As 2.0 opportunities emerge, can you still compete with 1.0 strategies?

Canadian cannabis consumer insights for legalization 2.0

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Introduction

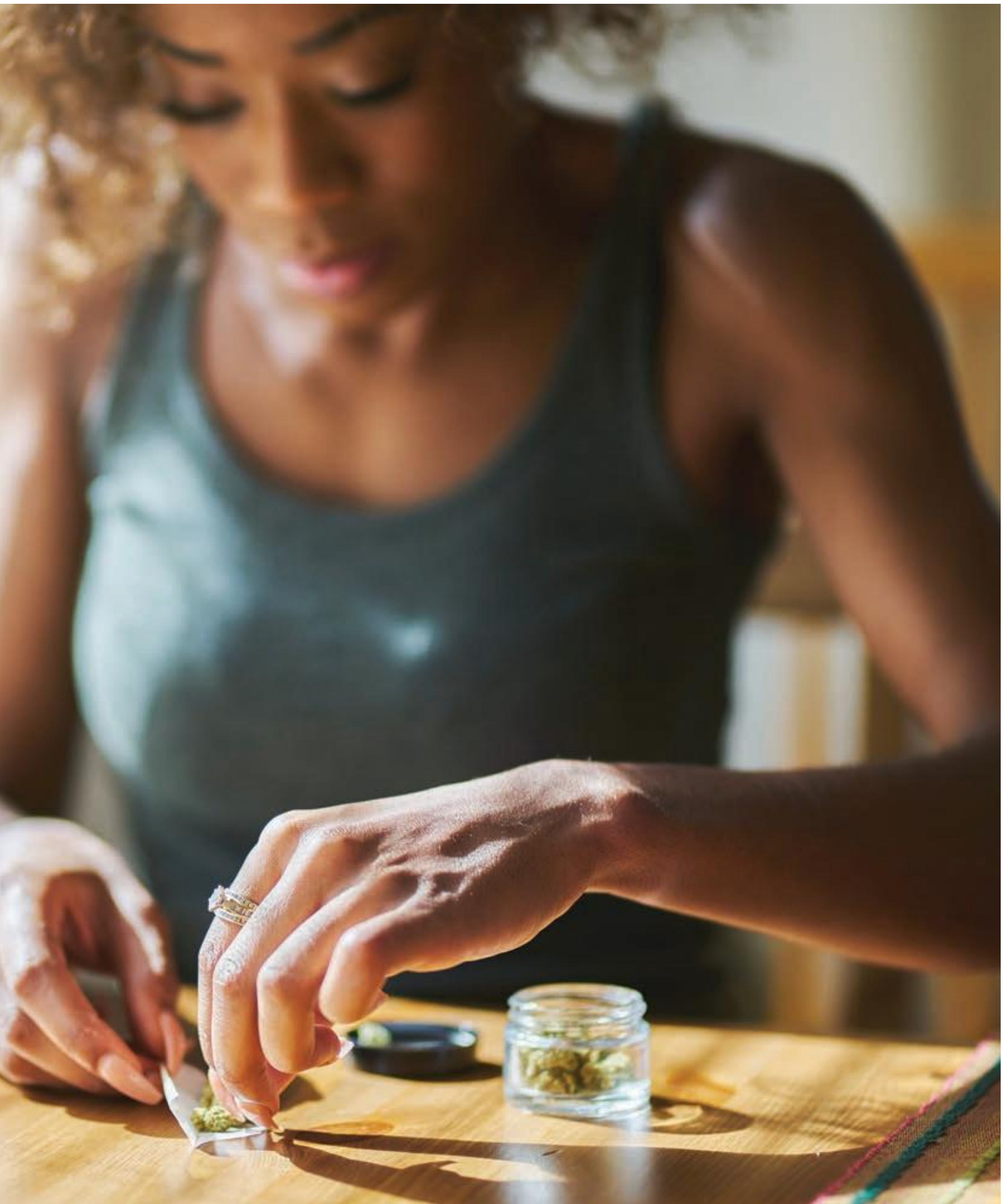
On 17 October 2018, the *Cannabis Act* and supporting Cannabis Regulations came into effect in Canada, legalizing the recreational use of cannabis federally. Health Canada took a phased approach to legalization and limited the product formats available for purchase in the first year to dried flower, cannabis oil, cannabis oil capsules, plants and seeds. Final amendments to the *Cannabis Act* and Regulations describing regulations for edibles, extracts, and topicals — referred to in this report as 2.0 products since they were intended for later legalization — were published in the Canada Gazette on 26 June 2019. Licence holders can begin to submit requests for licence amendments to produce additional product formats on 15 July 2019.

The amended regulations regarding the production and sale of 2.0 products will come into force on 17 October 2019. It's expected that a limited selection of edible, extract and topical products will be available online or through retail stores beginning 16 December 2019. Prior to this, federal licence holders will need to provide 60 days' notice to Health Canada to inform them of their new products coming to market.

Provincial and territorial regulatory bodies — which are also the sole distributors in every province except Saskatchewan and Manitoba — will also need time to put out requests for information, requests for proposals to qualify licence holders, issue product calls and purchase orders, and procure new products to make them available for sale. It is very likely that Canadians will not see robust product portfolios until late Q1 to Q2 2020.

To date, much of the consumer information collected on 2.0 products is from the US states where cannabis has been legalized, such as Colorado, Oregon, Washington and California. The differences between Canadian and US regulatory structures, both with respect to cannabis and other areas such as banking, the different levels of government and legal systems, as well as consumer attitudes within and towards the cannabis sector, give enough support to assume that Canadian consumers should be different from US consumers when referring to cannabis-based products.

Using this premise, Lift & Co. and EY have collaborated to enhance the understanding of the Canadian consumer. This report first explores the various consumer segmentations and their preferences, views on current and future products as supported by the survey results. It then further provides insights and perspectives for licence holders and retailers to challenge the way they currently integrate consumer data into their strategies.



Research methodology

EY and Lift & Co. undertook a study to better understand the following:

1. **Segmentation**
   Who are the Canadians currently consuming cannabis? Which Canadians (if any) are not interested in smoking dried flower but could be interested in purchasing edibles, extracts and/or topicals?
2. **Purchasing journey**
   What is the impact that budtenders have during the customer purchasing journey? What are important purchasing criteria for the consumer?
3. **Current retail environment**
   What are the budtenders experiencing as they serve a wide spectrum of consumers with varying degrees of cannabis consumption experience?
4. **Influencers**
   What are the factors that influence cannabis consumption?
5. **Barriers**
   What are the barriers to cannabis consumption for Canadians who are not currently consuming cannabis? What are the barriers that existing consumers face which are driving them to purchase from the illicit market?

Both EY and Lift & Co. worked together to design and develop online surveys aimed at three main groups: consumers, non-consumers and budtenders. The surveys were conducted between 3 May and 10 May 2019, by Lift & Co.

