

ESSENTIAL CANNABIS INSIGHTS

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PRICING COMPRESSION IN AN EVOLVING CANNABIS MARKET

With cannabis consumer participation higher than it's ever been, and new legal markets opening every year, the cannabis industry remains one of the fastest growing and most dynamic industries worldwide. Still, ongoing challenges impacted growth in 2022, and the realities of a tough macro-economic climate plus growing pains in a maturing industry are creating a more complex growth trajectory for cannabis in 2023.

Even as the industry matures and the stigma related to cannabis wanes, legal businesses are beset by regulatory setbacks. Inflated tax rates from IRS 280E, uncertainty regarding banking access, and onerous state and local taxes have been hitting the industry especially hard. Simply put, the industry is facing several systemic headwinds—but for the past year, an ongoing and persistent challenge that legal cannabis operators have been facing is price compression.

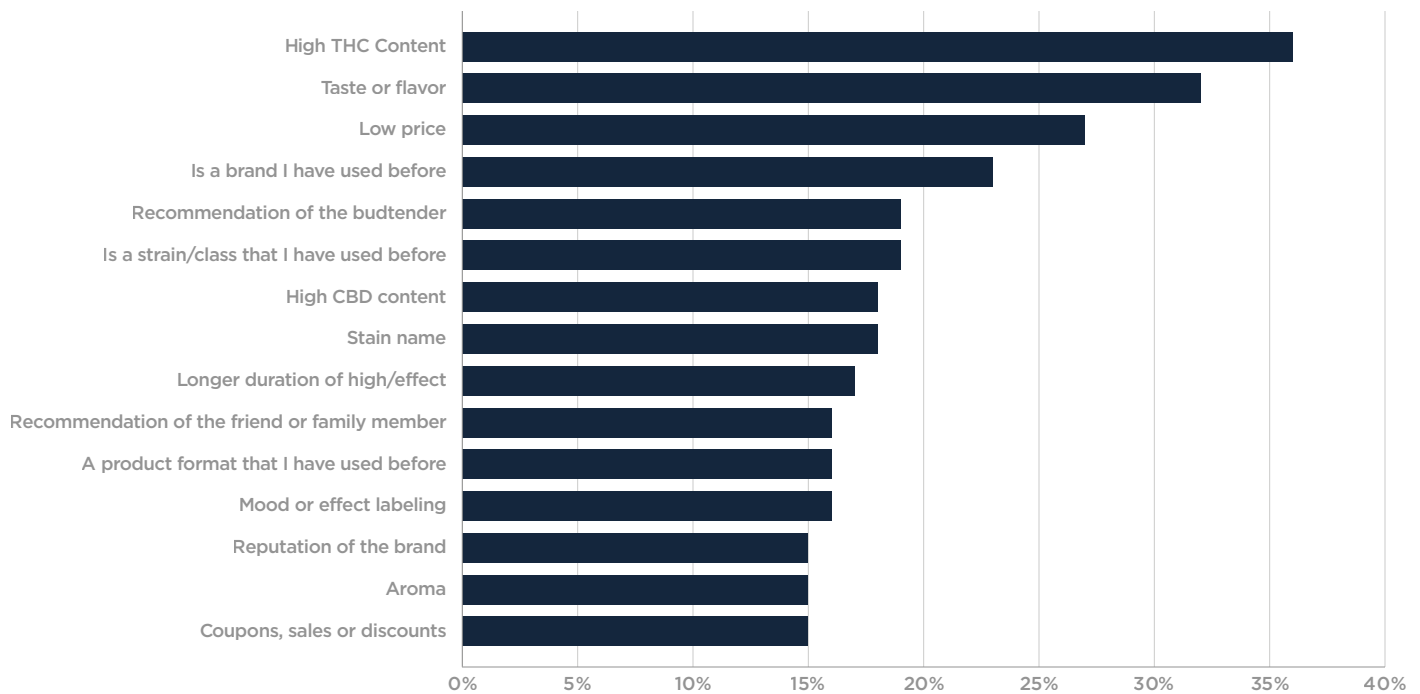
BDSA data show that equivalent average retail prices across mature markets (AZ, CA, CO, NV, OR) fell 13% between Q3 2021 and Q3 2022, with some markets seeing price compression higher than 20%. With little indication that cannabis prices will return to past highs in the coming year, having a tailored strategy to deal with price compression will be a crucial piece of the puzzle for retailers and brands alike.

