

# Profiting in the Cannabusiness Recreational Marketplace



# Handbook

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# Profiting in the Recreational Cannabusiness Marketplace

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# Introduction and Overview

When voters in Colorado and Washington approved recreational marijuana laws in November 2012, they opened the door for a brand new, billion-dollar industry in the United States: legalized retail sales of cannabis products to adults for personal consumption.

In the days and weeks that followed these historic votes, the jubilation of advocates and entrepreneurs alike was palpable. Business professionals across the country sat up and took notice of the possibilities created when America's most popular illicit substance is brought into the lime-light.

However, the excitement of experienced marijuana entrepreneurs – those who had set the stage for legalization by developing functioning medical cannabis markets within their own states – was strongly tempered by caution. After all, the growing, processing and selling of cannabis and its derived products remains illegal under federal law. And the federal government has not historically displayed a welcoming and respectful attitude toward state cannabis laws, even those crafted around compassionate uses.

On Aug. 29, 2013, the U.S. Department of Justice soothed concerns of hopeful business owners. In an open memo to all U.S. attorneys general (the so-called 2013 Cole Memo), the federal government provided a framework under which state-legal recreational cannabis businesses would be allowed to operate. As long as they obeyed their state laws and some fairly common-sense federal guidelines, the industry was implicitly given the green light to proceed.

In the months since the Cole Memo, entrepreneur and private investor interest in the industry has exploded. Capital is flowing in, new companies are launching, and existing companies and non-profits are expanding. State agencies in Colorado and Washington State have been flooded with inquiries from would-be cultivators and retailers. Several other states are exploring paths to create their own cannabis markets. Business people across the country scrambled to meet each other and learn more about the opportunities, with ticket sales for the industry's annual trade show, the National CannaBusiness Conference & Expo, selling out a full month before the event.

Thanks in part to heavy media coverage of the burgeoning industry, public perceptions of cannabis legalization have never been more positive. More than a dozen additional U.S. states are on a path toward potential legalization in the next few years. Some expect the entire nation to legalize marijuana within our lifetime.

In a country still buffeted by economic downturns, the possibility of a potential new multi-billion-dollar industry – especially one with high built-in consumer demand – is extraordinarily welcome. However, the industry has unique challenges and very high regulations at all levels of government – from federal to state to local – that make entrepreneurial dreams harder to achieve than one might expect on the surface.

The purpose of this Handbook is to shed light on both the opportunities and challenges ahead for a wide range of business niches that could profit, including:

- Cultivation
- Retail Sales
- Edibles and Infused Products
- Real Estate
- Marketing and Advertising
- Business Consulting
- Security and Alarms
- Payment Processing
- Packaging
- Insurance
- Smoking Paraphernalia
- Testing Labs

If you are considering launching a new business, expanding your current business to take advantage of the recreational opportunity, or playing a role as a financial backer of a cannabusiness, use this Handbook as your guide to evaluate the reality of the opportunity.

## Medical Marijuana vs. Recreational Marijuana

First legalized by California in 1996, with 20 states and the District of Columbia following suit in more recent years, medical marijuana (MMJ) laws allow for the cultivation and sale of cannabis to licensed patients. Patients medicate with their choice of smokable, edible, or infused cannabis products, in order to treat conditions ranging from chronic pain to post-traumatic stress disorders to chemotherapy-related nausea.

Recreational marijuana is that sold to U.S. adults in legal states for use beyond specific medical conditions, ranging from intoxication to relaxation to health maintenance. Recreational consumers do not need a patient license to purchase cannabis.

Each state's laws are different, often extremely so, and the laws range from allowing business to flourish or effectively strangling it. (For state-by-state specifics, see our Marijuana Business Factbook.) One commonality: The most stable markets are the most highly regulated, and many states either currently have or are trying to move toward a highly regulated and restricted industry.

In 2013, U.S. MMJ sales were an estimated \$1.3-\$1.5 billion. This total does not reflect the true marketplace potential for MMJ states, but rather what was sold under often-prohibitive conditions. The true U.S. medical marijuana market is estimated to be many billions of dollars larger.

The market size of the legal recreational cannabis industry remains to be seen.



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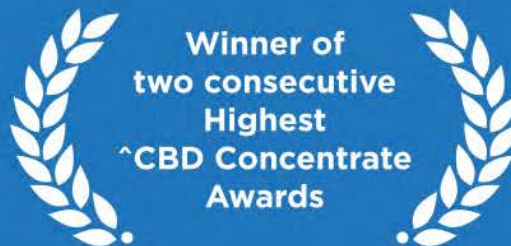
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# Chapter 1

## The Recreational Cannabusiness Opportunity

It's easy to see why entrepreneurs and investors are flocking to the cannabis industry. Based on available data, we estimate that if recreational cannabis was legal in all 50 states, it would generate at least \$46 billion annually. To put this in perspective, the U.S. beer market grosses approximately \$96 billion.

This estimated \$46 billion doesn't include the entire current black market, which is certainly far larger. That's because experts think it could take some years for legal retailers to gain market share in states where the black market has flourished for nearly 100 years.

Plus, the \$46 billion only accounts for retail cannabis sales. Tens of billions of additional dollars in business opportunities would be added to the total economic impact, due to the many ancillary industries that make the retail market possible – from accounting services to security systems. See sections further in this Handbook for details on the recreational opportunity for many important niches.

Lastly, this \$46 billion does not account for market size increases due to new product categories. Just as the consumer packaged goods (CPG) industry increases as new product types are launched, the cannabis market is poised to explode due to a range of potential product types.

### Current state market sizes

How big will the recreational market be? While estimates vary, *Marijuana Business Daily* predicts the Colorado market will hit \$1 billion in sales annually when the market is fully functional. For 2014, sales could come in around \$500 million, as it will take some time for more recreational shops to open and

### Marijuana vs. Cannabis

"Cannabis" and "marijuana" are interchangeable terms. Cannabis is the correct scientific name of the plant that produces the buds from which the psychoactive chemical THC (and other non-psychoactive compounds) is derived. Cannabis is the term preferred by industry professionals, botanists and scientists. The word "marijuana" is more commonly used by the general public, and it was popularized in the 1970s by anti-drug propaganda efforts. We use both terms editorially, but tend to prefer cannabis because it does not have a past history of pejorative use.

The term "cannabusiness" is a fairly new one and refers to any business directly involved in the cannabis industry, ranging from retailers to consultants.



<b>Cannabis vs. Other Industries</b>	
<b>Industry</b>	<b>Annual Revenue</b>
Beer	\$96 billion
<b>Recreational marijuana*</b>	<b>\$46 billion</b>
Wine	\$32 billion
Coffee and tea	\$11 billion
<b>Recreational marijuana in CO and WA **</b>	<b>\$2 billion</b>
Medical marijuana sold by dispensaries	\$1.1-\$1.2 billion
Doughnuts	\$700 million
* Estimate if legalized for general use nationwide (including CO and WA)	
** Estimates based on fully functioning marijuana market	
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for customers to develop tastes for the new products. Still, the 2014 sales estimate is higher than the \$329 million in medical marijuana sales Colorado generates annually. While Colorado's medical marijuana marketplace was extensive, it was imperfectly policed. In spite of the higher taxes applied to recreational sales, some portion of its existing MMJ marketplace sales could be cannibalized by the new retail availability.

Regardless, the total Colorado cannabis marketplace will be far larger than the MMJ market was alone. This is due to new customers ranging from tourists to law-abiding citizens. Initial January 2014 sales reports have already borne this out. According to these reports, the state's then-open 37 retailers sold \$1 million on the very first day of recreational sales. The market is expanding significantly, rather than just attracting existing MMJ customers in new ways.

Washington State's first recreational retail stores may not open until early summer 2014. Existing sales projections from the state's own research indicate its recreational sales will approach \$1 billion in a fully functioning market. However, these estimates presume legal retail only gaining 15-25% of the total market from the existing black market. The state has also limited the amount of space that cannabis growers can use for crops – which may create an artificial supply-side strain on the market. And only 334 licensed retail facilities will be allowed to sell marijuana. The cap could likely keep the market smaller than initial projections.

Still, initial revenues could hit \$500 million annually under Washington's current rules.



## Key predictors of recreational sales

As new states legalize recreational sales, each market's recreational laws will almost certainly differ – just like with MMJ. The key predictors to gross cannabis sales potential include:

### Population:

Total state population obviously affects sales. Strong tourism and/or seasonal population swings for states such as Nevada, Florida and Colorado also impact demand.

### Demographics:

Contrary to conventional wisdom, the fastest growing demographic of recreational users are those over 60. States with higher-than-average boomer demographics, such as Florida and Arizona, are likely to have stronger recreational marketplaces. Given the expense of cannabis products – for example, a single bottle of cannabis-infused water can cost between \$15 to \$17 at retail – areas with higher-than-average household income levels, such as Manhattan and the Boston area, would produce higher sales figures.

### Age limits:

Most states agree that “adult” means 21, but some states may buck that trend and set the limit at 18. This change would expand the market.

### Legislated limitations:

Just as with liquor licenses, recreational states will set strict limits on the number of retailer licenses allowed. We suspect states with a past history of tightly limiting MMJ dispensary licenses, such as Rhode Island, might be just as tight-fisted with recreational licenses. Just because a state allows recreational sales doesn't mean retailers will be allowed on every corner.

Some regions may follow Washington State's lead in limiting the amount of real estate that can be dedicated to professional growing, as well as the number of growing and/or retail licenses an individual proprietor can own. This legislation is aimed at keeping individual cannabis companies as relatively small scale operations, without the ability to create chain stores. On one hand this allows more entrepreneurs to become involved in the business; on the other, it substantially reduces potential business efficiencies.

## Newer cannabis products that will boost gross sales

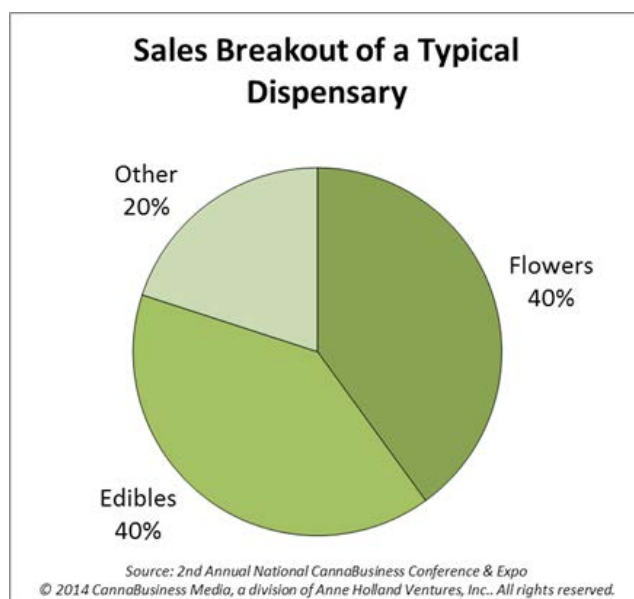
Aided by specialist testing labs, cannabis growers are developing new strains to appeal to the recreational marketplace. Some strains focus on different types of highs that would appeal to consumers who smoke for relaxation, while others are developed with high concentrations of cannabinoids or other chemical properties that may be used for naturopathic remedies. Cannabis strains can develop popularity



by region, however there are half a dozen or so strains that are popular throughout the country. That said, there is no single nationally famous brand or strain of marijuana. So, there remains an opportunity to create a “Budweiser” of marijuana.

Most Americans still think of marijuana as something you smoke. In reality, today’s cannabis market is composed of smokable marijuana flowers, foods and drinks, topical ointments and concentrated oils. While consumption percentages vary based on demographics, the average medical marijuana shop sells roughly 40% marijuana flowers, 40% edibles and 20% other products.

Early sales data from Colorado recreational retailers indicates these other, non-traditional forms of marijuana are even more popular with consumers – many of whom had no prior experience beyond smokables available on the black market. In fact, by the second week of recreational marijuana sales, many shops across Colorado said they had run out of edible and infused products due to extremely high demand.



Several edibles and infused product brands have become well-known at the state – and even multi-state – level in the MMJ community, but there is enormous room for new national household brands in the recreational market. (Note: given federal interstate drug trafficking rules, each state’s inventory would be required to be produced entirely in-state. This does not preclude companies from developing and marketing national brand names.)

In addition, aside from states with an expansive and longstanding MMJ dispensary system (such as Colorado), the general consumer population is largely unaware of the wide range of naturopathic remedies containing cannabidiol (CBD, a cannabis-extracted compound which does not convey the “high” usually associated with marijuana). These products include tinctures, salves and possibly supplements, without any THC content. Some organizations have also expressed an interest in developing medicinal edibles that do not contain THC or have psychoactive properties. The CBD remedies marketplace could also ultimately be worth billions of dollars with significant profit margins.

All of the above-mentioned product types have one key legal drawback. They contain cannabis. Although they may be legal at the state level, they are not legal federally. This thorny fact limits the amount of capital entrepreneurs can access. Although these products represent a business opportunity worth tens of billions of dollars, the true explosion will not come until the federal law changes.

Until then, these products are a risky business. That said, the risk could have significant rewards. Brands and financial backers who are willing to take on the risk now can build brands and

own market share that future newcomers will have difficulty competing against. It's a land-grab situation.

## Newer ancillary products and services that could increase industry revenues

Ancillaries are less risky because they do not touch cannabis itself. Thus, these firms have had a slightly easier time finding financial backers from the private equity community. Some have even raised capital by going public, however they have done so by selling small securities valued at below \$5 a share, commonly referred to as "penny stocks." Many cannabis stocks literally do sell for just pennies a share, and none are traded on major indexes such as the NASDAQ.

Each category's risk is different depending on whether the company involved receives revenues that can be traced directly to cannabis sales. These risks can be mitigated. For example, the hydroponics and cultivation equipment industry has been very careful to distance itself legally from cannabis cultivation – despite large volumes of sales to both professional and home growers – in part by using euphemisms in its advertising and requiring retailers to not discuss cannabis cultivation with clients. The paraphernalia industry has followed a similar strategy; most shops refer to bongs and hookahs as "tobacco water pipes."

Ancillaries break down into two main categories – products sold directly to consumers such as paraphernalia (itself a multi-billion dollar industry) versus products and services sold to professional cultivators, retailers and edibles/infused product makers.

The latter category carries an accounts receivable risk largely unknown in other industries. Due to federal banking laws and credit card regulations, the majority of retailers are all-cash businesses. Many do not have commercial bank accounts – or at least, cannot keep the majority of their revenues in commercial bank accounts. While they may have sufficient cash to cover their bills, their suppliers may not be set up to accept large cash payments. (In fact, we have heard of some ancillary businesses' own commercial bank accounts being at risk because banks are wary of accounts that routinely deposit large amounts of cash, due to money-laundering laws.)



In addition, managing cash flow for an all-cash business is an accounting art in and of itself. It's remarkably easy to go broke by overspending when you see lots of cash coming in. Suppliers to new recreational businesses need to assess whether the owners have the all-cash business background to be able to handle large amounts of cash successfully.

However, with risks comes the possibility of rewards. Because cultivators, processors and retailers can't get traditional bank loans, some of their suppliers offer customer financing. Due to the work and risks involved, this financing may carry high interest rates and can become a profit center in and of itself.

Ancillary businesses serving the cannabis field include, but are not limited to:

- Professional services ranging from lawyers and accountants to specialty consultants and realtors
- Lab testing equipment and services, a rapidly growing field due to increased state legislation requiring testing
- Processing equipment – much of which can cost tens of thousands of dollars
- Financial services, including insurance and private equity
- Packaging, a growing field due to increased legislation regarding child-proof packaging as well as increased desire for branding and professionalism
- Software
- Security services and technology
- Advertising, in particular online and on mobile devices

Many of the companies serving or entering the ancillary industry are new divisions of existing firms. For example, Franwell, a Florida-based logistics and supply chain technology firm founded in 1993, won the contract to provide the software powering Colorado's seed-to-sale tracking system.

To avoid the stigma still associated with cannabis, many of these companies have not publicized their involvement with the industry. So, the companies the public is aware of that are involved in the industry are just the tip of the iceberg compared to the companies that are actually involved in it.

As the industry becomes more legitimate, more companies will start to come “out of the closet.”

Other ancillaries are entirely new, but hedging their bets by creating product lines that can be sold outside of the cannabis industry. For example, Rodawg, a New York-based maker of branded packaging founded in 2012, has simultaneously created product lines targeting tobacco smokers.

The ancillaries targeting consumers tends to break into four further categories – home-grow supplies, paraphernalia shops, online dispensary listing sites and clinics serving MMJ patients.

As recreational retailers open, the home-grow may be a cannabusiness which will actually lose traction. Much like in the beer industry, there will always been a “make your own” hobbyist market, but with high-quality cannabis legally available, fewer and fewer consumers will be driven to grow their own. Suppliers serving that market have already begun realigning themselves to serve larger scale professional grower accounts instead.



Likewise, while clinics providing services including doctor recommendations to MMJ patients has been a popular ancillary business within states with medical marijuana laws, their services will become less necessary as recreational laws expand.

According to HQ Magazine research, the U.S. paraphernalia market is already \$9.7 billion in annual sales. With recreational, this market will only continue to expand. However, the actual headshop storefronts may decline. As some Colorado dispensaries have noticed, if consumers can get all their cannabis needs, including paraphernalia, taken care of in one single shopping trip, they are less likely to visit a headshop or shop online separately.

Online dispensary locators combined with strain reviews and daily deals appears to be the one area of the consumer ancillary market going strong as it transitions to serve the recreational market.

## Size of the US Paraphernalia Market



**\$9.7 billion**

*Source: HQ Magazine's Smokeshop Industry Statistics & Analysis, Summer 2013*



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# Chapter 2

## New Consumer Demographic: The Recreational Marketplace

Outside of the cannabis culture there's a popular myth that marijuana users fall into three categories: aging hippies, young slackers and cancer patients.