The population sample was extrapolated to be proportionately representative of the Canadian adult population based on age, gender and region. Assuming a non-probability sample of 1,546 non-consumers, the margin of error is +/- 2.492% at the 95% confidence level.

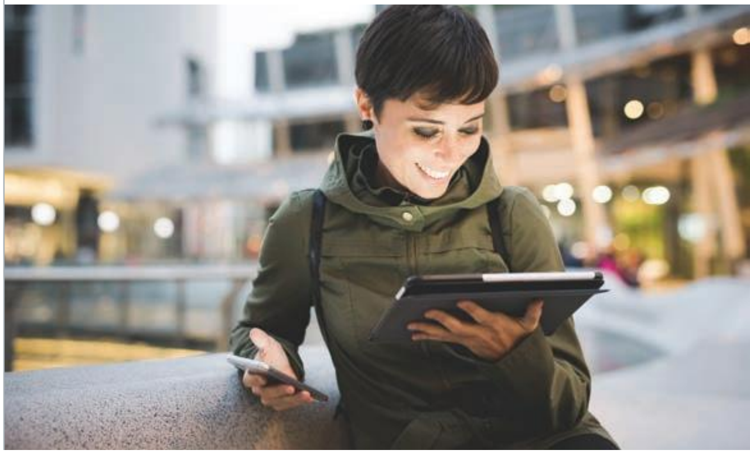
Results of the survey

Approximately 3,000 individuals across Canada responded to the surveys.

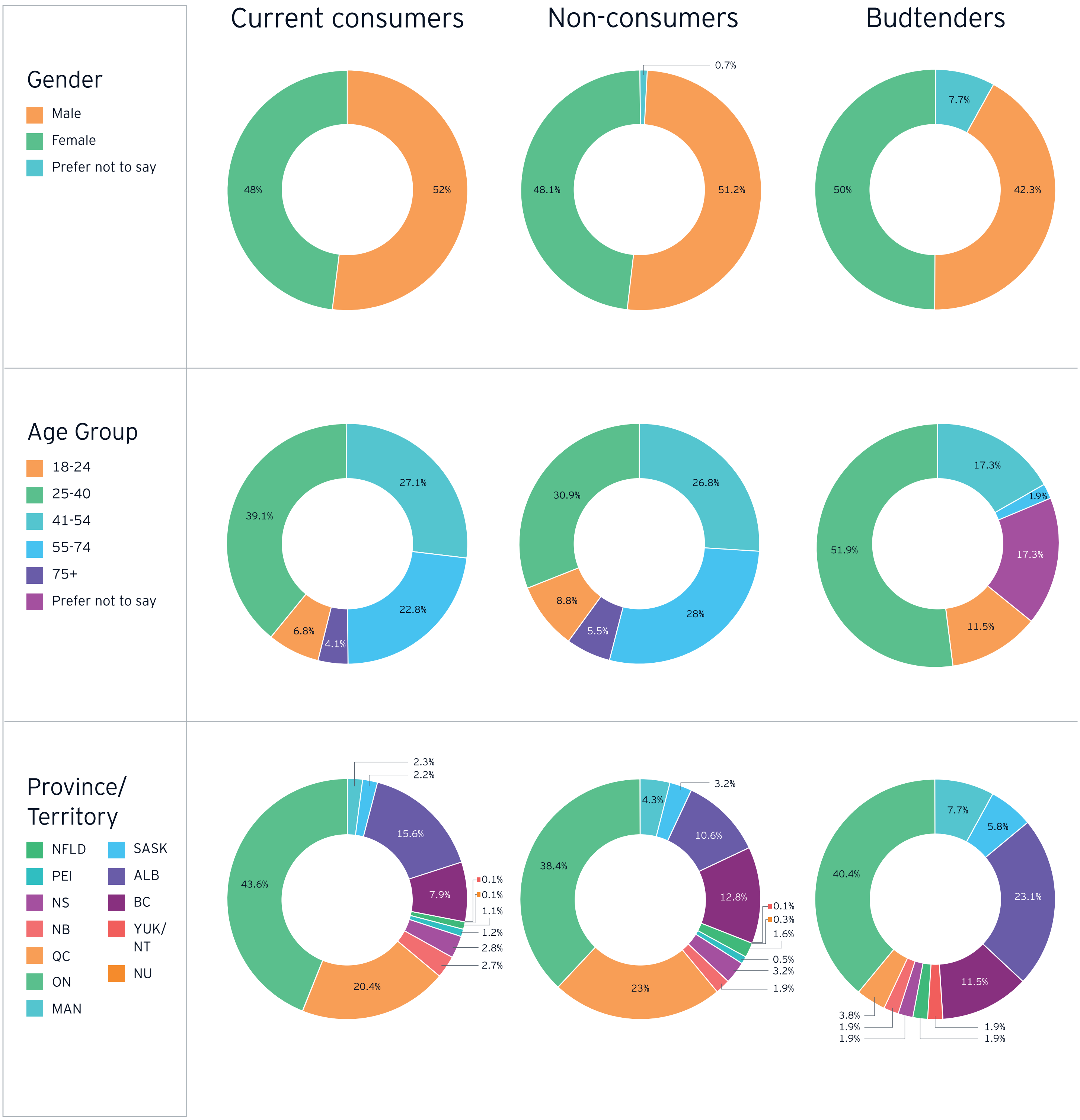
1,375
Canadians that identify as consuming cannabis products.

1,546
Canadians that are not currently consumers of cannabis responded on their potential to be consumers because of the products that are expected to be legalized near the end of 2019.

52
Budtenders, one of the key influencers in the purchase journey, described their influence by licence holders, online review forums and other channels.



