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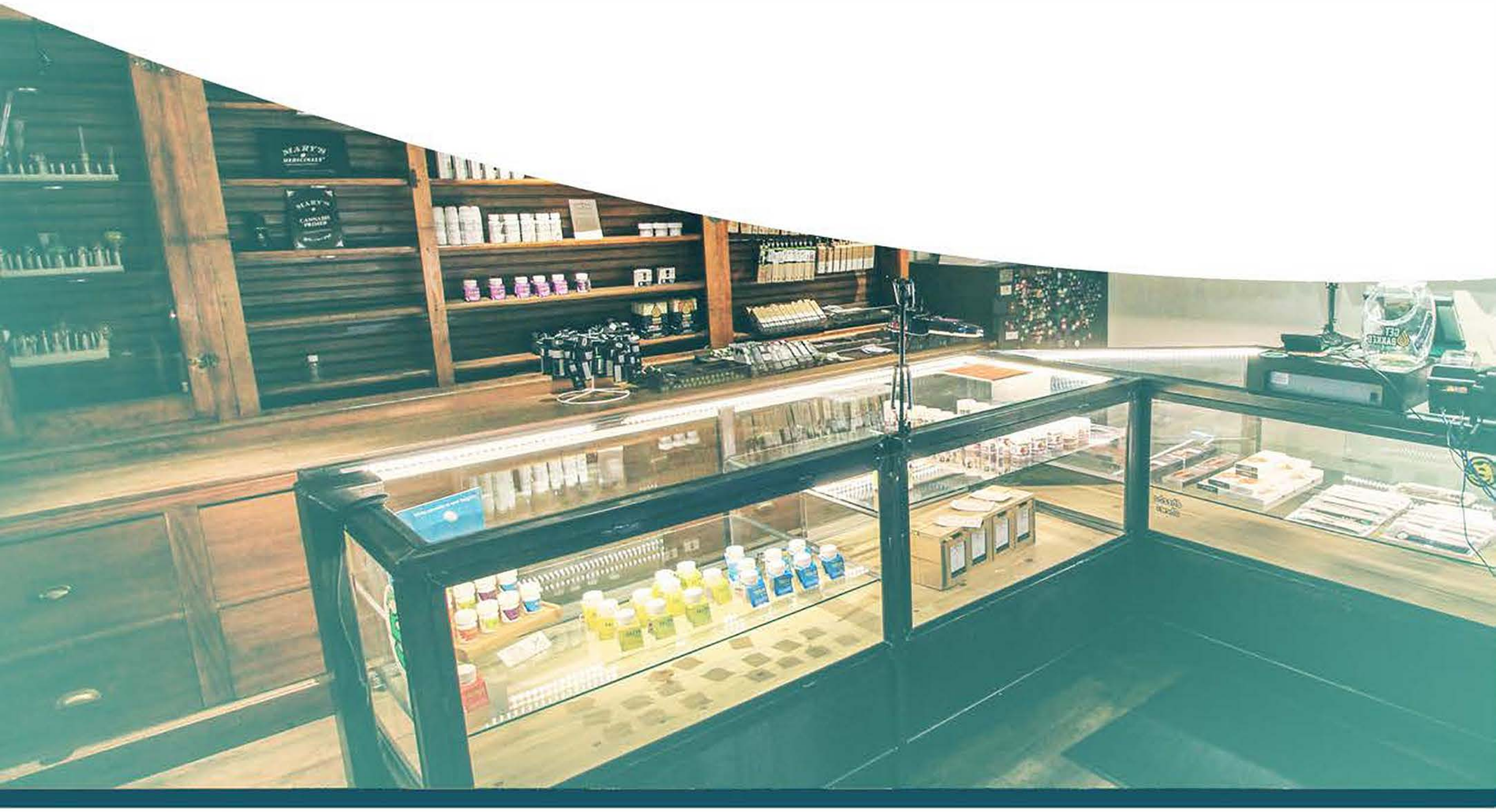
From Dispensaries to Superstores: Opportunities in US Cannabis Retail



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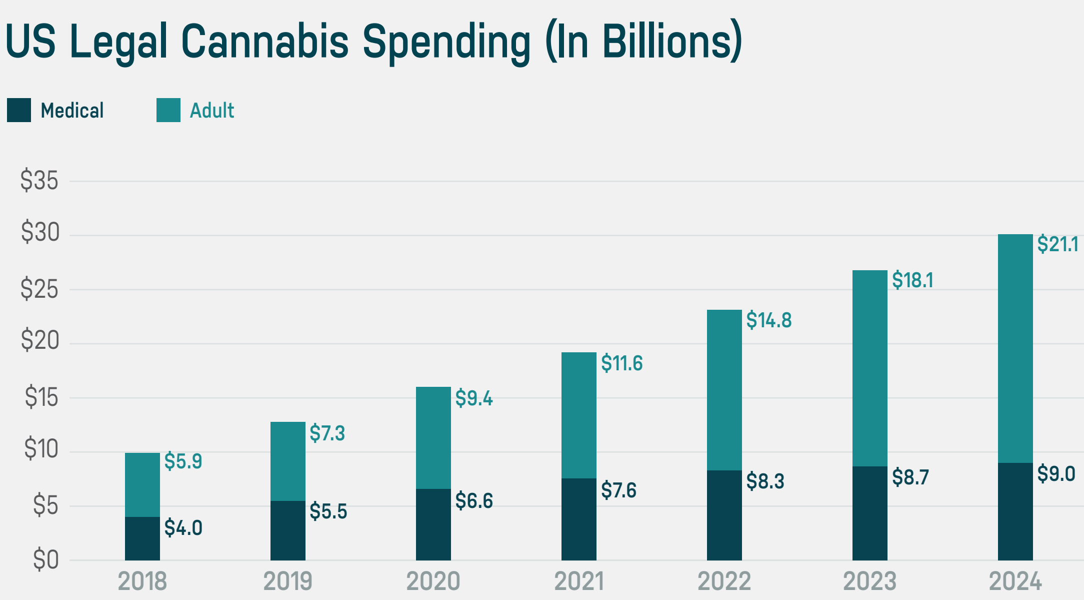
Executive Summary

Cannabis specialty stores are the beneficiaries of a series of fortunate events. For more than a decade, U.S. states have taken the lead on legalizing cannabis production, sale and use within their own borders. Their efforts, while in defiance of federal strictures, have begun the arduous process of diverting more than $50 billion in annual illicit spending into the new legal channels they have created. All of that redirected money flows first through the legally licensed cannabis retailer.

And the legal cannabis business in the U.S. is booming—especially since the first legal adult-use sales of cannabis began in Colorado and Washington in 2014. Annual legal spending reached $9.8 billion in 2018 and is forecast to grow by 30% to $12.8 billion this year, and at a compound annual growth rate (CAGR) of more than 20% to $30 billion in 2024. That $20 billion in additional annual spending will be driven by the massive growth anticipated in markets like California, with its



Source: Arcview Market Research/BDS Analytics

millions of receptive consumers, but every one of the U.S. states and territories expected to approve at least medical cannabis by 2024 will contribute.

Unlike retailers of most any other product, cannabis specialty stores operate in an inherently protected environment. They alone are licensed to sell cannabis to the large and growing segment of the population who consume at least occasionally. While there is increasing competition in cannabis retail, the space itself is walled off from the kinds of competitors who have made a business of killing off specialty retail segments: retail giants like Walmart, who sell everything under the sun at unbeatable prices, and online giants like Amazon, who do the same and deliver, too.

Though protected, there are still challenges—they include most of those typically faced by traditional product retailers plus the temporal and monetary costs associated with strict regulatory compliance, higher costs of capital and banking services, profit margins squeezed by Section 280E of the IRS code as well as limitations on conducting business across state lines. Nevertheless, the capital needed to grow retail businesses and build value was unleashed in 2018 when U.S. multistate operators discovered the route to public equity via the Canadian Securities Exchange. Despite this year's brutal correction in those public values, the pool of public funding will only increase as the U.S. legal cannabis market evolves—culminating, perhaps by 2021, in legalization of the industry at the federal level.

That change, when it comes, will ameliorate many of the issues that are crimping profit margins for retailers today as it remakes the landscape of the cannabis industry in many ways. While legislators, or voters, will still decide on a state-by-state basis whether to legalize cannabis and at what level, the end of federal prohibition will enable banks to serve cannabis retailers at the same rates charged to purveyors of other products and will enable retailers to realize economies of scale from freer cross-jurisdictional business after years of relegation to regulatory islands.

On the demand side, federal legalization would remove the final barrier to wider consumer acceptance of a product that about one-quarter of American adults report consuming in a given six-month period (classifying them as "Consumers") while another third say they would consider consuming in the future (making them "Acceptors"). In legal adult-use states, the combined Consumer and Acceptor categories amount to 67% of the adult population, more than the percentage that say they consume some alcohol.

That means cannabis retailing could become one of the most profitable and enduring specialty store categories ever. There are several existing giant industries that can provide a hint of where cannabis retailing goes from here, basically those that also market mildly psychoactive substances with a culture of connoisseurship such as specialty coffee, craft beer and fine wine. Each of those specialty store types started with enthusiastic single-store operators who were able to keep a profitable niche for themselves even as the bulk of total sales for their product category went to mass producers and mass merchants.

Cannabis retailers have the opportunity to do the same, in a product category that will be among the fastest growing in the world economy for many years to come.

While there is increasing competition in cannabis retail, the space itself is walled off from the kinds of competitors who have made a business of killing off specialty retail segments: retail giants like Walmart, who sell everything under the sun at unbeatable prices, and online giants like Amazon, who do the same and deliver, too.

Letter From the Editor

Cannabis is perhaps the most exciting physical retail opportunity to come along in decades. What other nascent industry has offered the lucrative combination of extremely rapid sales growth, a receptive and fast-growing customer base and government-enforced protection against both runaway local competition and store-killing mass merchant and online distribution? The answer is, of course, none.

Legal cannabis sales in the United States broke $9.8 billion in 2018. We forecast sales to rise at a compound annual growth rate of 20% through 2024, to top $30 billion. By that time, every U.S. state and territory will have legalized cannabis for at least medical use—and 23 for use by all adults within their borders. Even then, just 47% of Americans will have access to adult-use stores—so another wave of growth lies beyond 2024.

We're well past the point where, with any other product or service, we would be seeing a proliferation of physical and virtual retailers, alongside a host of acquisitors beginning to roll those up into a handful of concerns. And, in fact, we see the beginnings of that kind of consolidation now with cannabis. But the retailers of today have a window of opportunity to get established before federal legalization allows major public physical and e-commerce retailers to come for this business. Even then, states are unlikely to cede their control over licensing limits. And Walmart and Amazon have only been death to specialists because of their national—in fact, international—supply chains. That may not be an advantage available to them with cannabis, at least not any time soon.

In this report, we've attempted to lay out a clear picture of the current cannabis retail landscape in the U.S. and identify the myriad extant and future opportunities. We think you'll find it a valuable document for developing a winning strategy for the cannabis retail game.

