

ESSENTIAL CANNABIS INSIGHTS

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BDSA'S 2023 CANNABIS MARKET PREDICTIONS

2022 was an eventful year in the cannabis industry, with exciting new legal markets opening, and macroeconomic conditions presenting new challenges to businesses across the industry. There's no shortage of questions looking ahead, but BDSA has you covered with this fresh batch of Cannabis Market Predictions for 2023.

1. Continued price compression and competition from the illicit channel will drive brand share consolidation in mature markets.

Across the most mature cannabis markets, brand consolidation has accelerated under the economic pressures of 2022. BDSA expects consolidation and M&A activity to increase in 2023, as larger MSOs will absorb other MSOs and independent brands alike. MSOs will not be immune to the challenging macro-economic factors, but most will continue to see topline revenue growth regardless of federal legalization or banking relief, as they are more likely to be insulated from a downward economic environment relative to competitors. This is not to say that mature cannabis markets will see their brand landscape become monolithic as new entrants to the market will still seek opportunities.

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%. While brands across each mature market have responded to price compression differently, we have already seen some moves indicating further brand consolidation. BDSA's Brand House tracking shows that the share of dollar sales held by Brand Houses across CA, CO, NV, and OR has grown from 50% of total dollar sales to 60% between Q1 2021 and Q3 2022. Over that same period, the top five MSOs grew from a ~22% share to a ~26% share of those markets.

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In higher growth markets like MD, MI, and MO, independent, homegrown brands are expected to remain strong, while the opportunities in these markets have not gone unnoticed by MSOs and bigger Brand Houses. Given the better growth conditions in new and emerging markets, it's likely that M&A budgets of the largest MSOs will be concentrated in the Midwest and Northeast, though social equity parameters in some markets (such as New York) may make it more difficult for MSOs to gain a dominant market share.

2. Solventless products will represent the new wave of premiumization in the edibles and concentrate categories.

When looking at product data in 2022, one clear trend is the move towards solventless inputs in premium products, especially in the dabbable and vape subcategories. BDSA Retail Sales Tracking shows that rosin's share of dabbable dollar sales has grown significantly in mature markets (CA, CO, OR, MI, IL), from 8% in January 2021 to 16% in October 2022. Between Q3 2020 and Q3 2022, Solventless products have even made a name for themselves in the gummie edible space, with a leading solventless gummie brand landing a spot on the list of top ten best-selling California gummie brands.

Several attributes of solventless products make them appealing to consumers. Given the unique flavor profile that solventless products offer over light hydrocarbon extracts, solventless products like bubble hash and rosin prioritize flavor, a significant draw given that 32% of adult-use consumers cite Taste/Flavor as a main driver of product choice. Furthermore, solventless products offer a unique appeal to consumers who seek out products with natural inputs, with natural inputs being a top product choice driver for ~15% of adult-use consumers.

In an industry fueled by innovation, form factors that were exclusive yesterday can seem downright ordinary today. This is a trend playing out with Live Resin concentrates, which have long been seen as a premium element of the concentrate category. As prices for live resin declined significantly over the past two years, some live resin products may be less likely to be considered an exclusive or premium product in 2023.

Price compression has been hitting all segments of the industry hard since late 2021, and while solventless products are not immune to price pressure, BDSA Retail Sales Tracking data show that average retail prices (ARP) for solventless products like Rosin are holding significantly higher than for Live Resin. In the California market, the ARP for Live Resin has fallen to ~\$20/gram in Q3 2022, while Rosin's ARP has begun to stabilize at ~\$35/gram in Q3 2022, suggesting that solventless products can maintain a premium price point at retail even if price compression continues through 2023.

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3. Minor cannabinoids have been in the spotlight in 2022, a trend that will continue in 2023 as the traditional indica/sativa/hybrid classification fades from relevance. Going forward, more brands will focus their education and marketing on newer minor cannabinoids and terpenes, emphasizing the consistent, predictable experiences that these compounds drive.

Heading into 2022, BDSA predicted that classifications of indica/sativa/hybrid would begin to fade as designators of consumer experience and brands would embrace cannabinoid content and terpene-driven benefits in their brand and product stories. Products boasting minor cannabinoids have gone from having marginal presence in mature markets to being a requirement for a top performing brand portfolio, with all the top ten gummie brands by dollar sales in California offering at least one product with CBN or CBG as of Q3 2022.

Going into 2023, BDSA expects this trend towards marketing experience-driven benefits to continue, not only with minor cannabinoids but also with terpene profiles. BDSA Consumer data show that just 8% of consumers prioritize terpene content/profiles when shopping for cannabis, but 16% of consumers report that mood or effect labeling is a major influence of product choice. More brands are making mood and effect benefit claims on product packaging and other consumer-facing materials, and backing those claims up with terpenes and minor cannabinoids to strengthen the value proposition. Terpene-focused marketing is gaining traction in mature markets, with some brands providing terpene content on testing labels, and others producing “buyers guides” explaining the breakdown of terpenes across their product portfolio, tying these terpenes to repeatable, consistent experiences.