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Cost Conscious Consumers: How Pricing Impacts Consumer Behavior

While the industry has been working through new issues over the past year, one area where industry uncertainty **isn't** reflected is in consumers' interest in cannabis, as consumer participation rates continue to climb, indicating that the opportunity in the legal cannabis space is still significant. BDSA Consumer data show that the consumer rate across adult-use markets grew from ~35% in Spring 2020 to over 50% in Spring 2022.

Top-15 Drivers of Product Choice — % Selected as "Influencer"



Source: BDSA Consumer Insights; Spring 2022; Adult-Use Markets

BDSA data also show that the cannabis consumer pool is diverse and increasingly sophisticated, and that price continues to be a significant factor that many consider when deciding where to shop; this dynamic has only become more important in the past ~2 years. As of Spring 2022, over a third of consumers in adult-use states claimed that price is a significant influencer when deciding where to buy cannabis, and it's no secret that retailers have strong incentive to keep price top of mind to attract and retain existing customers.

After THC Content and Taste/Flavor, price continues to be top of mind for consumers when deciding which products to purchase, among both new users and experienced users alike. BDSA data even show that consumers cite price as being more important than brand familiarity. Brands are also keeping price at the forefront as they work to retain loyal consumers and to offer the most attractive pricing to retailers.

The Impact of Pricing Changes

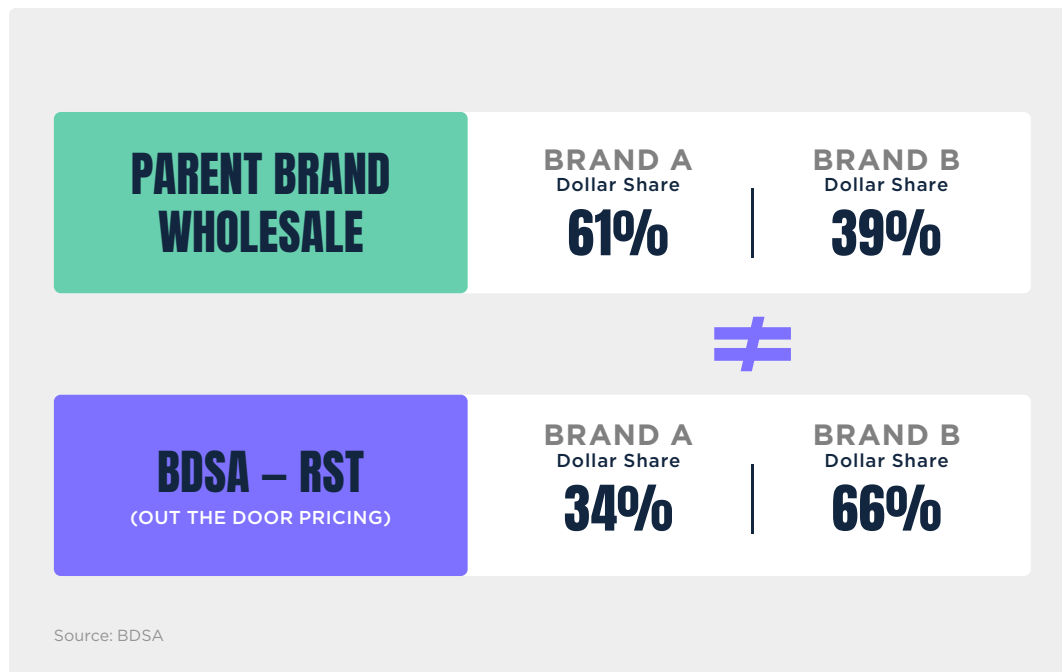
Considering how important pricing is to the cannabis consumer, and how these consumer attitudes drive shopping behavior, we can unpack the impact of pricing compression across markets. Aside from the obvious impacts of affecting profitability in an industry already dealing with razor thin margins, price compression makes it harder for brands to model their performance, impacts basket volume and size at retail, and complicates how brands and retailers must approach promotions and discounts.