The truth is, cannabis consumers come from all age groups, ethnic backgrounds and socioeconomic levels. The recreational market breaks down into the following broad demographics:

### The Party Crowd:

The younger consumer base is going to provide retailers with day-in, day-out business, especially in the lead-up to the weekend's parties and concerts. This market segment made up the lion's share of crowds that stood outside Colorado recreational businesses during the first week of operation. Shops hoping to harness these customers should position themselves in close proximity to college campuses or areas of town inhabited by college kids. A business hoping to harness this demographic should also hire a handful of employees from the local college community, because they will tell their friends.

Unfortunately, these younger consumers lack disposable income, so they will likely be attracted by one thing: price. The challenge with college kids and partiers, however, is that they likely have an existing source on the black market for their cannabis, and that supply is probably cheaper than the pricing inside state-regulated shops. They also are not as concerned with getting tested products packaged appropriately to avoid use by minors and properly labeled – or with the notion of staying above the law with their purchase. These have been the traditional advantages of purchasing at a dispensary.

The party demographic also extends to young adults in their twenties. They have more disposable income than their younger siblings, and may think of themselves as cannabis connoisseurs. Retailers hoping to appeal to them should carry a wide variety of strains, and frequently feature new strain introductions.



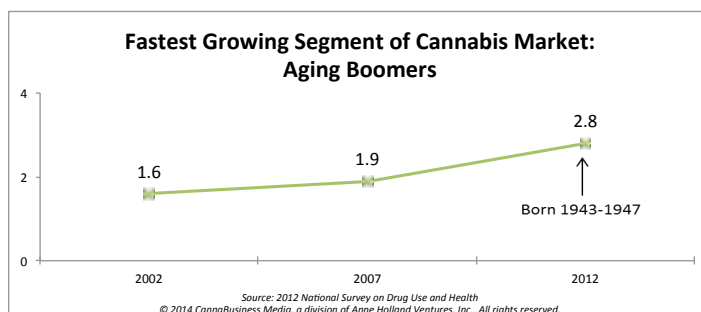
These consumers are likely to travel or move to new areas more frequently than other demographics. They rely on social media and mobile search to find retailers.

### Returning Users:

These Baby Boomers and the subsequent generation were cannabis users back in their youth. They eventually gave up smoking when Saturday Little League games and corporate drug-testing policies became part of their lives. But now, as they move toward retirement, they are once again enjoying cannabis.

A 2012 survey on drug use and health shows that the fastest-growing group of marijuana users was born between 1943 and 1947. So, they are 67-71 now.

Many of these users are retired. They have disposable income and are willing to try new products. They are a very valuable customer base. But the cannabis of today is vastly different than what they smoked in the 1970s, and so they may be somewhat cautious of the products.



These customers realize that marijuana has changed significantly since the last time they smoked regularly. But they are also sensitive to the experience they have inside of a business. These returning customers may require lots of hand-holding from budtenders, who must be patient and courteous. These customers also are not going to want to patronize a business that has an unprofessional interior appearance and is staffed only by half-stoned 20-year-olds. They want reliability.

They also are probably not looking for concentrates or high-THC strains. People of this generation are not necessarily on Yelp or other social media; they operate on a word-of-mouth basis. The experience they have within your shop will affect what they tell their friends.

### Law-abiding, mid-career adults:

Consumers in their 30s, 40s and 50s who in the past might have indulged in a nice bottle of wine or a craft beer are increasingly more willing to purchase and consume cannabis for occasional relaxation instead, particularly if it's both legal and readily available. This is as much due to societal changes – even President Obama says he thinks marijuana is no more dangerous than alcohol – as they are to changing laws.

This is the Starbucks generation. Retailers wishing to attract them should try for a professional, clean and attractive storefront. They may not be as price sensitive as other markets, nor demand an ever-changing deep inventory with dozens of strains. Instead, they are looking for consistency, branded packaging and clear explanations about the product. They may not be familiar with – or even interested in – detailed explanations about sativa and THC content. Like casual wine





drinkers, they don't want to have a full gourmet education to be able to decide what to buy. They just want to ask for something simple by name.

### **Tourists:**

This is a new market, so concrete demographics are not yet known. But it's a safe bet that the cannabis tourists will be primarily male and their education level in regards to marijuana will be varied. Yes, there will be a small group of cannabis connoisseurs from across the country that travel to legal states to enjoy hard-to-find strains and specialty products, such as gourmet edibles or elixirs.



Health tourists are another small subgroup that are already traveling to medical states to find specialty medical marijuana products that aren't available everywhere.

But most of the tourists are going to be similar to existing tourist groups: they won't stray far from city centers, ski areas and other existing tourist locations. In the first week of business at Colorado's retail shops, the majority of Denver stores' customers had Colorado driver's licenses. At the Breckenridge Cannabis Club, a shop employee estimated that three-quarters of the customers during the first week of recreational marijuana had come from out of state.

This group's shopping habits will be determined by location first, and tourism marketing (when legal) and word-of-mouth from local friends, social media, or their hotel concierge. They will tend to purchase in smaller amounts, such as eighths or grams instead of ounces.

To make the most of their visit, be sure your walls and packaging are clearly branded so your brand name shows up in the background of all the photos sure to be posted on Facebook and Flickr. Some Colorado retailers had no interior branding when recreational opened in Colorado, which was a major lost opportunity when news crews came shooting.

### **Health Seekers:**

The U.S. herbal remedies market is estimated to be as big as \$7 billion per year. That's a lot of echinacea and St. John's wort. Legal hemp-based products have already been making inroads into this marketplace – from topical salves to breakfast cereals – proving that an eager health-seeking market is ready for cannabis-based products.

These customers are largely women, often buying for their husbands and families. The most active tend to be over 50 years old. Unlike the college kids, these customers are not looking for smokable marijuana or THC-packed products. Instead, they want CBD-infused products, such as topical salves, healthy edibles, drinks and tinctures.



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Because they are shopping for products with therapeutic qualities, they want reliable products with clear instructional packaging and standard dosing.

Yes, they are looking for help from budtenders and other shop employees, however these consumers are educated; they read magazines and websites dedicated to herbal remedies. While their understanding of marijuana may be rudimentary, they are not entirely uneducated and have the desire to be treated as something more than a raw newbie. Like the older customers, they communicate on a word-of-mouth basis. They also like printed educational materials. So try to give them an experience they will want to talk about with their friends. Also, place articles or columns in local health or natural living publications.

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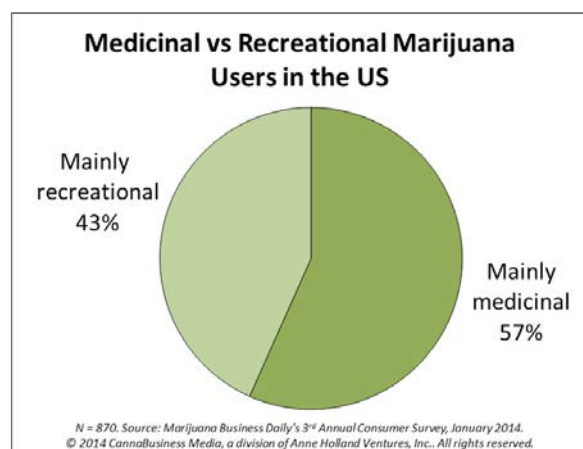
# Chapter 3

## What Recreational Customers Really Want: Exclusive Data

What do your potential recreational customers really want? The editors of *Marijuana Business Daily* conducted an exclusive study to bring the industry useful data.

Respondents were consumers from across the US who took a two-minute online survey in early January 2014 that they learned about from industry insiders who spread the word via email and social media to their customer and fan bases. The survey was geared toward medical marijuana consumers; however, there were many respondents from states without legal MMJ laws who likely procure cannabis from the black market.

We suspect respondents are, as a whole, more sophisticated than a typical new recreational customer might be, in part because the legal recreational market barely exists. So, these respondents are more likely to be current active users, either via the black market or by using medical marijuana programs for recreational purposes.



First, we asked respondents whether they used cannabis and related products mainly medicinally or recreationally. The data contained through this chapter reflects the responses of those who self-selected as “mainly recreational” users. The information contained here should be used as an indicator of what potential customers of a retail marijuana shop may look for in their purchase experience. We look forward to validating responses more effectively in future years, as the legal recreational cannabis market develops.

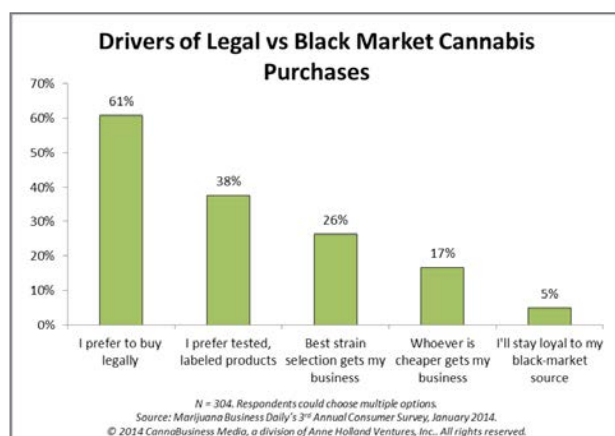
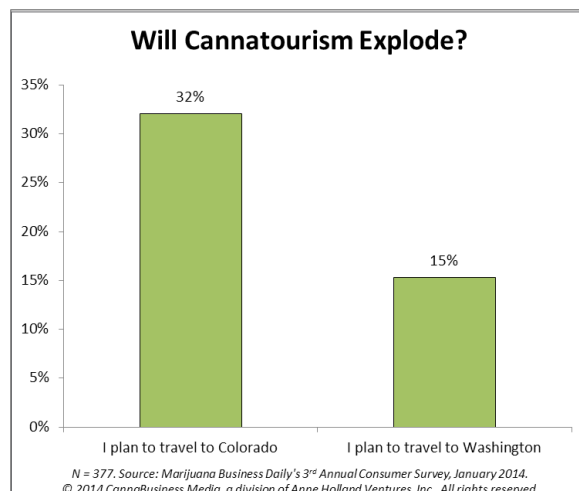
At the time of the survey, recreational cannabis had been sold only at retail for a few days in a single state (Colorado), while MMJ was legally available via dispensaries or home grows in many US states plus the District of Columbia. So, the portion of consumers saying they are primarily recreational users is unexpectedly high.

Warning: Don't extrapolate total, legal recreational market demand from this 43% figure! As sales data from Colorado attests, recreational demand is substantially higher than MMJ demand.

This data merely shows that recreational use is unusually large given the tiny amount of product currently available on the legal market.

One indicator of how large recreational could get: more than a third of surveyed recreational users from states other than Colorado and Washington State are planning cannatourism trips to one or both of these states specifically to purchase and consume marijuana. The number for Washington State may be lower both because the destination attracts somewhat fewer visitors anyway, and because recreational retail had not opened there yet at the time of the survey.

However, the bigger question may be: how long will the cannatourism explosion last? If other states legalize recreational retail, consumers won't have to travel for cannabis. In future years, a trip to top grow states might be akin to a visit to Napa Valley for wine lovers. It's a great vacation, but certainly not something more than 30% of America's wine drinkers will ever plan on.



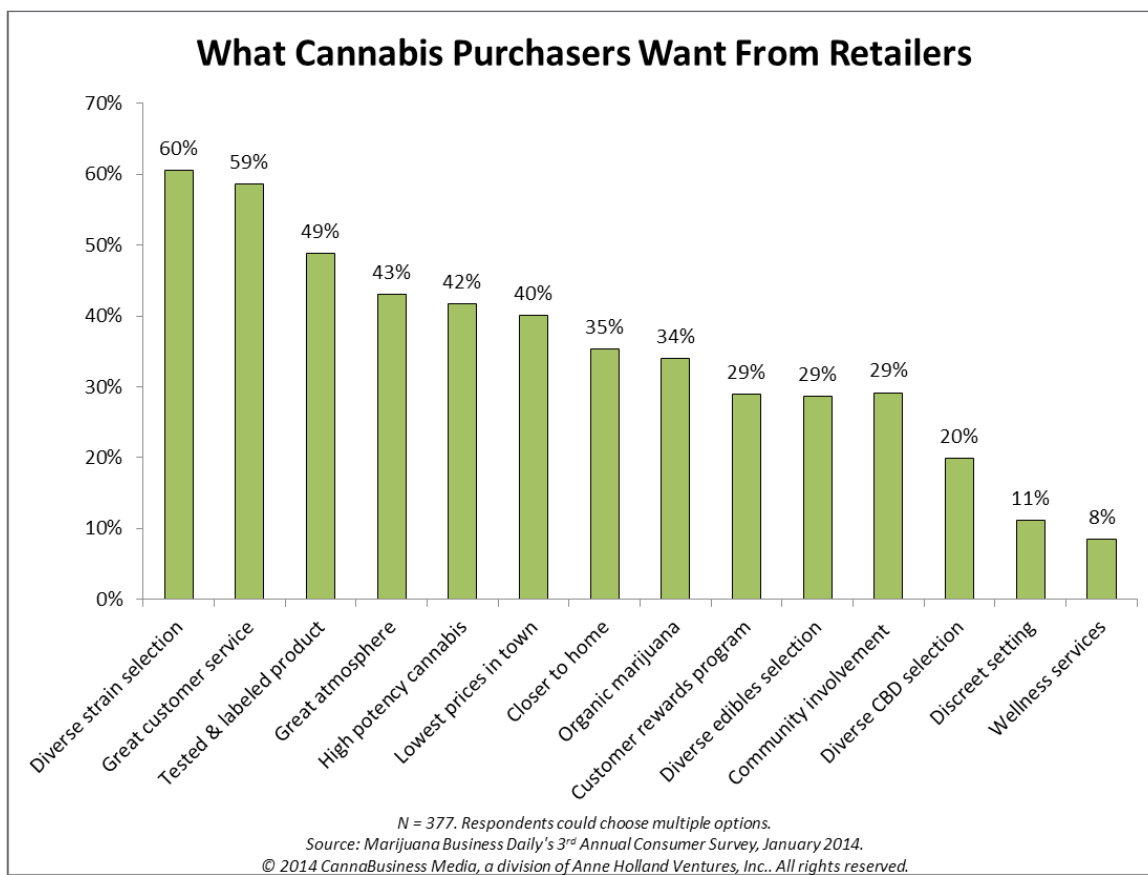
The black market will undoubtedly be the biggest competitor to the recreational marketplace for years to come. As mentioned previously in this Handbook, a Washington State-sponsored study indicated legal retailers might be able to capture only 25% of the market – with the black market keeping the other 75%. However, this survey data reveals that perhaps that analysis was overly pessimistic.

In fact, only a small percent of recreational users said that staying loyal to a black-market source was a key consideration in where they'd buy cannabis. (Black market prices are predicted to be substantially lower than legal retail for a variety of factors already discussed.)

Legal retailers hold a considerable edge just by the fact that they are legal and will almost certainly be required to carry only tested product. History has shown us that if testing is not required by law, the vast majority of cannabis sellers won't bother with it, in part because it adds to cost.

So, the recreational users of America are apparently eager to buy from legal sources, if possible. But what do they want these retailers to provide? We asked current dispensary customers to select what the most important factors were for a great retail experience.

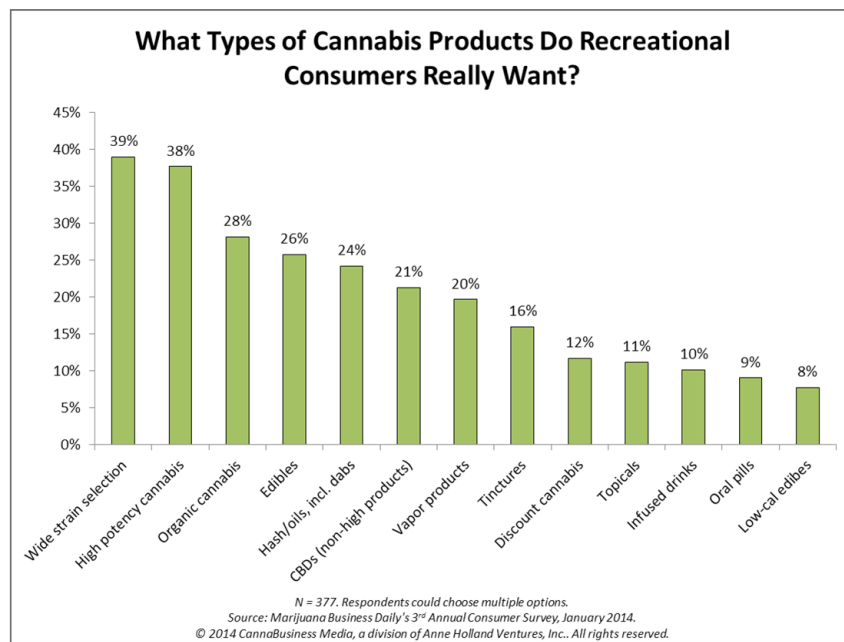
Interestingly, many of the items consumers who self-identified as primarily recreational users said were important are those where legal, licensed retailers may have an edge over the black market, such as having lots of tested products, offering a retail atmosphere and approach to the transaction, and providing a diverse selection of edibles.



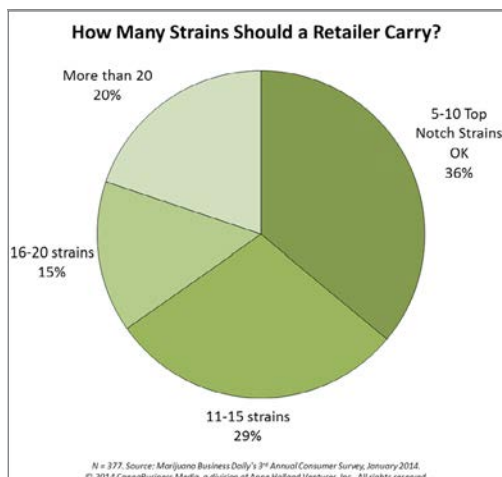
Items more related to wellness were less important, which makes sense as these consumers were self-identified as recreational users. However, we do not think this indicates a lack of a market for wellness products – and more specifically CBD products. Much of the general public know little if anything about CBDs. With more education and marketing, the CBD market should be a substantial one.

