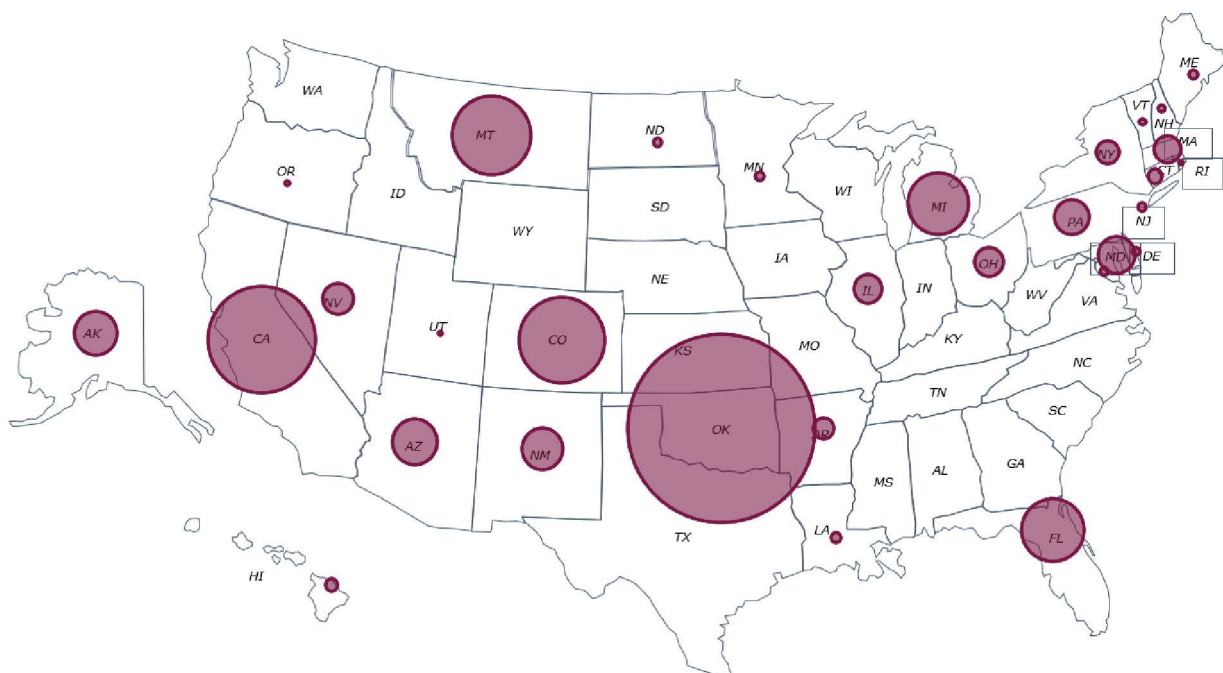
As Illinois opened in January 2020, the state's model was premised on 55 previously medical-only dispensaries serving the legal market until new retail could be approved and opened. However, this model quickly revealed a bottleneck in supply, causing shortages and limited availability of certain product types for recreational users as stock was set aside for medical card holders. As a result, sales underwhelmed and even declined in the state's second month, a first for the industry.

Michigan's adult-use sales opened in December 2019, one month earlier than originally anticipated. However, the state's market has struggled as Detroit and Grand Rapids, the state's largest metro areas, each experienced difficulties in establishing retail regulations, delaying sales in those areas and suppressing state-wide figures.

Access to retail locations also drives differing rates of success in medical markets. For example, Hawaii - the oldest medical market yet to open adult-use - has fewer patients than Oklahoma (one of the newest). The Aloha state has licensed about a dozen dispensaries while Oklahoma has come out of the gate with a progressive regulations that allowed over 2,000 dispensaries to open.

Medical Dispensary Count by State (2020)

OK = 2,035



Lack of access to a full range of preferred products can also stunt a state's sales and send consumers looking for product in nearby markets (or the illicit market). For example, during the vaping crisis in 2019 and subsequent banning of the format in Massachusetts, Maine retailers reported a spike in sales driven by consumers from the neighboring state. Similarly, 20-25% of legal sales in the Illinois market have come from out-of-state residents, revealing interest among Midwesterners that do not have access to legalized products at home.

The demand for adult-use cannabis is national and widespread. However, many potential consumers still live in areas of state-legal markets with little access to dispensaries or face restricted access to their products of choice.