Demographics of respondents

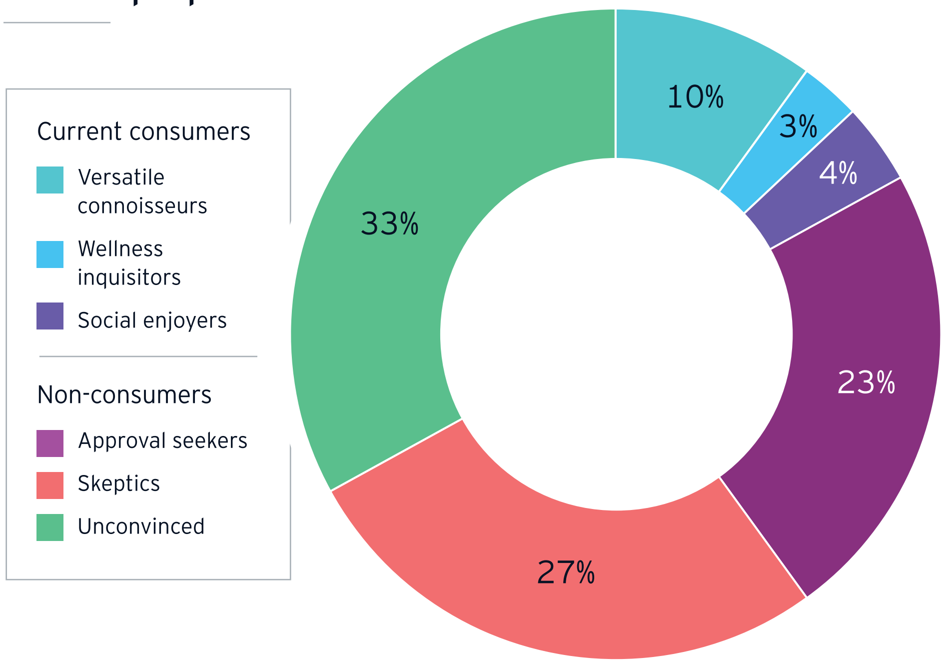


Survey findings and analysis

EY and Lift & Co. analyzed the responses, and in this report highlight some of the findings to help licence holders and retailers reflect on how they are viewing the consumer journey and the integration of their strategy with their existing and future products.

The respondents were segmented into six non-overlapping groups. Cannabis consumers were split into three groups based on their cannabis knowledge and frequency of consumption. Non-consumers of cannabis were split into three groups based on their attitude toward cannabis, legalization and likeliness of consuming cannabis.

% of Canadian adult population



Based on the results, it is expected as many as 3 million new consumers (12% of all non-consumers), who are not interested in purchasing dried cannabis products, may enter the cannabis market upon legalization and availability of new product formats.* The breakdown by product type is as follows (there are overlaps between the different groups):

1.5m
Potential new consumers of edibles (6% of non-consumers)

750k
Potential new consumers of extracts (3% of non-consumers)

2.25m
Potential new consumers of topicals (9% of non-consumers)

*Projections of potential new consumers are calculated based on the population of Canadian adults who are not among the most currently reported population of past 3 month consumers, according to Statistics Canada.

Results of the survey

	Versatile Connoisseur	Wellness Inquisitor	Social Enjoyer	Approval Seekers	Skeptic	Unconvinced
% of estimate Canadian Population	10%	3%	4%	23%	27%	33%
Frequency of Consumption	Daily	Almost Daily	1-3 times per week	Does not currently consume cannabis	Does not currently consume cannabis	Does not currently consume cannabis
Familiarity with Cannabis (knew some + well aware)						
THC	98%	91%	88%	59%	47%	35%
CBD	97%	84%	85%	51%	36%	28%
Barriers to purchase	Ineffective dose or high tolerance	I think they are expensive	I've had a bad experience	I'm concerned about the long-term effects of cannabis usage (health concerns)	I'm concerned about the long-term effects of cannabis usage (health concerns)	I'm concerned about the long-term effects of cannabis usage (health concerns)
	I think they are expensive	I've had a bad experience	I'm afraid of losing control and regretting my actions	Overall, I don't know enough about cannabinoids ingredients	I'm afraid of losing control and regretting my actions	I don't think it is socially acceptable to consume cannabis
	I'm concerned about what friends and family will think of me if I purchase from the legal market	I don't know how to use them	I think they are expensive	I'm afraid of losing control and regretting my actions	I don't like the flavour or the smells	I'm afraid of losing control and regretting my actions
					Overall, I don't know enough about cannabinoids ingredients	Overall, I don't know enough about cannabinoids ingredients; I don't like the flavour or the smells
Influencers for purchase (most important to respondents)	Quality	Quality	Quality	Quality		
	96%	83%	86%	62%		
	Potency	Intended effects	Intended effects	Intended effects		
	85%	76%	79%	54%		
	Intended effects	Price	Potency	Clinical research		
	84%	64%	62%	52%		
Preferred consumption method (very likely)	Vapourizer	Vapourizer	Vapourizer	Does not currently consume cannabis	Does not currently consume cannabis	Does not currently consume cannabis
	69%	43%	53%			
Top current product preferences	Dried flower (High THC)	Tropicals (CBD only)	Dried flower (Balanced)	Does not currently consume cannabis	Does not currently consume cannabis	Does not currently consume cannabis
	88%	36%	51%			
	Extracts & Concentrates (High THC)	Dried flower (High CBD)	Dried flower (High CBD)			
	65%	35%	46%			
	High dosage edibles (THC 5-10 mg)	Low dosage edibles (THC 0-2.5 mg)	Dried flower (High THC)			
	57%	31%	42%			
Preferred primary purchasing channels	A legal online store	A legal online store	A legal online store	A legal brick-and-mortar cannabis store	I don't plan to purchase any	I don't plan to purchase any
	38%	35%	43%	41%	89%	96%
Preferred secondary purchasing channels	A legal brick-and-mortar cannabis store	A legal brick-and-mortar cannabis store	A legal brick-and-mortar cannabis store	A legal online store	A legal brick-and-mortar cannabis store	A legal online store
	32%	22%	38%	28%	5%	1%
Preferred 2.0 products (top 3)	Hash	Vape Pen	Vape Pen	Baked Goods		
	Kief	Baked Goods	Hash	Confectionery		
	Vape pen	Food additives; Cooking ingredients	Kief	Food additives: Cooking ingredients		
Top 3 need states	Relaxed	Pain	Relaxed	Pain		
	Stress	Relaxed	Stress	Relaxed		
	Pain	Sleep	Pain	Stress		

Current consumer groups

Versatile connoisseur

Versatile connoisseurs make up 10% of the Canadian adult population, consume cannabis on a daily basis, and approximately 83% of them self-identify as connoisseurs. The largest barrier for versatile connoisseurs purchasing from the legal cannabis market is price; 22% of versatile connoisseurs believe that legal cannabis is too expensive compared to the illicit market.

In addition, 10% of versatile connoisseurs are concerned about what their friends and family will think of them if they purchase cannabis from the legal market. This could be due to the uncertainty of their friends' and families' views of cannabis users being perceived as "stoners."

When asked about interest in trying new product formats, 5% of versatile connoisseurs indicated that they have an existing preference for dried flower (easy to titrate, greater ability to choose products with specific cannabinoid ratios) and cannabis oil (easy to titrate, more discrete and the ability to have timed release). Of this segment, 34% believe that the maximum dosage of 10 mg of THC in edibles and beverages would not provide the intended or therapeutic effects they're looking for due to their high tolerance associated with long-term or frequent cannabis consumption.

Daily consumption of cannabis can be very expensive. This group spends about $320 on cannabis per month. When surveyed about their willingness to pay per gram of dried flower, 72% indicated that they were willing to pay more than $8 per gram. Only 27% indicated that they were willing to pay more than $11 per gram of dried cannabis.