Tom Adams
Editor in Chief
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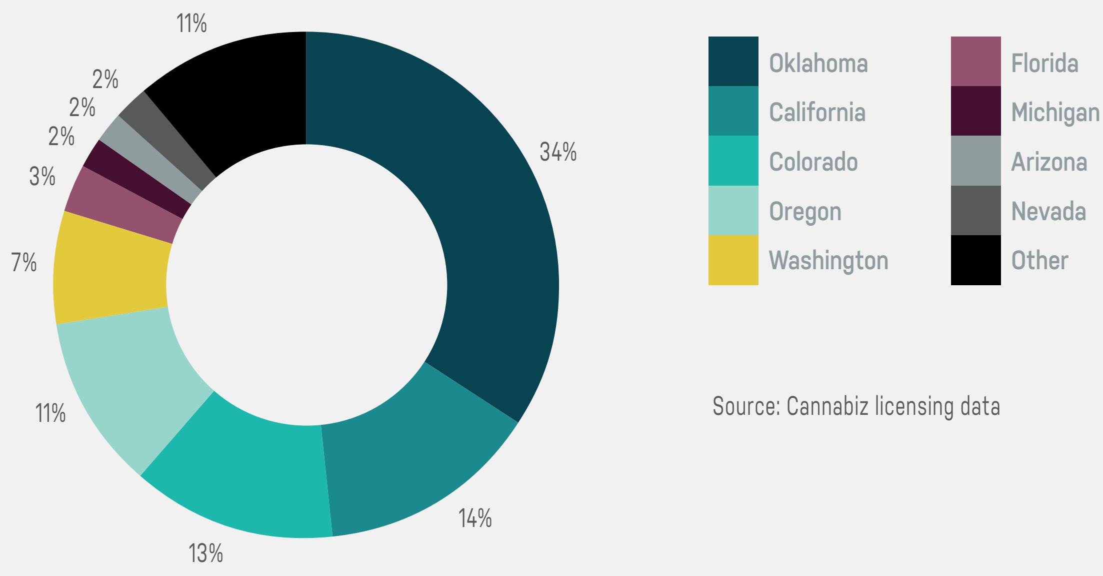
The New Face of Cannabis Retail

Like dozens of specialty store sectors before it, cannabis retailing was launched by people who simply loved the product. They may have already had illicit businesses cultivating or distributing flower or simply jumped at the opportunity to get a license when retailing cannabis from a storefront became legal. But for most of the early retailers in medical-only markets, the focus was on playing a part in ending prohibition.

When Colorado opened the adult-use era, that focus shifted to building sustainable business models, establishing brands and expanding home-state market share.

Active Retail, Dispensary and Delivery License Holders by State: 3Q 2019



Source: Cannabiz licensing data

By capitalizing on in-state knowledge, vertical integration and a newly regulated supply chain, the first generation of cannabis retailers enjoyed high double-digit growth rates as the roughly one-quarter of all adults who consume cannabis at least occasionally started pouring into stores.

Now the cannabis retail sector is entering a third phase of development, as some of those single-state operators look to broader national expansion while also facing new, increasingly business-savvy competitors in core markets. Many recent entrants come with deep pockets, having gone public on the Canadian Securities Exchange in the last 18 months with business plans aimed at scalable, national chain-building from the get-go.

A closer look at the current retail landscape—using Cannabiz Media's counts of 3Q 2019 active retail, dispensary and delivery licenses (i.e., those officially approved by the respective state to begin legal operations)—hints at the scale of that potential future growth. One reason we are confident that $30 billion is a reasonable expectation for the U.S. legal market in 2024 (see "The State of Legal Cannabis Markets, 7th Edition") is that the weight of the mix of currently licensed retail operations bears little resemblance to the weight of the U.S. population by state. Just four states (Oklahoma, California, Colorado and Oregon) make up 80% of the total active retail licenses as of 4Q 2019, a clear indication of the legal cannabis industry's relative immaturity as a consumer retail channel.

In fact, with some enormous states, like Texas, going medical-legal late in the forecast period and others just getting to adult-use legalization by then, growth past 2024 will continue to be robust.

Individual State Markets: Legal Fortresses Protected by Regulatory Moats

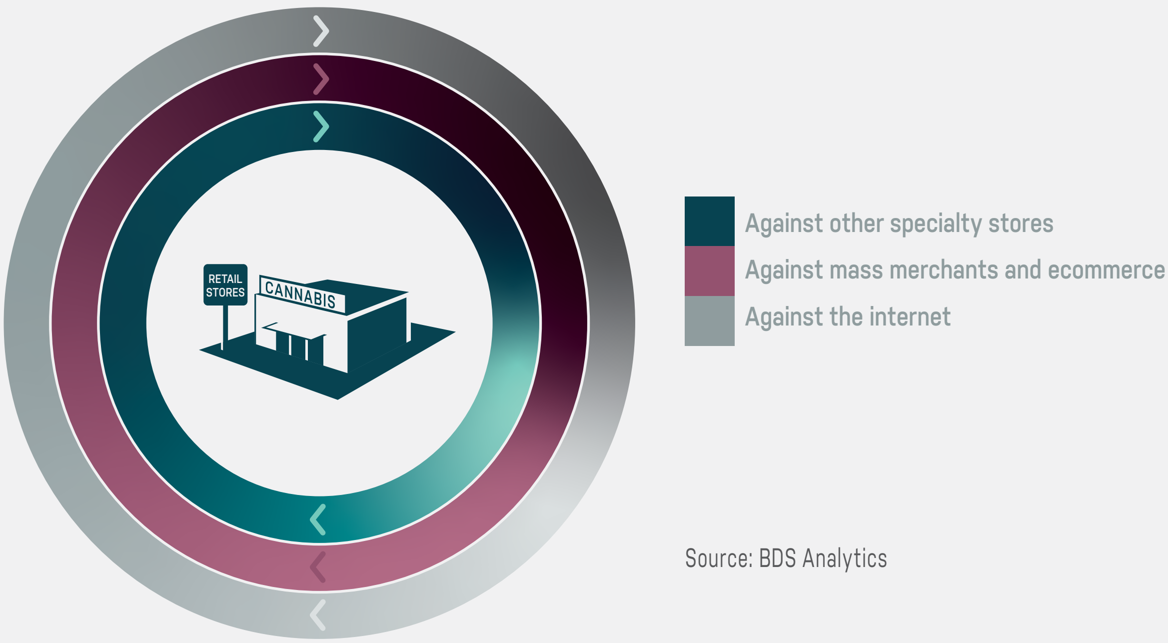
Legal cannabis retailing brings together what have so far been two very different businesses. During the past 50 years, the cannabis distribution pipeline has developed from illicit dealers to quasi-legal medical dispensaries to comprehensively regulated adult-use cannabis specialty stores. During that same time frame, U.S. retailing has gone from downtown mom-and-pop specialty stores to big-box chains of general merchandizers in the suburbs.

Now, cannabis is on track to become a mainstream product category, reflecting the fact that about one-quarter of American adults report consuming some cannabis in a typical six-month period (38% in states where it is fully legal to do so), according to the first half 2019 study by BDS Analytics Consumer Insights. Cannabis specialty stores in both medical and adult-use markets find themselves in an unprecedented and potentially very lucrative position: government licensed exclusive purveyors of a hugely popular consumer product.

Businesses in any industry hope to have one protective moat—a factor that protects them from the kind of competition that can put downward pressure prices and profits. Cannabis stores have three of them:

- **Against other specialty stores**—Local jurisdictions are generally limiting the number of cannabis retail licenses they will issue, often to unreasonably low numbers.
- **Against mass merchants and e-commerce**—Federal prohibition is keeping the Walmarts and

Strategies That Create Moats Around Retail Businesses



Source: BDS Analytics

Amazons of the world on the sidelines, at least for a while.

- **Against the internet**—Whole economic sectors have been devastated by the web—newspapers, video and record stores, travel agents and more. With cannabis, there is no electronic replacement for physical products.

Of course, legal cannabis stores have other headwinds, the most challenging one in the short term is their need to capture market share from an illicit market that long-time cannabis consumers were pretty comfortable using. Right now, legal stores are being dramatically undercut on price. Efficiencies of local cultivation (versus importing from California or abroad) will inevitably make legal stores more competitive as long as taxing authorities do not insist on pocketing those savings. Likely more important as a competitive advantage is that consumer tastes are expanding beyond raw flower product, and purveyors of edibles, concentrates, pre-rolls and topicals are bringing brand marketing techniques to bear in ways the illicit pipeline cannot.

Legal stores also have profitability pressure from several aspects of federal prohibition. Those headwinds stem from the inclusion of cannabis in Schedule 1 of the Controlled Substances Act (CSA) with heroin

Top 10 Privately Held US Cannabis Retail Dispensary Chains

COMPANY	HEADQUARTERS	ACTIVE US RETAIL, DISPENSARY AND DELIVERY LICENSES	ACTIVE STATES	DESCRIPTION
Surterra Florida, LLC	Ocilla, GA	28	1	Second-largest Florida dispensary chain with 32 operating stores (18%), as well as cultivation and processing facilities. Largest private active license holder the U.S., and the largest of four Surterra LLCs operating across three states (Massachussetts, Nevada and Florida).
The Green Solution, LLC	Denver, CO	27	1	Twenty-five active Colorado retail licenses (three dispensary, 22 retail) as well as cultivation and processing facilities; two active Illinois retail licenses.
Mr. Nice Guy	Santa Barbara, CA	26	3	Oregon, California and Colorado retail licenses, as well as cultivation and processing facilities.
CBD Plus USA	Oklahoma City, OK	24	1	Largest single licensed Oklahoma dispensary chain, specializing in high-CBD products. Also franchises CBD Plus stores in Texas, Tennessee, Maryland and Florida, but does not hold licenses there. Does not hold any cultivation or processing licenses.
La Mota LLC	Portland, OR	23	1	Oregon retail chain with several stores in the Portland metro area and throughout the state. Also has cultivation and processing facilities.
Native Roots Parentco	Denver, CO	20	2	Retail stores throughout Colorado, as well as cultivation and processing facilities.
LivWell LLC	Denver, CO	19	1	Colorado retail chain with additional processing and cultivation facilities.
MNG Holdings, LLC	Portland, OR	19	1	Oregon retail chain with cultivation and processing facilities. Parent company of multistate LLC, Mr. Nice Guy.
SGOK 1-2-3 LLC	Dallas, TX	19	1	Oklahoma dispensary chain supported by cultivation and processing facilities. Backed by Texas-based beverage distributor Southern-Glazer Wine & Spirits.
Knox Management Services LLC	Miami, FL	15	1	Operates the vertically integrated Fluent dispensary chain in Florida.

Source: BDS Analytics analysis of Cannabiz Media license data.

and other substances considered in 1970 to be without efficacy for medical uses, of high abuse potential and unsafe to use even under medical supervision. That inclusion in the CSA prompted Congress in 1982 to introduce Section 280E into the IRS code, disallowing the deduction of operating expenses for taxpayers generating revenue from the sale of Schedule 1 substances.

