Deloitte.

Seeding new opportunities
Listening to Canada's cannabis consumer

2021 CANNABIS CONSUMER REPORT

Contents

As Canada enters its third year of legalized recreational cannabis, what's next for the cannabis industry? What are the new growth opportunities for an industry that has reaped the rewards of years, if not decades, of pent-up consumer demand and interest?

Deloitte aims to answer those questions in *Seeding new opportunities,* our 2021 report on Canadian cannabis consumers. The study is based on a nationwide survey of 1,000 such Canadians aged 18 and older, conducted on the firm's behalf between January 6 and 13, 2021. We also included supplementary insights from discussions with retailers and licensed producers, and explored the preferences and behaviours of Canadian millennial and Generation Z cannabis consumers provided by Drop Technologies Inc. Drop is a consumer-led mobile rewards platform that can create on-demand surveys targeting respondents based upon verified in-store and online purchases—in this instance, of cannabis products.

We examined the usage habits and behaviours of three distinct groups of Canadian cannabis consumers—existing, new, and returning—to uncover the most promising growth opportunities for the sector. For this report, *existing consumers* are defined as respondents who had consumed cannabis prior to September 2020 and continue to do so; *new consumers* are those who first experienced cannabis on or after September 2020; and *returning consumers* are those who resumed cannabis use on or after September 2020 after having not consumed it since before October 2018, when it was legalized nationwide.

Overview of findings

We found that existing consumers currently represent the greatest volume growth opportunity for the industry, especially if the legal cannabis sector can successfully attract the sizable number of consumers who continue to buy products from unlicensed sources.

While new and returning consumers also offer growth potential, an effective sales strategy to reach them would link health and wellness with CBD products and cannabis that isn't consumed by smoking (i.e., non-combustible formats).

The 2021 Canadian cannabis consumer report and our discussions with many clients confirmed that, across all cannabis-consumer groups, sales drivers are consistent with those that are fundamental to other consumer-goods categories.

Existing consumers represent the greatest volume growth opportunity

CANNABIS FUNDAMENTALS SIMILAR TO OTHER CONSUMER-GOODS CATEGORIES

- **Product specifics** (i.e., preferred quality in the preferred formats and sizes)
- **Price** that delivers value
- **Location** that's convenient

We hope that these insights spark conversations among cannabis companies as well as industry regulators—and that these talks lead to actions that both drive industry growth and continue to restrict the size and reach of the illicit-market cannabis sector.

Existing consumers represent the greatest growth opportunity

Fish where the fish are

While some might consider the 75% of Canadians who don't consume cannabis as the industry's greatest potential growth market, it is in fact existing consumers who comprise the most significant growth market—accounting for an estimated 75% of the country's cannabis-volume consumption while making up just 58% of the cannabis-using population.[1] New and returning consumers may comprise a sizable 42% of purchasers, but they buy only 25% of the total volume of merchandise. These seeming disparities are primarily driven by usage differences across groups; existing consumers are more likely to imbibe daily (36%) than are those in the new (19%) and returning (21%) groups.

76% of existing consumers who purchase from unlicensed sources say "pricing is better"

More than half (54%) of existing consumers purchase cannabis from legal sources only. One-quarter (26%) say they buy it from both legal and unlicensed sellers; 66% of these so-called dual-source consumers say they buy more than 40% from unlicensed sellers. Canada's legal cannabis industry has made significant progress in curtailing the illicit market, but there's still work to do.

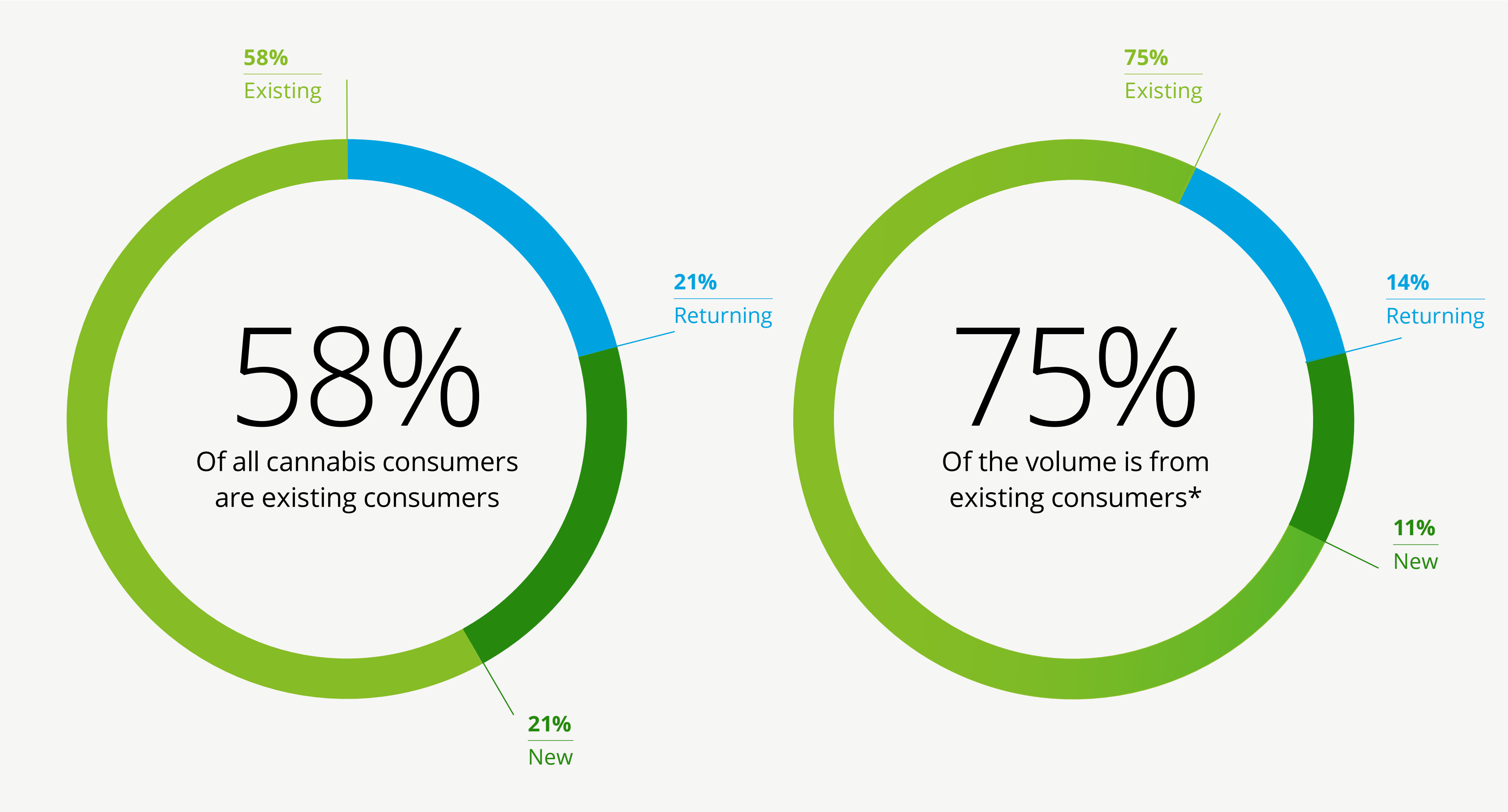
Price is the main reason unlicensed sales continue to thrive, with 76% of existing consumers who purchase from unlicensed sources indicating that "pricing is better" in unlicensed channels. These unlicensed sources are also considered to be more convenient or accessible (37%), to offer better quality (32%), to be more trusted (32%), and to provide a wider range of options (21%).