Versatile connoisseurs, as expected, have a high level of knowledge of cannabinoids. The majority (95%) responded that they are well aware of the potential effects of THC and 89% are well aware of the potential effects of CBD.

Half of versatile connoisseurs believe that clinical research in support of the medical and wellness benefits of cannabis plays a very important role in their purchase decisions. Nearly one third (31%) believe that product reviews shared through online platforms and forums are very important; 47% said that recommendations from retail store employees are somewhat important in their purchase consideration and 42% believe that suggestions or discussions with family or friends will somewhat influence their purchase decisions.

Versatile connoisseurs reported that they were very likely to use cannabis for relaxation (89%), managing stress (88%) and pain (84%), and as a sleep aid (84%), and 31% responded that they were somewhat likely to consume cannabis to be more sociable.

They indicated that quality (96%), potency (85%), intended effects (84%) and price (76%) are the most important purchase criteria when evaluating purchases. The brand or licenced producer was considered somewhat important. Additionally, 37% believe that terpene content is somewhat important.

Currently, versatile connoisseurs prefer consuming dried cannabis with a vaporizer (69%) and using rolling papers to roll a joint (54%). The top product preferences are high-THC dried flower (88%), high-THC extracts and concentrates (65%) and high-dosage edibles (5-10 mg of THC) (57%). Although the latter two categories are not yet legal in Canada, a large portion of consumers are currently choosing to make their own derivatives (32%) or purchase from the illicit market.

In relation to 2.0 products, versatile connoisseurs indicated that they would be interested in purchasing hash (93%), vape pens (89%), kief (91%), rosin (88%), wax (88%) and live resin (88%). Fewer than half (44%) of versatile connoisseurs are not likely at all to purchase low-dose edibles (0-2.5 mg of THC) or medium-dose edibles (2.5-5 mg of THC). Versatile connoisseurs are used to consuming high-potency cannabis products and therefore don't feel like low and medium potencies and dosages would be conducive to their desired experience.

Versatile connoisseurs purchase cannabis from legal online (34%) and legal brick and mortar cannabis stores (32%), though not exclusively; 19% are currently purchasing from an illegal online store, 12% from an illegal brick and mortar dispensary, 21% from friends, and 23% from a private dealer. The most common places of consumption are at home or at a friend's home (96%), outdoors (70%) and at parties or social events (53%).

Wellness Inquisitor

Wellness inquisitors make up 3% of the Canadian adult population and indicated that they are familiar with (65%) or new (35%) to cannabis. Wellness inquisitors consume cannabis almost daily and spend approximately $165 per month on cannabis. Most (71%) are willing to pay more than $8 per gram of dried cannabis flower, while only 29% are willing to pay more than $11 per gram of dried flower.

The main barriers that wellness inquisitors face to oncoming cannabis products are the fact that legal cannabis products are too expensive (16%), they've had previous undesirable experiences when consuming cannabis (14%), or they do not possess the knowledge to effectively consume cannabis products beyond dried flower and oil (11%).

More than two thirds (68%) of wellness inquisitors reported that they are well aware of the potential effects of THC, and 64% reported that they are well aware of the potential effects of CBD. Clinical research (56%) and the advice of health care practitioners (42%) were reported to be the most important information sources and influences over this group's purchasing decisions.

Wellness inquisitors reported that quality (83%) and intended effects (76%) are the most important purchase criteria. Terpene profiles (43%) and brand (40%) were identified by this group as somewhat important purchase criteria.

> "The preferred consumption method for wellness inquisitors is vaporizing dried flower.

The preferred consumption method for wellness inquisitors is vaporizing dried flower (53%). The top three primary needs that prompt wellness inquisitors to be very likely to use cannabis are for pain management (64%), enabling relaxation (63%) and as a sleep aid (61%). This group also indicated many secondary need states for consuming cannabis, including the desire to feel energized (38%), happy (34%) and sociable (34%).

Currently, the top two products that wellness inquisitors consume are CBD-only topicals (36%) and high-CBD dried cannabis flower (35%). This group is interested in purchasing vape pens (74%), baked goods (74%) and food additives (68%).

Wellness inquisitors currently purchase cannabis through a legal online store (35%) or a legal brick and mortar cannabis store (22%). Only 6% of this group reported currently purchasing from an illegal online store and 4% from an illegal brick and mortar cannabis dispensary. For the wellness inquisitors who are purchasing through the brick and mortar retail channel, about half (51%) did not know what they were going to purchase prior to entering the store. The most common places that wellness inquisitors consume cannabis are at home or at their friend's home (87%) and outdoors (35%).

Social enjoyer

Social enjoyers make up 4% of the Canadian adult population and 78% consider themselves as being familiar with cannabis. They consume cannabis one to three times per week and spend about $130 per month on cannabis. Most (78%) are willing to pay more than $8 per gram of dried cannabis, and 40% are willing to pay more than $11 per gram of dried cannabis. Further, when asked about their barriers to consuming legal cannabis, 24% have had a previous bad experience consuming cannabis, 12% are afraid of losing control and regretting their actions if they "get too high," and 10% believe that legal cannabis products are too expensive.

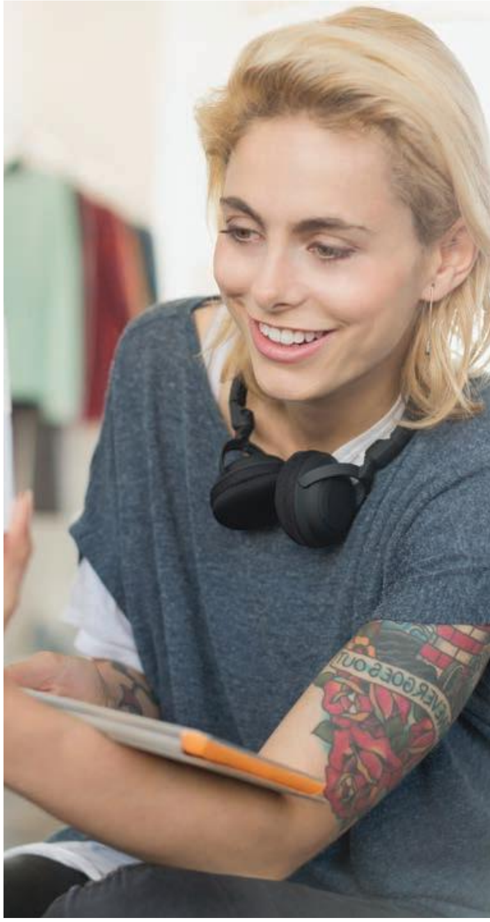
Approximately three quarters (76%) of social enjoyers reported that they are well aware of the potential effects of THC, while 70% reported that they are well aware of the potential effects of CBD. Their primary reasons for consuming cannabis include relaxation (69%), stress relief (63%) and pain management (58%). Their secondary reasons are to be sociable (37%), and to feel happiness (35%) and energized (35%).