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Volatile pricing because of price compression makes it difficult for brands to understand their place in the market, making the process of forecasting future sales even harder. Many brands generally rely on their wholesale data to better understand their brands' share within a given category and market, and even within their own portfolio mix, but the widening gap between the price brands suggest that retailers charge for their products and the true (often lower) price that consumers pay at retail means that brands need to pay even closer attention to the "out the door" price to more accurately understand their position within a market.

Here's a real-life example to illustrate this problem: a large brand with multiple banners was using its wholesale sales to understand the retail sales share split of two of their brands' same product offering. Their wholesale data for BRAND A product accounted for ~60% of the sales and BRAND B product accounted for the remaining ~40%. But when looking at BDSA's retail sell-through data, the shares were almost flipped with Brand B accounting for the larger share and BRAND A accounting for a significantly smaller share.

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Using BDSA's Menu Analytics data to better understand the dynamics at play, Brand B had higher advertised price on menus than Brand A by a wide margin. What the advertised menu price did not account for is that retailers were more deeply discounting the Brand B product, while selling Brand A's product at a higher markup. By utilizing wholesale, sell-through and menu analytics data together, the organization was able to see a more complete view across the supply chain and make more informed decisions regarding pricing and inventory allocation for both brands in question.

When looking at basket data, we can see that even with price compression, average basket size declined across most mature markets, with only CA, CO, and IL seeing a moderate increase in basket size over a year ago. While basket sizes and the number of baskets differed based on market maturity and concentration, falling prices did see consumers adding more items into their baskets this year than in the same period a year ago. And though more items per basket is a positive for retailers and brands, the additional items were not enough to outweigh falling prices in most mature markets. CA, CO, NV and OR all saw significant decreases in dollar sales in Q3 2022 vs. Q3 2021, with NV seeing the most dramatic decline of ~30%.

Strategies to Succeed in a Market with Continued Price Compression

With 2023 prices unlikely to return to the Covid-era highs of mid-2021, having a strategy to address the impacts of price compression is an absolute must for anyone who wants to stay afloat. While there is no one-size-fits-all strategy for pricing in cannabis, a careful look at retail sales data shows that there are ways to strategically approach pricing as we head into 2023.

- **Identify price points and package sizes that appeal to multiple consumer segments.**

- Budget-minded consumers may be looking to purchase a product at a given price point but appealing to these consumers doesn't mean upending your whole pricing strategy. By offering different package sizes that can offer value to the budget minded and the ballers alike, brands can maintain sales volume at retail without having to aggressively price down their whole product portfolio.

- **Be wary of heavy reliance on in-store promotions.**

- While promotions can be a valuable tool for retailers to retain their captured customer base, price declines that happen too fast and fall too far can impact elasticity and make in-store promotions less effective.
- Having a targeted approach to promotions that is centered around retaining traffic around crucial sales days, like Green Wednesday or 4/20, is one way to ensure consistent basket volume without losing competitive advantage.

- **With more aggressive pricing and promotional strategies at POS, brands and wholesalers need to consider out-the-door pricing in conjunction with keystone (or MSRP) in forecasts and models for more accuracy.**

- Wholesale data can be incredibly useful in building a brand strategy, but in an industry that's evolving as quickly as legal cannabis, having an approach that utilizes multiple pricing data sources is a must. That is where tools like BDSA's Menu Analytics and Retail Sales Tracking are critical, allowing brands to filter through noise and base a strategy based on data and facts.

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