[1] Volume calculation estimated by Deloitte using data from Burns, Rachel & Caulkins, Jonathan & Everingham, Susan & Kilmer, Beau. "Statistics on cannabis users skew perceptions of cannabis use." Frontiers in psychiatry. November 6, 2013. https://www.frontiersin.org/articles/10.3389/fpsyt.2013.00138/full.

HOME DELIVERY APPEALS TO MILLENNIALS AND GEN Zs

According to Drop, 41% of Canadian millennial and Gen Z cannabis consumers say they've made purchases from unlicensed sources, with 27% of respondents citing fast home delivery as a reason.

Fish where the fish are is apt advice



*Calculation estimated from Deloitte's 2021 Cannabis Survey data and data from the 2013 *Frontiers in Psychiatry* article (erratum version) "Statistics on cannabis users skew perceptions of cannabis use"

Embracing cannabis in all its forms

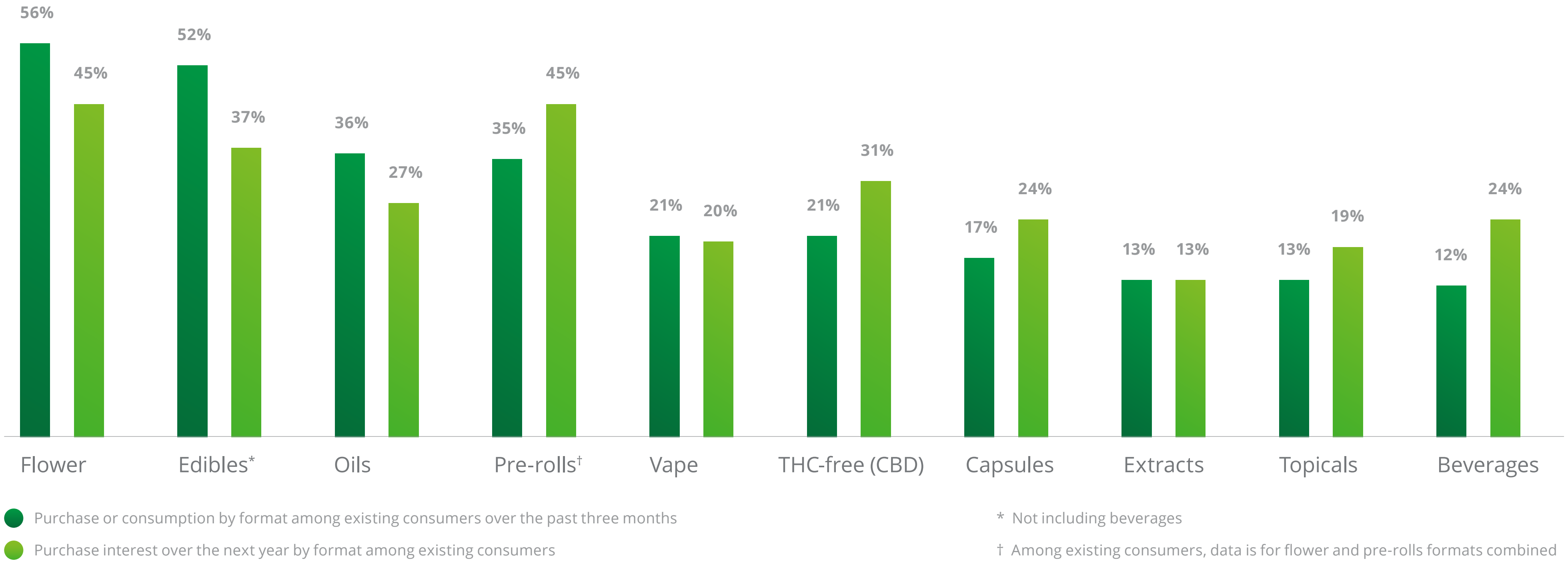
Demand for variety reveals an opportunity to drive growth

Existing consumers prefer traditional products, but they can also be adventurous. More than half said they bought or used cannabis dried-flower products (56%) or edibles (52%) over the previous three months; these products top the list of likely purchases for these consumers over the next year. However, this consumer group also demonstrated interest in trying a wide range of new formats over this same time frame, especially THC-free and CBD products, capsules, beverages, and topicals. Thus, demand for variety reveals an opportunity to drive growth among existing consumers.

CAPITALIZING ON LACK OF BRAND LOYALTY

Drop found that 71% of Canadian millennial and Gen Z cannabis consumers currently buy multiple brands or try new ones. This lack of brand loyalty means there's plenty of opportunity for cannabis companies to make inroads into the market.

Existing consumers prefer traditional products, but they can also be adventurous, showing interest in multiple formats



* Not including beverages

† Among existing consumers, data is for flower and pre-rolls formats combined

Improving sleep and relieving stress and anxiety are key drivers for existing consumers