Inclusion in the CSA has also made the largest banks leery of doing business with cannabis companies in legal states, thus increasing operating costs for retailers in many different ways—cost of financing, and conducting business solely in cash, for example. Banking reform is working its way through Congress, but the 280E reform would cost the U.S. Treasury more with each passing month of industry growth, so it will likely have to await the actual end of prohibition through removing cannabis from the CSA entirely.

State-based regulatory frameworks and licensing also add cost to cannabis retailing in some states, but they have profitability upside by protecting a limited number of licensed stores from the rampant competition that makes retail such a thin-margin sector in other product categories. Beyond that, in many ways they define the strategic landscape for those companies that do get licenses. California and Colorado's pioneering days show this, with California's medical regulations in the 1996–2017 era only allowing nonprofit cooperatives to buy product from members and sell it to others. When Colorado allowed adult-use sales in 2014, it allowed real capitalism, and product brands proliferated while a more profit-driven brand of retailers went to work building chains of stores.

Several chains emerged as market share leaders in Colorado, and their success in building out an individual state market inspired the business plans of several private chains in other legal states:

- Surterra Florida, one of several state-specific Surterra LLCs, holds the largest number of active licenses in Florida.
- SGOK is an Oklahoma dispensary chain supported by cultivation and processing facilities and backed by Texas-based beverage distributor Southern-Glazer Wine & Spirits.

While most retailers remain focused on growing their core markets, a few have begun to leverage their early success by moving into additional states, for instance:

- Mr. Nice Guy/MNG Holdings in Oregon expanded to California and Nevada.
- CBD Plus USA, a new Oklahoma-based chain focused on high-CBD and CBD-only products, has 24 licensed dispensaries throughout the state. It also has franchises throughout the Southern U.S., offering CBD-only products that lie outside the bounds of regulation.

Public Multiple State Operators

The investment community has been waking up to the potential for retail chain buildout since we published our first look at the economics of cannabis retailing in 3Q 2017. At that point, single-store operators dominated the U.S. landscape, although three chains (The Green Solution, LivWell Enlightened Health and Native

Top 10 Publicly Held US Cannabis Retail Dispensary Chains (Ranked by Market Cap)

COMPANY	HEADQUARTERS	ACTIVE US RETAIL + DISPENSARY + DELIVERY LICENSES	ACTIVE STATES
Curaleaf Holdings, Inc.	Wakefield, MA	44	7
Cresco Labs, Inc.	Chicago, IL	25	5
Green Thumb Industries, Inc.	Chicago, IL	31	5
Harvest Health & Recreation, Inc.	Tempe, AZ	19	6
MedMen Enterprises, Inc.	Culver City, CA	30	7
Acreage Holdings, Inc.	New York, NY	23	9
Columbia Care, Inc.	New York, NY	24	9
Trulieve Cannabis Corp.	Quincy, FL	34	1
Ayr Strategies, Inc.	New York, NY	10	2
4Front Ventures Corp.	Phoenix, AZ	4	3

Source: BDS Analytics analysis of Cannabiz Media license data and New Cannabis Ventures Market Cap at 10/11/19 close.

Roots) owned about 5% of Colorado's stores among them. Retail operations were being built out-of-pocket through friends and family financing or from the small cadre of private investment funds willing to "touch the plant," in the parlance of the time.

In an ironic, historical twist, it was e-commerce that opened up the bricks-and-mortar opportunity in cannabis. In Canada's medical market, the licensed producers were limited to selling online. But the success of their public equities inspired those running the largest multistate operators (MSOs) in the U.S. to take the indirect route to public capital through reverse takeovers (RTOs) of public shells on the Canadian Securities Exchange, starting in early 2018.

Today, the top 10 U.S. public cannabis retailers hold just 4% of available licenses outright but operate many more through off-balance-sheet LLCs. Curaleaf Florida, for instance, is an LLC run by publicly traded Curaleaf Holdings, which itself owns outright the largest number of currently operating retail dispensaries.

Revenue Growth Ahead with Bigger, Better Stores

These publicly held MSOs have been building national footprints through a variety of merger and acquisition strategies, acquiring other regional license holders and brand houses in states where they do not yet operate stores. But they are also starting to diversify their tactics in other ways tied more to store design, merchandising, marketing and all the other traditional retail strategies for driving revenue, market share and profitability growth.

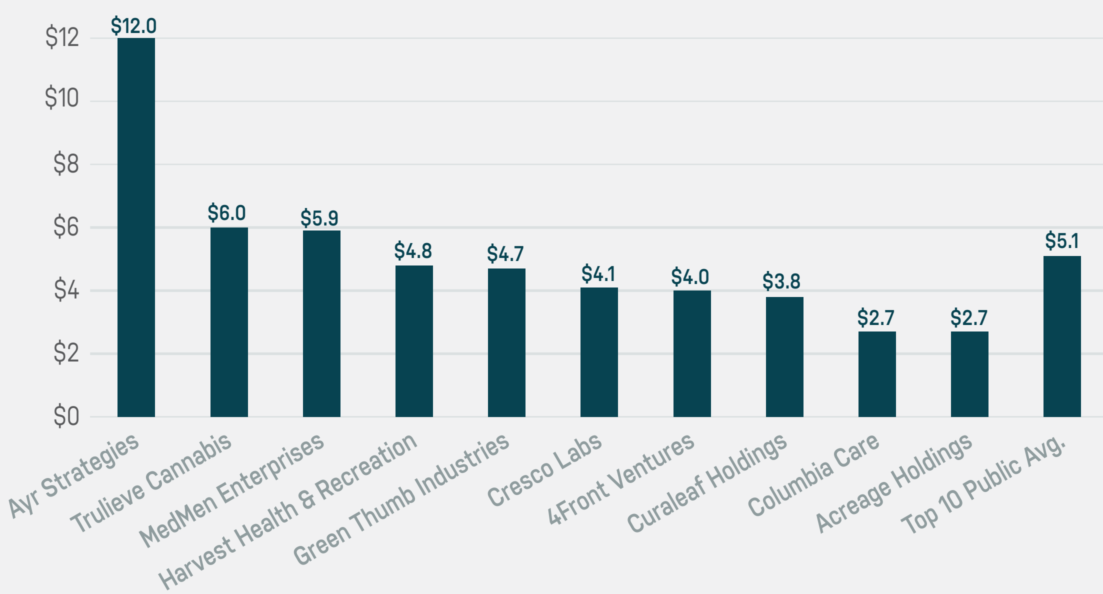
The superstore concept is new to cannabis but is many decades old in the broader retail landscape. In that broader retail economy, where should the cannabis industry look for models of success? At least three product categories come to mind as being very similar to cannabis when it comes to recent specialty retail success stories: specialty coffee, fine wine and craft beer.

Like cannabis, all three can trace the origin of their products back to the birth of an agricultural society, have their modern roots in the West Coast counterculture, are marketed as lifestyle enhancements, started being retailed by single-store independents and are now central to societal debates ranging from sustainability and resource usage to regulation and consumer protection.

Certainly, the cannabis industry could do worse than to replicate the history of the coffee business since 1984, when Starbucks added on-premises consumption to its over-the-counter coffee shop in Seattle. Since then, according to the Specialty Coffee Association of America (SCAA), the specialty segment has blossomed into an engine of the retail economy, now representing about 55% of $58 billion in total coffee sales.

Starbucks itself has, of course, been the biggest beneficiary of the boom. The SCAA characterizes "specialty

2019 Revenue Per Active License (In Millions)



Source: BDS Analytics estimates based on Cannabiz Media licensing data and most recent company reported actuals annualized for 2019 CY totals.

coffee" around a concept that longtime cannabis consumers can appreciate: "Special geographic microclimates produce beans with unique flavor profiles." Retailers in Washington, the second state to see the rollout of adult-use retail stores, can dream about emulating the 30-year run during which Starbucks went from its single Pike Place outlet to 11,952 U.S. outlets (21,536 worldwide) with a $100-billion-plus market capitalization.

Retailers just making their launch plans elsewhere, especially those in states that have not even legalized medical sales yet, can take comfort in the fact that, for all its dominance, Starbucks owns only about one-third of the nearly 30,000 specialty coffee stores in the U.S., though it has nearly 50% revenue share.

Many past retail chain builders (including eventual market dominant outfits like Blockbuster, Whole Foods and Starbucks) have been able to capitalize on the fact that they can acquire privately held stores for as little as half the revenue or EBITDA multiple at which Wall Street is willing to value their own public equity as market consolidators. This delta can drive rapid consolidation in an industry, and we are likely to see something similar in cannabis retail once the current "build them as fast you can" era comes to a close.

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Tracking Evolving Purchasing Patterns

What started in the medical-only era as a simple arrangement of nonprofit cooperatives buying raw cannabis flower from members who grew it and selling it to medical patients who needed it has been completely transformed since Colorado kicked off the adult-use era in January 2014. Taking a page (or rather, several) from the consumer packaged-goods industry, cannabis product brands and their retail distribution partners have developed a cornucopia of choices for cannabis consumers.

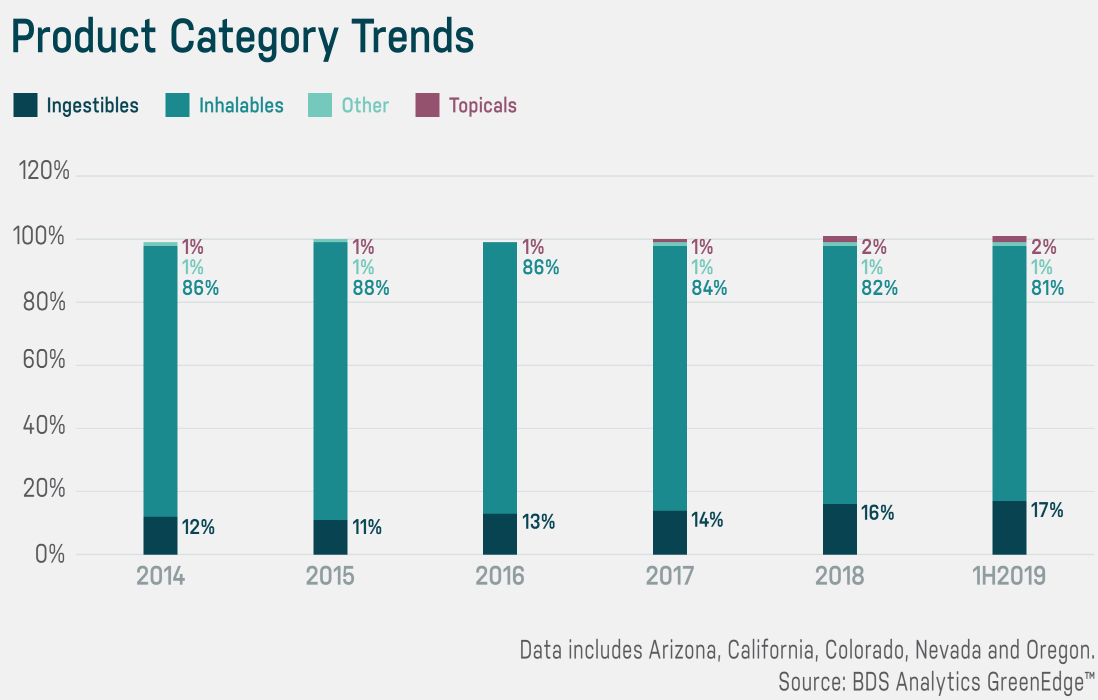
The industry has come forward light years since "Brownie Mary" Rathbun was first arrested for baking brownies for AIDS victims in the early 1970s, before helping Dennis Peron found the San Francisco Cannabis Buyers Club in 1992—the first open retail purveyor of cannabis products in the U.S.