One key advantage recreational retailers will have over the black market is the sheer range of products they can offer. Happily for business, discount cannabis is nowhere near the top of the list in terms of popularity.

Also worth noting: although hash, oils and dabs are obviously popular with consumers, some markets may follow Washington State's lead and not allow these to be sold legally. That said, there



could be work-arounds to such strictures; a miniscule amount of additive such as a drop of vanilla flavoring converts a pure cannabis oil extract into a legal product in Washington State.



The edibles industry, however, appears to be burgeoning with opportunity. Today's edibles go far beyond traditional pot brownies and range from pizza to chocolate bars. Past *Marijuana Business Daily* consumer surveys have shown sweets tend to be in much higher demand than savories.

Clearly a wide strain selection is top of mind for cannabis customers. But what does "wide" mean in their minds?

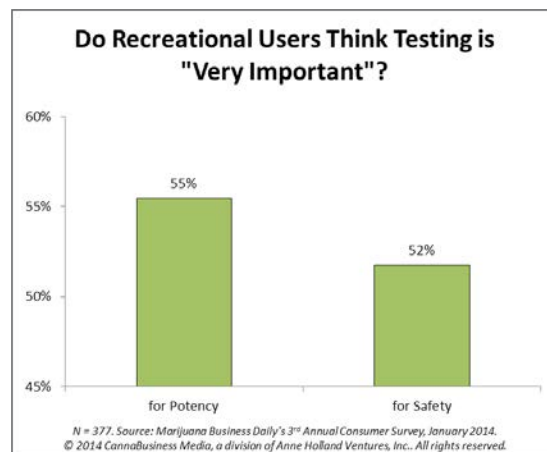
The good news is that 65% of recreational users say they would be satisfied by a retailer that stocked fewer than a dozen strains. To put this in perspective, a typical

US supermarket may carry more than 100 brands of breakfast cereal alone!

In a highly competitive market, retailers with considerably more cannabis strains will be more successful with the gourmet crowd. However, we suspect it's more likely that as long as you have ample stock of the most popular strains, along with a few specialty strains, you'll be fine. A liquor store doesn't need to carry dozens of obscure micro-brews and imported beers to serve the typical American consumer.

No matter how many strains a retailer carries, more than 50% of recreational users want your inventory to be lab-tested.

Interestingly, testing for potency was slightly more critical to consumers than testing for safety. Edibles and infused product makers should also pay attention to this data when creating and labeling products. Consumers want to know that the THC content of your product is the same each and every time they consume it. You would not expect one bottle of Pepsi to have considerably less sugar or caffeine than another bottle, after all. Consumers want standardization, if not between brands, at least within brands.



The edibles industry has been largely – although not entirely – mom-and-pop in the past, without strictly standardized production. Now, consumers will expect legal edibles and infused products to be similar to other consumer packaged goods brands.

As legal recreational cannabis goes mainstream, it has to meet a whole new level of mainstream expectations.

# Chapter 4

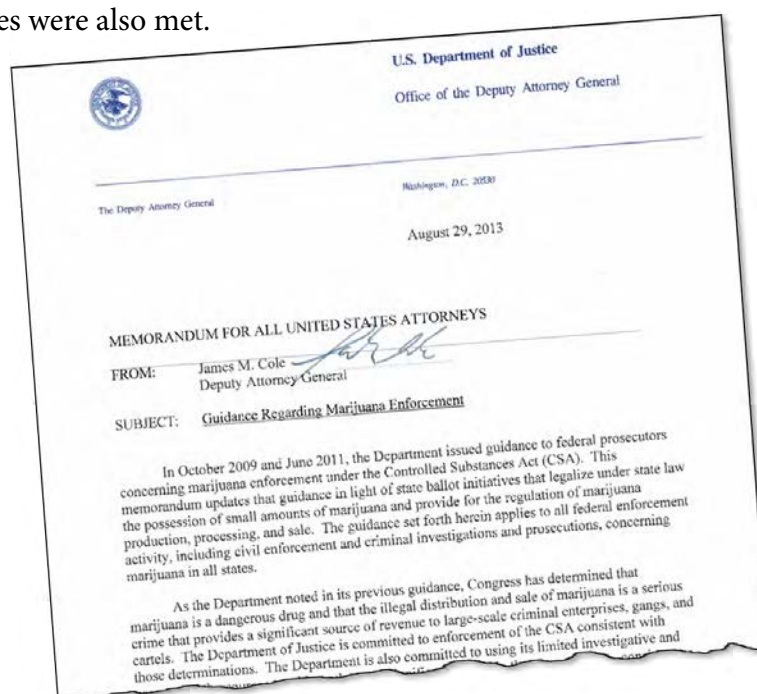
## The Federal Government & Recreational Cannabis

Although politicians and celebrities have openly discussed marijuana issues on a national level, the plant is still illegal under federal law, as it is still considered a Schedule 1 drug under the Controlled Substances Act. Under that statute, growing, processing, selling and possessing the plant are illegal.

Recently, the federal government has rolled back its no-tolerance stance toward marijuana as more states have passed medical and recreational laws. The biggest change came in August 2013 when the Justice Department released a memorandum written by Deputy Attorney General James M. Cole clarifying the Federal Government's stance toward marijuana in states that have passed laws allowing medical or recreational cannabis sales.

Known as “the Cole Memo,” this was the document that offered formal guidance to states that legalized MMJ and recreational cannabis. It effectively says the Justice Department would not pursue criminal charges against cannabusinesses that are following local and state regulations – so long as certain federal guidelines were also met.

Click [HERE](#) or on the graphic to the right to read the entire Cole Memo (located in the Appendix of this book).





It asked these states to ensure that their marijuana laws do not jeopardize the public safety or public health, and that they are enforced. Finally, it guided federal prosecutors to only bring marijuana prosecutions in eight specific cases:

- when the plant is being distributed to minors,
- when profits are flowing to criminal enterprises,
- when marijuana is being trafficked across state lines,
- when state-authorized marijuana activity is being used as a cover for the sale of other drugs,
- when violence is involved,
- when there are connections to driving while on drugs,
- when marijuana is being grown on public lands,
- or, when marijuana is being possessed or used on federal property.

The Cole Memo sent two major messages to the cannabis industry: First, it gave the industry a green light to proceed with caution – but without fear that federal agents would be swooping in at any moment to shut down operations.

Secondly, it gave the industry a framework of rules that absolutely should not be broken, under any circumstances. In broad terms, the Cole Memo provides business owners with the proverbial 10 Commandments of cannabis operations.

However, the industry still faces critical financial challenges that can only be resolved by change at the federal level.

### **Banking:**

The primary challenge, as every medical and recreational business owner can attest to, is the difficulty of obtaining a bank account or accepting credit cards as a marijuana business. Banks are forbidden from working with businesses that engage in the production or sale of these controlled substances. This affects even small local banks, as well as Indian Nation banks, because all banks are considered national in scope due to inter-bank financial dealings across state lines, as well as due to their FDIC insurance which allows them to operate.

Two recent occurrences brought some hope to this roadblock, however. In January 2014, US Attorney General Eric Holder confirmed that the Justice and Treasury departments were jointly developing guidance for banking institutions on acceptable ways to work with the cannabis industry. No timeline was given for





when the guidance may be released, or how extensive it would be. The comments, however, were the first positive signs the industry had received from the government involving banking.

Secondly, many of the retail businesses that opened in Colorado reported that they were accepting credit and debit cards for transactions. MasterCard and Visa have previously adopted a hard line against working with marijuana businesses; however The Wall Street Journal reported in January that the two card companies had actually relaxed their own policies.

We do not have confirmation of this change, though, and any business owner should proceed with extreme caution. If a card provider finds out that a retailer owner misrepresented the nature of his or her business on a merchant account application (for example, stating they operate a “health store”), that retailer could find their funds frozen, and the proprietor’s names placed on a Match List – which essentially is a black list that would prevent them from ever again having a merchant account issued to any business they are associated with.

### Federal taxation (280E):

While marijuana is quickly becoming a more recognized business within mainstream America, it faces an enormous obstacle from the Internal Revenue Service. Under the IRS’s civil tax code section 280E, no deductions or credit are allowed for any amount incurred in a business that consists of trafficking controlled substances prohibited by federal law. Since marijuana is still technically a Schedule I controlled substance, this means cannabusinesses cannot deduct the cost of producing marijuana. They must pay taxes on their gross income rather than on their net income.

#### U.S. Code 280E

##### Expenditures in Connection With the Illegal Sale of Drugs

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

In a 2007, the Californians Helping Alleviate Medical Problems (CHAMP) group sued the Commissioner of the IRS over tax deductions made by marijuana businesses. In the precedent-setting ruling which became known as the CHAMP case, the IRS conceded that marijuana businesses could deduct cost of goods sold under the 280E section of the tax code.

Marijuana businesses must take 280E into careful consideration when crafting business plans and paying taxes. If an audit occurs, a business could owe a substantial amount in back taxes to the federal government. Those back taxes could easily send a business owner into bankruptcy. And since there is a three-year statute of limitations on an IRS case, the agency has the power to scrutinize previous tax returns.

Experienced tax professionals can help businesses steer toward a handful of solutions for lessening the blow of 280E. Tax laws vary from state-to-state, and this book is not intended to be used for definitive accounting or legal advice. Consult an experienced professional before proceeding.

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With that caveat stated, here are a few helpful pointers:

- Push as many costs as possible into cost of goods sold
- Demonstrate non-marijuana sales activity, such as spa treatment or massage
- Push as many employees as possible into job classifications that are outside of the sales actions
- Minimize square footage of the business space that is devoted solely to cannabis sales, or mix this space with non-sales activities
- Immediately contact an attorney and your accountant if the IRS contacts you about an audit

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### About CannaBusiness Media

Founded in 2011, CannaBusiness Media is the most trusted, independent publisher and event producer serving America's cannabis industry entrepreneurs and investors.

Cited by the Wall Street Journal, Fortune, Dow Jones and a host of other media, our team of professional business journalists, researchers and event producers are dedicated to bringing the cannabusiness community the unbiased information and connections it needs to flourish.

We are headquartered in Pawtucket, Rhode Island, with staff located across the nation. We are a division of Anne Holland Ventures Inc. located at:

1005 Main Street, Suite 2130

Pawtucket, RI 02860

# Chapter 5

## 8 Top Challenges to the Recreational Boom

Along with lack of banking and an inability to deduct business expenses from taxes, recreational cannabusinesses face the following potential challenges to flourishing. Happily, we've seen significant progress in many of the following areas just over the past 12 months. However, no one should disregard these challenges.

### #1. Limited access to growth capital:

Access to adequate capital is essential for any industry to flourish. The cannabis industry has only very recently begun to receive funding outside of company founders' own pockets as well as their friends and family.

As mentioned above, some vendors, in particular in the processing and vendor machine equipment fields, have extended credit to existing retailers. At least one financial services firm has also started a lending fund to extend loans to existing businesses on the basis of their current cash flow. However, these loans require an existing business. They're not for raw startups. And the interest rates can be fairly high.

Low-interest, federally backed SBA loans are not, of course, available for cannabusinesses. No state-backed loans are available for recreational businesses either, startup or otherwise. Out of all 21 MMJ states, only New Jersey has provided financial assistance to an MMJ dispensary – and that was just one loan of \$357,200.

A few investing clubs and targeted investment funds do now exist that may be willing to help both startups and expanding companies find capital. (You can find more information on them in the Marijuana Industry Directory available online at <http://MarijuanaBusinessDaily.com/Directory>.) Most of these groups have heretofore limited pitching opportunities to ancillary companies only. However, in the wake of the Cole Memo, this hardline stance has begun changing.

Private investors – in particular longtime MMJ entrepreneurs who are in a cash-positive situation – are actively involved in backing MMJ license applications and related business. For example, the founders of California's Harborside Health Center also helped found a popular investor



network called the Arcview Angel Investor Network, which in turn finances marijuana businesses across the country. The group meets several times a year to hear pitches from entrepreneurs; it then matches these entrepreneurs up with interested backers.

Members on the investor side must be willing to invest at least \$50,000 in businesses. Currently, the group has more than 130 members.

## #2. High regulation

Recreational cannabis is one of the most regulated industries entrepreneurs can launch a business in today. Unlike big pharmaceutical firms, many canna-entrepreneurs don't have the resources or background to handle the extensive challenges heavy regulation brings. The paperwork and compliance burden is substantial. This is another reason why many entrepreneurs stick to ancillary industries.

It's also a reason why the cannabusiness consulting industry is flourishing... and often fairly pricey.

## #3. Municipal moratoriums

Hundreds of local cities and towns in MMJ and recreational states across the US enacted hastily legislated moratoriums when they suspected a dispensary, retailer or grower might propose entering their town. For example, more than 150 towns in Massachusetts alone passed moratoriums in 2013.

This "not in my backyard" syndrome may be fairly short-lived – most moratoriums are temporary in nature, designed so that the town can fully study the situation before making a final decision. However, just as there are still "dry" towns in parts of America 80 years after alcohol

prohibition ended, we suspect a few moratoriums may stick for decades.



States with a solid track record of successful and regulated medical marijuana businesses stand a greater chance of sidestepping moratoriums for recreational businesses. However, only 12 of the 21 states with MMJ laws – as well as Washington DC – have existing dispensaries at this time. The remainder allow patient and caretaker growing, or are in the process of getting a dispensary system set up.

The states that have existing dispensaries (or are working to launch them) are:

- |                        |                   |                       |
|------------------------|-------------------|-----------------------|
| ➤ Arizona              | ➤ Illinois *      | ➤ New Hampshire *     |
| ➤ California           | ➤ Maine           | ➤ New Jersey          |
| ➤ Colorado             | ➤ Massachusetts * | ➤ New Mexico          |
| ➤ Connecticut *        | ➤ Michigan **     | ➤ Oregon **           |
| ➤ Delaware *           | ➤ Montana **      | ➤ Rhode Island        |
| ➤ District of Columbia | ➤ Nevada *        | ➤ Vermont             |
|                        |                   | ➤ Washington State ** |

\*have passed legislation but dispensaries yet to open

\*\*dispensaries in operation but not recognized by state (note: Oregon and Washington State are in the process of implementing regulations on existing medical cannabis businesses)

#### #4. HR stigmas

Even ancillary companies have told us hiring good people is problematic. In many states, cannabusiness still carries enough of a stigma that professionals don't want it to appear on their resumes. This is especially frustrating for companies that need experienced professionals rather than just relying on on-the-job-training. For example, you can't turn a newbie into a skilled marketing director or laboratory professional overnight, no matter how much they happen to love cannabis.



This is one of the few areas where retailers have an easier time than ancillaries. You can train a bud-tender in-house in a matter of months.

Fortunately, with all the press the recreational cannabusiness is now getting, this stigma is rapidly lifting. Also, companies that are able to hire in states such as Colorado, where recreational is the new norm and cannabis is less stigmatized, will have an advantage.

#### #5. Price gouging

Although the mainstream press has accused recreational retail of price gouging (when in actuality retail prices are more driven by production and taxation costs, along with limited inventory), recreational cannabusinesses themselves are often on the receiving end of the price-gouging stick. For instance, property owners will double the cost of a building when selling it to a marijuana business. Some mainstream businesses – such as landlords – believe that recreational businesses are making tons of easy money... and they want their share of it.





## #6. The 'Old Guard'

MMJ's old guard – entrepreneurs who have been the backbone of the industry before recreational was a reality – can be considered both a blessing and a curse. On one hand, they are an important source of financial backing and industry knowledge. They are also largely responsible for the fact that the industry even exists today. Their legacy is priceless.

On the other hand, both their personal connections and their deep pockets coupled with state laws give their companies massive advantages over newcomers. For example, in Colorado, no one from outside the existing licensed pool of MMJ dispensaries can even apply for a retail store license until October 2014, moving their likely opening date to a full year or more after the first recreational shops. By the time newcomers are allowed in, much of the market share and available retail space may already be taken.

Entrepreneurs in future recreational cannabis states may not have as much of an advantage as they might think. The old guard is aggressively moving into new markets across the country, regardless of whether they have historic ties to these regions. Sometimes this move is behind-the-scenes, through financial backing and alliances. Be warned, even if you don't see it, it's there. Ignore the power of the old guard at your peril.

## #7. Black market competition

The black market is by far the biggest competitor to all licensed recreational growers and retailers. So much so, in fact, that a 2013 Washington State sponsored study by Botec Analysis Corp., concluded that state-licensed businesses can only expect to win a 15-25% market share from illegal producers.

Why? The black market has often decades-long customer relationships. Its products are also considerably cheaper because black market sellers don't have the add-on costs of taxes, safety testing, seed-to-sale tracking, and state-approved packaging that licensed sellers' prices must cover. Plus, black market dealers can offer the convenience of delivery services and operate at hours that licensed retailers are prohibited from.

State-legal businesses can only expect to win a 15-25% market share from illegal producers and distributors anytime soon.

- BOTEC Analysis Corp



The challenge for all marijuana entrepreneurs is to convince customers that purchasing through legitimate channels is better than buying on the black market. Retailers can accomplish this in a number of ways:

- Emphasize your product's lab-tested quality.
- Make sure your retail facility is an enjoyable place to visit with friendly staff, a clean interior and a convenient location.
- Create incentives for repeat business such as rewards programs or giveaways.
- Carry a wide range of products, from hard-to-find strains to edibles and CBD products.
- Increase your profitability by offering higher-margin, non-cannabis products such as paraphernalia.

While the black market will remain formidable competition for the foreseeable future, there are many potential cannabis customers who will never engage in illegal drug transactions.

## #8. Security

As businesses selling a popular and easily resalable product, companies with cannabis on the premises – whether they are growers, processors, edibles/infused product makers, or retailers – have serious security concerns. The all-cash retailers without adequate banking access have even bigger concerns.