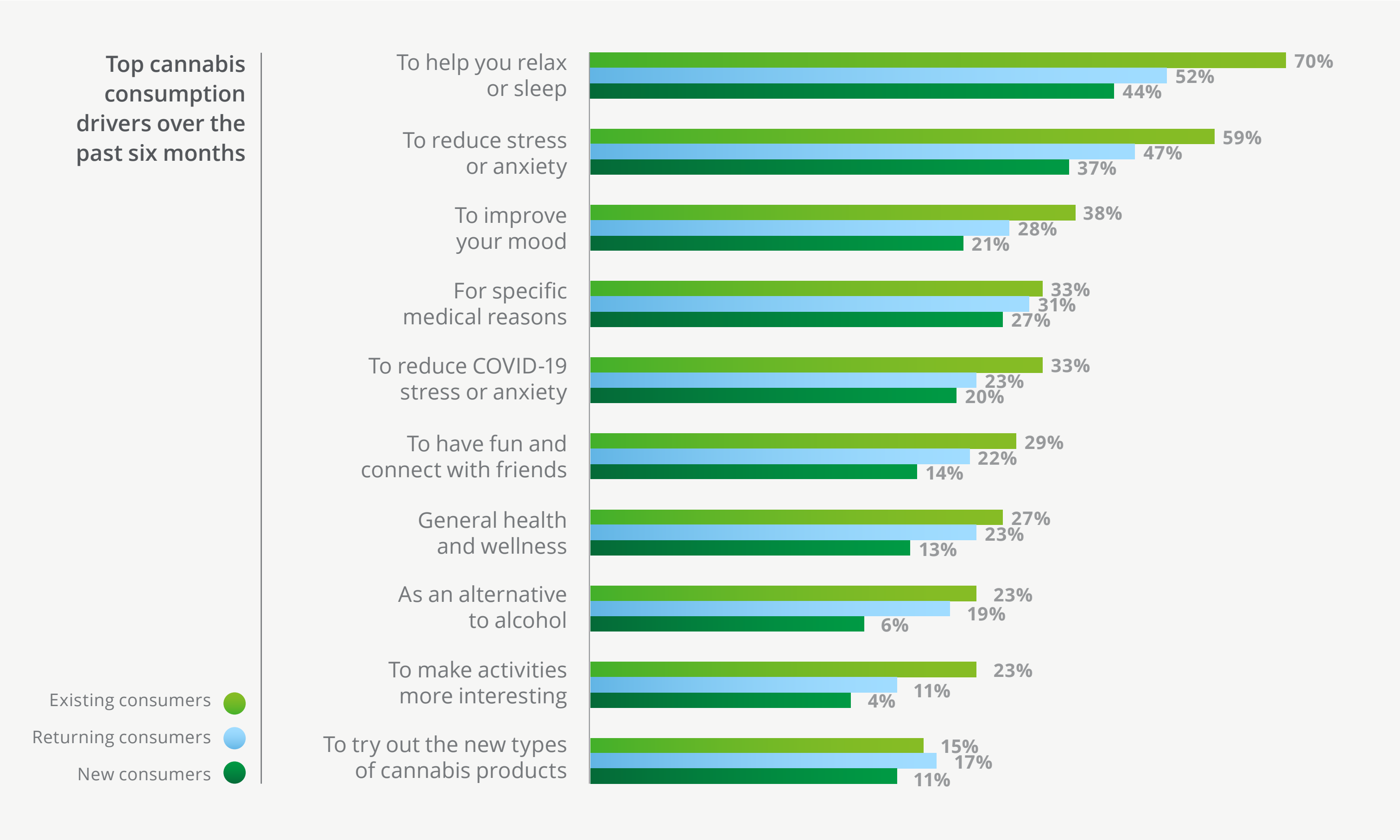
Those in this group are crystal clear about their reasons for using cannabis, with 70% consuming these products in the past six months to help with relaxation or sleep and 59% doing so to alleviate stress or anxiety. Other drivers include improving mood (38%) and easing specific medical conditions (33%). Considering these needs could prove a winning approach for cannabis companies.

In our 2018 survey, a key consumption driver for more than half (58%) of all cannabis consumers was having fun and connecting with friends; this statistic dropped to 23% in our 2020 report and edged up to 25% this year. We'd expect this social factor to continue to gain momentum as more and more Canadians receive COVID-19 vaccinations and, hopefully, gatherings become more common as a result.

70%

of exisiting consumers use cannabis to help with relaxation or sleep

Improving sleep and relieving stress and anxiety are key drivers for existing consumers



Quality starts with THC, but it doesn't end there

Tetrahydrocannabinol (THC) and cannabidiol (CBD), above all, matter to the discerning buyer: 64% of existing cannabis consumers say THC and/or CBD proportions are key measures of quality. Roughly one-fourth (26%) of these favour THC-only offerings, while more than half (56%) prefer both THC and CBD products, either in combination or separately.

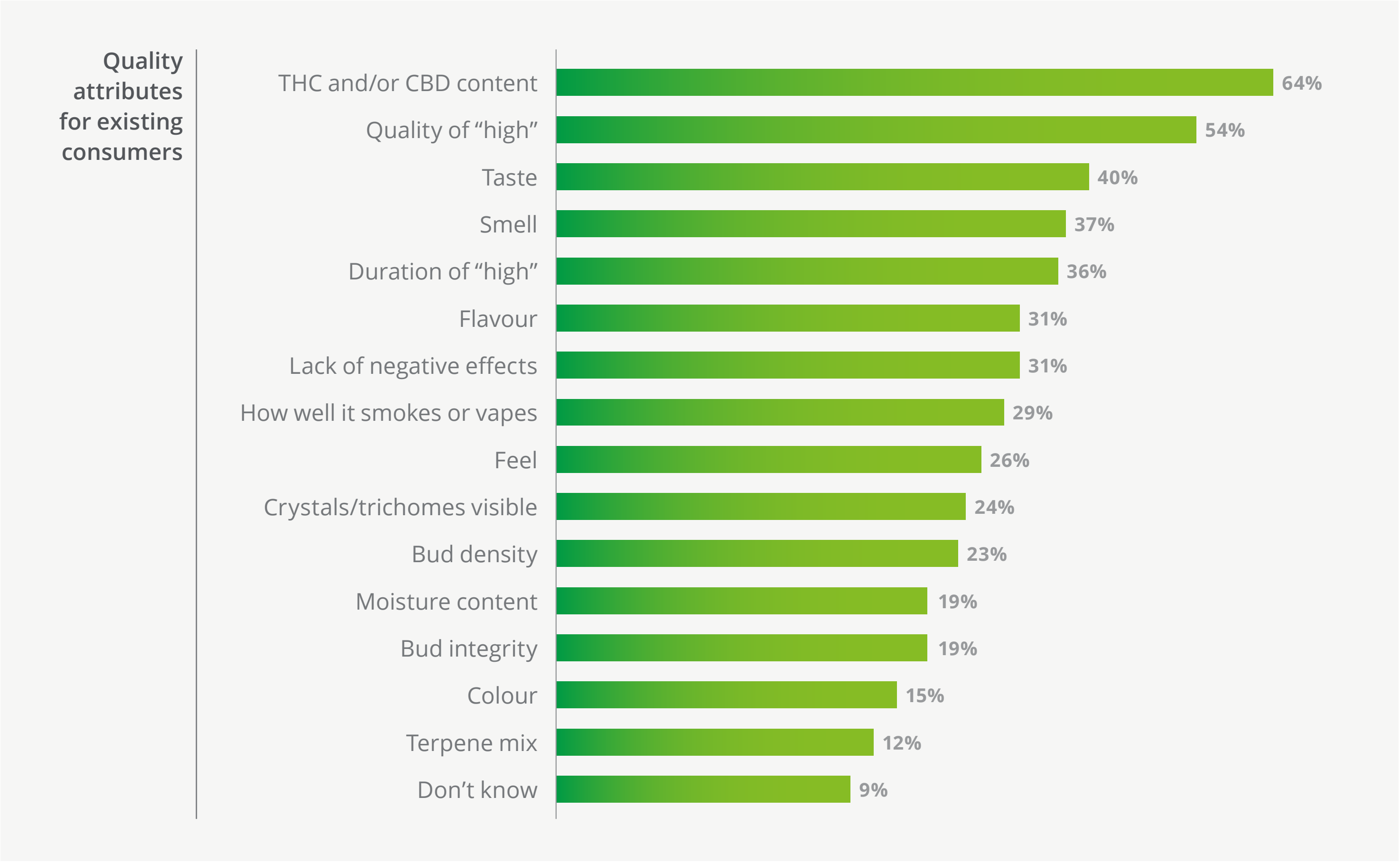
Existing consumers also make sensory evaluations when assessing product quality. These considerations generally fall into two categories: the physical properties of a product—e.g., taste, smell, colour, bud density—and the full cannabis-use experience—e.g., the quality and duration of the high is important, but these consumers also assess the presence or absence of negative effects.