In 2014, in the early days of adult-use legalization, inhalables accounted for 86% of total spending in the legal cannabis markets, according to BDS Analytics GreenEdge™ retail tracking data. In the nascent market, product makers were focused on providing customers with products that had long been in use in both the illicit and legal medical markets—smokable flower. It was sensible and logical to start off the market with a familiar consumer product, and it bore the lowest barrier to entry for companies.

Because flower had such a long history in the legal medical and illicit markets, it was easier to transition to the legal adult-use market. So it makes sense that in the first quarter of legal adult-use sales in Colorado (Q1 2014), for example, flower accounted for 69% of spending through licensed dispensaries. In the first months of official legal adult-use sales in Oregon (Q1 2016), flower accounted for 74% of spending.

Several intersecting forces came together through 2017 and 2018 that had significant impacts on flower pricing and its contribution to total cannabis spending. In Colorado, more product makers entered the market with a diverse range of offerings, from edibles to topicals. This pushed flower spending down to 40% of the total by the first half of 2019. In Oregon, the "green rush" brought that same increased product diversity, and also attracted a glut of flower suppliers to the market, far exceeding demand and pushing wholesale, and subsequently retail, prices sharply down. By the first half of 2019, flower in Oregon accounted for just 40% of total spending as well.

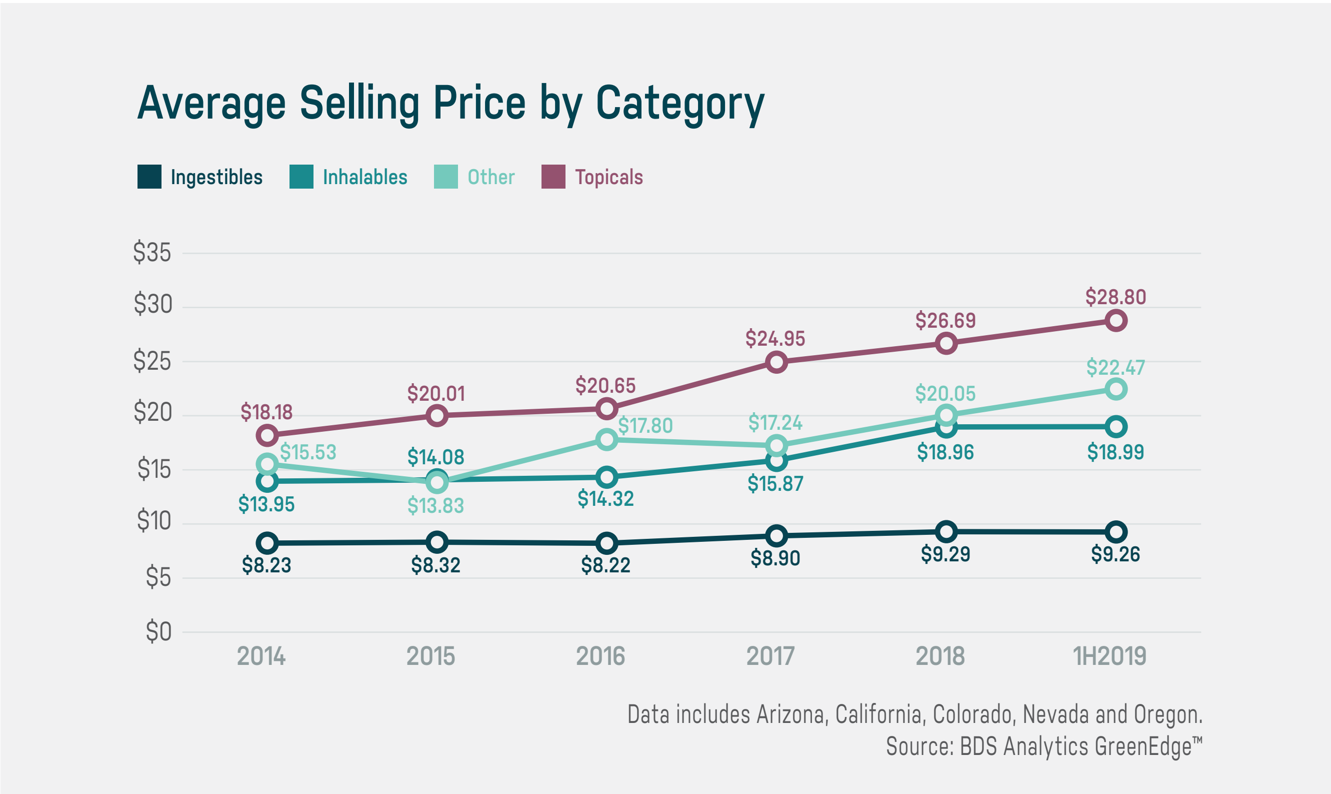
Despite the declines in flower sales, inhalables still account for the majority of spending in legal states, tracked by GreenEdge, accounting for 81% of total spending in the second half of 2019. The category includes dried flower and pre-roll but also concentrates,



including vapes Concentrates now account for a significant portion of the spending in that category.

Despite the steady decline in spending share for flower, the higher prices on concentrates (primarily vapes) have buoyed the inhalable category share above the 80% mark since tracking began in 2014. It is too early to tell if the current controversy over vaping will have long-term impact on the spending mix in legal states tracked by BDS Analytics. While the cause of specific health problems is still undetermined, most issues have been traced back to illicit vape products. It remains to be seen how dispensary customers are reacting with their wallets and if they are being cautious about the use of vape products from legal dispensaries.

The high average selling price of concentrates, combined with increasing unit sales, has a significant impact on the average pricing of the inhalables category. Inhalable prices have remained fairly constant in the legal states tracked by GreenEdge, rising from $8.56 per unit in 2014 to $9.26 in 1H 2019. But flower's decline from 67% of spending in Q1 2014 to 37% in the most recent quarter of 2019 (Q2), and concentrates growing from 15% to 34% during that same period, indicate just how much the pricing of concentrates has supported that slight increase in the average selling price of inhalables. Breaking it down further, the average selling price of flower in 2014 was $7.69, which then fell to $5.72 in 1H 2019. Concentrate pricing has been stable over that time period, dropping only slightly from $30.93 per unit to $30.78.



Ingestibles hovered between 11% and 12% of total spending for the first several years of legalized adult-use in states tracked by GreenEdge. In 2018, the category saw a bump in its share of spending (to 16%), and its share continued to grow in 1H 2019 (to 17%). Several factors have come together in the ingestibles category to account for this increase in spending. First, the category commands a higher price than flower, the low cost of which weighs down the inhalables category. Second, brands, such as Kiva Confections and Wana Edibles, have increased the number of products available across markets. Additionally, ingestibles are becoming a more common way of consuming high-CBD products from legal dispensaries, and those products typically command a higher price.

Edibles is the dominant subcategory in ingestibles and accounted for 13% of total spending in 2H 2019, up from 9% in Q1 2014. These products command a higher price than flower as well, with an average selling price of $17.36 per unit during in 1H 2019. Edible cannabis products sold as high-CBD command a significantly higher price point than those marketed for their THC content, with high-CBD edibles selling at an average of $19.62 per unit compared to $16.78.

While topicals account for a very small portion of the market currently, at just 2% of spending in 2H 2019, the pricing shows the opportunity exists for higher-price, higher-margin products. Most of these products are focused on pain relief, which has been overshadowed

Top Flower and Pre-Roll Brands (Alphabetically)

Caliva
Canndescent
Connected Cannabis Co.
Elyon Cannabis
FloraVega
Flow Kana
Henry's Original
Korova
Lowell Herb Company
Old Pal

Year to date, August 2019. includes Arizona, California, Colorado, Nevada and Oregon., Source: BDS Analytics GreenEdge™

Top Concentrates Brands (Alphabetically)

Absolute Xtracts
Bloom Farms
Dosist
Heavy Hitters
Jetty Extracts
Kurvana
O.penVape
Pure Xtracts
Raw Garden
Select Oil

Year to date, August 2019. includes Arizona, California, Colorado, Nevada and Oregon., Source: BDS Analytics GreenEdge™

Top Ingestibles Brands (Alphabetically)

Care By Design
District Edibles
Incredibles
Kiva Confections
Kushy Punch
Papa & Barkley
Plus Products
Sunderstorm
Wana Edibles
Wyld

Year to date, August 2019. includes Arizona, California, Colorado, Nevada and Oregon., Source: BDS Analytics GreenEdge™

Top Topicals Brands (Alphabetically)

ApotheCanna
BASKiN
Dixie
Escape Artists
Foria
High Desert Pure
Mary Jane's Medicinals
Mary's Medicinals
Nordic Goddess
Papa & Barkley

Year to date, August 2019. includes Arizona, California, Colorado, Nevada and Oregon., Source: BDS Analytics GreenEdge™

in the dispensary channel by more traditional usage modes such as flower. However, with the current focus on CBD and the plethora of delivery mechanisms for CBD, topicals are a wide-open category for companies looking to move away from lower-margin, lower-priced products. Topical average selling prices have increased from $18.23 per unit to $28.80 between 2014 and 1H 2019. High-CBD topicals commanded a significantly higher average selling price of $31.68 compared to high-THC (products marketed for higher THC content regardless of their CBD content) at $17.66 per unit in 2H 2019.

While the overall market has been characterized by consolidation at the retail level and massive investments by big-name corporations at the cultivation level, these product lists show that specialized cannabis product makers still dominate their categories. As retail markets mature, oftentimes a single brand will dominate across categories. This has yet to happen in cannabis.

These brands, especially in the ingestible category, where the form factor may be less controversial and more familiar, have already been acquisition targets. As ingestibles and topicals become more popular with consumers, and product makers push to enter higher-priced, higher-margin businesses, it is likely there will be more crossover seen in these top five lists going forward as brands expand their product lines and MSOs seek entry into markets in which they do not have licenses.