The MMJ industry has been plagued with security problems in multiple states, ranging from employee pilferage to violent thefts. And beefing up security incurs significant production, operational and personnel costs.

Many cannabusinesses use armored car services for cash transportation and storage. One service



Image: <http://www.flickr.com/photos/jermainejustice>

founded by cannabis industry veterans and geared specifically to the unique needs of this industry recently launched – and it might be a good idea to stick with people who know the ins-and-outs of the marijuana marketplace.

In this situation, the disparity between federal drug laws and state-legal cannabis markets again comes into play. Should a federal raid occur, if a security guard armed with a firearm is on the property with your cannabis inventory, your legal issues would get a whole lot more complex.

# Chapter 6

## Which States are Likely to Join the Recreational Cannabis Market?

Colorado and Washington likely won't be the only states to proceed with a legal recreational cannabis market. Aside from public opinion, politicians are also interested in new sources of local jobs and tax revenues.

So which states will be next?

Currently, 15-20 states have a clear path established to legalize recreational cannabis. Some states are further along than others.

Key advocates, including the powerful Marijuana Policy Project (MPP), believe 2016 should be the next big year to push for recreational ballot measures. That's because it's a presidential election year, and far more voters both pay attention and actually turn out to vote in those years. It's one of the reasons many believe the 2012 measures in Colorado and Washington State were successful. However, there could be positive progress before then.

### Group 1: Recreational legalization could occur in 2014



#### Alaska

Alaska looks to be heading for a general election vote on marijuana, which would happen in August. In early January the group The Campaign to Regulate Marijuana earned great fanfare from the industry when it submitted nearly 46,000 signatures to Lt. Gov. Mead Treadwell, beating its deadline to turn in the signatures by nearly two weeks. The petition included a proposed draft of legislation, which includes many of the same rules and regulations as Colorado, only with a \$50 per-ounce tax.

If the state's Division of Elections can verify 30,169 of those signatures, the initiative will appear on the ballot. Early polling shows the pro-marijuana side has a slight advantage. But advocates realize that legalization will not come easy; the group Smart Approach to Marijuana plans to enter the fight in Alaska and fund opposition. And failure in Alaska would be a huge setback to marijuana advocates because it would advance the belief that voters are not yet ready to proceed with legalization.



### Oregon

Voters in Oregon have not been kind to legalization efforts. The state rejected initiatives to legalize marijuana in general election votes in 1986 and 2012, and in 2010 the group Oregonians For Cannabis Reform failed to collect enough signatures to put a legalization initiative on the ballot. But advocates believe that 2014 may be the year that the state moves ahead with legalization. The state's medical marijuana industry has grown into 200 or so unregulated dispensaries, but Oregon has moved to create regulations for these businesses.

A poll taken in May 2013 shows that support for legalization is at 57% . And the group New Approach Oregon, which is spearheading the latest push, has financial backing from The Drug Policy Alliance as well as from billionaire Peter Lewis, who donated to the organization shortly before his death in November 2013. New Approach Oregon will push lawmakers to refer the legalization measure to the November 2014 ballot. If that route fails, the group will go on the hunt for signatures: it needs 87,213 signed petitions in order for the measure to appear on the ballot.



### Rhode Island

Unlike Colorado and Washington, Rhode Island would proceed with legalization after a legislative vote in its General Assembly, not a general election. The country's smallest state could legalize marijuana as early as June or July, despite Gov. Lincoln Chafee recently saying Rhode Island should wait a year before voting on marijuana legalization. Advocates have introduced a legalization bill during the last three sessions of Rhode Island's General Assembly and spent upwards of \$20,000 in campaign contributions to lawmakers.

They've also had permanent lobbyists on retainer there, working to advance pro-legalization sentiment throughout the state's House and Senate. Recent estimates put support within Rhode Island's Senate at above 50%, which is a good sign. Passing legalization would require a simple majority of lawmakers to support the bill, not a two-thirds majority. Chafee could always veto the decision. But Rhode Island has passed medical marijuana and decriminalization laws in succession, and that momentum could dissuade Chafee from taking such an action.



### New Hampshire

If New Hampshire legalizes marijuana, it will likely be from legislative action, not a popular vote. In early January, New Hampshire's House of Representatives voted to legalize recreational marijuana. The only hurdle standing in the way now is a few committee votes and a final sign-off by the governor. New Hampshire legislators saw a similar bill in 2012 that fell one vote short of being approved by the House Criminal Justice and Public Safety Committee.

## Group 2: Recreational legalization could occur in 2016



### California:

Many advocates believe that 2014 is simply too early to push forward with a legalization effort, however there are strong signs that advocates could move forward with an attempt to legalize in 2014. In December 2013 the Drug Policy Alliance submitted the Control, Regulate and Tax Marijuana Act, and two other legalization initiatives had been submitted in California as well.

But the 2010 defeat of Prop. 19, the most recent legalization effort, left a bad taste in the mouths of many marijuana advocates. Many advocates believe that the legalization effort should be held until 2016, which would give them three extra years to raise funds for an expensive media push before the election. Still, support for legalization is there: a Field Poll released in December showed that 55% of Californians support the initiative.



### Arizona:

Arizona authorized a medical marijuana industry in 2010; in December 2012 the first state-licensed dispensaries began to open after a series of legal challenges to the law were finally settled. Some believe it could pass legalization as a ballot initiative in 2016. But the state's conservative majority could delay a vote. The success of the state's medical marijuana program could help sway elderly voters.



### Maine

Maine came close to legalizing marijuana in 2013, however the legislature shot down a bill that would have paved the way for legalization. The 10-member group of legislators voted 5-5 on the bill, which effectively killed it. Indications are that the existing medical marijuana business owners lobbied strongly against the bill, possibly in an effort to avoid new competition and stiff licensing fees which would likely result.

Unfortunately, the legislature will not hear the bill again until 2015. But local are overwhelmingly in favor of legalization. Three cities, including the state capital, have passed local legalization initiatives, with all three passing with more than 60% of the vote.



### Massachusetts:

Massachusetts legalized medical marijuana in 2012, and the state is still in the process of rolling out its medical program. Patients are waiting for identification cards to become available and the state is on the verge of issuing 35 licenses for non-profit dispensaries. Based on the success of the medical program, Massachusetts could push forward with legalization in three to five years.



**Nevada:**

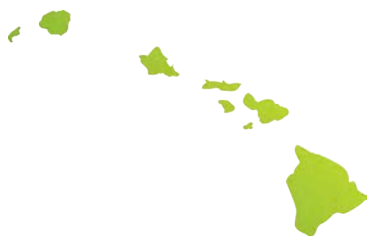
Nevada legalized medical marijuana dispensaries in 2013. The state could become the first to allow out-of-state patient cards, which points to support for marijuana legalization. Advocates there are laying plans for a petition drive in 2014 that would put a recreational bill in front of lawmakers in 2015. If Nevada does legalize, it will do so via a legislative vote.

**Group 3: Realistic recreational legalization may be a few more years out****Montana**

Appeared to be headed toward looser marijuana laws, but a backlash by lawmakers has stalled much of the progress.

**Delaware**

Passed medical marijuana legalization in 2011; the first dispensary could open in mid-2014.

**Hawaii**

Legalized medical marijuana in 2000; has yet to legalize dispensary system.

**Florida**

Could legalize medical marijuana later in 2014; however a strong paid opposition exists, which could curtail efforts for recreational legalization. Aging population and lots of tourists provide the basis for a very healthy recreational market.

**Vermont**

Passed medical marijuana legalization in 2004; only four non-profit dispensaries allowed in the entire state. Strong market potential in this state, with a significant population of health seekers, retired boomers and tourists from across New England.

**New York**

Ample popular support for both medical and recreational legalization in New York. The pathway to recreational marijuana leads through the state's infamous legislature, which can keep bills in purgatory for years. Recent legislative and executive-branch actions on medical marijuana provide hints that lawmakers may be inching toward pro-marijuana legislation, but full legalization is still years away.

# Chapter 7

## Paths Toward Recreational Legalization

There is no set path that states have taken toward launching a legalizing recreational marijuana marketplace. Colorado and Washington both passed their laws in similar ways (popular state-wide votes). From there, the states went about implementing their programs in vastly different ways. How future states go about legalizing marijuana will be unique to their respective cultural and political climates.

There are a handful of similarities to come out of the process by which Washington and Colorado legalized marijuana. Steps in future states will likely include:

1. Getting an initial MMJ law passed, either via legislature or a state-wide general election
2. Proving to the populace that MMJ can work as a regulated industry
3. Getting an initial recreational law passed, either via legislature or a state-wide general election
4. Further action on taxes
5. Further actions to propose regulations
6. Further action to adopt regulations
7. The licensing process
8. Adoption of additional business regulations, such as monitoring program, packaging and real estate requirements
9. Getting local municipal approvals (or overcoming moratoriums) to be able to actually open a business

No matter how the process works – we know one thing for sure: once recreational legislation passes, cannabis entrepreneurs requiring licenses will end up waiting at least a year and likely longer before they can open their doors. (Some ancillaries, such as consultants and lawyers who help entrepreneurs get applications in order, will begin profiting far earlier.)

So, the anticipated recreational cannabis gold rush resulting from the November 2016 elections probably won't pan out until 2018-2019.

## Add 12+ Months Vote or Passage of Legalization



Image: Katy Warner via Flickr

## Day One of Business

### Make Sure Recreational Laws Are Business Friendly

Not all states' laws will be unreservedly pro-business. Many lawmakers believe capitalism and cannabis should not mix, and the state itself should oversee production and sales. And the political evangelists pushing for legalization do not always put business considerations into the mix, perhaps because they are themselves of a non-profit nature.

Budding cannabis entrepreneurs have a key role to play in crafting business-friendly laws which will govern their state's market and allow it to co-exist peacefully with other businesses and residents. Key factors we've seen in laws and proposed regulations that could affect the success of markets:

- **State taxation**

Washington State's various recreational cannabis taxes are onerously high, and Colorado's tax structure for recreational cannabis has garnered much opposition as well. Much of the taxes will be passed along to consumers – but this will lead to some consumers buying less product, and others staying with cheaper, untaxed black market providers.

On one hand, the industry welcomes taxation in large part because anticipated state tax revenues help get recreational measures on the table, and help prove the industry's legitimacy. On the other hand, excessive tax burdens are stifling, especially when competing against the large and healthy black market.

- **Local taxation**

Local tax revenues are a strong incentive for municipalities to allow cannabusinesses in their city limits. Looking at the high sales figures for the first day of recreational sales in Denver alone, the city is reaping financial benefits for allowing cannabis retail shops in its city limits. Lobby for (reasonable) local taxes as an alternative to moratoriums and bans.

- **Non-profits**

Some states have ruled that medical marijuana businesses must be non-profit. Whether states attempt to impose such rules on recreational businesses is yet to be seen. If it does take a non-profit structure, that could affect available sources of investment funding.

- **Number of locations**

Some states may follow Washington State's lead in strictly limiting the number of retail and/or grow locations each cannabis company – or its principals – can operate. Although limiting proprietors to just a handful of locations does allow for a greater number of entrepreneurs to participate in the cannabis retail market, it also stops chain stores in their tracks ... which hinders production efficiencies that could help this industry compete with the black market.

- **Products allowed**

States may rule out certain infused products over a certain amount of THC per gram. This could stop hash, dabs, or other oils from being sold. Some of these products are very popular – in particular dabs, which are taking over some market share from the more traditional smokables and edibles.

- **Plant and product tracking requirements**

The so-called seed-to-sale security requirements whereby each plant is carefully tracked from the moment of propagation to the moment of sale are largely a boon to the industry. They reassure local and federal authorities that product is secure and will not seep to the black market, into minors' hands or across state borders.

These product tracking requirements need to include realistic logistics so that edibles, infused products and CBD companies can flourish. Each of these businesses is a specialty, requiring expert staff and often expensive equipment. If seed-to-sale regulations require that all production, from cultivation to sale, occur under the roof of a single vendor, the industry will lose the brands and variety it needs to please consumers. It would also require extraordinary amounts of startup funding for new retailers.

- **Distance requirements**

As Washington State recognized, regulations must spell out precisely how the federally mandated rules, regarding retail store distances from various public buildings, areas and schools, will be applied. Otherwise, many cities could find themselves with a dearth of legal commercial real estate for the industry.

- **Licensing processes**

If licensing fees are too high, it stops potential entrepreneurs from applying. Perhaps more importantly, businesses need a fair and transparent licensing process. If procedures are shrouded in secrecy – or run by a committee with little relevant experience or cannabusiness education – there's room for mistakes and corruption. Some states are considering lotteries, but unless all applicants are thoroughly vetted prior to being allowed in the pool, this process could produce too many failing businesses.



- **Define the medical and recreational markets separately**

Learn from the lessons of Washington State's MMJ versus recreational retail confusion. Lobby for legislation that clearly allows both services to co-exist. MMJ patients have different product and customer service needs than recreational patients. And, it's important for the future legitimacy of cannabis as a medicinal plant, as well as the MMJ movement in other states, to legally recognize its pharmaceutical value. No one expects the same type of products, service or educated staff from their neighborhood liquor store that that they expect from their neighborhood pharmacy.

The majority of new businesses in America fail in their first five years. No new business, even a cannabis one, is an easy or guaranteed win. Given licensing requirements, it may be tough and/or slow for M&A in recreational retail. Dying businesses not only create bad PR for the industry, they may also not be replaced quickly enough for market demand. That would only give the black market another foothold.

Although many MMJ and recreational business owners have been heavily involved (some for decades) as evangelists for legalization, and many donate significant funds to industry lobbyists, few have been actively influential in drafting legalization. Advocacy groups, generally, are the ones that pursue this task.

Businesses cannot expect business-friendly legislation if they allow others to take over the language of relevant measures. Evangelists and politicians have multiple constituencies to please when they write bills. Business must step forward to take more of an active role to be sure its needs are recognized in the mix.

# Chapter 8

## Overview of State Recreational Laws



Every state's recreational laws and regulations will inevitably be different, just as they are for MMJ states now. However, lawmakers will certainly review Colorado and Washington State laws – particularly, how effective they have (or have not) been – when creating new legislation. A common framework could develop which would broadly apply similar rules in many of the states.

State and municipal regulations are enormously detailed for both states. Fortunately, both states have made vast amounts of information available online.

Here, in broad brushstrokes, is a summary of the business regulations having the greatest impact on the development of each state's industry. We've also provided the links to where you can find additional, fully detailed information.

Retail Shops	Colorado	Washington
# Licenses Available	Unlimited, awarded on merit	Capped at 3 and limited geographically. All pre-qualified applicants will enter a lottery for 334 total licenses statewide.
Retail + Medical Shop Structures	Can be Recreational-only, or Recreational + Medical if the two sides are completely separate	Current regulations apply only to Recreational sales. Significant concern exists that the Medical industry will be pushed out of the marketplace due to regulations
Location	Moratoriums allowed. Shops must be removed from areas where children gather, i.e. 1000+ feet from schools	Moratoriums allowed. Shops must be removed from areas where children gather, i.e. 1000+ feet from schools. Regulations detail how these distances will be measured
License Requirement Highlights	For 1st year: License applicants must be existing medical shop operators. New entrants can apply for licenses starting Oct. 1, 2014. Unlimited licenses can be awarded to a single business to create a chain of shops	Residency, background check and other fairly standard requirements apply. Only 3 licenses per applicant will be allowed
Per-Transaction Purchase Limits	1 oz for Colorado residents, .25 oz for non-residents	Adults 21 and older can have 1 oz of marijuana at a time

<b>Cultivation Facilities</b>	<b>Colorado</b>	<b>Washington</b>
# Licenses Available	Unlimited	Unlimited, though total cultivation is capped at 2 million square feet of canopy.
Cultivation Operations Structure	Retailers must produce at least 70% of their own product (vertical integration), limiting opportunities for wholesalers	3 Tiers of Licenses: Tier 1: less than 2,000 sq ft Tier 2: 2,000-10,000 sq ft Tier 3: 10,000-30,000 sq ft
Home Grows	Allowed, up to 6 plants per person	Allowed for medical purposes
Location	Moratoriums allowed. Grow houses must be removed from areas where children gather, i.e. 1000+ feet from schools.	Moratoriums allowed. Grow houses must be removed from areas where children gather, i.e. 1000+ feet from schools. Regulations detail how these distances will be measured

<b>Product Requirements, incl. Processors &amp; Testing</b>	<b>Colorado</b>	<b>Washington</b>
# Processor Licenses Avail	Unlimited, awarded on merit	Unlimited. Can be Producer and Processor, but not a Retailer and Processor
# Testing Lab Licenses Avail	Unlimited, awarded on merit	Not licensed by the state
Edible & Infused Products	Full range allowed	Hash & concentrates not allowed as a pure extracts
Testing & Labeling requirements	For purity & potency	For purity & potency
Packaging	Child-proof packaging required	Child-proof packaging required

<b>Marketing Restrictions</b>	<b>Colorado</b>	<b>Washington</b>
Mass Media Advertising (i.e. TV, Billboards, Radio)	Allowed if less than 30% of readers/viewers are under 21.	Not allowed
Publically-Viewable Signage	Restrictions on sidewalk ads	Retail signage limits
Other Restrictions	Limits in the regulations restrict advertising where it may reach kids. Business owners may also not target out-of-state consumers	No cannabis-related advertising may represent that it has curative or therapeutic effects

<b>Taxes</b>	<b>Colorado</b>	<b>Washington</b>
Total Tax Burden (State + Local + Excise)	Can reach 40% or higher	Can reach 75% or higher
Earmarks for Tax Revenue, After Program Funding	Funding public school construction	Substance-abuse prevention, research, education, and healthcare

<b>Operations</b>	<b>Colorado</b>	<b>Washington</b>
Seed-to-Sale Tracking	Required	Required
Selected Tracking Vendor	Franwell	BioTrack HTC
Security	Required 24-7 at all facilities with specific conditions detailed in the regulations	Required 24-7 at all facilities with specific conditions detailed in the regulations
Ecommerce & Delivery	Not allowed	Not allowed
Sampling & On-Site Consumption (i.e. Clubs)	Not allowed	Not allowed

<b>Major Concerns</b>	<b>Colorado</b>	<b>Washington</b>
	Cultivation licenses were awarded concurrently with retail licenses, a few days prior to the legal opening day. Therefore, production was not sufficient to meet demand in the early days of recreational sales.	The combination of total canopy for production, unlimited cultivator licenses and the cultivator “tiers” based on grow size have caused concern that grows will not be sized at a sustainable level.