Once existing consumers find a strain or product they like, they are often loyal—but they are also willing to try something new. 29% of these respondents say they prefer strains they already know and enjoy, 37% favour a combination of known and new strains. Again, offering variety—here, in the form of available strains—represents a key opportunity to drive growth among existing cannabis consumers. Ensuring that product portfolios include both tried-and-true strains and new ones that consumers can test will be crucial to building brand loyalty among variety-seekers.

EXISTING CONSUMERS' SOPHISTICATION COULD PAVE THE WAY FOR PREMIUM OFFERINGS

Experienced cannabis users' refined, nuanced views on quality as well as their receptiveness to new products could open the door to cannabis companies developing and introducing premium products. According to Drop, as long as cannabis consumers believe higher-end offerings provide sufficient value for the price, 86% of them are likely or very likely to buy these products.

Existing consumers use all their senses to evaluate quality



Existing consumers prefer THC or a combination of THC and CBD, while new users are more likely to prefer CBD

Cannabinoid preference among consumers

	Existing consumers	Returning consumers	New consumers
THC only	**26%**	13%	15%
THC and CBD	**56%**	**54%**	36%
CBD only	10%	22%	**39%**
Other / Don't know	7%	11%	10%

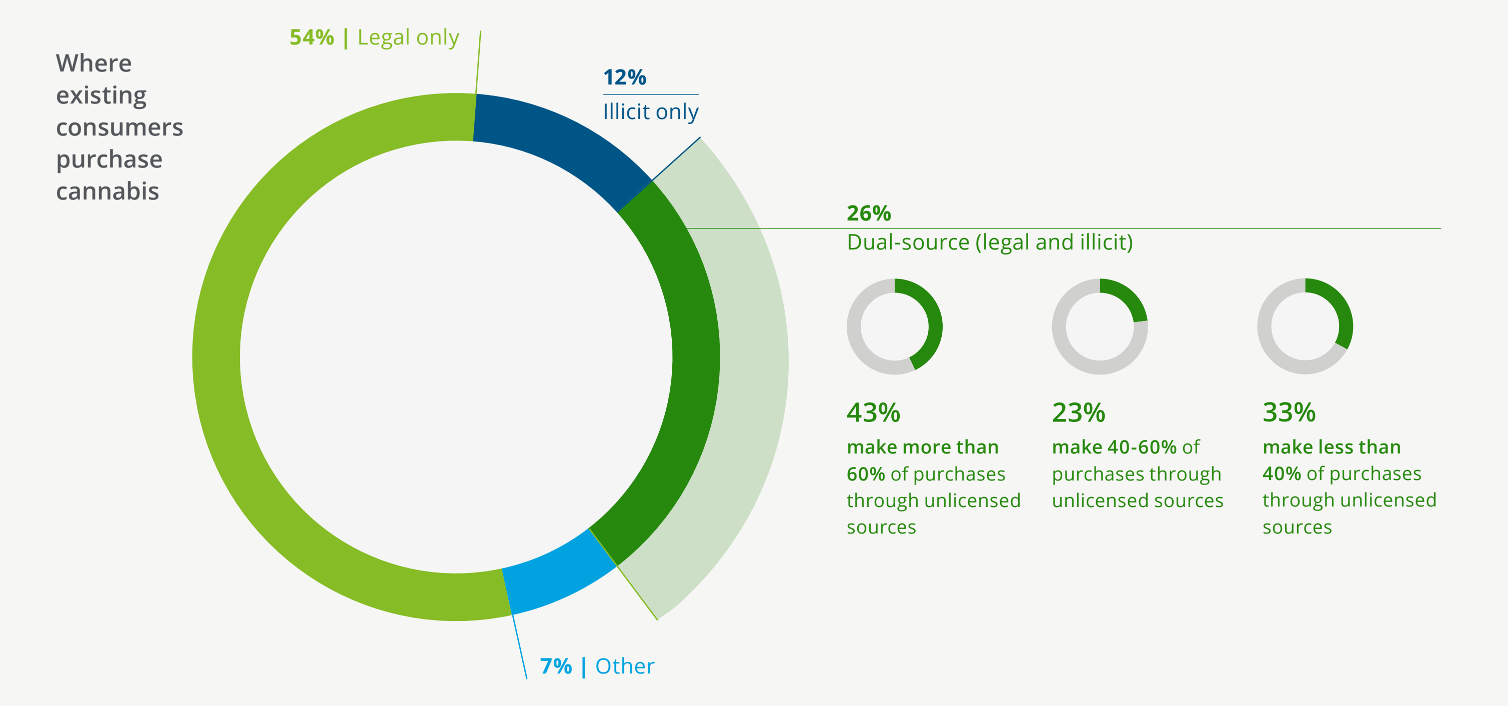
Experienced consumers seek a combination of familiar and new when selecting strains

Strain preference among existing consumers

Strain preference	All consumers	Existing consumers	Dual-source shoppers
Strains I know and enjoy	31%	29%	26%
New strains to try	11%	7%	10%
A combination of known and new strains	28%	**37%**	**42%**

Existing consumers buy from both legal and illicit sources

Twenty-six percent of existing consumers shop from both legal and illicit sources. And, almost half of dual-source consumers purchase more than 60% of their cannabis from unlicensed sources.



Top illicit-market drivers

- **76%** Price is better or lower
- **37%** Unlicensed source is more accessible/ convenient
- **32%** Quality is better
- **32%** I trust my preferred unlicensed source
- **21%** There are more options for the types of products I can buy

Quality and price are key to convert dual-source cannabis consumers

Redirecting buyers from the illicit market to licensed sellers is a significant way to boost growth in the short term. But to do so, cannabis companies will need to offer higher-quality products, greater variety, competitive pricing, and a convenient shopping experience.

Nearly half (45%) of existing consumers say that a good-quality product is the top non-price factor that could convince them to choose legal sources; 28% also say that, specifically, higher THC content could persuade them. Roughly one-fourth (27%) would make the switch if there was more product variety, and the same proportion would do so if there was convenient home delivery.

Some survey respondents cited lack of trust in government-run retailers as personal barriers to engaging with the legal market.

