



Article

Cannabis Law

May 2021

Reflections and Trends to Look for Since the Legalization of Recreational Cannabis in Canada

By [Andrew J. Wilder](#) and [Siena Hilley Bland](#)

In October 2018, Canada became the second country in the world to legalize the production, use and sale of recreational cannabis. In the approximately two-and-a-half years since its inception, the legal cannabis market touts an impressive resume and continues to advance ahead of countries who have yet to fully legalize.

However, the industry has not been free from complications. In particular, the stringent regulatory regime that imposes restrictions on advertising, promotion and sponsorship has made it challenging for cannabis companies to build their brands and grow their businesses. In addition, issues regarding production, variety and the price of products, as well as overall market competition have created challenges for this emerging industry. For more detailed discussions of these market barriers, you can refer to our earlier articles, from April 2020 and March 2021 which are posted on the Torkin Manes LLP cannabis blog.

Despite these challenges, Canada has made ground breaking progress in navigating this novel industry and continues to see growth year over year. In 2020, even amidst a global pandemic, Canada's recreational sales experienced a roughly 120% increase from the previous year, totaling approximately \$2.6 billion. Moreover, consumer interest and usage has also continued to rise, with roughly one in five, or 20% of Canadians now reporting that they have used cannabis in recent months. This is approximately a 6% increase from similar reports taken prior to legalization.

Canada has, and continues to set the precedent for the commercial and regulatory structure of legalized cannabis. As the market is ever-evolving, in order to maintain their competitive advantage in the global cannabis market, it is imperative that industry stakeholders continue to stay apprised of the evolution of market trends, as well as the development of new opportunities for expansion and growth.

With the intention of providing the reader with a stronger understanding of this market, this article will reflect upon the evolution of legalized recreational cannabis in Canada, and consider some ongoing and upcoming developments that will help shape the future of this nascent industry.

Statistics and Trends

To properly understand the recreational cannabis market, it is helpful to first look at the predominant consumer and market trends that have emerged over the last couple years.

Retail Expansion and Recreational Sales

The rapid expansion of retail is to date, one of the most notable developments that has occurred in the industry. Since recreational cannabis was legalized in the fourth quarter of 2018, the number of legal retail stores across the country has increased nearly eightfold by the end of the fourth quarter of 2020.

In 2020 in particular, we saw the growth of retail increase exponentially, with the number of retail stores doubling twice over between the third quarter of 2019 and the fourth quarter of 2020. Statistics Canada reported that at the end of 2020, there were just under 1500 retail stores operating across the country.

This ramp up of retail is in part attributable to the changes in some of the provincial licensing programs. For example, up until January 2020, Ontario had awarded retail licenses through a lottery based system, but in 2020, the province opened the licensing application process to the public and continued to accelerate the rate at which the Alcohol and Gaming Commission of Ontario processed and awarded licenses to prospective licensees.

Even with the challenges imposed by COVID-19, the expansion of the retail market resulted in huge increases in recreational sales. This upward trajectory has only continued through the first quarter of 2021. With legal cannabis sales reaching roughly \$262.2 million in February, some commentators have projected that the country will reach \$4 billion in recreational sales this year.

The Consumer

Like any analogous industry, a vital component to the continued growth and success of the recreational cannabis market is an understanding of the consumer and their preferences.

In its recent 2021 consumer report, Deloitte advised that the majority (75%) of the market volume continues to be from existing cannabis consumers with their preferred product remaining dried flower. However, Deloitte also noted that long-term expansion is likely to depend on new consumers. According to Deloitte's report, distinct from existing consumers, new consumers prefer non-combustible cannabis products, with edibles holding the largest share (40%) of new consumer purchases. Notwithstanding these preferences, reports have indicated that both existing and new consumers remain interested in having a wide range of products available and in trying new formats for different usage purposes.

What this information tells us is that consumer purchasing trends are seemingly product based, rather than brand based and as a result, we have yet to see a strong sense of brand loyalty develop amongst consumers. We anticipate that with time, brand loyalty will develop, but as of right now, the consumer demand for variety continues to provide opportunities for cannabis companies and retailers to enter the market, to develop and provide a wide range of products, and distinguish themselves as a trusted consumer brand.

We have already begun to see some brands employ strategies to take advantage of these opportunities. For example, some retailers have begun working in partnership with licensed producers to launch private label products.

Cannabis companies and retailers may be able to further capitalize on the opportunities for brand loyalty by reaching consumers through new product offerings including edibles and drinkables. With new consumers most likely to use edibles and drinkables, existing consumers eager to experiment with these products, and commentators projecting that the edible and drinkable sector will continue to see expansive growth in the coming years, there is ample opportunity for brands to utilize this sector to establish and grow their relationship with consumers.

In addition, other venues for purchase and consumption, such as consumption lounges and farmgate cannabis stores, may provide cannabis companies with further opportunities to connect directly with their consumers. With consumption lounges not yet legalized in Canada, and Ontario the only province to have

incorporated farmgate stores into their regulatory model, it will be interesting to see if, and how these developments influence the Canadian cannabis industry in the future.

Price of Products and Competition with the Illicit Market

Across the country, product price continues to be the key influence on consumer decision-making. Over the last year, as the industry has continued to evolve, and competition has increased, the price of legal products has generally declined. As an example, the Ontario Cannabis Store (the “OCS”) reported that the price per gram of dried flower on the OCS website dropped from an average of \$10.80 in the second quarter of 2019, down to an average of \$6.24 in the fourth quarter of 2020, while the price in Ontario retail stores dropped from an average of \$12.40 to an average of \$9.13 in the same time period.