<b>For More Information</b>	
Colorado State Laws, Forms & Licensing Info	<a href="http://www.colorado.gov/cs/Satellite/Rev-MMJ/CBON/1251581331216">http://www.colorado.gov/cs/Satellite/Rev-MMJ/CBON/1251581331216</a>
Washington State FAQs & BOTEC Research Reports	<a href="http://lcb.wa.gov/marijuana/faqs_i-502">http://lcb.wa.gov/marijuana/faqs_i-502</a>
Denver Regulations	<a href="https://www.documentcloud.org/documents/789801-denver-retail-marijuana-rules-and-regulations.html">https://www.documentcloud.org/documents/789801-denver-retail-marijuana-rules-and-regulations.html</a>
Seattle Ordinances	<a href="http://www.seattle.gov/dpd/cs/groups/pan/@pan/documents/web_informational/p2080978.pdf">http://www.seattle.gov/dpd/cs/groups/pan/@pan/documents/web_informational/p2080978.pdf</a>

# Chapter 9

## Useful Lessons From the First Recreational State: Colorado

As of this Handbook's publication, only Colorado retailers have opened for recreational business. The challenges faced by the new retail shops in the state serve as a helpful guide for entrepreneurs in future states that legalize recreational cannabis.

Note: Under the Colorado law, pre-existing medical marijuana dispensaries became the first businesses to receive licenses to open recreational cannabis shops. This rule directly impacted the success of initial sales, as discussed below. For additional insight into the laws and regulations governing the Colorado industry, see page 40.



### Inventory:

In Colorado, cultivators received their recreational licenses at the same time as most shops, just a few short days before cannabis sales to the public began. Hence, no one could actually grow inventory specifically for recreational use prior to the first day of retail sales. The state allowed shops a one-time transfer of cannabis products from the medical side of the business to the recreational side, to be used for starting inventory.

This approach proved problematic. Shops had to first guess initial demand, then determine how heavily they were willing to dip into their patient inventory to meet the expected rush.

At several stores, consumer demand exceeded available inventory. Recreational demand was in some cases 300% higher than typical MMJ demand at the same location. Purchase limits were implemented at many shops in an effort to stretch product to serve as many customers as possible. Stores that avoided caps – and even some that did resort to them – ran out of inventory and were forced to shut down temporarily. Other stores changed hours to weekends-only, in an effort to conserve inventory until more could be grown.



Of the products that were on the shelf, some were not the “right” ones for a recreational consumer. Not only could cultivators not get ahead of demand; edibles manufacturers were unable to supply enough specialty products more suited to recreational use than medicinal use.



### Key lessons:

- If/when your state is in the process of deciding start dates, lobby for measures to allow growers, processors, edibles makers and infused product makers at least a few months to prepare product prior to retail openings. Otherwise, the eager public's first experience of recreational retail may be one of disappointment or long lines, coupled with (largely unfair) media reports on “price gouging.”
- If your state follows Colorado's model (which at launch only give retail licenses to existing MMJ dispensaries and then restricted initial retail inventory to a one-time transfer from existing MMJ inventory to stock retail shelves), try to transfer plants that were near or close to being ready for trimming so you'll have enough cannabis on hand for the early days. Entrepreneurs in Colorado transferred anywhere from 25% to 85% of their medical marijuana inventory over for recreational sales, and many businesses simply sold out.
- Check with wholesalers to see if they can provide additional quantities of popular strains. It's better to have enough of the most popular strains at first, than to sell out your limited quantities of specialty strains before new customers can have a crack at them.
- Stock plenty of tasty edibles and similar specialty products. Flowers are available to recreational customers on the street via the black market. What's harder to find are the new forms of marijuana delivery. Sure, customers will come into stores partly for the thrill of making a legal purchase, but they will also be heavily motivated to gain steady access to these new products, which have only been available previously to medical marijuana users.

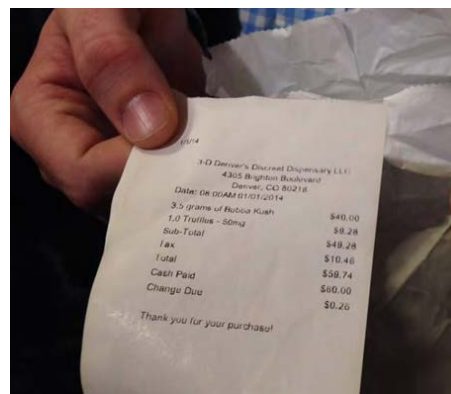
A word of caution: Thoroughly vet edibles companies before carrying their products. Some edibles products are wildly inconsistent in terms of potency (despite labels that say otherwise). A dissatisfied customer may not only blame the edibles brand, but also the retailer where they bought the product.

- If you suspect you may sell out early, it's better for customer relations and media mentions to impose per-customer buying cap of an eighth – or just a few grams – per customer, or one to two edibles. You also might want to limit the number of customers you'll serve. Some dispensaries in Colorado imposed limits of, say, 200 customers each day until they were able to restock. Others cut off the lines outside their stores several hours before their closing time.

- Include non-cannabis products such as best-selling paraphernalia in your inventory from the start. Your goal is to educate customers that they can come to you for one-stop shopping. But you may not need to stock esoteric items for newbies.

## Pricing:

When doors opened on Colorado's recreational shops, a photo of the receipt of the first legal retail sale of cannabis in decades went viral on social media sites. Some of the retweets highlighted the historic nature of the moment. And many derided the total bill.



## Important takeaways:

- Carefully and strategically determine a stable pricing structure prior to opening. In spite of the tweets mentioned above, recreational customers may have less price resistance than you think. Being the cheapest store in town won't do you any good if you run out of inventory and disappoint people ... and neither will the charges of price gouging if you raise prices unexpectedly mid-way through launch.

However, prepare to tear up your pricing strategy overnight based on supply and demand. Many shops in Colorado readjusted prices on a daily basis during the first month of sales. You need that flexibility to ensure you're both competitive and also pricing at market levels.

Note: You can adjust prices each morning before your store opens, but do not make changes throughout the day, as that does not make for a good customer experience.

- Consider printing an informational flyer: "What's behind cannabis pricing?" to hand out to new shoppers. In it, you can explain things such as: the value of lab testing, child-safe packaging, trained budtenders, high-quality strains, state/local tax structures, what those taxes are allocated toward, seed-to-sale tracking to keep the federal government from shutting you down, and professionally made edibles. Also make this information available online.

Advocates and MMJ customers will already have a good handle on this information. With a flyer of this nature, you're looking to educate older customers who may not have purchased cannabis since their college days, or black market customers who may be used to artificially low prices.

- If needed, make sure your Cash-Only policy is posted prominently both at your entrance and at the register. Add a short note to the signs, explaining that due to federal banking regulations, unfortunately you cannot accept plastic. These customers may not be aware they can't swipe their debit card at the register. If you don't already have an ATM in your store, consider installing one.

- Add signage near the door explaining customer policies such as ID requirements, and whether customers should wait in line, take a number, or just join the jostle at the counter. (Hopefully not the latter.) Consider how airports often have signage at the start of a security line so travelers can prepare as they wait their turn.

## Marketing and Sales:

How will customers know you're there? State regulations in Colorado – and likely elsewhere as other markets develop – impose heavy restrictions on marketing, so heavy that certain elements of the law are currently under litigation.



However, since “win in court” is not always a winning business strategy, here are some tips:



- Hang an “Opening Soon”, “Now Open!” (or if applicable, ‘Now Open for Recreational Sales’) signage to the outside of your store so street and sidewalk traffic know you’re there and eager for their business. This may seem like a no brainer, but some Colorado stores neglected to do it.
- Consider hiring a local PR specialist a month prior to the launch to help YOU be the retailer who lands local media interviews. The media won’t interview everyone – why not make sure it’s you? If you’re a pre-existing dispensary now adding retail, don’t rest on your laurels and assume you’ll get the coverage. The press may need a nudge.
- Add branded signage to your store’s interior walls, so photos taken by customers and the press will include your name in the background. Several Colorado stores missed out on invaluable PR when press crews filmed inside their stores on the first day, and viral pass-along from excited customers posting pictures to their social media feeds.
- Have a prominent “Follow us on Facebook” sign that includes your Twitter ID on your front door as well as inside the shop near the check-out counter. Then, actively use those social networks to keep your customers regularly up-to-date with specials, new products, “tell a friend about us” offers, and general updates about your store.
- Before launch day, assign a staffer to keep on top of your store’s listings and reviews on retail finder services such as Leafly and Weedmaps. Your inventory and pricing changes should be reflected everywhere online as instantly as possible. Plus, be prepared to re-

spond to consumers comments and reviews about your store on these sites. Thank people for compliments and apologize humbly for problems.

- Email newsletters and alerts are still powerful – in fact often more powerful than social media – if you send them to preferred customers. (Anyone who stops in during your first few weeks in business should be considered in that category.) Make sure your website home page has a “free email newsletter” offer, and ask customers for email addresses for your Store Alerts newsletter as they check out. Promise them privacy – and follow through with that promise. Never, ever share or rent their addresses.

Then send routine emails – best time: every Friday at noon to hit the weekend shopper crowd – offering something special such as a new edible or strain. Email services such as MailChimp and Emma.com are very low-cost and easy to use for this purpose.

- New customers are not guaranteed to be loyal customers. In fact, these novelty seekers may be far more likely than typical MMJ patients to shop around at multiple retailers.

Be prepared to roll out a loyalty program on Day One of opening, and train your counter staff to promote it cheerfully and consistently. Systems that require you to gather an email address from customers, so you can proactively reengage them, are better than punch cards, which are easy to forget or misplace. Make sure the cards have your shop hours, address, phone number and website and/or Facebook ID. This is info customers need for reference. Your logo alone is not nearly enough.

- If your state law allows it, invite your preferred edibles manufacturer to do in-store sampling promotions during heavy traffic times. Where samples are prohibited, consider striking a deal to have a rep set up just inside the store entrance along with printed marketing materials. Promote these sorts of “special events” online and via email. The increased traffic can help them as much as it helps you.

This is also a big chance for those edibles companies to build strong customer brand relationships, perhaps for a lifetime. Create professional packaging, including a website, Facebook page, and an offer of more information.



- If you operate an MMJ dispensary as well as a retail store, don't forget about the loyal customers who got you this far. In Colorado, some dispensary owners effectively penalized their loyal MMJ customers when preparing to add on recreational retail by raising MMJ prices as high as 20-40% prior to launch, or simply shutting down all MMJ business for a short time, in order to conserve inventory for retail. Consider sending out a courtesy email to your pre-rec patients explaining any changes once recreational sales begin and telling them how much you still value their business.



Remember, your MMJ patients have friends and family who themselves are more likely to be cannabis evangelists due to these connections. Keeping patients happy is critical for the word-of-mouth which drives acquisition of recreational customers.

- To win support not just from potential customers, and also to pick up some PR value among the cannabis deriders: Promote responsible and safe use of cannabis among the people who walk in your shop.

Join together with other retailers in your area to create a common “Toke Responsibly” campaign, including posters in your shop and hand-out leaflets which go into the bag with completed transaction. Explain just how strong a dab can be. Remind people to dispose of packaging appropriately. Add notes to ensure cannatourists fully understand the public-use prohibitions in place in your state.

## Operations:

Lines around the block. Hundreds of people waiting, thankfully with great patience, for hours, in snow flurries, to make their purchase. Crammed stores that had to limit the number of people inside at one time. Pictures of scenes like this became the face of Jan. 1 recreational cannabis sales as they were splashed across news sites and social media.



The problem: these businesses had spent years getting very good at one-on-one private consultations serving a few dozen patients per day. When 600 people arrive as the doors open, the shops and staff simply were not equipped to handle the change in operations.



As legal cannabis sales become less of a novelty, customers may not remain as patient. Here are key lessons to guide your operations plan:

- When planning out your recreational store, don't copy traditional MMJ dispensary footprints. Often, dispensaries have large waiting rooms, coupled with smaller buying areas suitable for intimate chats with budtenders. 100% of your retail space should be dedicated to retail ... no waiting room. Optimize your counter space for a high volume of transactions.
- Rehearse with your front-store team, including budtenders and security, before the store opens. Retrain them with an eye toward speed and efficiency. At least at first, your store traffic will be exponentially larger than it would be for a comparable MMJ dispensary. For example, Patient's Choice/Bud Med in Edgewater, Colorado, which typically handles 30-35 MMJ sales transactions per day, reported 595 transactions on the opening day of recreational sales.



Although subsequent days won't be this crazy, your store should see at least double the number of units sold per day that a typical dispensary would. Is your staff quick enough to handle that kind of flow? Or, should you staff up with extra short-term counter and security help (if available given whatever your state's staff licensing rules may be.)



- Consider assigning a staffer to be 'new customer happiness manager' for the launch. For example, if you have long lines, that person could set up signs indicating typical 'wait time', offer free cups of lemonade or hot chocolate, and spread friendliness as new customers are waiting. These first impressions can create life-long customers.
- Assign someone to answer phone calls during busy times, instead of expecting your counter staff to handle it. If you can't manage this, at least assign someone to update your recorded phone message daily if possible.
- Script guidelines for whoever will update your recorded store phone message. Update your message as frequently as needed (at launch, this may be multiple times per day.) A basic message should include your address, hours of operation, and any specific policies new customers should be aware of. Also include updated information regarding inventory, in particular if a popular inventory item sells out.
- Choose your software vendors with care – at least where you can.

If you're thinking, "I'm opening a retail shop, I don't need to know about software!", think again. A hallmark of all the new state marijuana laws is seed-to-sale tracking, particularly in the wake of the Cole Memo. RFID tags and other tracking mechanisms means new software.

New software is invariably buggy. Lobby for your state to select a seed-to-sale tracking software system that's already fully programmed and quality-tested. For the parts of your system not mandated by the state, don't trust retail software vendors' promises around functionality and ease-of-use. Give a proposed new system a thorough shakedown before signing a long-term agreement. Ask to speak with other retail owners who use the system currently – not brand new customers. You (and the software sales rep) might be surprised at how ruthlessly honest they'll be.

Make good friends with your software sales rep. Despite sometimes overpromising and under-delivering, these people can be invaluable allies and great business partners. They have a view into how dozens or hundreds of other retailers and dispensaries are doing business. This knowledge translates into consulting-style advice that can be worth its weight in gold.

Finally, ask your software vendor for ideas about how you can use the data the system is collecting about your business to help improve your business. Multiple software vendors have told us their clients dramatically under-utilize the potential of their information.

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## Be Prepared for Anything:

The biggest lesson learned from the Colorado experience is that even the most regulated, best-thought-out systems are going to have their initial hiccups. In Colorado, the required RFID tags for the state's seed-to-sale tracking system were not available in sufficient quantities. Licenses were finally issued less than a week before shops were allowed to open.

- Flexibility is key. Have a solid, well-developed plan for pricing, products, your shop, and letting people know about you. And be ready for the possibility that you may have to walk away from that plan and create a new one on the spot.
- Be in great standing and friendly with your local regulators. When you come to them with legitimate issues – such as you can't get RFID from the state's chosen vendor – be ready to suggest a work-around that will let you proceed. That old adage “come with solutions, not problems” holds very true here.

Lastly, don't forget to plan for the long-term. It's easy to get caught up in opening day hoopla. By day one, you should also have an annual plan in place including upcoming promotions, inventory optimization, staff training and operational improvements. Otherwise you can find yourself running fast just to stay in place.

# Chapter 10

## Top 4 Cannabusiness Niches

### Commercial Cultivators

These growers produce large-scale amounts of cannabis specifically to be sold wholesale to re-tail, processors and/or edibles makers. Some grow outdoor, however most in northern states grow indoors because it allows them to generate more harvests.

The stages of growing and processing the cannabis plant include propagation, generally by cloning (note: in a seed-to-sale state, each newly cloned plant is the “seed”), graduating plants to larger pots as they grow (if indoors); harvesting; and initial processing which includes drying, trimming and packaging for wholesale distribution. Additional steps can include lab testing and oil extraction.

In states with partial or total vertical integration laws, retailers are required to grow some or all of their inventory.

### Market Potential: Very Strong

Cultivation is an attractive segment of the industry because of the ability to generate revenue quickly even in a crowded market.

As previously mentioned, recreational markets require lots of inventory to satisfy the rush of customers, especially in the first few months. Growers can generate substantial income during this window.

Later, as a state settles into routine recreational sales, consumer demand will still be substantially greater than MMJ demand due to the far larger customer base. In some states with MMJ patient limitations, the difference could be extraordinary; but, even in other states, recreational cannabis will have a greater market demand than MMJ alone would.

In recreational markets, there is also a greater demand for extractions and cannabis oils to be used in the edibles, extract products and wax. Edibles are specifically seeing a skyrocketing increase in demand. Professional extraction equipment costs tens of thousands of dollars. So, some growers or processors may either specialize in it, or create partnerships with extraction companies.

In recreational markets, we forecast an increase in demand for organically grown products. Propagating seedlings under organic rules can be difficult. So some growers may produce “organic” crops that did not begin organically.

Growers may split between focusing on mass market strains - a “Budweiser” type of cannabis strain, which appeals to the masses, has a fast gestation period and can be sold at a lower price point – versus specialty strains. The connoisseur crowd will be interested in the latter, but it’s a smaller market segment.