GreenEdge retail tracking data shows that the market is still wide open for cannabis product makers. Over 80% of cannabis products sold are still in the inhalables category, meaning very little exploitation of other product categories has happened. While flower has had its growing pains over the last few years, it continues to be the mainstay of what cannabis customers are buying. That was on track to change as concentrates began to take up more of the market. The fallout from the vape crisis will be seen in tracking data collected over Q4 2019 and into Q1 2020. Customers may retreat back to flower, but the issue is likely to have opened doors for other nontraditional cannabis products if customers are shying away from vaping and are looking for an alternative to smoking.

The impact of CBD will also be felt over the next 12–18 months as more dispensaries take advantage of the attention that cannabinoid is receiving in the popular press. The beginnings of that shift are already being seen, with CBD rapidly gaining sales share—up to 11% of total spending in 1H 2019. CBD will open the doors for topicals, pet products and other product lines as CBD attracts additional shoppers to the legal dispensary channel.

Retailers control every aspect of success for the cannabis industry. So far in the legal adult-use era, dispensaries have had little incentive to help build well-known flower brands. Even in 1H 2019, over $1 billion in sales tracked by GreenEdge are in unbranded flower. Dispensaries are continuing the long tradition of both the illicit and medical markets where cannabis was sold based on the reputation of a strain and the knowledge of the budtender selling it. Why mess with something that works? If pricing pressures continue, margins in other categories will make unbranded flower a less attractive subcategory for dispensaries. Until then, brands will have to rely on consumer pressure and an outstanding sales force to move some dispensaries to abandon their roots.

Who, What, Where and Why?

Success in the cannabis retail space depends on the ability to anticipate the characteristics of the consumer base in a given market. Knowing the extent and the preferences of the existing consumer base allows a retailer to structure a new retail business in a way that not only appeals to their target buyers, but also has the potential to attract non-consumers who are open to trying cannabis.

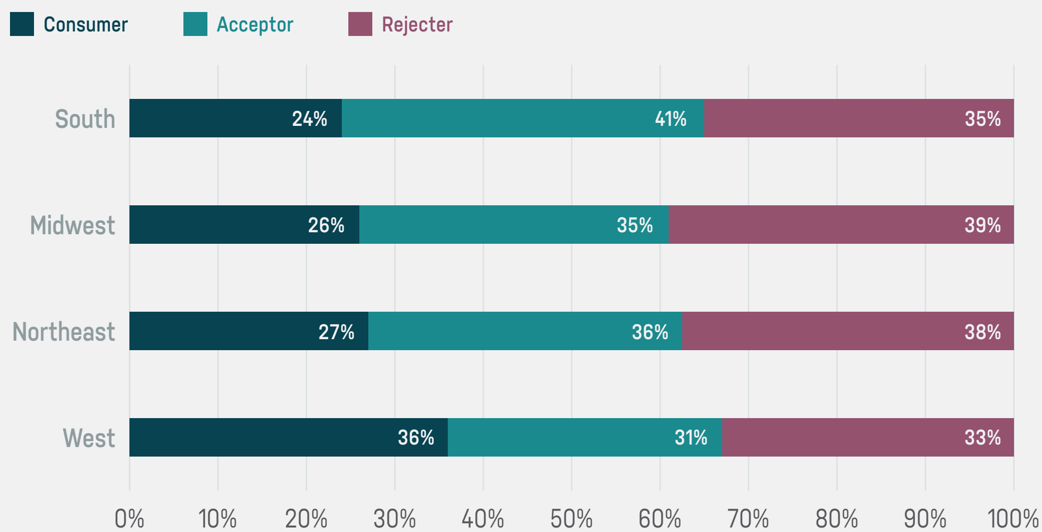
Consumers, Acceptors and Rejecters

The basic driver of the future success of cannabis retailers is simple: Cannabis consumption is on the rise. Between the first quarters of 2018 and 2019, BDS Analytics consumer research shows that the number of legal adults who report consuming cannabis in the past six months ("Consumers") is steadily rising. While adult-use markets have a higher total percentage of Consumers, reported consumption is increasing at substantial rates for both adult-use and medical-only states. The percentage identifying as Consumers in adult-use states rose from 31% in Q1 2018 to 38% in Q1 2019, while Consumers in medical states rose from 18% to 25% over that same period.

That's helping to drive what we forecast will be 24% year-over-year growth in adult-use cannabis spending nationwide in 2019 and 30% growth in total legal cannabis sales. It is part of a larger shift among consumers that supports our forecast that legal cannabis sales will grow from $9.8 billion in 2019 to $30 billion in 2024. The percentage of adults saying they would consider consuming cannabis in the future ("Acceptors") declined between Q1 2018 and Q1 2019 in adult-use states from 32% to 29%, and in medical states from 43% to 38%. The good news for cannabis companies is that they are moving into the Consumer category. Additionally, in adult-use states, those who say they would not consider consuming in the future ("Rejecters") fell from 37% to 33% over the same period.

The makeup of Consumer/Acceptor/Rejecter rates differs significantly between U.S. regions, especially when taking highly restricted medical states into account. The region friendliest to cannabis is the West, with the highest percentage of Consumers (36%) and the lowest percentage of Rejecters (33%). The Western states generally have the most liberal cannabis laws, but legality is clearly not the only factor in consumer attitudes toward cannabis. The potential customer base for cannabis retailers is mostly made up of Consumers and Acceptors, which, combined, total 62%-67% of adults in all regions of the country. But it actually extends even into the Rejecter group, a substantial number of whom

US Cannabis Consumer Landscape



Only includes data from legal medical and adult-use markets within these regions.
Source: BDS Analytics Consumer Insights

say they would consider using cannabis medicinally if their doctor recommended they do so. That suggests the actual potential customer base for cannabis may approach 80%.

In the near term, though, today's consumers are what matter to today's retailers, and BDS Analytics' data shows higher percentages of Consumers in states with the highest proportion of retail licenses to adults over the age of 21. Oregon boasted the highest percentage of Consumers of all benchmark adult-use states, with 47% of adults in Q1 2019 reporting consuming cannabis, compared to 41% in Colorado and 40% in Washington. The Beaver State also has the highest ratio of retailers per adults over 21, with one licensed retailer for every 4,486 legal adults. Colorado has 5,453 adults per retail license, and Washington has 11,904 adults per retail license.

Despite its history as a hotbed for the legal cannabis movement, Californians had a significantly lower percentage of Consumers than Colorado, Oregon and Washington, with only 35% reporting consuming cannabis in the past six months. While some of this can be attributed to California being the most recent state to legalize adult-use, and the dramatic diversity of its populace, California's lower percentage of Consumers is also likely due to the lack of retail coverage in many areas of the state. Among the states that have legalized adult use, California has the lowest ratio of retail licenses to potential cannabis Consumers, with just one retailer for every 34,256 adults over the age of 21.

Generally, the public presence of cannabis dispensaries is making a difference in consumer attitudes: States with the highest number of retailers per adult saw the greatest declines in Rejecters. Oregon Rejecters were 37% in Q1 2018 but that plummeted to 29% in Q1 2019, and Colorado Rejecters fell from 37% to 30% during the same period. By contrast, in California 38% were Rejectors in Q1 2018, and that only fell to 35% in Q1 2019, giving the Golden State a higher percentage of Rejecters than Oregon, Washington and Colorado.

Several inferences can be drawn from the consumer landscape across the U.S., and from legal states in particular. The declines in Acceptors and Rejecters in adult-legal states suggests that simply with more exposure, Rejecters can be swayed to be more open to cannabis use, with some even becoming Consumers, underscoring the importance for retailers to utilize education as part of their marketing and advertising strategies. Additionally, the higher percentage of Consumers in states with strong retail coverage suggests the presence of retailers plays an important role in changing consumer attitudes toward cannabis. This presents an advantage for those looking to enter the retail sector in states with liberal licensing programs.

Consumer Product Preferences and Usage

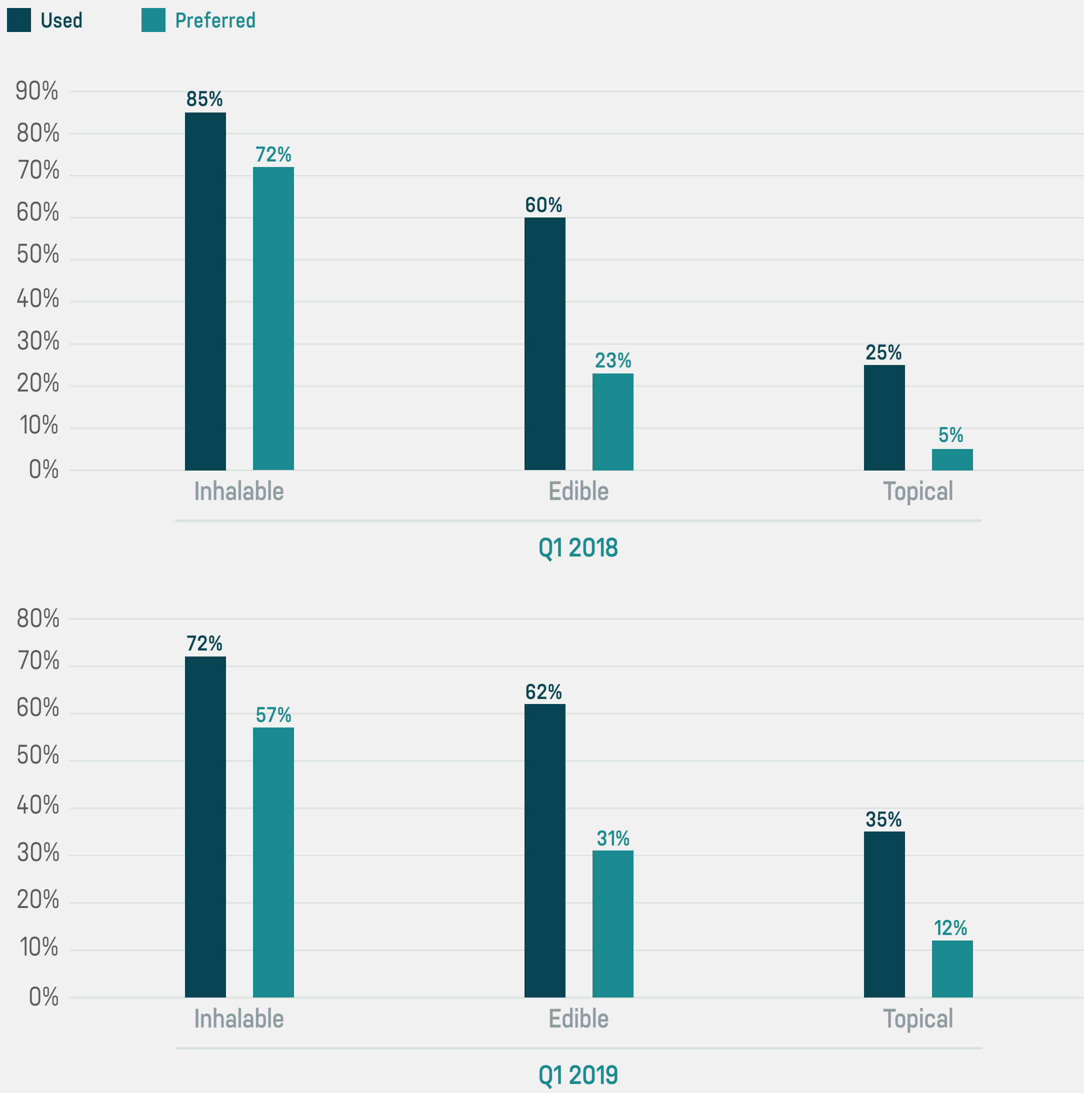
A critical question for retailers going forward is which products to offer those consumers, both the long-time cannabis consumer and those moving from the Acceptor to Consumer categories. While Consumers largely report preferring flower—and inhalable products generally—manufactured cannabis products, like tinctures, creams and various forms of edibles, have been steadily growing in popularity.