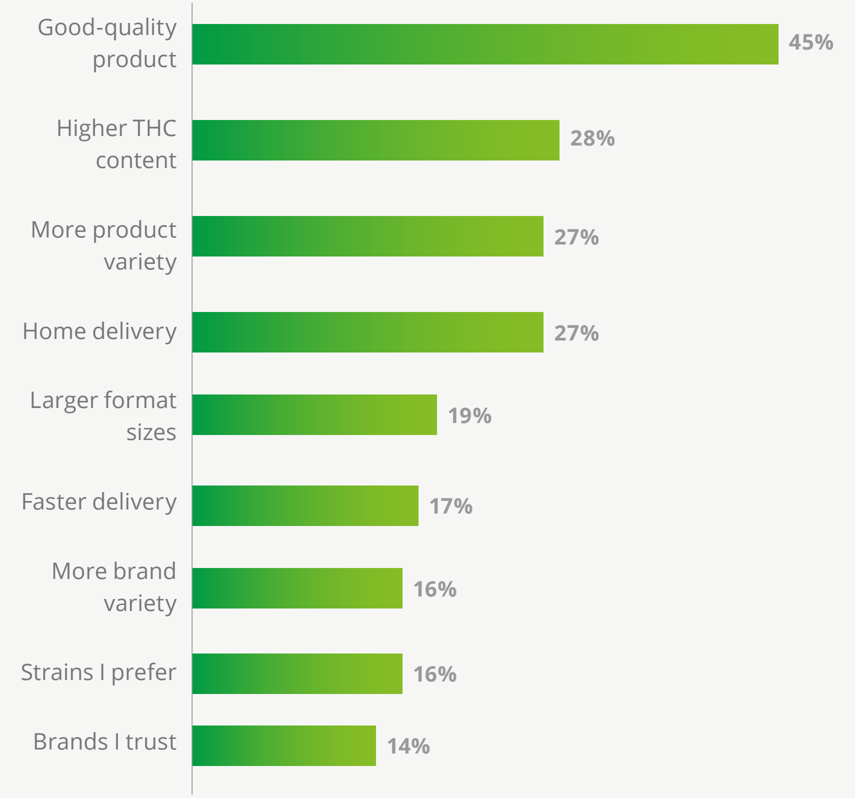
Our research suggests that, rather than requiring these potential consumers to buy from government facilities, if private legal vendors were allowed to sell online (and to deliver), this would substantially encroach upon the unlicensed market: 77% of existing consumers—and 83% of all illicit-market buyers—support e-commerce for private retailers.

Accordingly, it's imperative for cannabis companies to explore more closely how unlicensed-market buyers, especially dual-source consumers, define value and to develop strategies to meet these consumers' demands in order to fully capture this target segment. If governments and the industry can work together to shift the cannabis sector toward e-commerce/home-delivery, the results could drive significant growth while weakening the illicit market.

EDIBLES AND BEVERAGES DRIVE CONVERSION TO LEGAL MARKET

According to Drop data, 42% of those who've purchased illicit-market cannabis report they now frequently buy edibles and beverages from licensed sellers. However, 33% haven't yet made the switch, because they believe these specific products are more expensive—or available in fewer options—from legal retailers.

Top non-price drivers for conversion to the legal market for existing consumers purchasing from the illicit market



77%

of existing consumers support private e-commerce (v. 57% new users)

83%

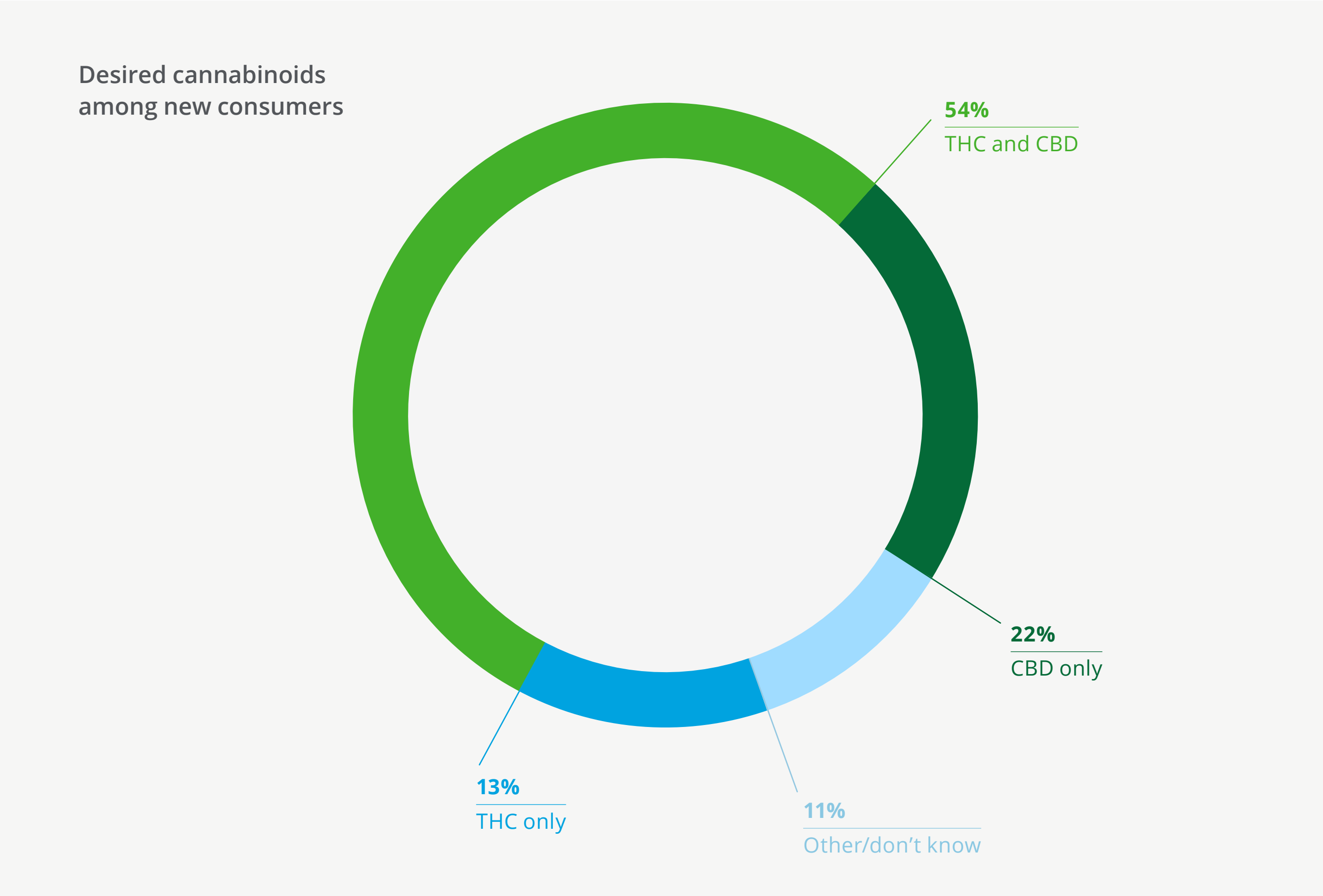
of all illicit-market buyers support private e-commerce (v. 67% legal-market buyers)