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4. New strategies at retail will be needed to meet evolving consumer needs and retail options such as curbside pickup, delivery, and direct-to-consumer sales are here to stay.

The Covid-19 pandemic led to a sea change in the way consumers buy cannabis. BDSA Consumer Insights data show that the share of consumers in California who reported purchasing cannabis from delivery services grew from ~20% in Spring 2019 to ~25% in Fall 2020. Over that same period, the share who reported buying cannabis from a mail order service grew from ~5% in Spring 2019 to ~15% in Spring 2022.

A growing number of top brands in mature markets have also embraced direct to consumer (DtC) sales, with mature market California being the major test case for the strategy. Among these DtC brands are leading California beverage brand Cann (#1 in beverage sales for Q3 2022), and top brand houses Kiva Confections and CannaCraft. More markets are also moving to allow adult-use delivery, including the New York market which plans to include delivery with their adult-use sales launch, and Illinois, where Gov. Pritzker has hinted at the possibility of adding delivery access.

Brick-and-mortar experiences will mature as well. As consumer education improves, we expect retailers to evolve with them. Less directed, more open retail environments will thrive, moving away from the traditional dispensary retail experience and towards a premium CPG shopping experience, even with the stringent regulations placed on cannabis retail across legal markets.

5. As mature markets out west continue to struggle with price pressure and regulatory issues, international markets and markets in the Northeast of the US will represent the biggest growth opportunities in legal cannabis.

The Northeast region represents a significant opportunity, with an estimated 21+ population of ~48 million across CT, DE, DC, ME, MD, MA, NH, NJ, NY, PA, and RI. The annual sales total across these markets is forecast to grow ~30% in 2023, and more than double between 2022 and 2026. Important to note is the fact that these markets are moving into adult-use sales with medical markets that are much less-developed than other recently launched adult-use states, giving them room to grow in comparison to other states with more storied medical programs such as Arizona. At the launch of legal sales in April 2022, New Jersey had less than one retailer per 100,000 residents, while Arizona had roughly five retailers per 100,000 residents when it launched adult-use in 2021. New Jersey is expected to see annual adult-use sales more than double in the coming year to reach ~\$925 million in 2023, driving total 2023 legal sales to ~\$1.2 billion.

International markets are also expected to come into their own in 2023. BDSA expects Mexico start adult-use sales in 2023, with total legal sales expected to surpass ~\$400 million for the year. This is likely to be the first of several large international market launches in the next few years, with BDSA forecasting Mexico and Germany to both be top five contributors to Global sales growth between 2022 and 2026.

6. New York will be the single biggest new market in the world in 2023, but the delay of adult-use sales, limited licensing, and illicit competition will limit potential in the first year of adult-use sales.

With an estimated ~15 million 21+ adults in 2022 and millions of tourists every year, the Empire State holds huge potential as a legal cannabis market, even though New York has seen its fair share of bumps on the road to adult-use sales. While New York had ambitiously planned to launch adult-use in concert with neighboring New Jersey and Connecticut, the start of legal sales has seen repeated delays, and retail availability is expected to remain constrained even after legal sales launch in the final days of 2022 and early 2023.

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In contrast to many other emerging markets, New York has a very limited medical program, with a constrained retail landscape and only ~\$175 million in medical sales in 2021. A look at the brand and product landscape in New York also tells the story of a less-developed medical market. In October 2022, BDSA Retail Sales Tracking data show that New York had 33 brands active in the market, with ~720 distinct product SKUs, making New York less mature from a brand landscape perspective than even the young New Jersey market, which was home to ~1,830 distinct SKUs from 65 different brands in October 2022.

New York regulatory officials announced in summer of 2022 that 150 turn-key storefront facilities would be constructed for social equity licensees to operate out of, but the firms selected by the state have yet to break ground on these crucial facilities. So far, state officials have issued 36 retail licenses, and approved adult-use delivery to kick-start the market launch, although it comes on the heels of repeated delays and setbacks from New York cannabis regulators.

While illicit competition is a thorn in the side of all legal markets, New York City has seen an especially robust grey market since legalization was signed into law. The lead-up to adult-use sales has coincided with an explosion in illicit retail activity, not only through unlicensed delivery services, but also a host of storefront retailers that have become a challenge for regulatory officials. New York City Mayor Eric Adams vowed to crack down on unlicensed cannabis retail, but previous examples such as California's struggles with the illicit supply chain suggest that grey market competition will be a persistent feature of the New York adult-use market, especially if retail availability in the state remains limited.

The sheer size of New York's population, and its rapidly growing consumer participation (with BDSA Consumer data showing ~50% reporting past six-month cannabis use in Spring 2022) point to New York holding huge potential as a legal market. BDSA still predicts that New York will be the biggest new cannabis market in 2023, but the struggles that the industry has been dealing with in the year leading up to adult-use sales show little sign of fading. This likely means that New York will not hold as much early-stage opportunity for new market entrants as previously thought.

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