BDS Analytics' research into consumer attitudes reveals that inhalables remain the most widely used product category in adult-use states, though the popularity of these products has been waning. In Q1 2019, 72% of Consumers in adult-use states reported using inhalable cannabis products in the last six months, down from 85% in Q1 2018. The percentage of Consumers who report that they prefer inhalables has also been declining significantly over the period in question, from 72% to only 57%.

Data suggests inhalable products are more popular in medical-only markets than in adult-use markets, with 76% of adults in medical states reporting past-six-month consumption of inhalables and 62% citing inhalables as their preferred method of consumption in Q1 2019. But rather than reflecting a true preference, those results are more likely a function of product availability. The well-stocked dispensaries found in adult-use states offer a wide range of product types and choices that may not be available in medical-only states. The length of time a state has had legal stores is also a factor. There are consistent changes in preferences as markets mature, with flower losing share as topicals, edibles, tinctures and other options grow in popularity.

Flower continues to be the most preferred type of inhalable cannabis product, though the percentage of Consumers in adult-use states who prefer flower has been on the decline, with only 55% currently citing flower as their preferred method of inhalable consumption. Though the relative popularity of inhalables has been declining at similar rates across all adult-use states, California has the lowest percentage reporting the consumption of inhalable products, with 69% reporting having used inhalable products over the past six months.

Adult-Use Market Usage and Preference by Method of Consumption



Source: BDS Analytics Consumer Insights

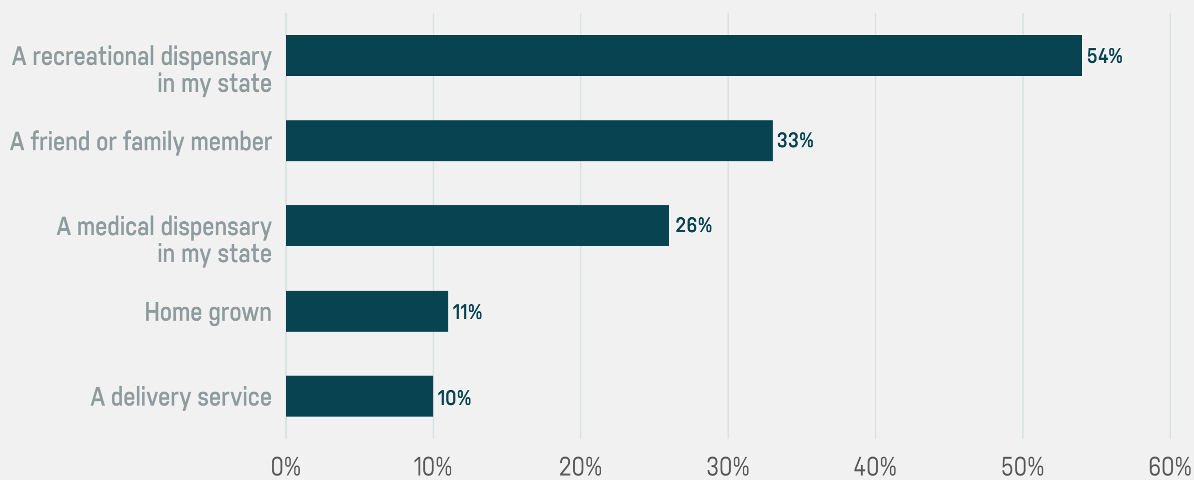
The consumption of and preference for inhalable products has been steadily declining as other cannabis products have gained. In adult-use states, 60% of consumers reported past-six-month usage of edibles in Q1 2018, increasing to 62% by Q1 2019. The percentage of Consumers in adult-use states who report preferring edibles over other product categories also rose over the period, from 23% to 31%.

Consumption of topical products is also on the rise in adult-use markets. In Q1 2019, 35% of respondents reported using topical cannabis products, up from 25% in Q1 2018. The percentage of consumers who prefer topical products has increased from 5% to 12% over that period.

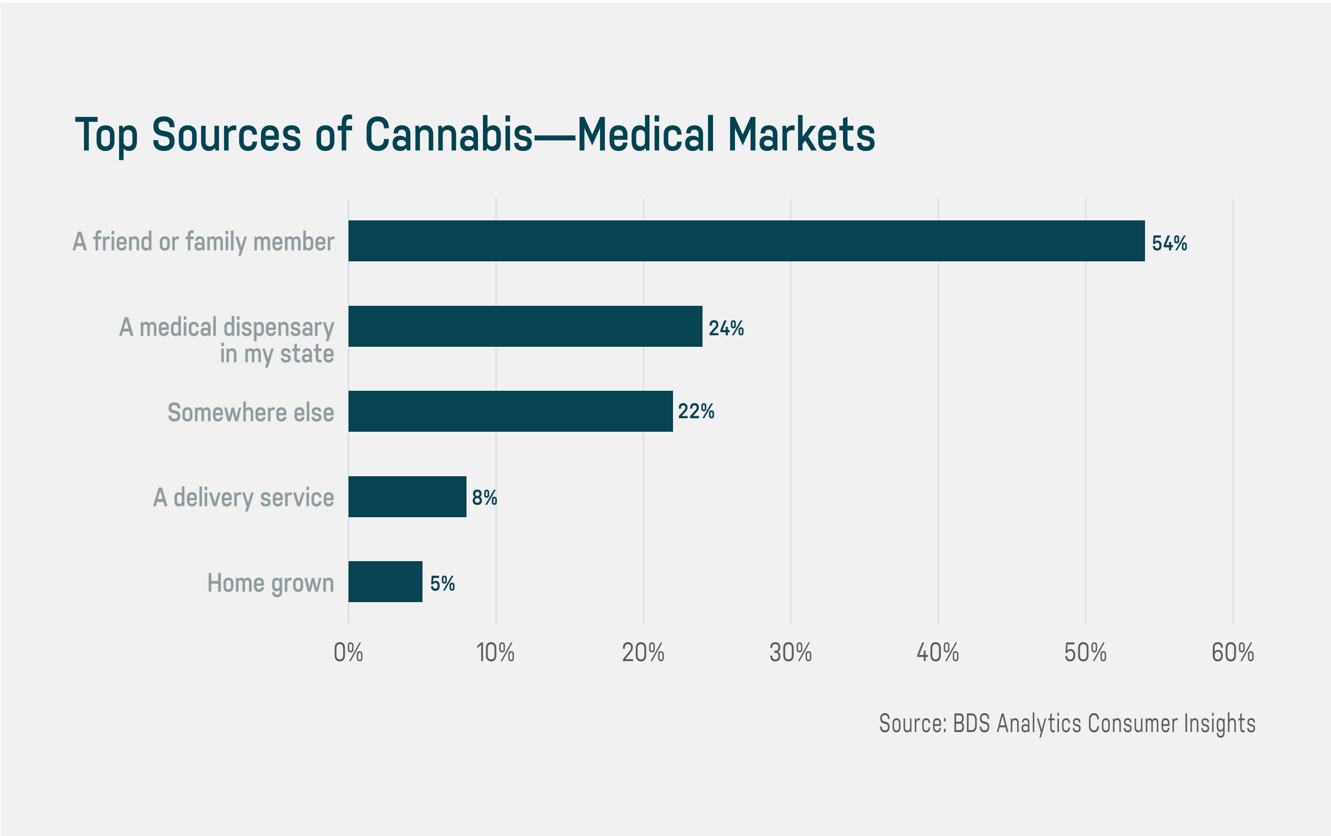
Consumer Cannabis Sources

Legal status may have only a modest impact on overall consumption, and somewhat more on what gets consumed, but it makes all the difference when it comes to where consumers obtain their cannabis. While greater access to a broader array of products and product types is a clear reason for consumers to purchase from legal retailers, many in adult-use states still choose to obtain

Top Sources of Cannabis—Adult-Use Markets



Source: BDS Analytics Consumer Insights



cannabis from other sources. Having the data on consumers' preferences in cannabis products and types can give retailers an edge over their competitors, including those operating outside the law.

BDS Analytics research shows dramatic differences in location-of-purchase trends between adult-use and medical-only states. Consumers in adult-use markets are much more likely to buy their cannabis from a storefront dispensary or delivery service. Among Consumers in adult-use states, 54% report buying their cannabis from a recreational dispensary in the past six months, while 26% report purchases from a medical dispensary and 10% report buying from a delivery service. Still, a significant percentage of Consumers in adult-use states (33%) report obtaining cannabis from a friend or family member, while 11% rely on homegrown cannabis.

The data shows much different patterns for Consumers in medical-only states. Friends and family members remain the most common source for cannabis in medical states. Among medical-state Consumers, 54% report obtaining cannabis from a friend or family member in the past six months, compared to just 24% who report a medical dispensary as their source for cannabis. The percentage of Consumers who get their cannabis from a home grow is also lower in medical states than adult-use states, with only 5% citing a home grow as their source of cannabis in the past six months. Many remaining medical-only states have sparse retail coverage compared to adult-use markets and laws against home growing, giving Consumers in these markets fewer options for obtaining cannabis, so there is a greater reliance on friends and family as their cannabis source.