As state markets continue to evolve and open, it will be imperative for the industry to push state and local legislators to allow for even access for all consumers. This will allow states to reach their full potential, create much needed tax revenue, and keep sales out of the illicit market.

New Markets on the Rise

Utah was the first state to see its medical program kick off in 2020, with sales officially beginning in March. It will be followed by Missouri and Virginia later in the year, while West Virginians will have to wait another year until their program is enacted. These launches succeed the commencement of sales in Arkansas, Louisiana, North Dakota, and Ohio in 2019. Of these four launches, Ohio has seen the most explosive growth and is well-positioned to expand continuously through 2025.



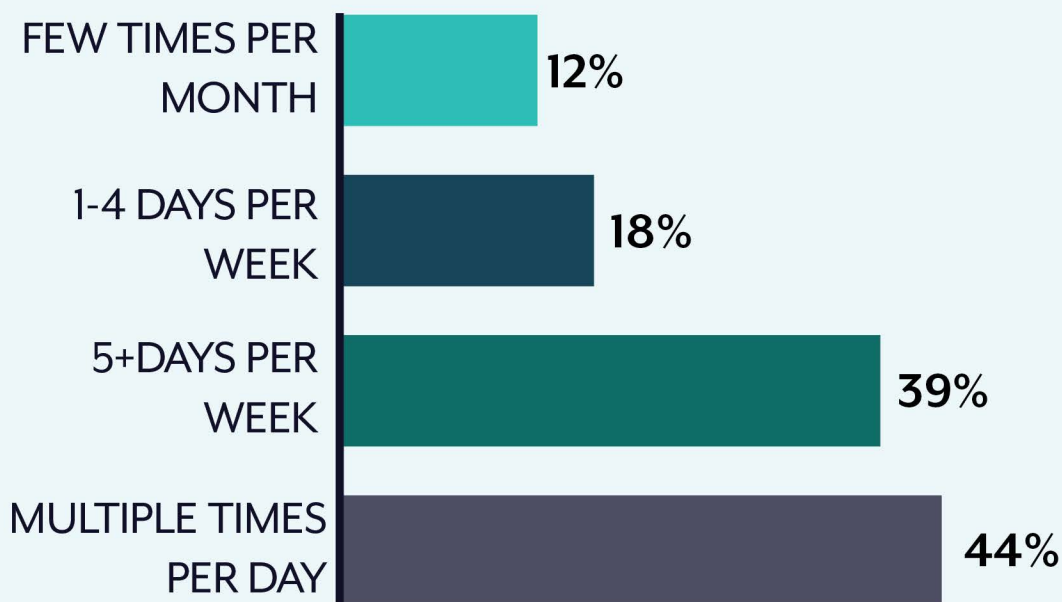
COVID-19 Spreads: Impacting Consolidation, Sales, and the Industry at Large

Due to a lack of capital and the coronavirus pandemic, consolidation is expected to slow considerably, at least until smaller companies actively look for buyers to avoid bankruptcy. The biggest operational driver of consolidation right now is licensing. Most states continue to offer a fixed number of licenses to grow and sell cannabis and once all the licenses have been issued, the only way a firm can expand its retail distribution in a given state is through buying competitors' licenses. Large firms will use this to expand their reach within a state and to gain exposure to additional states. Smaller firms welcome these purchases, too, as a premium is often associated with these buyouts.

Fortunately for players with retailer licenses, cannabis sales were deemed “essential” services in most states during stay at home orders. While some operational changes had to take place (e.g., curbside pickup, online ordering, adding delivery, etc.) many dispensaries saw an increase in sales as consumers began to “stock up” on products to limit the number of trips they would have to make. This changing shopping landscape presents an opportunity for dispensaries to embrace click and collect and find new ways to digitally connect with consumers. Additionally, some consumers’ usage frequency increased during stay at home orders. Most notably, heavy users over-indexed on an uptick in usage frequency, emphasizing the value of these loyal consumers to brands across the country.