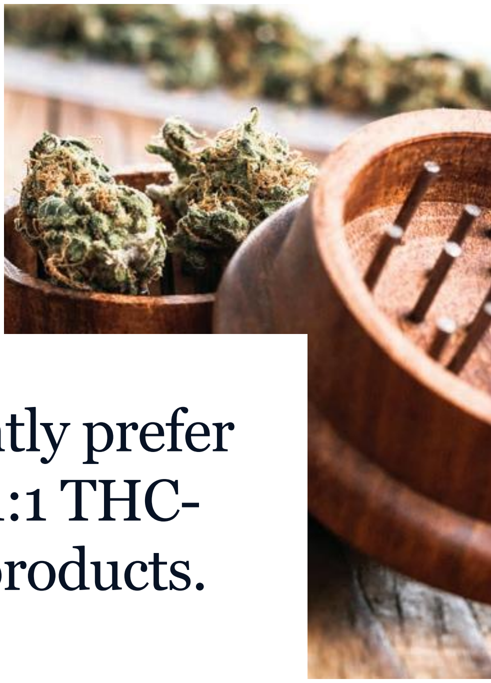
Social enjoyers reported that clinical research (43%) was the primary information source that had the most influence over their purchasing decisions. Budtenders (52%), reviews and forums (50%), and family and friends (47%) are secondary (somewhat important) influences over their purchases.

Primary purchase criteria that are very important to social enjoyers include quality (86%) and intended effects (79%). This group also reported that terpene profiles (47%), brand (39%) and potency (35%) are secondary purchase criteria that are somewhat important in their purchasing decisions.

Half (51%) of social enjoyers currently prefer consuming balanced 1:1 THC-to-CBD dried flower products, 46% prefer consuming high-CBD dried flower products and 42% prefer consuming high-THC dried flower products. Social enjoyers indicated that they would be interested in purchasing vape pens (87%), hash (87%), cartridges (78%), live resin (78%) and baked goods (78%).

Social enjoyers currently purchase from legal online stores (43%) and legal brick and mortar stores (38%); 21% purchase from friends and 16% from private dealers. For the social enjoyers who are purchasing through the brick and mortar retail channel, 39% didn't know what they were going to purchase prior to entering the store. Social enjoyers reported that they normally consume cannabis at their home or a friend's home (89%) and more than half (54%) enjoy consuming cannabis outdoors.





> "Social enjoyers currently prefer consuming balanced 1:1 THC-to-CBD dried flower products.

Non-consumer groups

> “Only 48% of approval seekers considered price as a primary driver.

Approval seeker

Approval seekers make up 23% of Canadian adults. This group hasn’t ruled out trying cannabis-based products. There is a normal distribution of the approval seekers from those who know nothing about the potential effects of THC and CBD to those who are well aware of the potential effects.

Nearly half (45%) of them don’t support legalization because of negative perceptions, and the same percentage have concerns about its potential long-term effects and impacts on adolescents.

Some approval seekers (15%) don’t think that they have enough knowledge about cannabinoids to feel comfortable with consuming cannabis products. Additional barriers to entering the cannabis market include concerns about potential long-term effects of cannabis usage (14%), the fear of losing control of their actions if they consume cannabis (12%) and disliking the smells and taste of cannabis (10%).

Approval seekers consider clinical research (52%) and recommendations from health care practitioners (47%) as a very important part of their purchasing decisions. They are less concerned with product reviews (18%) as a very important consideration.

Interestingly, approval seekers placed less emphasis on the price, potency, quality, intended effect and brand reputation, items that were very important to the broader current consumer segment. For example, current consumers say price is very important (60% to 76%), whereas only 48% of approval seekers considered price as a primary driver. Current consumers view quality as very important (83% to 96%), in comparison to 62% for approval seekers.

Approval seekers reported that the top three products they would be interested in purchasing are baked goods (67%), topicals (including creams and patches) (55%) and confectionery products (54%). Approval seekers are likely and somewhat likely to try low-dosage edibles, with slightly fewer willing to try medium-dosage edibles.

Approval seekers report low (15%) familiarity with kief, shatter, wax or resin, but approximately 30% to 35% are familiar with hash and vape pens.

However, there was generally no difference between which 2.0 products approval seekers were willing to try; between 40% and 45% are willing to try all products. The only method of consumption this segment was opposed to adopting was smoking dried cannabis flower using a bong, with 66% reporting they were unlikely or somewhat unlikely to use bongs for cannabis consumption.

Skeptic

Based on the survey, 27% of the Canadian adult population would be identified as a skeptic. The skeptic has not and does not currently consume cannabis. And while seemingly similar to the approval seekers, the skeptics have even less awareness of cannabinoids and thus are less likely to consume cannabis.

Skeptics are unlikely to consume cannabis based on concerns about the long-term impacts (21%), lack of knowledge about cannabinoids (11%), have a fear of losing control and regretting their actions if they "get too high" (11%), or have an aversion to the odour or flavours of cannabis (11%).

While 25% of approval seekers responded to having knowledge of the potential effects of THC, a smaller group of only 18% of skeptics believed they fully understood the potential effects of THC. In relation to CBD, 20% of skeptics had never heard about CBD, and approximately 48% had heard about CBD but knew little to some of the potential effects.

Approximately 80% of skeptics have indicated they have no plans to purchase cannabis. However, in the event a purchasing decision is made, only 5% indicated a preference to purchase from a legal brick-and-mortar cannabis store. Although this segment indicated there is no certainty of consuming any cannabis products (current or 2.0), products such as topicals (CBD only) and low-dosage edibles (0-2.5 mg of THC) appear to have a slightly more positive response. The dissonance with other product types (e.g., high dosage edibles, high THC products) are not viewed as strongly as lower-dosage edibles and CBD-only topicals.

Of the skeptics, the majority were unaware of the product types being introduced during legalization 2.0, while 50% of the segment group was familiar with vape pens. More than 85% of the skeptics had no knowledge of or familiarity with kief, resin, wax, cartridge or shatter.

The skeptics are viewed differently than the pessimists based on their level of knowledge and awareness of cannabinoids and cannabis products.

> "Skeptics are unlikely to consume cannabis based on concerns about the long-term impacts.

Unconvinced

The unconvinced make up the largest group, comprising 33% of the Canadian adult population, split equally between female and male respondents. The unconvinced have a low awareness of the potential effects of THC and CBD (less than 35%), and indicate that they are not likely to purchase any current or future products.

This segment has concerns about the potential long-term effects of cannabis (30%), don't believe that consuming cannabis is socially acceptable (11%) and don't like the smell or flavour (8%). The unconvinced hold very strong views that cannabis is still a narcotic that contributes negatively to society. Even though the unconvinced may never become a consumer, the industry can't turn away from the social concerns they have.