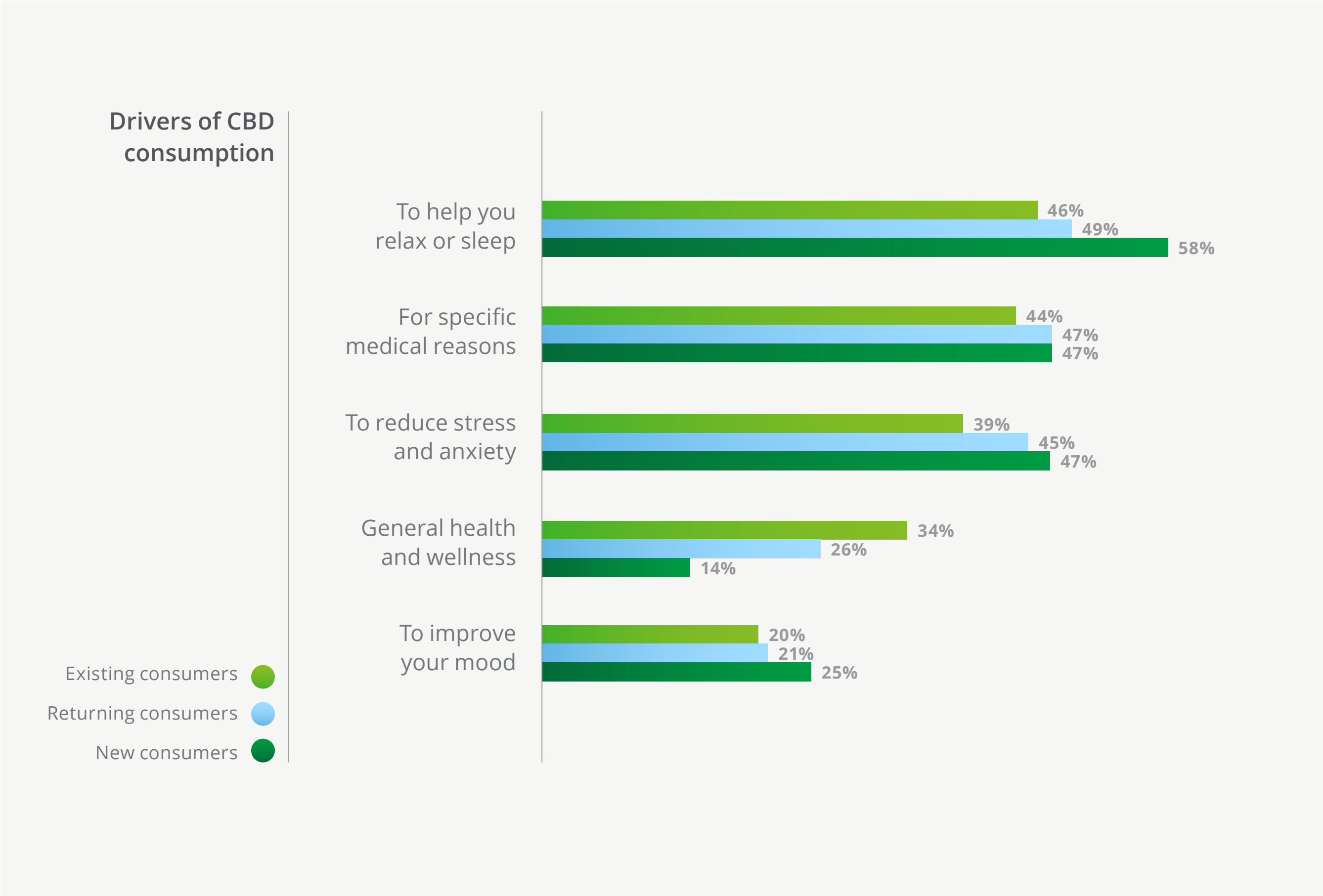
New and returning consumers focus on health and wellness

New consumers favour CBD, while returning ones opt for both CBD and THC

New cannabis consumers display slight preferences for CBD-only products (39%), while 36% are partial to a combination of THC- and CBD-based offerings. A significantly smaller proportion (15%) favour THC-only products. For returning consumers, the majority (54%) want a selection of THC- and CBD-based products, compared with 22% in the CBD-only camp and 13% who prefer THC alone.

There is a clear preference for CBD-based products





The quest to address insomnia, medical conditions, and stress drives consumption

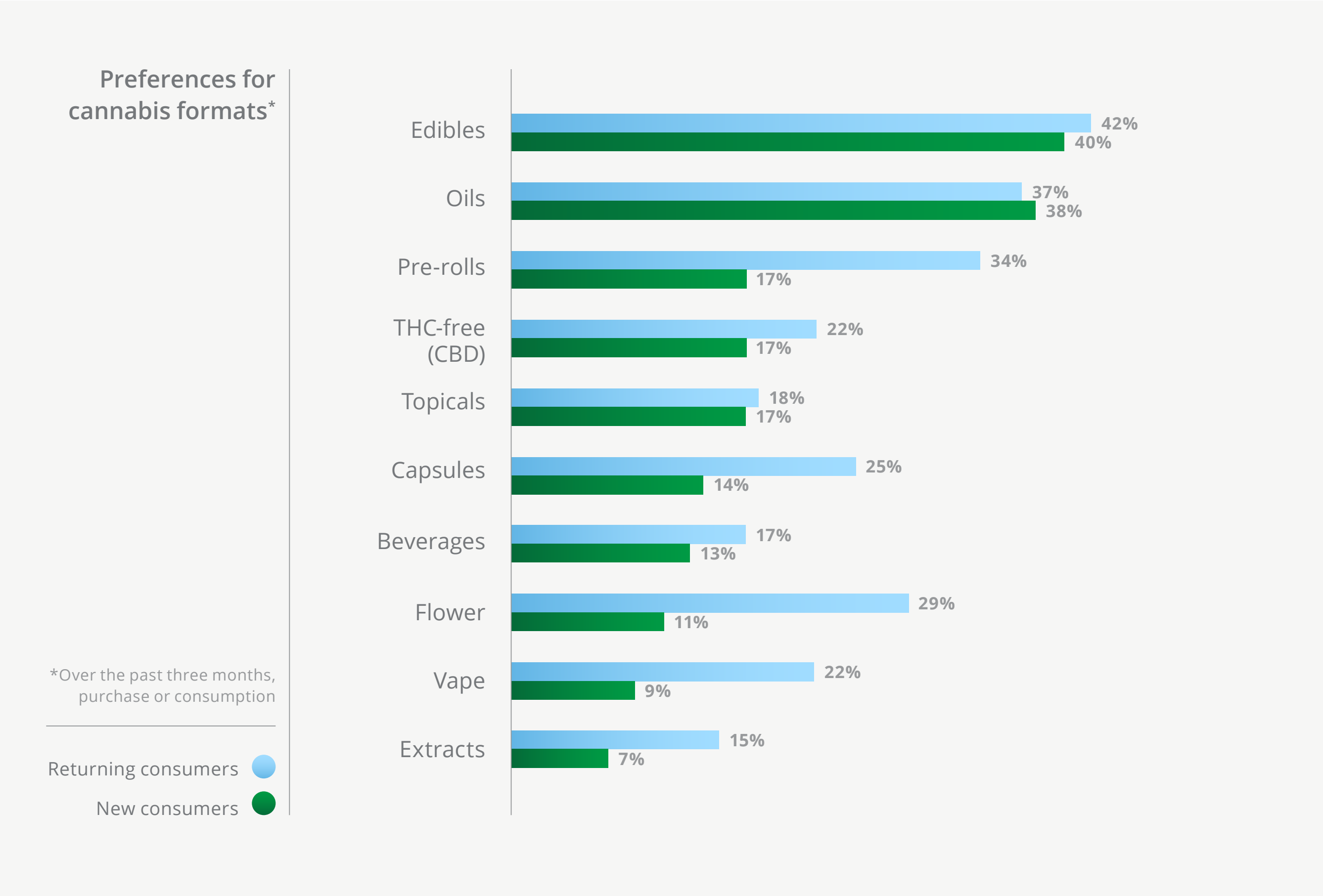
While new and returning consumers may prefer cannabis products featuring CBD, their reasons for consuming them are similar to those cited by existing consumers. More than half (58%) of new and 49% of returning consumers use cannabis for sleep and relaxation, while 47% of both these groups imbibe for specific medical reasons. Similarly, 47% of new and 45% of returning consumers say they use cannabis to reduce stress and anxiety.