% PLANNING TO USE CANNABIS MORE OFTEN BY FREQUENCY OF USE



Source: Brightfield Group Data, March + April 2020, n = 2,217

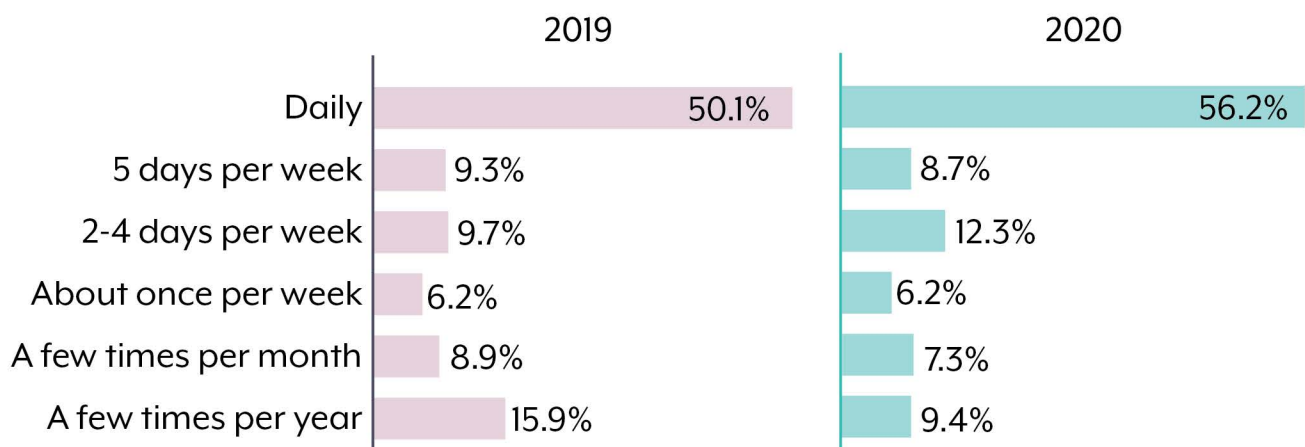
As more consumers have become with acquainted click and collect, curbside pickup, and delivery, these types of shopping alternatives are likely to gain momentum and continue to be offered in many states. If and when delivery is allowed to expand, there will likely be a few dominant platforms, much like in the food delivery space where Grubhub, Postmates, UberEats and DoorDash lead the market. While smaller, local delivery options will likely still exist (especially in smaller markets), expect platforms like Eaze and Meadow (and maybe even Uber) to deliver cannabis products from local dispensaries by car, bike, or foot. Alcohol-delivery company Drizly is also looking to enter the cannabis space, applying its existing infrastructure to the adult-use market.

Consumer Trend: Heavy Usage Increases



With expanded access to cannabis coupled with strong public support for legalization, usage is on the rise and consumers are finding new occasions to experience their products. In 2019 and continuing in 2020, the number of consumers using cannabis five or more days per week is increasing. In 2019, half of consumers reported using at this rate, an increase of 11 percentage points over 2018. In the first quarter of 2020, 65% of consumers report using cannabis five or more days per week (56% reporting daily usage).

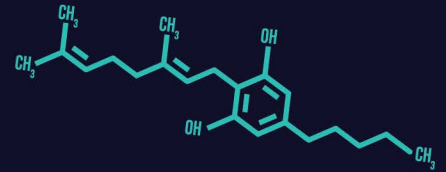
Cannabis Usage Rate by Year



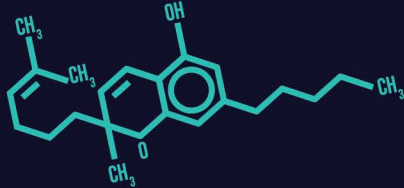
With a wide range of innovations launching over the past year, consumers have more selection of products that address specific physical and emotional need states. Most heavy users are using cannabis frequently and in smaller doses to treat anxiety, pain, depression or insomnia. They still tend to use cannabis in more leisurely, solitary occasions, like relaxing at home, right before bed, and taking care of home

Top Occasions of Cannabis Use (2020)