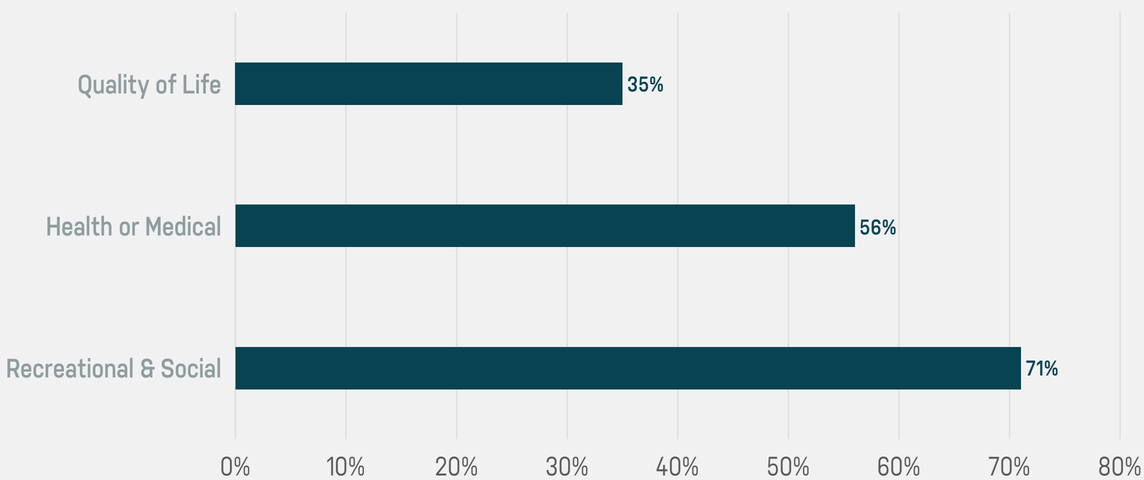
Though they may rely on different sources for their cannabis, Consumers in adult-use and medical states do have some similarities in the attitudes that influence how they buy. Consumers in both cite price, followed by THC content, as the two biggest factors influencing their product choice. Consumers in both also noted trustworthiness as the most important factor when deciding where to shop.

Consumer Motivations

As cannabis retailers move beyond simply handling the excited throngs that show up when the first legal stores appear in a state, understanding purchase motivators will become critical to merchandising, marketing and, eventually, advertising strategies. Successful retailers will be the ones who are mindful of the reasons Consumers seek out cannabis, crafting their marketing to effectively draw from—but also to expand—the existing consumer base.

Though Consumers in adult-use markets get their cannabis from different sources than Consumers in medical states, their primary reasons for using cannabis are nearly the same. The majority of Consumers

Reason for Consuming — Adult-Use Markets



Source: BDS Analytics Consumer Insights

in adult-use states (71%) as well as medical states (73%) describe their cannabis consumption as recreational or social, while 56% in adult-use states and 53% in medical states cite health or medical reasons; 35% of Consumers in adult-use states report consuming for quality of life reasons, compared to 34% in medical states.

When asked in more detail about motivators, however, the most common single reason reported for using cannabis is pain relief, showing that medical concerns are actually a primary driver of cannabis consumption, despite most people describing their consumption as recreational. After pain relief, the most common single reason for consumption is relaxation, which speaks to the high percentage of Consumers who describe their cannabis use as recreational and social, but in our high-stress world can also be considered a health benefit.

Consumers are most likely to use topicals for medical reasons, noting pain relief and management of health problems as their benefits. Consumers most commonly report relaxation and better sleep as the primary benefits of inhalables or edibles consumption.

Retail Strategies

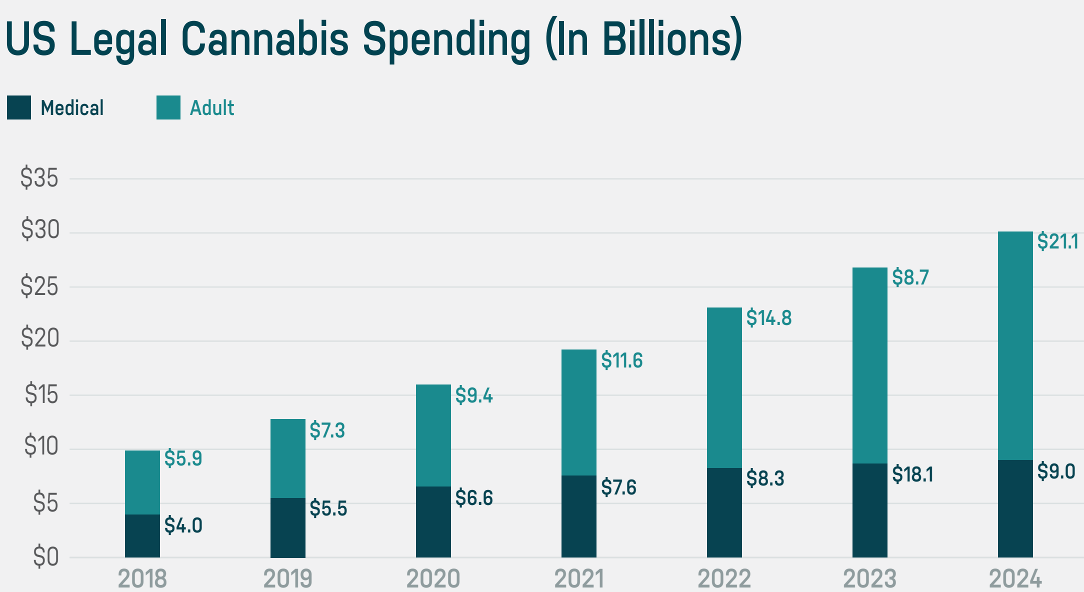
Overall, BDS Analytics consumer research suggests a booming future for the cannabis retail trade. As a starting point, they are simply offering a legal shopping environment to consumers who, before the first adult-use stores opened up in Colorado, were spending $59.6 billion on illicit cannabis.

Legalization can quickly move those willing to try cannabis into the Consumer category, especially once adult-use passes and they no longer need a doctor's recommendation. Sales become robust once people can simply respond to the recreational and social motivations for consumption.

For both Consumers and newly converted Acceptors, the usage and preference by product-type data suggest that cannabis consumption will only grow going forward. Retailers that apply merchandising and marketing techniques long proven to be effective in other product categories can both drive greater overall consumption and capture greater market share against their cannabis specialty store competition in the years ahead.

Gauging the Opportunities

Total consumer spending on legal cannabis in the U.S. is on track to top $30 billion annually in 2024, rising at a CAGR of more than 20% from $9.8 billion in 2018. That $20+ billion increase in annual spending on legal cannabis represents a major opportunity for the cannabis retail sector—as substantially all of it will flow through the registers of licensed retailers of adult-use and medical cannabis. Yet the highly regulated, piecemeal nature of the U.S. legal cannabis market presents a conundrum for would-be operators, suppliers and investors in this burgeoning retail space. Which opportunities are the best?

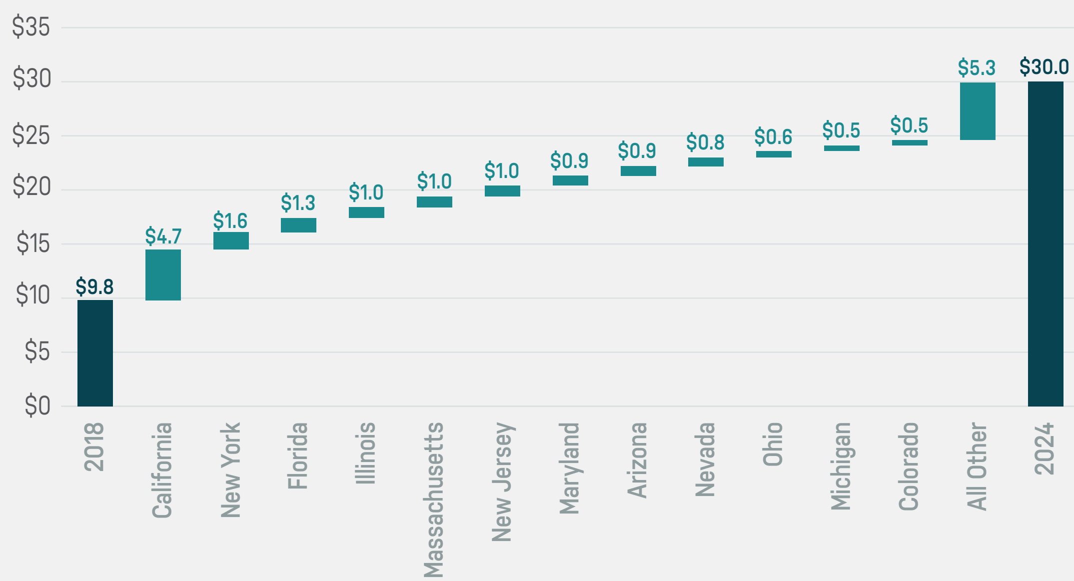


Source: Arcview Market Research/BDS Analytics

The answer to that question depends nearly entirely on goals. The potential strategies are innumerable, but can be boiled down to a few key approaches:

- Build value from the ground up in the protected state cannabis markets by acquiring new licenses or small existing retailers and building value with an eye toward an exit strategy of selling to a larger consolidator. This can be an especially potent strategy in medical markets, where early protections are generally high, if the ground gained during this period can be leveraged post the legalization of cannabis consumption for all state residents.
- Acquire value, consolidating existing retail concerns into in-state chains, perhaps in multiple states, to gain share within the various U.S. markets. Until national legalization, the cannabis space is largely hands-off for the nation's retail juggernauts. Once legalization ensures "the coast is clear," major retailers will be seeking acquisition targets.
- Eschew retail operation and investment altogether and focus instead on supplying the products demanded by these markets as they mature. Cannabis consumers share key purchasing habits, product preferences and motivations

US Legal Cannabis Spending (In Billions)



Source: Arcview Market Research/BDS Analytics

> for consuming that cross state lines and vary only slightly from medical-only to adult-use markets. As with retail operations, the main consumer product companies in the U.S. are keeping cannabis at arm's length until national legalization—afterward, they will be looking to get into this business in a big way.

The legal cannabis business in the U.S. changed in a substantial, irreversible way in 2014, with the introduction of legal cannabis sales to all adults in the states of Colorado (January) and Washington (July). At the time, the medical cannabis industry served just over a million customers—the number of registered patients in all states at the end of 2013—and generated $2.5 billion annually. In one year, the industry grew its potential customer base to nine million people and generated $3.4 billion annually.

By the end of 2018, the addition of sales in a host of new medical markets across the country and adult-use markets including California, Nevada and Oregon, had driven total sales to more than $9.8 billion with a total potential customer base of more than 50 million. Barring the increasingly unlikely prospect of direct federal intervention to slow or stop it, that train will keep rolling. Sales are forecast to grow by nearly 30% in 2019 to almost $12.8 billion.

By 2024, every U.S. state and territory is projected to have an active medical cannabis program, and 23 of those will have allowed cannabis sales to all adults, driving sales to more than $30 billion—more than three times total spending in 2018. That represents an increase in annual legal cannabis spending of $20.2 billion. Three-quarters of that growth in annual sales will be generated by just 12 markets, each adding more than half a billion dollars.

What Will Be the Hot US Markets?

At the top of that list sits California, which introduced adult-use sales on Jan. 1, 2018. While that market has faced initial difficulties as the industry and regulators dealt with the headaches of a new, untested regulatory scheme, rigorous new testing requirements, heavy compliance and tax burden and some slow-moving licensing jurisdictions, retailers in the state still managed to generate more than $2.5 billion in sales. Over the next five years, they can expect annual sales to swell by an additional $4.7 billion—more than 23% of the $20 billion in additional annual sales expected in the U.S. by 2024.