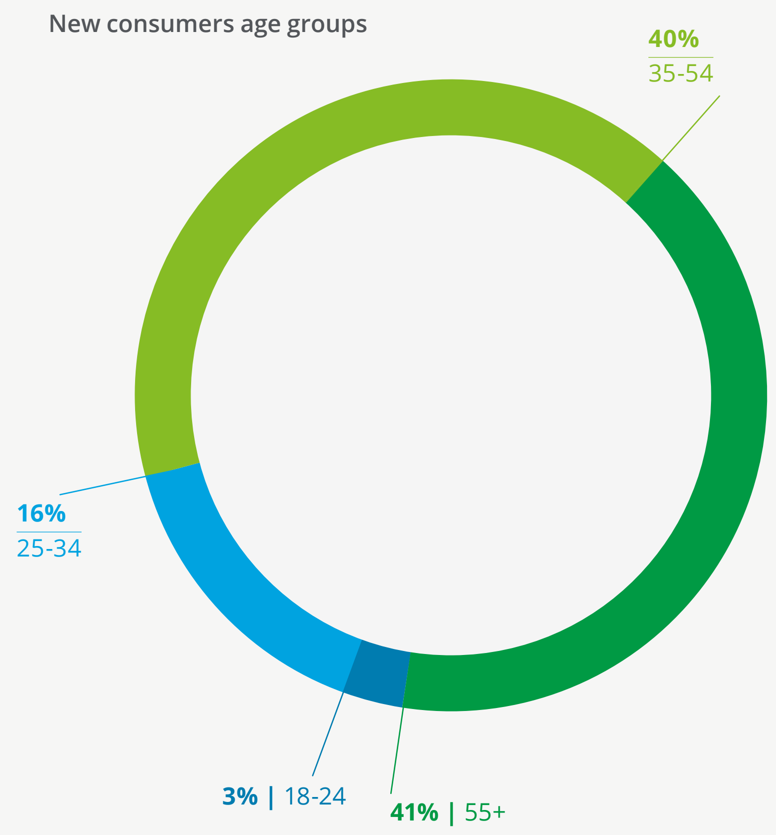
Sleep, relaxation, medical conditions, and stress relief drive cannabis use among new and returning consumers

Giving combustibles a pass

New and returning consumers demonstrate clear preferences for cannabis products that aren't smoked. In fact, over the three months prior to being polled, 40% of new and 42% of returning users say they bought or consumed edibles, with these numbers at 38% and 37%, respectively, for oils. In contrast, only 11% of new consumers bought or used dried-flower products over this three-month period, compared with 29% of returning consumers and 56% of existing consumers.

Edibles (including oils) are important for new and returning consumers, while those who are returning also like flower and pre-rolls





46% Women
54% Men

21%
over 65+ (compared to 13% of returning and existing users)

26%
are retired (compared to 17% of returning and existing users)

29%
hold a graduate degree (compared to 26% of returning and 16% of existing users)

New consumers are older, well-educated, and health-focused

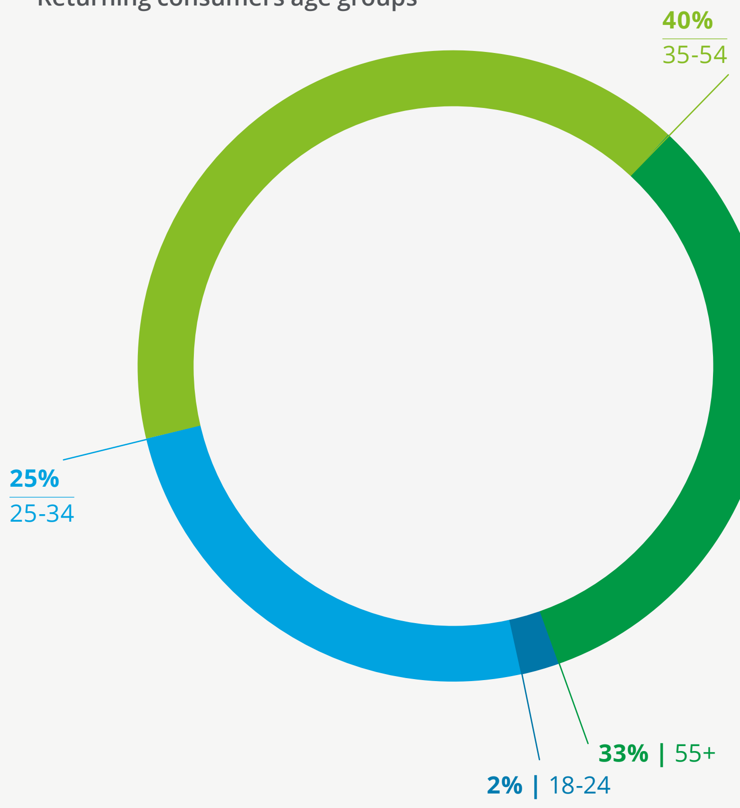
Of the new consumers group, 80% are aged 35 or older—with 40% each in the 35–54 and 55-plus age groups, and one-fifth aged 65 or older. This group is also well-educated, with 29% having completed a graduate degree.

New consumers prefer to shop in-store from legal sources (82%), keeping both price and quality top of mind. They also tend to be light consumers: only 19% say they use cannabis daily. Additionally, similar to existing users, new consumers judge quality in terms of a product's physical attributes and the consumption experience itself: chemical makeup (e.g., THC and CBD proportions), taste, and, most importantly, an absence of negative effects associated with quality.