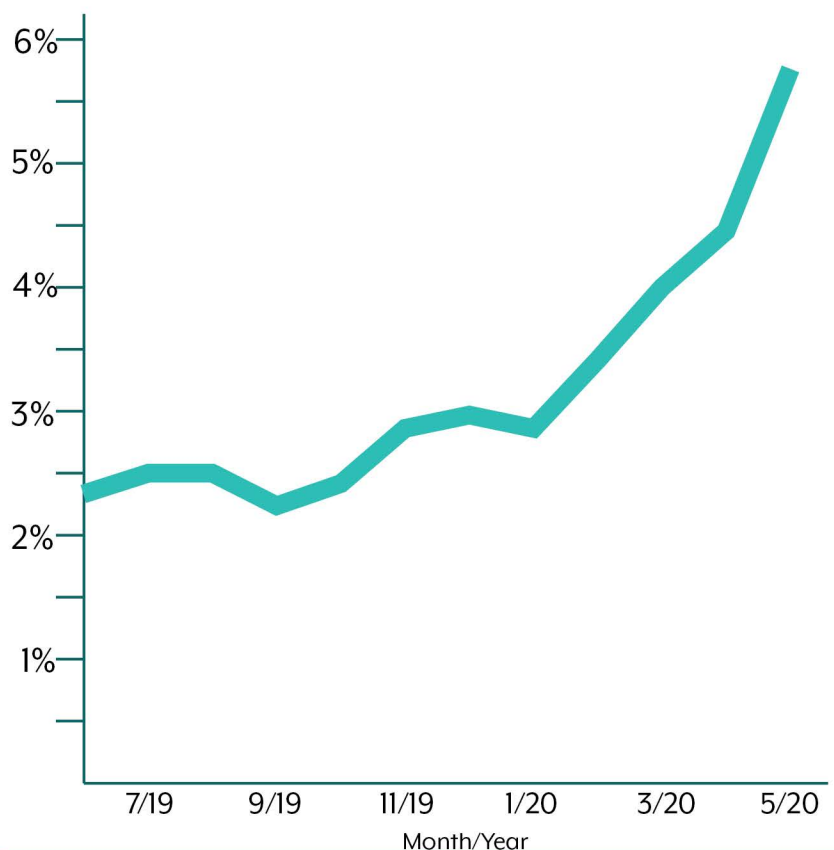


Product Trend: Cannabinoids on the Rise



THC and CBD aren't the only players anymore. CBN, CBG, THCa and other minor cannabinoids are hitting shelves as an additive to innovative cannabis products. Though these cannabinoids have been known about for years, they are just starting to hit store shelves as companies look for novel products to bring to market. Though not all of these items are regulated under the same conditions as cannabis because their effects are not psychoactive, they are nonetheless gaining shelf space in dispensaries and are often being combined with THC. This is similar to the growing number of products containing both THC and CBD. In fact, Brightfield Group has seen an 86% rise in products featuring alternative cannabinoids since May 2019.

% Share of all Products on Shelf Containing Alternate Cannabinoids Over Time

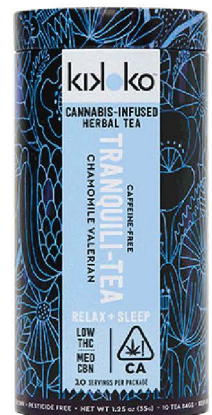


One example of this is Kiva Confections' Camino Gummies, specifically the Midnight Blueberry variety. This product contains 100mg of THC and 20mg of CBN in each package and is targeted towards consumers looking for a good night's sleep. Though there has been interest in CBN, CBG, and THCa, CBN has constituted the bulk of novel cannabinoid products hitting the market thus far.