One benefit of these consistent decreases in price is that the legal market has been able to start to close the gap with the illicit market.

With the distinct advantage of having existed for many years prior to legalization, the illicit market has continued to be a strong competitor for the legal market. Moreover, as the illicit market is not subject to the stringent regulatory regime that continues to challenge the legal market, the illicit market has been able to continue to attract existing consumers through factors including product price, cannabis content in products, and convenience.

Nevertheless, the scales are beginning to tip in favour of the legal market. According to Deloitte, more than half (54%) of existing consumers only purchase cannabis from legal sources, while 26% indicate they purchase from both legal and unlicensed sellers.

At the provincial level, in Ontario, between the fourth quarter of 2019 and the fourth quarter of 2020, the legal market’s share of the recreational industry has increased by approximately 19% (increasing from 21.4% to 40.3%), with the average price per gram sold on the OCS website finally dropping below the average price per gram sold on the illicit market.

On a larger scale, Statistics Canada reported that the legal market overtook the illicit market in sales in 2020. In that regard, Cannabis Benchmarks recently noted that, as compared to the same timeframe in 2019, in the fourth quarter of 2020 legal recreational cannabis expenditures across Canada grew 101%, while illicit cannabis expenditures dropped by 20%.

The various advancements across the industry have led to a curtailing of the illicit market and have enabled the legal market to slowly make progress towards the federal government’s goal of eliminating the illicit market. As the legal market continues to gain momentum, and as the illicit market appears to be losing steam, we anticipate that the gap between the legal and illicit cannabis markets will continue to widen in favour of the legal market. However, in order for progress to continue, it is imperative that cannabis companies and retailers remain focused on fundamentals including a variety of product offerings, competitive pricing and a convenient shopping experience for consumers.

Looking Forward

Taking into consideration the above data and trends, it is worth highlighting a couple of emerging developments that we expect to be responsible for the further expansion and advancement of the industry.

Presently, what is likely causing the most excitement among industry stakeholders is the continued progress of cannabis legislative reform in the United States. Support for the legalization of cannabis has been steadily growing across the U.S., with a recent Gallup poll finding that nearly 7 in 10 Americans continue to believe that cannabis should be legalized.

As a result of the 2020 election and 2021 run-off elections, the Democrats secured control of the Senate, the House of Representatives, and the presidency. These changes are furthering the sense of optimism that legislative reform will finally occur at the federal level. We know that legislators on both sides of the aisle are working towards legislation that could potentially result in the descheduling of cannabis as a controlled substance. In January, we discussed a number of these promising legislative changes.

Of particular note is the *Secure and Fair Enforcement (SAFE) Banking Act*, which was passed by the House in April 2021. If enacted, this piece of legislation would protect banks and other financial institutions from federal prosecution in situations where they are lending to legally established cannabis companies who are operating in states in which cannabis has been legalized. By enabling cannabis businesses to gain access to traditional financial services that are available to most other industries, the *SAFE Banking Act* would aid substantially in the growth and development of the legal U.S. market.

While the potential passage of U.S. federal law is attracting the attention of industry investors, commentators still believe that state-by-state legalization remains the key factor right now. To date, 36 states have either decriminalized or approved the medical use of cannabis and 16 states, as well as Washington, D.C., have fully legalized recreational cannabis.

With a number of states having already legalized cannabis programs (either medical and/or recreational) in 2021, including New York and New Jersey, and several other states anticipated to do the same, the progression towards U.S. legalization is set to accelerate through the remainder of 2021.

As commentators project that the U.S. legal cannabis market will add more than \$US92 billion to the economy in 2021, Canadian cannabis companies are actively making moves to enter the U.S. market and establish a foothold ahead of U.S. legalization plans. Some Canadian companies have already begun to make their presence known by investing in hemp production and the U.S. legal CBD industry.

Looking forward, we anticipate that the excitement and optimism regarding the U.S. legal market will continue to grow in conjunction with the acceleration of legislative reform at both the state and federal levels. In addition, we expect that the emergence and growth of the U.S. legal market will assist in driving the continued expansion of the Canadian legal market. We have already begun to see this spillover effect on the Canadian public markets.

Shortly before the legalization of recreational cannabis in Canada and the unprecedented expansion that followed, many cannabis companies decided to go public to tap into the unparalleled demand for investment in this promising new sector. Although volatile, this trend continued into 2019 until we witnessed a steady pull back in stock prices as the valuations upon which investments were made were reconsidered given that most cannabis companies were not profitable.

Towards the end of 2020 and continuing through the beginning of 2021, we saw a resurgence of the cannabis public markets with trajectories trending upwards until there was a significant market correction in mid-February 2021.

Many commentators have suggested that much of the public confidence that led to the resurgence of the cannabis public sector was driven by public optimism regarding legislative cannabis reform in the U.S. Despite the recent pull back, most commentators have a bullish outlook on 2021 for many reasons including the growing likelihood of meaningful U.S. legislative reform, the improvements in fundamentals as consumers move away from the illicit market, and the increase in significant investments being made by institutional investors into U.S. cannabis companies.

When considering where we have come from, and the trends and opportunities that are on the horizon, we anticipate that in 2021 the Canadian recreational cannabis industry will achieve new heights and experience advancement like never before.

This article was originally published on Business of Cannabis.

Authors



Andrew J. Wilder
Partner

Tel: 416 777 5402
awilder@torkinmanes.com



Siena Hilley Bland
Student-Articling

The issues raised in this publication are for information purposes only. The comments contained in this document should not be relied upon to replace specific legal advice. Readers should contact professional advisors prior to acting on the basis of material contained herein.