Not all returning consumers are the same

These buyers make up a curious but diverse group: some behave like new consumers (they're relatively light imbibers; just 21% claim daily use); others, like existing consumers. They tend to be younger than new consumers, with 25% aged 24–34; but, like that group, they tend to be well-educated, with 26% having a graduate-school education. The majority (71%) buy from legal sources and tend to seek convenience, shopping online if possible. Like new consumers, they generally prefer edibles and oils but, similar to their existing-consumer counterparts, are open to combustible formats, primarily pre-rolls (34%, as compared with 35% of existing consumers). Like the other groups, returning consumers evaluate product quality in terms of physical characteristics (e.g., taste, smell, appearance), but the full experience also matters—for example, like new consumers, they prefer to avoid negative effects.

Returning consumers age groups



44% Women
56% Men

25%
aged 25-34 (compared to 16% of new users)

59%
work full-time outside the home (compared to 51% of new users)

26%
hold a graduate degree (compared to 29% of new, and 16% of existing users)

Key take-aways

There’s no shortage of growth opportunities for Canada’s cannabis industry. Realizing this potential will require a deep understanding of today’s consumers as well as dedicated action. This year’s survey results and our ongoing conversations with leaders across the cannabis industry lead us to four significant insights for the growing sector ⟶

Evaluate quality through consumers' eyes

To cannabis consumers, quality may start with chemical makeup (e.g., proportions of THC and CBD), but it certainly doesn't end there—so understanding consumer needs is essential. With multi-sensory approaches to evaluating cannabis quality, consumers assess products in two additional key ways. First, they use most of their primary senses—they consider look, smell, feel, and taste. Next, they assess the overall user experience: those in the existing consumers group focus primarily on the quality and duration of the high; new consumers mainly prioritize avoiding unpleasant effects; and returning consumers seek products that provide the best of both worlds.

Although some cannabis companies currently evaluate quality in technical terms—with a focus on THC—few, if any, consider other quality attributes and value in terms of consumer perception. As our research shows, because of this oversight, industry businesses are missing a huge opportunity to refine their pricing, upgrade their communication and branding strategies, and develop premium products that consumers will choose over the offerings of competitors.

Existing consumers focus on the quality and duration of the high; new consumers prioritize avoiding unpleasant effects; and returning consumers seek products with the best of both worlds

Use price, quality, and convenience to drive growth and curb the unlicensed market

Dual-source cannabis consumers have shown they're willing to buy from licensed sellers, representing a substantial short-term growth opportunity for the industry. Investing in studying this segment of the consumer population will help to clarify relevant motivational and behavioural drivers.

Better pricing remains a key advantage for the unlicensed market, despite the legal industry's progress in narrowing the price gap. Cannabis companies therefore need to continue prioritizing pricing in their business strategies if they're to continue to draw sales volume away from unlicensed sources. But pricing isn't exclusive to price: Our research shows that consumers are willing to pay a premium for products they consider to have value. Thus, building value and delivering on quality will be crucial to developing successful pricing plans. Moreover, given that continuous improvements to a firm's operations may help drive down production costs and protect the bottom line—especially in a volatile price market—cannabis companies must also consider operational costs in their pricing strategies.

Much more can be done to persuade consumers to seek legal sources. First, industry leaders will need to be meticulous in understanding consumer behaviour and demographics—e.g., where and how potential clients live, from whom they buy cannabis (i.e., private versus public sellers), points of sale (such as online sites and in person at bricks-and-mortar locations). This also means working closely with retailers and using data-driven insights and operational efficiencies to improve consumer experience at points of sale, all with the aim of becoming preferred suppliers.

Cannabis companies must also consider operational costs in their pricing strategies

Enabling private retailers to sell cannabis online would greatly improve the perceived convenience of legal-channel shopping for those who otherwise favour unlicensed sellers. Moreover, distinct strategies for online and in-person shopping experiences can allow retailers to better understand the preferences and purchasing habits of increasingly sophisticated consumers in order to reach them more easily. Additionally, further research can help identify how product categories might be used to drive ordinarily illicit-market consumers to the legal market.

Recognize that innovation will be vital to meeting consumers' demands

Because consumers' preferences and their interests in merchandise and strain variety are ever-evolving, cannabis companies will need to invest in optimizing their product portfolios and in ensuring they have established processes that will allow them to continually foster innovation, in areas from genetics and cultivation to sales and marketing. They can use proven processes and targeted consumer-group analyses to guide those innovation strategies—which should focus on cannabis-strain genetics and new offerings—all with the goal of improving business outcomes, maximizing innovation success, accelerating speed to market, and making better use of limited human, capital, and financial resources.

Cannabis companies must also be tactical regarding the consumer segments and product categories on which they'll focus, fully understand these targets, and continually reassess their pipeline and innovation strategies.

And even though CBD and health-and-wellness development don't currently represent big growth opportunities, it may be tactical for businesses to devote a portion of their resources to these areas; alternately, companies can maintain their current focus on augmenting their operations regarding THC-based cannabis strains and products.

Businesses across the industry should also consider how their innovation strategies might affect product quality, variety, consistency, and pricing—key factors that influence consumers' perceptions of specific cannabis brands and items. Companies are thus likely to benefit from establishing consumer standards and then reassessing them as required by a rapidly evolving market.

The challenge for cannabis companies will be to determine whether their cultivation and processing facilities and operations are adaptable enough to carry out the consumer-focused, innovation-driven strategies needed to meet consumer demand.

Think about tomorrow's cannabis consumers today

Existing cannabis users may currently be the primary consumer source of growth for the industry, but long-term expansion is likely to depend on new and returning consumers, given the relatively large segment these consumer groups represent. Businesses need to be tactical about capturing the attention of these two groups, all the while working to ensure they don't underprepare for the growth potential these consumers represent, given their developing preferences and behaviours.

Similarly, it seems highly likely that cannabis non-combustibles and health-and-wellness products now represent the industry's greatest long-term growth potential in terms of merchandise. While companies act on the three key take-aways explored earlier in this report, it's imperative they also prepare for the long-term future of the industry.

Considerations for the cannabis industry

Be consumer-centric

Understand a client's needs and develop consumer-focused strategies to enhance product quality and promotion.

Learn how consumers define value

Work closely with retailers to understand how buyers use data and insights to make pricing decisions.

Know the target consumer

Identify points of sale (online or in-person) and suppliers (bricks-and-mortar, government, and/or private retailers), and include every aspect of production and distribution to improve visibility, build awareness, and test new offerings.

Invest in finessing product portfolios

Portfolios represent the most important marketing elements a company has.

Lead through innovation and improvement

Use proven methods to promote innovation from top to bottom, and then continually reassess operational efficiency.

Contact

Dale Hooper
Partner, Risk Advisory
Deloitte
dahooper@deloitte.ca

Acknowledgements

Adrian Rodriguez
Manager, Risk Advisory

John MacLeod
Senior Manager, Financial Advisory

Mary Beth Williamson
Practice Lead, Risk Advisory

Rishi Malkani
Partner, M&A Advisory
Cannabis Leader

Sean Delsnider
Senior Manager, Financial Advisory

Brittany Trumper
Senior Manager, Financial Advisory

Dan Bogdanic
Specialist, Risk Advisory

Peter Nashed
Senior Manager, Consulting

Deloitte.