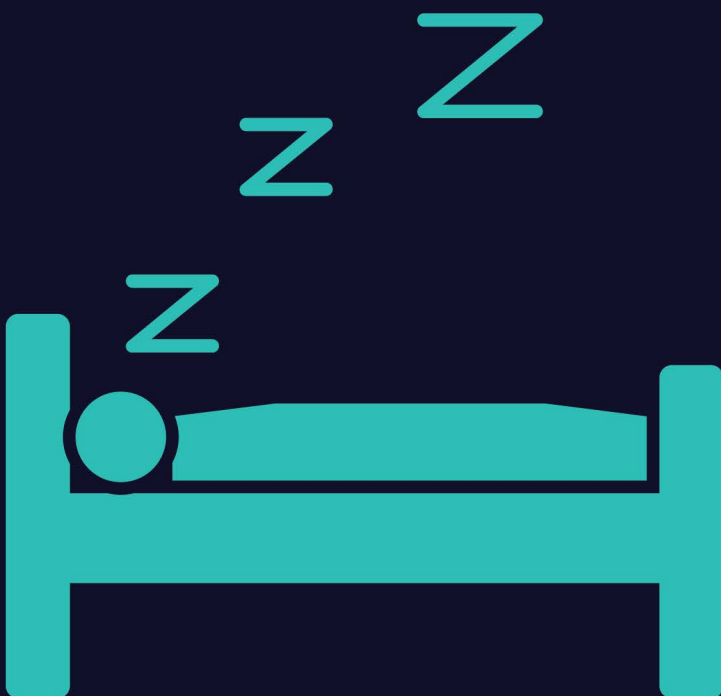


Kiva Confections' Camino Gummies

Because it is purported to aid with sleep disorders, its inclusion in sleep-oriented product lines is a natural combination which distinguishes it from indica-derived THC products and others which tend to contain a hefty serving of CBD instead. Many of these products are also rolling in other natural herbs and supplements with sleep associations, such as Kikoko Tranquili-Tea which contains 3mg of THC and 5mg of CBN in each serving alongside valerian root and chamomile.

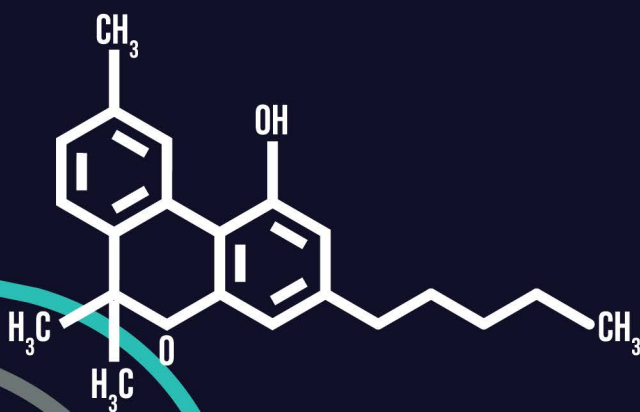


Kikoko Tranquili-Tea



Companies entering the CBN space are pioneers. Currently, only 14% of cannabis consumers are aware of CBN, with 29% aware of THCa and 13% having heard of CBG - well below the 83% who know of THC and 80% who are familiar with CBD. However, those who do know about these cannabinoids are very interested. 79% of cannabis consumers who know about CBN are likely to purchase it, with similar numbers for CBG and THCa.

Once consumers become aware of novel cannabinoids, consumer interest is piqued. As consumer awareness of these novel cannabinoids remains low, brands will need to spend time educating and targeting existing cannabis consumers to grow their addressable market. Kiva Confections and Kikoko are doing this in two different ways. Firstly, these brands are creating an association between CBN products and sleep. Consumers who are browsing store shelves looking for a sleep product will now start to see CBN pop up, prompting them to ask a budtender or search on their own for more information. Secondly, they are combining CBN, the novel cannabinoid, with the well-established THC (similarly to THC:CBD ratio products) so that consumers have some idea of what effects to expect and can then compare their experiences to other THC-based items they've tried. If new customers can be effectively educated and acquired, novel cannabinoids are poised for significant growth.



Conclusion

In 2020, new consumers across four states have already or will gain access to cannabis, including adult-use consumers in Illinois and medical patients in Utah, Virginia, and Missouri. Legalization will continue to gain momentum as cannabis gains recognition as a mainstream recreational packaged good and alternative medical solution. At least nine new markets are expected to begin sales over the forecast period, including adult-use sales in the populous Northeastern region that will help drive over \$12 billion in incremental sales from 2020 to 2025.

As markets open, brands must focus on reaching more consumers through retail expansion, whether brick and mortar or online, to realize their full potential. The legacy of the COVID-19 crisis is likely to be felt in a challenge to the traditional shopping model of browsing for items in a brick and mortar dispensary. While this is likely to remain a popular routine, click and collect, perusing products online, and expanded delivery options are likely here to stay. Digital marketing initiatives, upgraded websites and apps, and even more sophisticated in-store technology will be paramount to connecting with an increasingly digital consumer.

Lastly, with cannabis becoming more mainstream, the need to reach different segments of consumers with varied marketing and product offerings is key. While brand love and loyalty are still developing, industry players have an opportunity to set themselves up for success with more sophisticated consumer segmentation and innovative products that appeal to these segments. Expect to see more brands getting on board with broader trends in consumer-packaged goods (CPG) such as personalization, premiumization, sustainability, mission-driven brands, and nostalgia. These trends, along with strategic innovation and portfolio optimization, will help capture new consumers, retain long-time heavy users, and make brands stand out in this evolving industry.

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