Depending on legislation, some growers may specialize as seedling nurseries or clone factories. This industry allows a grower to flip inventory swiftly, and react to market demand for specific strains quickly.

### **Costs**

Grower costs vary greatly due to a wide range of factors, including fees and licenses that each state will require, and the type of growing space a business owner will choose (indoor versus outdoor). Major expenses include:

- Applications and permits: can range from the thousands to the tens of thousands of dollars.
- Utilities: as much as 80% of total costs for some indoor operations are for utilities. In addition to electricity, you will need expensive generators if you are in an area that occasionally loses electricity.
- Real estate, rent and renovation: most indoor cultivators use warehouses or office spaces for their grows, however the buildings are not initially set up to handle a grow. Thousands or tens of thousands of dollars must be spent in building smaller rooms for veg and flowering, installing HVAC or cooling systems and preparing the space for growing.
- Lights, bulbs, hoods, nutrients: commercial equipment firms often will extend credit to good customers.
- Seed and plant containers.
- Labor: expect to pay \$45,000 to \$80,000 a year for a head grower and \$10 to \$15 an hour for low-level employees, such as trimmers.
- Tracking system and radio identification tags.
- Processing equipment.
- Professional services: legal services, insurance, accountants, etc.
- Security: both employee and criminal theft is a problem at grow houses and growers should invest in a video cameras and an alarm system. Many also have security guards.

### **Challenges & Risks**

Growers’ biggest risk is prosecution by state or federal enforcement agencies for violating regulations. Some violations, such as growing more cannabis than is allotted by regulators, will likely lead to fines. More serious violations, such as selling cannabis to minors or black market dealers, could lead to a loss of license or even prosecution and incarceration.

Other risks include:

- Theft: some growers told us that 10% to 20% of their entire inventories were lost in the pockets of employees. Cultivation centers also are often the target of robberies.
- Sick plants: whole crops of cannabis can be lost to mites, disease, mold and other plant-related pests.
- Cannabis price fluctuations.
- Strain demand: keep an ear to the ground, including data from retailers and online data sources such as Weedmaps and Leafly to determine which strains are hot and which are not.
- Arrogance: it's frequently said that every grower thinks their crop and strains are the best in the world. This dismissiveness toward what's going on in other growers' yards leads them to miss new developments and to underestimate the competition. This is the #1 one thing people who have been in the industry for a long time say is a common growers' Achilles heel.
- Hiring: home grow experience is not highly relevant to large scale commercial activities. Hire botanists who have managed large scale crops of other types instead of homegrow fans without commercial experience.

## **Access to Capital**

Currently, cannabis growers do not have access to traditional banking services or loans from banks or lending institutions that are FDIC insured. Growers must seek cash from angel investors, family donors, investor networks or other private groups. Although some grow loans carry interest rates as low as 15%, most are currently in the 20% to 25% range.

## **Benefits**

Why grow cannabis in a recreational market? For starters, it is a quick way to generate revenues, as some cannabis strains can be ready for processing and sale just six weeks after being planted as clones. The demand for cannabis increased substantially in recreational markets, specifically during the first few months of recreational sales. So, cultivators are guaranteed to have business, even if they are only selling wholesale.

Entering the cannabis growing business has a medium degree of difficulty. A business owner must procure the necessary state licenses before launching a business. After that, however, a business owner can quickly get an operation up to speed by learning from peers and consultants. Commercial botany experience is a huge advantage.

## **Competition & Existing Players**

Growers will continue to be regional players, so long as the federal government prevents interstate commerce from happening in the cannabis industry. Many growers have come from the black market world (which is substantially more profitable than licensed growing). Others come from commercial cultivation backgrounds for other types of plants and foodstuffs.

## Retail

Retail recreational cannabis stores are where consumers can purchase cannabis products. (Under MMJ, these businesses are commonly called dispensaries or centers.) Recreational retail stores sell cannabis flowers, edibles, infused products and paraphernalia, such as pipes and bongs.

Note: despite some entrepreneurs' hopes, it is unlikely that any state will pass laws allowing on-site sampling or other recreational use. This means no cannabis clubs. Retailers will sell packaged products only.

The location of retail shops is usually determined by zoning laws in a specific municipality. Owners must receive state licenses to operate. In some states, retailers may be required to also grow part of or their entire inventory.

Recreational retail will be a highly regulated business. Rules will govern everything these businesses do, from how they advertise to how they manage inventory and hire employees.

## Market Potential: Strong

Due to the increase in demand within recreational cannabis economies, retailers have strong market potential. The number and size of retailers are limited by legal regulations versus market-demand.

In new states, retailers can expect to see a sizable sales rush during the first months of a recreational economy, followed by a leveling off as business becomes more regular. We predict that overall a typical retailer will have exponentially more customers than a typical MMJ dispensary.

## Costs

- Startup costs include finding real estate, which could be extremely difficult (not to mention expensive) depending on local zoning rules.
- Store build-out costs including counters, decor and security equipment.
- Cost of inventory will also be a major expense, especially in states without vertical integration laws.
- Licenses and state fees could range in the thousands to high tens of thousands of dollars.
- Prior to start-up: Shelving, cases, furniture, decorations.
- Payment processing software or cashless ATM's.
- Software to track inventory and sales, as well as state-required tracking software.
- Staff: budtenders, managers, backroom employees.
- Marketing: Leafly and Weedmaps advertising subscriptions, local media sponsorships, community outreach PR/goodwill, customer rewards programs, legal signage, legal print ads.
- Packaging, often required to be childproof, for any product packaged in-house.
- Professional services: legal, accounting, insurance, marketing, etc.
- High local, state and federal taxes.

## Challenges & Risks

Retailers face the biggest risk of fines or prosecution from local governmental agencies for violating various rules. Smaller violations, such as mislabeling inventory or stocking too much can-



nabis, will be punished by fines. Larger violations, such as selling to minors, could be punished by jail time. Other risks include:

- Local moratoriums and planning permissions.
- Limited real estate that is legally available under zoning laws; and, higher-than-normal rental costs.
- Robbery and employee theft.
- Bad business relationships, poor choice in picking business partners.
- Cash management in an all-cash or heavy-cash business. Without proper accounting, it's easy to mismanage cash.
- Competition: new customers are likely to be fickle and try out several retailers before settling into a relationship with a favorite (assuming the state allows multiple retailers in an area).
- Competition from the black market.
- Tax audits: most MMJ dispensaries have been audited; its likely recreational retailers will also be targeted by the IRS.
- Inventory management: picking the right strains and items to stock, having enough supply to meet demand consistently and supply chain management.
- Staff training (or retraining): bud tenders should be able to answer newbie questions, but not get drawn into too lengthy conversations when there is a line out the door. Choosing staff that will show up on time and not think the job is a party.
- Demand fluctuations during the early days of a recreational cannabis market.

## **Access to Capital**

Although banking regulations may transition in the future, we suspect US banks will not be likely to give cannabis retailers loans anytime soon. Neither will the federally-backed small business administration (SBA). Only one state (New Jersey) has provided state-funding for an MMJ dispensary at this time and no state agencies have funded recreational retail. Therefore, retailers will either be self-funded by their owners' pockets, or funded via private loans and/or equity partners.

Angel investors and private, accredited investor networks are beginning to show interest in retail, especially for licensed retailers who already have a track record as successful MMJ dispensary owners. Many potential backers are themselves involved in MMJ dispensaries or growing, often in states other than the ones they are now backing entrepreneurs in. However, some state laws may restrict financial backing or equity ownership to in-state residents.

Retailers may get private loans for interest rates as low as 15%; however, it's more likely they will pay in the 20% to 25% range for loans.

## **Benefits**

Retailers can grow their customer bases quickly in a recreational market, and grab a chunk of market share before larger players enter the market. Some launch a business sideline, offering consulting to less mature markets. Should the federal government ever relax laws prohibiting interstate commerce, existing retailers could quickly spread into other states.

## Edibles/Infused Products

Edibles and infused manufacturers make products that contain THC, cannabinoids (CBDs) or other chemicals that have been extracted from the cannabis plant via a variety of methods. These products include cannabis food, candies, oils, hashish, drinks, tinctures and waxes (sometimes called “dabs”).

There are two primary categories within this segment: THC-based products which contain psychoactive drugs and are used for recreational purposes, and CBD-rich products which do not contain THC and are used for health-related purposes.

Depending on state laws and wholesale cannabis availability, these manufacturers either grow or purchase cannabis or oils derived from the plant. They then synthesize extracts from the plant and create their products.

Product may not be moved across state lines. Some brands set up separate production facilities in each state they intend to sell in. Or, they may license their brand name and recipes to local producers.

### Market Potential: Very Strong

The recreational market potential for edibles and infused products is enormous. Unlike smokable flowers, most of these products are not readily available on the black market. Market demand is demonstrably significant.

The segment has a medium-to-high barrier to entry, with much of the challenge coming from obtaining a state license and then finding a suitable kitchen or production space. Many mom-and-pop manufacturers make products out of their homes; however, the market is maturing quickly. Successful brands are expanding to state-wide and multi-state distribution. Mainstream consumer packaged goods and herbal remedies firms are also keeping an eye on the market.

Multi-state brands can sidestep laws banning interstate distribution and any local residency requirements by licensing their brand to local manufacturers.

### Costs

The overall cost of the operation will be determined by its size and scope. Low-level extraction processes involving glass tubes and butane can be relatively inexpensive, however state regulations could require entrepreneurs to invest in professional closed-circuit extractors, which can run in the tens of thousands of dollars. Also, rented kitchen space and extraction space can raise the total cost.

Other expenses include:

- Rent and equipment: the largest cost, nearly 50%.
- Kitchen equipment.
- Closed-circuit extractors, glass tubes for traditional butane or water extraction, infrastructure for creating waxes or hashish, if needed.
- Purchasing of cannabis wholesale (if allowed by state law).

- Testing: depending on state regulations, owners may have to test their products for potency and quality control.
- Branding, sales and marketing.
- Packaging: childproof regulations may make this more expensive.
- Research and development costs for new products.
- Distribution.
- Staff/employees.

## **Challenges & Risks**

Edibles/infused manufacturers can face backlash from state agencies and federal investigators if they are selling their products directly to consumers without a retail license. Smaller violations, such as misreporting to regulators about inventories, will likely be punished by fines.

Other risks include:

- Employee theft.
- Contamination.
- Distribution relationships: retailers will not automatically stock your product on their shelves unless they know you and trust your product's quality.
- Inconsistent product: especially THC levels which can cause your line to be dropped quickly by retailers.
- Inconsistent packaging.
- Federal prosecution/fines: if business is not following regulations.
- Competition: considerable if the state allows independent makers to produce these products vs. requiring vertical integration.

## **Access to Capital**

These businesses do not currently have access to traditional financing such as bank or SBA loans. You can expect to pay in the neighborhood of 15% for loans from investors. Private investors, especially those with a background in MMJ or consumer packaged goods, are interested in funding edibles manufacturers with solid business plans and strong management teams.

## **Benefits**

Edibles firms can generate quick and steady cash flow, as long as your product is of a steady and high quality so retailers will continue carrying it on their shelves. Today's best-selling local brands may be tomorrow's national brands.

## Testing/Labs

Testing laboratories put cannabis and cannabis products through a variety of different scientific tests to determine potency (THC content) and safety (contamination from mold, fungus and pesticides). Within recreational markets, government regulations will likely force growers and edibles/infused manufacturers to submit samples of their product to be tested on a regular basis.

Some labs also offer R&D testing services, such as measuring CBDs for a grower hoping to produce strains that cater to specific segments of the recreational industry.

This niche also includes testing technology companies which offer specialized lab equipment and supplies to testing labs and growers.

### Market Potential: Strong

Testing-related companies are guaranteed to see business increase in a recreational economy because government regulations are likely to require testing. It's worth noting that although MMJ patients strongly prefer tested product, labs have had a hard time gaining business in MMJ states where testing is not legally required. So, industry growth is currently largely driven by regulations instead of market demand.

Although the business opportunity is strong, it is limited to just a few labs per region. New launches should aim to dominate an under-served market, rather than assuming there's room for another competitor in an already-served area. Due to the high equipment and staffing costs, testing labs are not quick money makers.

### Costs

Renting lab space and then renting equipment can easily boost startup costs above \$100,000, not including staffing. Key business costs include:

- Instrument rental: can range from \$50,000 a year to \$250,000 a year depending on the equipment.
- Staffing: market rate for a skilled scientist is in the \$80,000 to \$100,000 annually.
- Marketing materials: cannabis businesses will be looking for a testing option in recreational markets; however it is unlikely that government officials will point them your way. Marketing at industry events and in industry-specific publications could help grow your business.
- Solvents and chemicals used for testing.
- State certification and licensing fees.

### Challenges and Risks

This is not a business for the faint of heart or light of wallet. Aside from high costs, the business is not guaranteed to generate quick cash flow. Other challenges include:

- Compliance requirements: testing requirements are not guaranteed in states that legalize recreational marijuana; and, if testing is not required by law, the business opportunity could be very limited until the market matures.

- Fire, explosions and harm caused by the solvents and chemicals used in the testing procedures.
- Shipping or taking cannabis products across state lines is still illegal. You must open a separate lab (with separate local licenses) in each state where you intend to do business.
- Competition: as the market grows and cannabusiness loses its stigma, mainstream labs may move into the market.

### **Access to Capital**

Although banks should be able to provide loans, since laboratories do not sell or grow cannabis, most are highly wary of dealing with ancillary cannabusinesses. The safest bet for financing is still from private investors, friends and family, or investor networks.

### **Benefits**

In states that mandate testing protocols for recreational businesses, labs are guaranteed to see growth. In Colorado, for example, labs expect to see a tenfold increase in revenue compared to under the MMJ system. Tests there range from \$50 to \$80 per product. Every cannabis producer and edible/infused company must test every single strain, brownie, wax and infused product. So there is the potential to profit as a lab, however the road to ROI is long.

Labs that are able to create a strong customer base in each local market they serve should be able to thrive.

### **Existing Players**

There are not many existing players in this segment of the market, however it is expected to become more crowded as larger laboratory companies and universities see the opportunity for business.

# Chapter 11

## Top 9 Ancillary Niches

### Cannabusiness Consulting

Consultants provide business advice for one or more areas (growing, retail operations, accounting, tax advice, legal advice, licensing, edibles making, etc.) to cannabis entrepreneurs who require additional knowledge in these areas.

Consultants come from an extremely wide range of backgrounds, including divisions of current cannabis businesses, former cannabis business owners, advocacy experts, business experts from other industries hoping to break into cannabis, or even individuals who simply took a class on cultivation. Consulting has the lowest bar of entry for any segment of the cannabis industry.

#### Market Potential: Strong

Consulting can be lucrative; however, consultants that are successful must have deep knowledge of a specific hard-to-understand niche within the industry (cultivation, license applications, etc.) Or, they must be able to create a large network of newbie clients and offer them expert advice across a wide range of cannabis operations.

The opportunity for consulting will grow as the industry matures, however this niche is guaranteed to become more competitive as more former cannabis business professionals and business consultants from other industries begin to jump in.

Consultants are usually paid an hourly fee with a small retainer. Some consultants also ask for equity in the business; however business owners are offering this less frequently.

#### Costs

Aside from basic office expenses, expenses include:

Travel expenses: either you may be working across multiple states, or you may need to do extensive in-state networking. Either way, be prepared to travel a lot.

Legal advice for contracts (if you are not a lawyer).

Training and/or continuing education on legislation and/or process in multiple states.

Marketing.



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## **Challenges & Risks**

The biggest challenge currently is competition. So many people are offering consulting services that it's difficult to stand out. Other top challenges include:

Threat of litigation. If a consultant obtains equity in the business, it can be as risky as it may be profitable.

Risk of non-payment - even with a contract. Your clients are small businesses, new businesses and/or otherwise risky businesses. When clients go under, or worry about cash flow, consultants don't always get paid.

Difficult prospecting. There are no lists of wanna-be cannabusiness entrepreneurs who have not yet applied for licenses, and only a few sources of names for current cannabis entrepreneurs. You'll need to do significant digging and networking. Then, filtering out the potential whales from the minnows will also be tough.

## **Access to Capital**

Traditional financing is limited for consultants, but not specifically because they are operating in the cannabis business. Services firms are not an easy to find financing for in any industry. Some of the most successful consultants, then, currently are divisions of existing firms which underwrite their expenses until they can get their feet off of the ground.

## **Benefits**

You can start a consulting practice with relatively little investment, beyond your expertise and networking time. Your client connections can pay off in other ways, such as business partnerships and private investments, as the industry takes off in years to come. You can also cross-sell other products and services if you are a division of a cannabusiness company with relevant offerings.

## **Existing Players**

The consultant space is becoming increasingly crowded each day due to the low barrier to entry. In some markets, previously solo practitioners are banding together in partnerships to offer a range of services, from licensing advice to growing tips, as a team. Going forward, competition will be increasingly stiff.

## Insurance

Retail insurance salespeople connect cannabis businesses with the handful of insurance carriers that actually offer policies for the industry. These larger insurance companies operate in the “excess and surplus” category of the greater insurance industry; they are not household-name firms that market to mainstream clients. The job of the insurance salesperson is to analyze each client’s risk proposition, and then decide which type of policy is correct for that type of cannabis business, and then sell that policy along to the carriers.

### Market Potential: Medium

Like other businesses, cannabis businesses need insurance to guard against a wide range of risks, from theft and fire to federal raids and price fluctuations. Growers, retailers, edibles firms and all other niches have specific insurance requirements.

To specialize in cannabis insurance, salespeople must have a deep knowledge of the “excess and surplus” segment of the insurance industry, and business connections at these firms. These firms are very skeptical of the cannabis industry.

If a salesperson can create these types of relationships, there is a strong potential for business growth within a recreational market. Mainstream insurers will likely warm up to the cannabis industry as governmental regulations are relaxed and more companies generate strong revenue.