Similar to other industries, word of mouth is a very strong influencer; this segment has the ability to transfer their views of cannabis consumption to other segments.

According to the study, this group focuses on the criminal elements that surround this industry. It is important for companies to continue to make sure their operations are within the legal framework.

“The unconvinced hold very strong views that cannabis is still a narcotic that contributes negatively to society.

Insights and perspectives

Consumer insights

Low awareness and cannabis literacy in Canada among non-consumers

Knowledge of cannabinoids in Canada is low among individuals who didn't currently consume cannabis. Non-consumers didn't know as much about the potential effects of THC (54%) or CBD (63%), compared to 6% and 9% of current consumers, respectively. One third (33%) of non-consumers surveyed reported that they don't know enough about cannabis to consider consuming cannabis products.

In addition, non-consumers indicated a strong dissonance based on:

Consumption method

"I do not smoke and do not intend to smoke."

Potential negative effects

"I'm concerned about the short-term and long-term negative health impacts of cannabis consumption."

"I'm uncertain about the interactions of cannabis with current pharmaceuticals that I am taking for a pre-existing condition."

CBD-infused products are subject to the marketing and promotion prohibitions under the *Cannabis Act*, which allow brand preference and educational promotion only. Despite the latter, licence holders and retail staff aren't able to educate consumers about the intended effects of a given product. Instead, a noticeable trend is renaming genetics and cultivars to recommended occasions in which consumers may want to consume a specific product without promoting effects. Examples include associative social nights out, running errands, getting ready for bed or completing a specific task.

> "Non-consumers didn't know as much about the potential effects of THC or CBD, compared to current consumers.

Education should be a key component of the customer acquisition strategy

For consumers who may be interested in cannabis, finding credible and sufficient information can be difficult, given the large amount of misinformation that exists on the internet. Lack of credible information means it's harder for cannabis companies to attract consumers into stores.

In the introductory stage of the product lifecycle for a new product, a substantial level of effort and resources are devoted to marketing a product, within the regulatory guidelines, to create awareness and education, and to encourage product trials.

Under the *Cannabis Act*, licence holders are not permitted to give out infused-samples or bundle products to provide purchasing incentives. As a typical product category grows and matures, more effort would be typically devoted to marketing the brand and differentiating it from competitors. This will be more difficult for the cannabis industry in Canada given the regulatory restrictions on advertising and marketing.

Educated consumers are more adventurous and willing to experiment with different product formats

Experienced cannabis consumers are more open to trying new product formats due to familiarity and product knowledge. Ease of use and adaptability of cannabis products is an important factor for reducing barriers to consumption and contributes to a positive first-time experience.

A big challenge for companies in the cannabis industry is capturing and analyzing data to anticipate changing consumer preferences and needs. They will need to find a way to successfully introduce new products with limited data, create compliant but compelling content to engage with consumers and potential new consumers, and introduce new features and products to achieve sustainable market share and market acceptance.

"The ability of the legal market to match illicit prices will be a challenge that may never be achieved.

Product insights

Price elasticity of dried cannabis flower is very high among current consumers

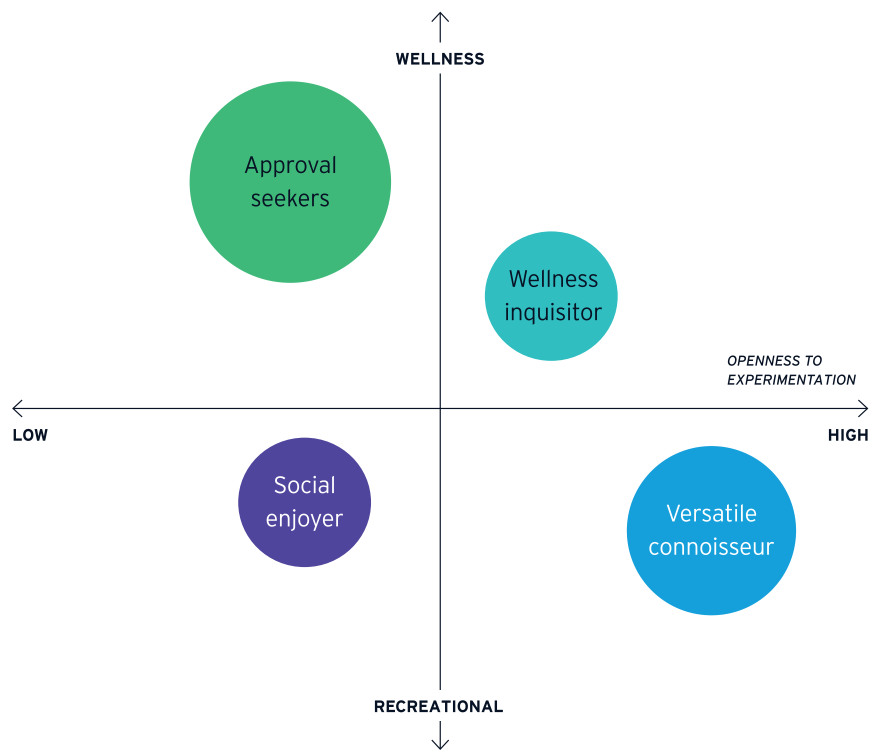
According to Statistics Canada's Cannabis Stats Hub, the Q2 2019 average price per gram for non-medical cannabis from licenced sources is $10.65 compared to $5.93 from unlicenced sources. Price elasticity among current consumers for one gram of dried cannabis flower ranges between -1.27 and -1.22, indicating that consumers are very price sensitive when it comes to dried flower. These results are based on consumer opinion, which will vary based on actual volume and price data. But, they indicate that consumers are very price sensitive to the average price of the illicit and legal market.

The ability of the legal market to match illicit prices will be a challenge that may never be achieved, similar to the struggle of legal cigarettes to compete with their contraband counterparts. However, the licence holders that can find technologies to improve yields and efficiencies in their functional processes to manage their costs and spending habits will become the most adaptable and responsive to price elasticity.

In addition to being too expensive, a common remark about the quality of legal cannabis is that it is too dry and has lower terpene levels (as determined by aromatic characteristics of dried flower). If prices are higher, the value add of quality must match such premiums. According to cannabis sommeliers, some characteristics to evaluate cannabis flower quality include moisture level, trichome density and maturity, and terpene profiles.

Canadians are concerned with the efficacy of cannabis products

Non-consumers that are considering trying cannabis are primarily interested in cannabis products for therapeutic and functional benefits as opposed to use in purely recreational or non-medical occasions. Nearly half (46%) of non-consumers and 19% of current consumers are concerned about the potential long-term health effects from consuming cannabis. More than 80% of approval seekers indicated that the following factors were most important when considering whether to purchase cannabis products: intended effects (89%), recommendations from health practitioners (85%) and clinical research that supports the medical and wellness benefits of cannabis (83%).



