

Expectations for Recreational Marijuana in 2018

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Last November, California passed Proposition 64, the Adult Use of Marijuana Act (AUMA), which would allow the possession, sales, use, and cultivation of marijuana for adult use for those 21 years and older. On January 1, 2018, the state is required to open applications for licenses so businesses can begin legally selling recreational marijuana. By January 1, 2018, California must construct regulations and rules that will govern the state's emerging legal cannabis market, from where and how plants can be grown to setting guidelines to track the plants from fields to stores. The new industry has a projected value of \$7 billion, and state and local governments could eventually collect \$1 billion a year in taxes. Over the next four years, annual legal cannabis sales will grow at a compound annual growth rate of 23.1%, from \$2.8 billion in 2016 to an estimated \$6.5 billion by 2020. This article is the second of a three-part series discussing the Cannabis Industry.

Licensing

As a result of AUMA, tens of thousands of people and businesses will require licensing. The job of overseeing the industry includes issues from protecting water quality for fish in streams near pot grows, to safely collecting hundreds of millions of dollars in taxes from businesses that often operate in cash. The new law calls for nearly 20 different types of licenses, including permits for farmers; delivery services that will take pot to a buyer's front door; testing labs; distributors; and dispensary operators at the retail level.

Three state agencies will regulate the cannabis industry -- the Department of Food and Agriculture for cultivators; the Department of Public Health for manufacturers; and the Bureau of Cannabis Control for retailers, distributors and testers. All license fees will be set on a scaled basis by the licensing authority, dependent on the size of the business. Additionally, the legislation requires the regulatory agencies to limit the number of Type 3 (Medium Cultivation) and Type 7 (Manufacturer 2 - Volatile Solvents). The legislation does not specify whether there will be limits on the number of licenses issued for other license types. Moreover, the three state agencies regulating the cannabis industry proposal will begin accepting applications for temporary business licenses prior to January 1, 2018.

Regulations and Taxes

Regulations for production and sale of adult-use cannabis are set to be in place by the beginning of 2018, and the scope of the introduction is huge, including cultivation, manufacturing, testing, distribution and sales. According to a report from Fitch Ratings, high taxes on legal cannabis in California could have the potential to turn many

consumers away from California's cannabis shops and toward underground activity. Recreational marijuana will be taxed on both the state and local level, contributing to the potential for high rates. California will impose a 15 percent excise tax, as well as cultivation taxes. Municipalities will also levy sales tax and a business tax, which could be anywhere from 1 to 20 percent, on gross receipts. California will implement a statewide framework for marijuana legalization, but each municipality must decide whether it wants to house marijuana businesses and, if so, map out its own regulations and tax structure.

The Fitch Ratings report further indicates that legalization will yield extremely high stakes for parts of California, including the so-called "Emerald Triangle" in northern California - Trinity, Humboldt and Mendocino counties. According to the report, legalization may create large-scale marijuana farms that undercut the small, often family-run operations. The credit rating agency's report also estimates that combined state and local taxes could reach as high as 45% in some areas — higher than any other state except Washington, which levies a 50% tax. The Fitch report warns that "the existing black market for cannabis may prove a formidable competitor to legal markets if new taxes lead to higher prices than available from illicit sources." Lastly, it is predicted that California will see high sales figures at the onset of legal recreational sales in January, but that sales will decline over time. The U.S. cannabis industry is expected to maintain growth over the next four years; revenue projections, earnings, and profit margin data are not available at this time.

Cannabis and E-Commerce

Significant changes are already underway in California for recreational and medical cannabis laws, which will have major implications for the cannabis industry, including e-commerce and delivery services in the state. In general, California will treat cannabis like alcohol, allowing people 21 and older to legally possess up to an ounce of marijuana and grow six marijuana plants at home. The California budget agreement includes \$118 million to finance startup costs for the newly regulated industry, including technology and staff to work on regulations and issue licenses.

There is a growing class of technology companies and marijuana industry insiders that predicts that California will serve as the epicenter for an e-commerce cannabis revolution due to recently passed legislative provisions that state dispensaries are not required to have a storefront. Senate Bill 94, which effectively repeals the Medical Cannabis Regulation and Safety Act was designed to unify California's existing medical marijuana regulations with those for forthcoming recreational sales and will open the doors for more virtual operations. A cannabis retailer can have a discreet licensed and regulated facility out of which to conduct deliveries.

New Frontier Data underscores California's marijuana delivery services as an area with substantial potential for expansion. The growth of e-commerce within the cannabis industry is expected to be explosive. California Growers Association (CGA) estimates that there are over 7,500 cannabis delivery companies statewide that conduct up to 55 percent of the

current medical marijuana transactions. Additionally, according to New Frontier, California's sizable population and economic dominance in areas such as technology, media, and cannabis cultivation are expected to contribute to the modernization, the increased sophistication and the maturation of the cannabis industry. Lastly, notable companies that exhibit the projected growth of the legal and medical cannabis market include: Global Payout, Inc. (OTC: GOHE), Cara Therapeutics Inc. (NASDAQ: CARA), American Cannabis Company, Inc. (OTC: AMMJ), Cannabis Science, Inc. (OTC: CBIS), OWC Pharmaceutical Research Corp. (OTC: OWCP).

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