### Costs

Aside from routine office expenses, insurance pros major expenses revolve around educating the marketplace (some of whom have never bought commercial insurance before – or are aware cannabis businesses can be insured) and marketing outreach. Sales reps must expect to spend a lot of time on the road, traveling to industry events and client meet-ups. Cannabusiness owners prefer to meet face-to-face, which puts an emphasis on travel.

### Challenges & Risks

Aside from understanding the “excess and surplus” segment of the insurance industry, insurance reps must also understand the unique risk profiles of a variety of cannabis businesses. The job requires years of experience in traditional insurance to understand the relationship between client and underwriter, and what role insurance salesperson plays in that relationship. Key challenges include:

Slow pay cycles: the Insurance Agent is not paid until a policy is signed, sealed and delivered. This can take six months to a year of research and sales before a policy can even be pitched to a client.

Prospect education: many owners in this segment have negative views of the insurance industry and operate without any type of business insurance.

Underwriter education: this industry is still foreign to most insurance carriers.

Stigmas: insurance salespeople may be targeted by activist groups and ignorant policy officers for selling insurance that some believe is bogus.

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**Access to Capital**

Most salespeople in this segment are attached to larger insurance firms, so they have their expenses underwritten by the firm. Traditional bank loans are available to these businesses to fund an insurance salesperson.

**Benefits**

Insurance salespeople focusing on cannabis can operate across multiple states (with appropriate licenses) and target a wide range of businesses within the industry. However, they must overcome the before-mentioned challenges before the industry really steps up to the plate and begins purchasing insurance policies en masse. This may come down to the types of policies that underwriters agree to, such as crop coverage or theft protection.

**Existing Players**

Only a handful of cannabis-specific insurance professionals are currently serving the industry. Most are attached to existing mainstream business insurance firms.

## Marketing/Advertising

Marketing and advertising firms help cannabusinesses build brands, develop packaging, advertise appropriately, drive foot and online traffic and generate sales. Specific opportunities include:

Retail marketing: drive foot-traffic and awareness, in particular via mobile and social media marketing. Rewards and loyalty programs are a solid secondary opportunity.

Edibles and infused product brand marketing and packaging consults.

B2B marketing: helping ancillary products and services, along with wholesalers, gain a client base in the cannabusiness industry.

Note: much like pharmaceutical or tobacco advertising, marketing and advertising to cannabis consumers is highly regulated. Firms should offer specialty services for clients in this niche.

### Market Potential: Moderate

Any entrepreneur or marketing services firm can provide marketing services to the industry, as long as they are willing to learn the regulations and restrictions surrounding it. However, most potential clients are currently fairly small, local businesses, run by entrepreneurs with little or no marketing experience. This means you'll need to be ready to educate clients – do a lot of hand-holding – for fairly lowball accounts.

CPG (consumer package goods) and naturopathic remedy branding and packaging specialists have the best shot at landing multi-state or national accounts.

Otherwise, most accounts are in the local retail arena. These retailers (including MMJ dispensaries and the limited pool of recreational retailers) are spending tens of millions, as a whole, on online advertising via services such as Leafly and Weedmaps. However, retailers generally manage this activity in-house.

Both cannabusiness people and their customers tend to have higher-than-average mobile device usage. These executives and their customers are not sitting at desktop computers as often as they are viewing their mobile devices on the go. Marketing services with strength in mobile will have the edge on landing new accounts and servicing them.

### Costs

Aside from routine office expenses, client handholding is a key cost of doing business. You will probably spend more time on the phone with cannabusiness clients than you do with executives in other industry niches.

Also, your prospective clients have a very strong preference to do business only with people they have met in person. So, you'll need to budget staff time (and possibly T&E expenses) to meet prospects in person rather than just using online forms, phone and email.

### Challenges & Risks

Although nearly all aspects of the industry have a significant need for professional branding, marketing and advertising, most companies are small and led by proprietors who do not have a

marketing background or know how to budget or buy marketing services. They may not think marketing is important beyond their online listings on services such as Leafly and Weedmaps. Other challenges:

**Bad ideas:** Due to inexperience or personal background, your clients may prefer/request campaigns that won't help them. For example, they may think low prices equal branding, or request creative with stoner or sexist images that may not play well in the marketplace.

**Marketing limitations:** Facebook does not currently accept any ads for cannabusinesses. Google silos those ads to very limited audiences. In addition, state laws generally will not allow any advertising on mass media that could be viewed by minors or target out of state tourists.

**KISS (Keep it Simple Stupid) copy:** Although industry insiders have a wealth of knowledge about their products and cannabis properties, they may not understand that the general recreational public does not. Campaigns focusing on technicalities may not play well outside of the gourmet crowd.

**Cash management:** Clients may request long-term monthly billing rather than up-front payments for campaigns or services. Some retailers may ask to pay you in cash only.

### **Access to Capital**

Service firms typically fund expansion into the cannabis marketplace out of their cash flow or owner's pockets.

### **Benefits**

As an ancillary business, marketing service providers do not share the risks of federal or state prosecution that their clients may have. Firms have the potential to work with multiple clients across multiple niches and/or states. Marketers also have the potential to create a division (or career) that will grow as the industry matures.

### **Existing Players**

Some cannabusiness consultants offer marketing advice as part of their services. Although they may have an industry background, they may not have deep general marketing experience that may be needed as the industry goes mainstream. Increasingly, mainstream marketing consultants are considering working in the industry, but most underestimate how difficult it will be to serve it.

## Packaging

Packaging companies manufacture glass jars, plastic bags, plastic tubes or boxes that hold cannabis and edibles or infused products. This may include custom branded packaging, childproof packaging and vacuum packaging that helps keep contents shelf-stable longer and prevents the cannabis smell from escaping. State recreational cannabis laws will likely require businesses to use some type of childproof packaging. Packaging may also include labeling, which requires design skills as well as full knowledge of each state's labeling laws.

### Market Potential: Weak-Moderate

The potential for these businesses could increase significantly, depending on the rules and regulations for packaging established by legislators. In some markets, lawmakers may create mandates for childproof packaging.

Existing large-scale packaging companies hold a huge advantage due to their ability to sell in bulk, which keeps prices low. Local manufacturers have the upper hand with producing smaller quantities on a shorter lead time.

With small margins and sizable costs, packaging is a business for entrepreneurs who are patient, not ones looking for quick cash.

### Costs

Most (but not all) packaging makers outsource manufacturing overseas, predominantly in Asia but also in other areas where labor is cheap. Packagers must pay for R&D, manufacturing and transport to their warehouses. For larger companies, these expenses can easily be in the hundreds of thousands of dollars. Other expenses include:

- Warehouse space, shipping costs (sea, air or ground.)

- Salaries of employees, both full-time and contract workers.

- Marketing and sales.

- Product testing.

### Challenges & Risks

Packaging is a capital-intensive business, so mistakes in demand forecasting, shipping or logistics can lead to huge losses in investment. Other challenges:

- Legislative changes: due to long lead times between final design and when products arrive, changes in packaging legislation can render huge amounts of product useless, or it can put serious strains on supply-chain requirements.

- Quality control: can be an issue with manufacturers in Asia and abroad. The distributor has to eat the cost of problems, since there is no way to send inventory back.

- ROI can take years to achieve.

- Some banking risks: some packaging companies have lost merchant or bank accounts when



banks realized the business was related to cannabis, even though it does not touch cannabis directly.

Competitors: the number of entrants in the field is growing quickly.

Client education: many edibles and infused product makers and retailers are not from traditional business backgrounds and do not understand the value of branded or sophisticated packaging beyond what is required by state law.

Childproofing: some legislators may expect that ‘childproof’ packaging actually means ‘minor-proof’ packaging – i.e. packaging that stops anyone under the age of 21 from accessing it. If this becomes the law, packaging companies have an R&D challenge.

### **Access to Capital**

Traditional forms of banking and bank loans are available for these businesses, since they are not directly involved with cannabis sales. However, the large startup costs may scare off some lenders.

### **Benefits**

Entrepreneurs in this sector do have the potential to make a decent profit, however the business requires that most revenues are invested back into the company. If new states legalize recreational, existing packaging manufacturers have a major advantage due to the huge startup costs in this sector.

### **Existing Players**

Smaller regional companies can produce childproof packaging and even some well-designed packages for products. The large, national companies with overseas connections will be the ones to supply the lion's share of the industry since their production costs and ability to deal in volume will keep the price of the final product low. However, larger companies are not particularly nimble and sometimes take more than six months to react to required design changes.

## Paraphernalia

Traditionally, paraphernalia has included bongs, pipes, vaporizers, hookahs, glass bubblers and the like. The introduction of vaporizer pens and then smoking devices for waxes, oils and hashish has helped increase growth.

In the past, paraphernalia retail was largely reserved for smoke shops, also called “head shops,” and direct-to-consumer online sales. Although the recreational boom could bring more business to headshops and online, we’ve seen headshops go under in neighborhoods served by a strong MMJ dispensary. Therefore, the true recreational market growth opportunity is for products sold in recreational retail stores, instead of traditional sales channels.

In this section, we outline the potential for paraphernalia manufacturers who are hoping to do business with these recreational cannabis retail shops.

### Market Potential: Strong

Last year, the US head shop industry generated nearly \$10 billion in total U.S. retail sales, according to HQ Magazine. Given that recreational cannabis was not available legally anywhere in the US at that time, the market forecast for paraphernalia sales growth in recreational markets is rosy.

The breakthrough paraphernalia product, generating heavy sales at retail and MMJ shops, is the vaporizer pen, which allows consumers an odorless way to smoke. Shaped like a ballpoint pen, these burn cartridges of cannabis oil. These retail in the \$100 to \$250 range. They cannot be sold at head shops because their vapor cartridges contain cannabis. Manufacturers predict sales will continue to increase exponentially, as consumers realize the pens provide an odorless product that can be consumed in public. Others, however, believe that vape pen usage will decline because legalization will eliminate the need for a stealthy product, and cannabis smokers will return to bongs and pipes.

### Expenses

For both bong manufacturers and vaporizer companies, the primary expense for doing business with the cannabis industry is sales and marketing. The marketplace for paraphernalia is already crowded, so these products must convince retail store owners to stock their products.

Marketing budget includes advertising in consumer media and point-of-purchase displays as well as travel to events and industry meet-ups to network. It also includes event sponsorship. A common event sponsorship tactic in the paraphernalia market is sponsoring parties based around specific events, such as Oscar night or a Cannabis Cup.

Other expenses include:

Raw materials: glass, plastic, acrylic or small metal parts.

Labor: glass blowers and glass artisans can earn up to \$80,000.

Rent, real estate for company headquarters.

Manufacturing and shipping costs.

Advertising in industry and lifestyle publications online and off.

### **Challenges & Risks**

The primary challenge for these businesses is in creating and maintaining relationships with retail shops to stock and sell the products. Also, maintaining pricing is a concern. Cannabis retailers (whether MMJ or recreational) will, on occasion, undercut headshop prices as a marketing ploy to bring in more customers to cross-sell on cannabis offerings.

Vape pen manufacturers could have problems opening a bank account with a mainstream bank or securing lending from mainstream sources. The financial industry sees vaporizer pens as a grey-area product, since the product is connected with cartridges that contain cannabis products. Similarly, operating with credit card companies for direct sales could be a challenge.

Bong and pipe manufacturers, however, do not face these hurdles.

Other paraphernalia business challenges include competition from a crowded marketplace, and product failures, breaks and returns.

### **Access to Capital**

Traditional funding is available for most bong and pipe manufacturers, however vaporizer pen companies could have problems with bank accounts and securing loans from mainstream banking.

### **Benefits**

The recreational market is guaranteed to grow the marketplace for paraphernalia. Newer products in the market are going to be in high demand due to media reports and other free advertising around cannabis consumption. Marijuana smokers who are returning to the plant could likely explore new options.

### **Existing Players**

Major paraphernalia manufacturers are located in The Netherlands, Germany, the United Kingdom and other European countries, and they compete with the major brands in the United States. Also, regional glass blowers make bongs and pipes, and can develop a strong local following. Finally, a handful of national vaporizer pen manufacturers are trying to gain market share in that segment.

## Payment Processing

Payment processing firms facilitate electronic transactions between retail shops and their customers. They accomplish this through several different technologies: cashless ATMs, regular ATMs, debit card software and, sometimes, misadvised ways such as offshore accounts or mislabeled coding for traditional credit card companies.

### Market Potential: Moderate

More retailers and transaction volumes translates into more opportunities for these companies.

Since cannabis retailers cannot currently work with traditional banks and credit card companies, they need to enlist help to be able to receive payment via credit cards and debit cards. Specialist payment processors facilitate these transactions.

As banking regulations and merchant account rules change over time, payment processing will still be important. However, it may not require cannabusiness specialists.

Payment processing entrepreneurs can quickly set up shop and begin marketing their services to cannabusiness clients, although for specialist systems, the startup costs can be sizable.

### Costs

Cashless payment processing technology startup costs can alone top \$200,000. Monthly technology licensing fees and training fees are in the \$50,000 to \$60,000 range. Other costs include:

Staff salaries and basic office costs.

Marketing and sponsorships: the only way to earn business is to go out and find it. This means local advertising in business-to-business publications as well as sponsorships for industry events.

Travel: payment processors must be willing to travel across the country to network with potential clients. Event marketing is a must, but so is just getting out and meeting people at their place of business.

### Challenges & Risks

The biggest risk facing payment processors is the threat of being targeted by the federal or state government with accusations of fraud, or being targeted by the banks and credit card companies for violating their policies against working with cannabis businesses. The former threat can lead to serious fines or even jail time if serious fraud is detected. The latter can lead to payment processors being placed on black lists within the lending industry, which could prevent future business options.

But these pitfalls are only there for payment processors who are knowingly violating the rules, or who are incredibly sloppy in their work. We sincerely hope that none of the readers decide to go down either path.

Other challenges include:

Making sure your sales reps don't misrepresent your service to potential clients or the retailer's

actual business on account applications.

Convincing cannabis entrepreneurs to purchase your services.

Avoiding partnerships with fraudulent entrepreneurs who want you to violate the rules.

### **Access to Capital**

Some banks will loan money to payment processors, who can then loan that money to cannabis business owners. Larger card companies, such as Chase, will not work to open an account with third-party payment processors.

### **Benefits**

The biggest benefit for third-party payment processors is the ability to establish working business relationships with a wide swath of the industry in hopes that legislation change will open the floodgates for new business. Payment processors who are able to start small and establish a good relationship within the industry are poised to create lots of business for themselves, should rule changes open the door for major players to enter the industry. The service also gives an entrepreneur relatively fast access to cash, as well as a steady cash flow from clients.

### **Existing Players**

Most of the existing players in this space are independent contractors. No institutional banks or credit card companies have entered the space... yet. A few sponsor banks are hovering around the industry, waiting for legislation to change.

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## **Real Estate**

Two primary real estate services are being offered to the recreational cannabis industry: landlords who rent to cannabis businesses and real estate consultants who help these businesses obtain property.

In addition, some commercial real estate investors are purchasing space with the intention of renting or re-selling to cannabusinesses.

Typically, retailers, growers and edibles makers tend to rent space, rather than buying. This is in part because banks may not give mortgages to cannabis-touching companies, and in part because startups don't have the initial capital or cash flow to buy outright.

### **Market Potential: Medium**

Few businesses face as many real estate challenges as cannabis businesses. Despite high demand, zoning laws and unfriendly local business climates make the search very challenging.

Entrepreneurs with strong cash flow may prefer to buy property rather than rent it; however, it's unlikely they'll be able to get bank mortgages. So, they'll seek rent-to-own leases or ask the seller to hold the mortgage.

Commercial property owners who are willing to work with cannabusinesses could profit substantially. Entrepreneurs who hope to purchase real estate for the sole purpose of renting to cannabis cultivators or retail centers should expect to wait between 7-10 years to see a return on their investment.

### **Costs**

For investors who are going this route, beware: if the current building owner discovers you are hoping to rent to a cannabis entrepreneur, the price will likely go up, as the space for cannabis cultivation centers and retail centers is limited.

### **Challenges & Risks**

Owners of cannabis real estate face several risks, chief amongst them the threat of confiscation from federal or local law enforcement if the tenants are not abiding by ordinances. Other risks include:

Property damage from raids or thieves. Property owners should ask for a significant security deposit.

Losing your mortgage if your bank does not like the business that your tenant is in.

Depending on whether your tenants are able to get a bank account, you may need to accept cash payment for rent, vs a check.

Loss of property value: buildings that house grow/retail facilities may lose value due to stigma or perception of contamination.

There is the risk that the company may go under due to bad business practices or other rea-



sons.

Most commercial leases have an initial three-year term. With an entirely new industry, it's tough for entrepreneurs to judge from the start just how much space they will need for the next three years.

### **Access to Capital**

Landlords do have access to traditional capital, such as bank loans, however landlords do face the threat of backlash from these mainstream lenders if they discover a landlord is doing business with a cannabis client. Banks can call in a note if this happens, and they can put the landlord on a blacklist if they feel they have been cheated, or that the landlord has misrepresented himself or herself.

### **Benefits**

Rents are generally above market average. Many landlords also gain a sense of personal satisfaction from supporting the industry. Others find satisfaction from finding a use for structures and warehouses that have been overlooked by more mainstream commercial enterprises.

Unlike cannabis-touching companies, landlords can own real estate in multiple states, which allows them to diversify their cash flow and do business with cannabis entrepreneurs in different regions.

Real estate consultants in this segment can charge \$250 an hour, with a retainer of several thousand dollars.

## Security/Alarms

Cannabusiness security products and services include everything from cameras and alarms to Tasers, armored vehicles (to move cash) and security personnel. Many of the businesses are traditional camera and alarm companies, which install and then help businesses monitor the systems. This is because many states mandate some type of security system at grow houses and retail centers.

Local security businesses, then, should pay attention to legislation within recreational markets, because the decisions of lawmakers could create a bonanza of new business.