More than 50% of approval seekers are more likely to try cannabis products if they could produce functional benefits for pain relief (72%), stress relief (59%) and/or and act as a sleep aid (57%). Health care practitioners are a very important stakeholder in providing medical information and access to cannabis, as they are seen as credible and objective.

In the current regulatory environment, for licence holders to permissibly make product health claims about their cannabis products, they must undergo fulsome clinical trials and obtain approval from the Food Directorate of Health Canada to do so. Science will continue to advance as more investment comes into the market to determine the efficacy of cannabinoid products and various therapeutic uses. Canada is not the leader in this area and currently lags behind Israel and certain parts of Europe in terms of cannabis research. Canadian licence holders need to be cognizant of the development of the acceptance in Canada versus other international markets.

Maximum THC dosage limits could bring unintended consequences

Under the final version of the Cannabis Regulations, edible cannabis (including food and beverages) will be restricted to a maximum of 10 mg of THC per unit. This limit is currently also applicable to medical products, as there is no proposed regulatory pathway for edible cannabis intended for medical use.

It should be noted that 21% of current consumers believe that the 10 mg of THC limit for ingestible products (food and beverage) wouldn't provide the intended effects or therapeutic effects they are seeking due to their high tolerance. Further, survey feedback indicates that prices in the legal market are too expensive, making it price restrictive for consumers to purchase multiple units of distinct cannabis-infused products.

Canadian interest in trying cannabis-infused beverages is high but sale volumes may still be low

About 40% of current consumers reported that they are very likely to try cannabis-infused beverages once 2.0 products are legally available for sale in Canada if beverages could provide the intended effects they're seeking. For non-consumers, more than half (51%) indicated that they would be very likely (11%) or somewhat likely (40%) to try cannabis-infused beverages if beverages could provide the intended effects that they're seeking (i.e., with dosages greater than 10 mg of THC).

Beverages have been profiled as an explosive product category in Canada, likely due to the entrance of alcohol companies into the cannabis industry. However, in US states where cannabis is legal, cannabis-infused beverages account for less than 10% of the total market.[2]

Even though there might be a large percentage who will consume this product, licence holders have to be cognizant of limitations on the place of consumption. Without the ability to legally consume in bars or restaurants, individual purchases will be limited to either online or licenced retail stores. In addition, the existing stores will need to consider refrigeration, storage and allocated space within their footprint to maintain profitability. Factors

[2]Top Ten Cannabis Market Trends for 2019, BDS Analytics. January 2019
https://bdsanalytics.com/wp-content/uploads/2019/01/BDS-Analytics-Top-10-Trends-2019.pdf

like these will affect the ultimate purchasing volume and result in lower-than-expected market share of infused beverages regardless of their popularity.

Low bioavailability, late onset and emulsification are a subset of challenges that cannabis beverage makers will face.[3] However, companies in the cannabis industry are innovating quickly. New product formats and delivery systems are constantly being developed, allowing those who are not as comfortable smoking or vaping to have a potential for a variety of applications.

Building the consumer's knowledge and brand loyalty through purchase influencers

The Canadian market has been structured with a disconnect between the licence holders and the consumers. The customer relationship lies mainly with the budtenders (retail store employees), physicians and third-party publications. With the limitation on marketing and promotion, legacy methods of creating and maintaining brand loyalty are not available. Companies are unable to articulate what is different and special about their brand, and the lack of consumer data results in low levels of supported insight.

The level of in-store education is inconsistent across the country. This is due in part to the patchwork of retail and distribution frameworks across the provinces and territories. In some cannabis retail stores, there are small areas that are dedicated to cannabis education — safe and responsible consumption, short-term and long-term effects associated with cannabis use, ways to reduce the risks of negative outcomes associated with use, cannabis products, accessories and formats, cannabinoids, aromatic components of terpenes, and differences between "indica," "sativa" and "hybrid."

Even with the information that is available through various digital platforms, 70% of customers still reported that they did not know what they were going to purchase in advance of entering a cannabis retail store. Customers were then left to make decisions on the information available in the store and the knowledge and advice of the budtenders.

"The level of in-store education is inconsistent across the country.

[3]"Pharmacokinetics of cannabinoids," McGilveray Pharmacon Inc, and University of Ottawa, August 2005. https://www.ncbi.nlm.nih.gov/pubmed/16237477

The budtender – a prominent influencer during the purchasing journey

Budtenders play a pivotal role in providing education and information to consumers while they are in the store and at the point of purchase. They’re not permitted to recommend products for specific ailments or make therapeutic claims. But, there is still a wealth of knowledge they can offer to help a consumer make a choice that will contribute to a positive cannabis consumption experience among the broad array of available products. As the main source of information for customers within a store, 96% of budtenders believe that the information they provide to customers has at least some impact on their purchase decisions. More than half (56%) of budtenders view themselves as playing an active role in providing information to guide their customers’ experience and purchasing decisions.

The top three questions that get asked of budtenders are:

1. What are the differences between “sativa”, “indica” and “hybrid”?
2. What are products that can be recommended for [specific effects] (e.g., relaxation, sleep, pain relief)?
3. Can you recommend a product?

When customers ask for product recommendations:

85% of budtenders consider their own personal cannabis usage experience and described what types of products they like

77% of budtenders consider the budget price range

58% of budtenders recommend the store’s top-selling products

Many (40%) budtenders reported that their product recommendations are influenced by the brands that have provided product education. The three most cited sources for cannabis product information that they rely on are word of mouth (79%), online product review sites (75%) and product package labelling (71%).

Word of mouth often coincided with discussions with other retail employees regarding fast-selling products. Product package labelling was often referred to when recommending a product to a customer after discovering their familiarity with cannabis and their desired potency (high: >20% THC, medium: 19%-15% THC, low: <14% THC), and whether a product contained CBD.

Given the rapid growth and change in the cannabis industry, budtenders indicated that they would like to receive information and updates on new cannabis products (including consumption information) (94%), overall industry trends (89%), top-selling products (89%) and regulatory updates (85%).

How well informed is the budtender?

Given budtenders' potential to influence, increasing their depth and breadth of knowledge about products and brands should directly increase that of the customers. Budtenders rely on engagement from licence holders to provide product and brand information: 69% reference the information from product display pamphlets and 61% use information from workshops run by licence holders to guide the customer experience.

Majority of budtenders indicated that licence holders have hosted product and brand information sessions at their respective retail locations. These sessions provide the opportunity for licence holders to tell their brand story, provide product education, and give them the chance to differentiate their products from the competition.