While the Golden State will remain the largest U.S. state market for legal cannabis, representing nearly a quarter of total legal sales by 2024, it will also be one of the most competitive for retailers. The state is poised to rubber-stamp any license a local jurisdiction approves—and those local jurisdictions, where state laws allow delivery services to bring cannabis to consumers with impunity, can be expected to get over their qualms in pursuit of tax revenue. There will shortly be thousands of retail stores in California.

There are a host of other large markets—many of which are just getting up and running—that are likely to restrict competition levels given their regulatory histories to date. New York's medical market generated just $39 million in sales in 2018 and is expected to grow to $144 million in 2019. But the anticipated passage of adult-use legislation there, with sales due to commence in 2022, is forecast to add $1.6 billion (8%) of the $20 billion annual sales increase by 2024.

Another heavy hitter is Florida, which is forecast to add $1.3 billion (6%) in sales by 2024. Unusual among its peers, Florida is a medical-only cannabis market and is expected to remain so throughout the forecast period.

The recent addition, via a state supreme court decision, of smokable flower to the list of available products and changes to the Florida's previously limited licensing scheme have opened up that Sunshine State to even greater growth potential—already high due to a comprehensive list of qualifying medical conditions and an aging population, many of whom suffer from one or more of those conditions. Florida's median age is 42, compared with 36 in California and 37 in Colorado. Nearly 21% of the state's population is age 65 and older, compared with California's 11% and Colorado's 10%.

While total spending and growth over the next five years are key factors in deciding to make an entrée into a given state market, they are certainly not the only ones. Other primary considerations include:

- **Lifecycle stage**—Cannabis markets have tended to go through several stages during their development, as seen in Colorado and elsewhere, typically:

  - **Inception**—Usually the introduction of a medical-only program that creates a basic infrastructure for cannabis cultivation, processing and sales. Usually limited to a few hundred thousand to a million customers, but growth may be brisk within that limited total available market.

  - **Hypergrowth**—Typically brought on by the deployment of legal cannabis sales to all adults. Cultivation, processing and retail licenses generally expand, offering additional opportunities for new entrants, and sales grow rapidly as usage rates for now-legal cannabis increase. New customers drive a proliferation of products as demand for products beyond flower grows.

  - **Maturity**—Beginning to be seen in Colorado and Washington. Growth tapers, but continues and may even be brisk, as brand leaders emerge and product categories stabilize. Acquisition prices may rise but the opportunity to dominate a stable, established market is attractive.

- **Regulatory conditions**—The overall cost of operating under a state's regulatory scheme—taxes and fees plus testing and other compliance costs—is a primary consideration that directly affects a retailer's bottom line. Restrictive licensing regulations, including limits on out-of-state ownership (and potential work-arounds) and licensing moratoriums (as in Washington), are potentially even more important.

- **Extralegal market**—Generally, the introduction of legal cannabis sales—whether medical-only or both medical and adult-use—results in a rapid shift of spending from extralegal channels into the legal market. That shift, however, can be slowed or even reversed by government decisions, such as relaxed enforcement against previously criminal activities and loading up legal operators with taxes and regulatory costs. Decriminalization often accompanies legalization, eliminating or reducing penalties for extralegal activity, and high tax and compliance loads can drive up costs, making legal product less competitive with extralegal alternatives.

The U.S. illicit market for cannabis reached an estimated $53.1 billion at the end of 2013, after growing steadily with population, inflation and spreading cannabis usage since the 1960s. In 2014, following the rollout of adult-use sales in Colorado at the beginning of the year and Washington in the middle, illicit sales growth rate fell to just 1% nationally. That growth rate fell to just 0.2% in 2015, in which Colorado and Washington reached $996 million and $481 million in sales, respectively, and Oregon began late-year, ad hoc adult-use sales through existing medical dispensaries.

Annual illicit market growth became annual declines in 2016 (-0.4%) and 2017 (-1%) as existing markets added bulk and new markets emerged—though the difficulties of California's adult-use rollout brought back a small amount of growth (0.1%) in 2018. The next several years, however, will see a continued, deepening decline as some $10 billion in annual spending through illicit channels disappears or shifts into the legal market by 2024.

Notice that figure is just half of the expected $20 billion increase in expected annual legal cannabis spending over that time. There are a couple of factors here: 1) Legal products, especially raw flower, are cheaper, and drive down the prices across both channels, 2) New demand is blossoming due to legalization, driven by customers who have eschewed illicit channels or have developed an interest in cannabis based on its newfound acceptability in legal markets.

Retailers are playing a key role in developing that new demand. Their very presence in shopping districts makes cannabis' new legal status tangible to consumers. Their budtenders are increasing the public's knowledge of the potential therapeutic effects of cannabis. Their involvements as businesspeople in local organizations is reducing the stigma the stigma associated with being either a cannabis consumer or market participant in the past. Colorado's past-month usage rates have increased from an estimated 11% in 2013 to nearly 16% at the end of 2018. Oregon's rate has increased by about four percentage points over that same time.

The Impact of Federal Legalization on Cannabis Retailing

The wild card in increasing acceptance of legal cannabis as a part of life is legalization at the federal level. All signs point to it being inevitable, but the remaining question is when, and how much impact it will likely have on the course of legalization and market development. Legalization prior to 2024 seems a near certainty but it could take place much earlier—we expect as early as 2021 as post-2020 politicians bow to the obvious will of the people.

But federal status is likely to take the form of something like the STATES Act, which would simply leave the legalization decision to each state, which would still need to decide whether to legalize, and to what degree, within their own borders even if the federal government gives the all-clear. Since it has been obvious for some time that there are few consequences to states asserting their own authority over the matter within their jurisdiction, our forecasts for market growth are not highly dependent on federal legalization.

Federal legalization will, however, have a huge impact on cannabis retailing specifically for several reasons:

- It will introduce the ability to transport products and otherwise operate across state borders, easing the way for the growing number of multistate operators to maximize efficient operations.

- The barriers and stigma associated with financial transactions related to cannabis will be removed, freeing up considerable sources of capital and enabling cannabis retailers to take advantage of banking and other financial services.

- Federal acceptance will remove the final hurdle to acceptance of cannabis for a large portion of the potential customer base—all but the roughly one-third of the population who say they will never consume.

- Finally, and most importantly for early investors, it will open up a flood of investment and acquisition activity from mainstream retailers, consumer packaged goods companies and other well-heeled players from the national consumer product stage.

The Future Wave of Consolidation

The type of consolidation that would ensue has been seen before, but it may happen even faster in this case. U.S. retailers have found a home for their public shares on the Canadian Securities Exchange, but their stocks would gain newfound liquidity on U.S. exchanges post federal legalization, and billions in institutional capital would suddenly be looking for a cannabis play. Those institutions have profited from many past waves of public consolidators sweeping up privately held assets into market-dominant giants.

The classic case of retail store consolidation through arbitraging the gap between private and public market values was Blockbuster Entertainment. The company started as one of several dozen regional video rental store chains with a difference. It defied common industry wisdom by building giant stores with 10,000-title inventories on pads in parking lots on the busiest corners in town, not in 1,500-square-foot, inline stores in strip malls, as was typical of the era.

In a market where retailers were valued publicly and privately at 1x revenue or 5-6x earnings before interest, taxes and depreciation (EBITDA), Wall Street was willing to value Blockbuster at 10-12x EBITDA. Hence, the company was able to buy regional chains at 5x EBITDA, get 10x from Wall Street for that cash flow and end up selling out to Viacom in 1994 at a price that meant its stock outperformed fellow "IPO Class of 1986" member Microsoft during eight years of consolidating the hottest retail sector of its time.

Today's cannabis retailers are building chains in an industry that is growing just as fast as video retail did in the '80s and '90s, will continue that growth rate far longer given the gradual state-by-state rollout of legalization, and just as desperately needs an upgraded store concept as it moves uptown.

Blockbuster, of course, came to a bad end. But the better parallels for the cannabis retail endgame are probably Starbucks and Whole Foods. These specialty retailers saw growth slow as other physical retailers piled into their product categories. But neither cannabis, coffee nor organic food stores can be "Netflixed" into oblivion by electronic delivery of the core product the way Blockbuster was. There will be equity-market bumps along the way, but today's cannabis retailers are building what should be one of the most enduring retail categories ever.

The Store of the Future

Cannabis retail stores have changed dramatically in recent years, but the new wave of public-equity capital and professional retailers rushing into the business will change the retail landscape even more in the years ahead. Already, the humble medical dispensary—in a quiet, mixed-retail, light industrial neighborhood, discreetly signed by a green cross, with a doctor's-office-style waiting room and a locked "consultation room" lined with apothecary bottles—finds itself competing with a brightly lit showroom with products in display cases on main thoroughfares in heavily trafficked suburban shopping districts.

The cannabis "store of the future" will take many forms before retailers can decide what works best with the exploding base of cannabis consumers. Likely that will be a wide variety of retail formats for some time to come—and perhaps permanently. The fact that the Internet can't replace cannabis stores the way it wiped out record and video stores and magazine stands means there will be a retail presence for cannabis for the foreseeable future. Also encouraging to cannabis retailers is the fact that, among the few specialty store survivors of the Walmart/Costco-led hollowing out of America's retail space, are coffee shops, brew pubs, wine tasting rooms and other purveyors of mildly psychoactive substances with a culture of connoisseurship.

The connoisseur culture around cannabis suggests there will always be a spot, although likely a shrinking one, for even single-store independents to survive, bringing their "neighborhood" expertise to cater to the specific needs of their distinct customer bases. As the industry develops, however, especially as cross-state-border operations can be streamlined, some national retail chains will develop a uniform look and feel, product selection and service characteristics that will deliver the same shopping experience at the 42nd Street store or the location on Market Street. Starbucks and hundreds of other chains have accomplished just this—MSOs will do the same in the cannabis space.

The most profitable vision may be the just-emerging cannabis "superstore," such as Planet 13's 16,000-square-foot "Cannabis Superstore and Entertainment Complex" in Las Vegas. With soaring ceilings and a pressure-sensitive floor in the entry that puts on a light show as customers walk (or dance) across it to the product showroom, the huge footprint of this retail location is designed to offer a wider range of products to more customers, generating higher annual sales and, presumably, higher profits for the retailer.

Planet 13's Vegas outlet also has square footage set aside for a concept that would dramatically enhance the potential profitability of the cannabis retail model: onsite consumption. This essential business element for specialty coffee, quick-service restaurants and other retailers of consumables could quickly become a mainstay in cannabis retail—especially in tourist-heavy legal states such as California, Colorado and Nevada. Whether this takes the form of a winery-style tasting room or full-fledged lounge, the addition of onsite consumption will bring another dimension to the business of cannabis retailing.

And, of course, the margins for onsite consumption of alcohol dwarf those of packaged sales. The same would apply for cannabis, if state regulators allow it. It would be an amazing arc for cannabis retailers to take, but one that seems in the cards. Retailers who today are struggling under outsized taxes on profits and constrained by competition with illicit sellers may see a future with more equitable taxation and real a chance to push illicit sellers out of the business, finally bringing the cannabis consumer in from the cold.

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