Building the consumer's knowledge and brand loyalty through purchase influencers

Awareness of the top 20 cannabis brands varies among budtenders, from low to high. Some advantages, such as being the first movers and indirect press releases about the company, can contribute to name recognition and the sense of trust and reliability. However, the balance of the brands, might be missing the mark because they aren't spending the time with the budtenders and/or customers, educating them about their product, answering the right questions that may be inhibiting a referral because of unfamiliarity. Or they might not be providing the right product to meet the market demands.

As more products become legally available in Canada at the end of 2019, there is greater uncertainty as to how to guide a customer to create an optimal experience or desired outcome. The budtender is the customer representative for all products and it makes sense for them to be well equipped to answer consumer questions that go beyond "what is the difference between sativa and indica?"

Budtenders reported that the top three product categories in terms of consumer popularity are:

1. High THC
2. Lowest Price
3. CBD-only products

> "The budtender is the customer representative for all products and it makes sense for them to be well equipped to answer consumer questions.

These factors are causing some products to be in demand and others to be slow movers. For the latter, stale inventory creates the risk of quality degradation, which can result in sunk costs, potential product returns, dissatisfied customers, scorned retailers who will not reorder the brand or SKU, and unfavourable financial statement write-downs.

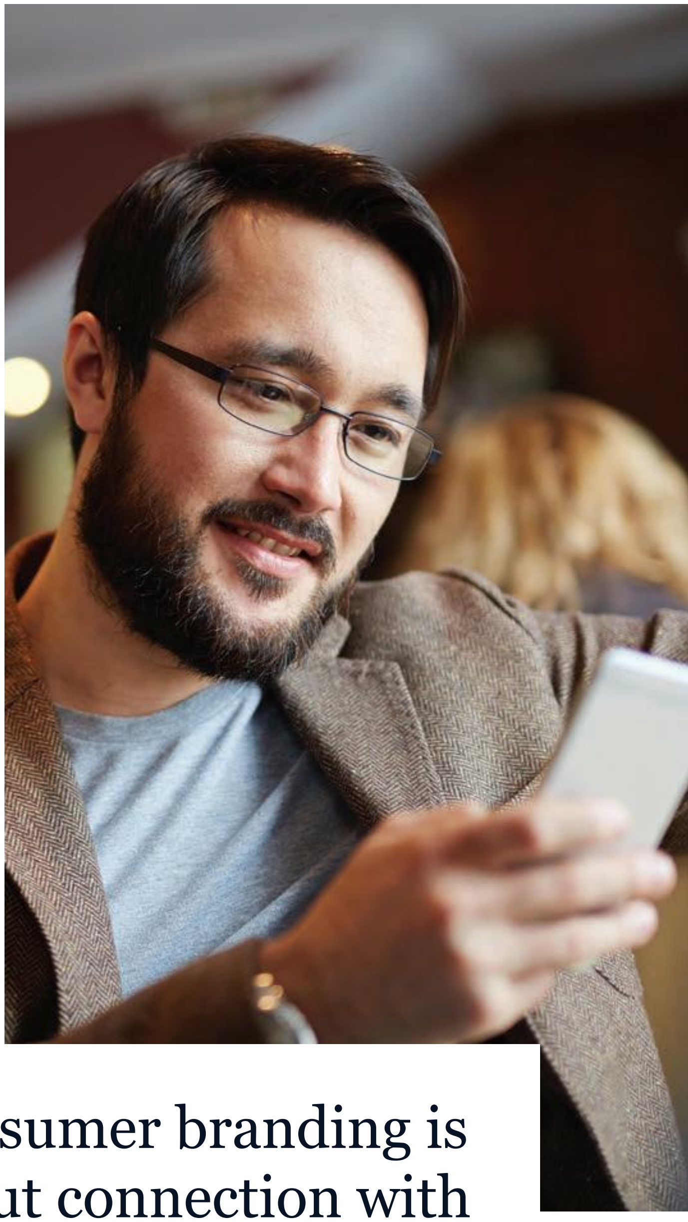
Using a version of the "value, good, better and best" price segmentation framework, it appears that very few licence holders are creating products targeted for the value segment. Licence holders are either not targeting or they are missing products for the value-conscious segment when data supports price as a significant purchase criteria. To adjust to the consumer trends, licence holders should consider shifting their cultivation to genetics that fit this profile or find ways to have more competitive pricing.

There is also an opportunity for licence holders to build their marketing platforms, as permissible under regulatory guidelines. Consumer branding is about connection with customers: understanding who they are and what they value. A significant amount of information can be collected through consumer feedback, insights from retailers and point of sale (POS) data. This information can be used to understand consumer patterns, impacts of price changes, responses to new product offerings, and reactions to messaging and permissible marketing efforts. Having the right data will allow companies to continually find ways to innovate, create value for consumers and build customer loyalty.

Although 2.0 products are not yet legal, budtenders reported that customers are already asking for edibles and extracts on a daily basis. Consumers who fit this profile were willing to try oils and capsules in the place of edibles. These consumers were majority men and their product preference was broken down by age group: younger (extracts), middle-aged (edibles) and older (topicals – CBD only, for pain relief and don't want to "get high").

Based on budtender interactions with customers, the top three products expected to be popular will be edibles (baked goods and confectionery products) (83%), vape pens (48%) and shatter (48%) when 2.0 product portfolios are expected to hit retail shelves. Competition will be high and products will be priced competitively.

Separately, retailers should consider if they have enough shelf space, display areas or designated inventory areas to showcase or store the addition of 2.0 products. Making a brand stand out and draw in the first purchase is one thing – the ability to build a loyal following is more difficult. Licence holders should be thoughtful in their product development and commercialization process and be mindful of not sacrificing quality.



> "Consumer branding is about connection with the customer.

Looking forward with better questions

As Canada gears up for 2.0, it's worth noting that there are many companies in the US that have already launched the full spectrum of cannabis products. These companies have gone through the growing pains of developing their products, their brands and understanding their consumers.

Ahead of legalization 2.0, cannabis licence holders and retailers should consider the following questions:

Customer

1. Do you have the right data to know if you are attracting your targeted segment? Do you have the right data to know what segment you are attracting?
2. For cannabis 2.0, what is your strategic approach: product focused or customer focused?
3. How well are you educating consumers and working with the budtenders to increase brand and product knowledge?
4. Are you effectively teaching consumers without breaching the rules in a strictly regulated market?

Strategy

1. As big, established players enter the market, is innovation your greatest asset?
2. How do you strategically deploy resources to be ready when the new market opens up without sacrificing quality?
3. If you've changed your strategy, can you handle the change in infrastructure needed to meet the new demands?
4. You've planted the seeds for growth – but have you cultivated the right strategy?

Brand

1. As market entrants proliferate, how can you keep your brand from blending in?
2. In a sea of similar products, will you ride the brand wave or be swept under?
3. For cannabis 2.0, will you be ready to seize the potential of a new market?

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