### Market Potential: Medium-Strong

If legislation does require cannabis businesses to have security systems, then security firms could create a boon in business by catering specifically to the industry. Both grow houses and retail centers are frequent targets of theft. Grow house security generally includes closed-circuit television as well as an alarm system. This is the same for the retailer. Some retailers also hire unarmed guards to be on the premise during particularly busy times of the year.

Although nearly every firm will have some type of security, not all will sign up for expensive services unless it is required by law.

### Costs

New entrepreneurs will have high startup costs, as they must front the cost of camera equipment and alarm systems wholesale via a distributor. These systems can run in the hundreds of thousands of dollars, even at the wholesale level. Additional costs include staff salaries, sales and marketing.

### Challenges & Risks

Competition presents the biggest risk in this industry. Most of the competitors in this space will be existing security firms that then decide to win business from the cannabis industry. These businesses will already have vendors for cameras and alarm systems, and staff that can do the installing. Individual entrepreneurs who have detailed knowledge of the security industry can establish a business for themselves relatively quickly, however they face an uphill battle against more established firms.

Other risks include:

Dealing with new businesses that may or may not go out of business before the end of a contract.

Meeting the standards of state-imposed security measures is a minimal challenge in this space. Most rules will simply require some type of closed-circuit video and alarm system to be installed, however the rules will likely not be challenging to follow.

### Benefits

For existing security companies, the ease at which they can operate within the cannabis industry will depend on whether the state will require a cannabis-specific license to operate.

Once recreational laws are approved, security and alarm companies will likely see an immediate uptick in business. Since much of the work is done upfront, these businesses may have to do limited upkeep and follow-up with the businesses they work with. Finally, security firms and alarm companies can work with multiple cannabis companies across various states, so there is the opportunity to create a national brand, or at the very least leverage business relationships within the cannabis industry to secure additional business.

**Access to Capital**

Traditional lending from banks is typically available for these businesses.

**Existing Players**

The security and alarm space is dominated by larger regional companies that work with large industry, as well as sole proprietors and startups that target smaller businesses. All of these players can be expected to take a look at the cannabis industry, because the security requirements of these businesses is constant.

## Technology & Software Companies

Numerous technology and software companies serve the cannabis industry, selling everything from business software to grow and extraction equipment. Many focus on grow efficiencies -- which will be critical for growers and retailers competing against the cheaper cannabis the black market offers. Some focus on mandated government oversight.

The field is also wide open for new technology introductions – in particular specialized harvesting equipment for cannabis.

### Market Potential: Strong

Opportunities for business greatly improve in a recreational market, since government agencies could require growers, retailers and edibles/infused manufacturers to track their inventories and sales using software. Plus, the increase in competition within these markets will put pressure on all companies to operate more efficiently, and software provides a great opportunity to root out waste within a cannabis system. Also, the introduction of more businesses-minded entrepreneurs will increase the sales numbers for software, since these entrepreneurs are likely familiar with these types of systems from other industries.

On the hardware side, extraction technologies such as large closed-loop systems will also see greater demand under recreational cannabis. Recreational laws will likely require extraction companies to abandon the old and sloppy methods of packing cannabis into PVC pipes or glass columns for extraction. Also, the emphasis to create better edibles and more creative extractions will require more professional techniques.

### Costs

On the software end, creating a product requires a sizable upfront investment to hire programmers. The initial cost to create workable inventory tracking software can be as high as \$300,000. It is not a business for someone who is averse to spending money. Other costs include:

Server space: most software companies rent space on servers, and this can run between \$1,500 to \$10,000 a month, depending on space and quality requirements.

Ongoing development costs: software is not a static product. Instead, it requires constant updating and reworking after its initial development. Developer fees can range from \$50 to \$60 on the low end, up to \$250 to \$300 on the high end. You will spend many hours with your developer.

On the hardware side, closed-loop extraction systems require investments in research and development, as well as construction costs. Then, manufacturers of these products need to convince the industry to purchase them at the desired price point, which can range from \$4,000 on the low end up to \$150,000 for large custom units. All told, these firms can expect to spend in the \$150,000 to \$250,000 in startup costs. As an ongoing concern, your costs will include specialist staff with construction or welding backgrounds.

All technology firms also have these costs:

Marketing: both technology and software products require ample marketing to convince those in the industry to use these services. Sponsorships and event marketing are very important for

these two sectors.

Travel: along with marketing, travel is important for these two segments, since both products can be sold to cannabis business owners in multiple states. Place an emphasis on traveling to events and industry meet-ups in order to network.

### **Challenges & Risk**

For manufacturers of extraction technology: you will need to convince edibles and extraction groups to abandon their basic and inexpensive extraction methods (PVC pipe or glass column) and invest tens of thousands of dollars in a professional unit.

Software firms face similar challenges, however the price point is lower, so convincing cannabis professionals to purchase software may be an easier sell. Other software challenges:

Software firms can be called into court to testify against clients by the IRS.

Software firms can be called into court to testify in court cases that come from partnership problems with your clients.

Software bugs.

Constant updating of software can lead to huge expenses and time investment.

Clients who are not software or technology savvy, some may not have operated a business requiring complex technologies in the past.

Mobile-readiness: your clients are far more likely to be using a mobile device than a desktop computer for much of the day, so if your product isn't mobile, it could be a problem .

### **Access to Capital**

For companies that also offer services to non-cannabis clients, banking may not be a huge obstacle. But this could be an issue for companies that solely work with the cannabis industry. For these, the best option could be private funding options, such as friends and family, investor networks or private loans.

### **Benefits**

Both segments of the industry allow the entrepreneur to do business across multiple states and create important business relationships that can lead to other ventures. And both segments allow for entrepreneurs with knowledge or expertise in other industries to bring those skills into the cannabis industry.

Owners of accounting software, for example, can tweak their product to fit the needs of the cannabis industry, and then begin marketing to this segment of the industry relatively quickly. Entrepreneurs who have knowledge of extraction hardware from the pharmaceutical or supplement industry can also market their products similarly to cannabis entrepreneurs.

That said, these segments have different business models.

Extraction equipment is extremely expensive, so the entrepreneur is not looking for a volume

business, but rather the chance to sell a small number of units per year. This means the business is built around lump-sum transactions with few clients.

The model is different for software companies, which generally charge an upfront fee as well as a monthly fee to maintain the software and host each client's data. The ability to have steady cash flow is definitely an option for software manufacturers.

### **Existing players**

For software companies, there are a handful of existing firms that are specifically marketing their inventory tracking and accounting software to the industry. Some of these companies have national footprints, but in many cases, they are regional in nature and owned by entrepreneurs that also do business with other industries.

In extraction technology, there are many small players who are building closed-loop systems in machine shops or workshops.

# Appendix 1

## The Cole Memo



U.S. Department of Justice


Office of the Deputy Attorney General

The Deputy Attorney General

Washington, D.C. 20530

August 29, 2013

### MEMORANDUM FOR ALL UNITED STATES ATTORNEYS

FROM: James M. Cole   
Deputy Attorney General

SUBJECT: Guidance Regarding Marijuana Enforcement

In October 2009 and June 2011, the Department issued guidance to federal prosecutors concerning marijuana enforcement under the Controlled Substances Act (CSA). This memorandum updates that guidance in light of state ballot initiatives that legalize under state law the possession of small amounts of marijuana and provide for the regulation of marijuana production, processing, and sale. The guidance set forth herein applies to all federal enforcement activity, including civil enforcement and criminal investigations and prosecutions, concerning marijuana in all states.

As the Department noted in its previous guidance, Congress has determined that marijuana is a dangerous drug and that the illegal distribution and sale of marijuana is a serious crime that provides a significant source of revenue to large-scale criminal enterprises, gangs, and cartels. The Department of Justice is committed to enforcement of the CSA consistent with those determinations. The Department is also committed to using its limited investigative and prosecutorial resources to address the most significant threats in the most effective, consistent, and rational way. In furtherance of those objectives, as several states enacted laws relating to the use of marijuana for medical purposes, the Department in recent years has focused its efforts on certain enforcement priorities that are particularly important to the federal government:

- Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;



Memorandum for All United States Attorneys  
Subject: Guidance Regarding Marijuana Enforcement

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- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.

These priorities will continue to guide the Department's enforcement of the CSA against marijuana-related conduct. Thus, this memorandum serves as guidance to Department attorneys and law enforcement to focus their enforcement resources and efforts, including prosecution, on persons or organizations whose conduct interferes with any one or more of these priorities, regardless of state law.<sup>1</sup>

Outside of these enforcement priorities, the federal government has traditionally relied on states and local law enforcement agencies to address marijuana activity through enforcement of their own narcotics laws. For example, the Department of Justice has not historically devoted resources to prosecuting individuals whose conduct is limited to possession of small amounts of marijuana for personal use on private property. Instead, the Department has left such lower-level or localized activity to state and local authorities and has stepped in to enforce the CSA only when the use, possession, cultivation, or distribution of marijuana has threatened to cause one of the harms identified above.

The enactment of state laws that endeavor to authorize marijuana production, distribution, and possession by establishing a regulatory scheme for these purposes affects this traditional joint federal-state approach to narcotics enforcement. The Department's guidance in this memorandum rests on its expectation that states and local governments that have enacted laws authorizing marijuana-related conduct will implement strong and effective regulatory and enforcement systems that will address the threat those state laws could pose to public safety, public health, and other law enforcement interests. A system adequate to that task must not only contain robust controls and procedures on paper; it must also be effective in practice. Jurisdictions that have implemented systems that provide for regulation of marijuana activity

<sup>1</sup> These enforcement priorities are listed in general terms; each encompasses a variety of conduct that may merit civil or criminal enforcement of the CSA. By way of example only, the Department's interest in preventing the distribution of marijuana to minors would call for enforcement not just when an individual or entity sells or transfers marijuana to a minor, but also when marijuana trafficking takes place near an area associated with minors; when marijuana or marijuana-infused products are marketed in a manner to appeal to minors; or when marijuana is being diverted, directly or indirectly, and purposefully or otherwise, to minors.

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Subject: Guidance Regarding Marijuana Enforcement

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must provide the necessary resources and demonstrate the willingness to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities.

In jurisdictions that have enacted laws legalizing marijuana in some form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale, and possession of marijuana, conduct in compliance with those laws and regulations is less likely to threaten the federal priorities set forth above. Indeed, a robust system may affirmatively address those priorities by, for example, implementing effective measures to prevent diversion of marijuana outside of the regulated system and to other states, prohibiting access to marijuana by minors, and replacing an illicit marijuana trade that funds criminal enterprises with a tightly regulated market in which revenues are tracked and accounted for. In those circumstances, consistent with the traditional allocation of federal-state efforts in this area, enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity. If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.

The Department's previous memoranda specifically addressed the exercise of prosecutorial discretion in states with laws authorizing marijuana cultivation and distribution for medical use. In those contexts, the Department advised that it likely was not an efficient use of federal resources to focus enforcement efforts on seriously ill individuals, or on their individual caregivers. In doing so, the previous guidance drew a distinction between the seriously ill and their caregivers, on the one hand, and large-scale, for-profit commercial enterprises, on the other, and advised that the latter continued to be appropriate targets for federal enforcement and prosecution. In drawing this distinction, the Department relied on the common-sense judgment that the size of a marijuana operation was a reasonable proxy for assessing whether marijuana trafficking implicates the federal enforcement priorities set forth above.

As explained above, however, both the existence of a strong and effective state regulatory system, and an operation's compliance with such a system, may allay the threat that an operation's size poses to federal enforcement interests. Accordingly, in exercising prosecutorial discretion, prosecutors should not consider the size or commercial nature of a marijuana operation alone as a proxy for assessing whether marijuana trafficking implicates the Department's enforcement priorities listed above. Rather, prosecutors should continue to review marijuana cases on a case-by-case basis and weigh all available information and evidence, including, but not limited to, whether the operation is demonstrably in compliance with a strong and effective state regulatory system. A marijuana operation's large scale or for-profit nature may be a relevant consideration for assessing the extent to which it undermines a particular federal enforcement priority. The primary question in all cases – and in all jurisdictions – should be whether the conduct at issue implicates one or more of the enforcement priorities listed above.

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Subject: Guidance Regarding Marijuana Enforcement

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As with the Department's previous statements on this subject, this memorandum is intended solely as a guide to the exercise of investigative and prosecutorial discretion. This memorandum does not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law. Neither the guidance herein nor any state or local law provides a legal defense to a violation of federal law, including any civil or criminal violation of the CSA. Even in jurisdictions with strong and effective regulatory systems, evidence that particular conduct threatens federal priorities will subject that person or entity to federal enforcement action, based on the circumstances. This memorandum is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal. It applies prospectively to the exercise of prosecutorial discretion in future cases and does not provide defendants or subjects of enforcement action with a basis for reconsideration of any pending civil action or criminal prosecution. Finally, nothing herein precludes investigation or prosecution, even in the absence of any one of the factors listed above, in particular circumstances where investigation and prosecution otherwise serves an important federal interest.

cc: Mythili Raman  
Acting Assistant Attorney General, Criminal Division

Loretta E. Lynch  
United States Attorney  
Eastern District of New York  
Chair, Attorney General's Advisory Committee

Michele M. Leonhart  
Administrator  
Drug Enforcement Administration

H. Marshall Jarrett  
Director  
Executive Office for United States Attorneys

Ronald T. Hosko  
Assistant Director  
Criminal Investigative Division  
Federal Bureau of Investigation

# Appendix 2

## Glossary of Common Cannabis Business Terms

**420:** A term used to refer to cannabis consumption or as a way to identify oneself with cannabis culture. Observances include smoking cannabis at 4:20 p.m. or on April 20. Some cannabis businesses incorporate the term into their company or product names.

**280E:** A section of the federal tax code that effectively bars businesses selling marijuana from taking common business tax deductions, such as payroll, utilities and insurance.

**Access Point (also see: Dispensary):** In Washington, medical marijuana dispensaries are classified as “access points” by the state’s medical marijuana law. This term may become obsolete when the state implements new regulations governing its recreational cannabis law later in 2014.

**Adult Use (also see: Recreational):** A term commonly used by those in the cannabis industry when referring to the laws that legalize the use of cannabis by adults 21 and over for any desired purpose (vs. medical marijuana). Adult-use marijuana laws have been approved in Colorado and Washington State.

**Cannabidiol (CBD):** Commonly referred to as CBD, cannabidiol is one of many cannabinoids found in marijuana, but it does not have intoxicating effects. CBD is believed to help patients with a wide range of ailments, from cancer to multiple sclerosis.

**Cannabis:** Also known as marijuana. A genus of plants native to South and Central Asia that includes three varieties: Cannabis Sativa, Cannabis Indica and Cannabis Ruderalis.

**Cannabinoids:** Chemicals produced in the cannabis plant that cause marijuana to have medical and psychoactive effects.

**CHAMP Case:** A 2007 case in which the *Californians Helping Alleviate Medical Problems* group sued the Commissioner of the IRS over tax deductions made by marijuana businesses. The IRS conceded that marijuana businesses could deduct cost of goods sold under the 280E section of the tax code.

**Clone:** A non-sexual reproduction of a plant that results in a plant genetically identical to the donor plant. Many times, the plant is clipped off of the mother. In many cases, the donor plant is female.

**2013 Cole Memo:** Nickname of an August 2013 memorandum by U.S. Deputy Attorney General James Cole that allows states with recreational marijuana laws to move forward with establishing and regulating the industry, so long as they implement “strong and effective regulatory and enforcement systems.” The memo also specifies eight enforcement areas the U.S. Department of Justice should prioritize when targeting marijuana businesses. The Cole Memo serves as guidance to state Attorneys General, and is not a binding document they are obliged to follow.

**Collective:** A collaborative effort by patients and caregivers to grow, process and/or distribute cannabis. Usually a non-profit, these groups only distribute marijuana to active members.

**Controlled Substances Act (CSA):** Passed by Congress in 1970 and signed into law by then-President Richard Nixon, the CSA is the federal drug policy under which the manufacture, importation, possession, use and distribution of controlled substances is regulated. Marijuana is classified as a “Schedule I Controlled Substance” under the CSA, alongside mescaline, peyote and LSD.

**Cross-Breeding:** The breeding of the male of a particular strain to the female of another strain.

**Curing:** The act of slowing the drying process of marijuana in order to allow metabolic processes to continue after harvest. Curing enhances flavor, aroma and potency.

**Dabs:** Solidified hash oil or wax created through an extraction process commonly involving cannabis being blasted by butane or alcohol. These cannabis concentrates have extremely high percentages of THC, sometimes 70%-90%.

**Dispensary (also see: Access Point and Wellness Center):** A retail point for selling medical marijuana.

**Ditch Weed:** A generic term used for bad marijuana. Marijuana that is so bad it must have been grown by the side of the road or in a ditch.

**Edibles:** A generic term referring to food and beverages made with marijuana extracts, oils or leaves. Formerly resigned to brownies and other baked goods, today marijuana edibles include potato chips, chocolate candies, peanut brittle and even baklava.

**Extracts:** Products made from resin or wax that has been removed from the marijuana plant by a separation process, such as CO2 extraction or ice water submergence. Common extracts include butter, hashish oil or kief.

**Grow:** A facility used specifically for the cultivation of marijuana. Grows are often indoor warehouses, greenhouses or converted outdoor space. Also commonly called cultivation sites or growhouses.

**Hashish:** A paste-like cannabis product composed of pressed or purified trichomes. Hashish is most commonly created by sieving cannabis through a screen or mechanical tumblers.

**Headshop:** A store that specializes in marijuana smoking products, such as bongs, vaporizers, pipes or rolling papers. Most headshops advertise their products as being for tobacco use only.

**Home Grow:** A personal-use marijuana cultivation operation, which is usually located inside a patient's house. Of the 21 states allowing medical or recreational marijuana, 14 allow users to grow their own plants. Home grow laws mandate how many plants each individual can legally grow.

**Hydroponics:** The act of fertilizing a plant via the application of a water-soluble chemical nutrient to an inert growing medium.

**Hybridization (Hybrid):** The crossing of sativa with an indica, or of one strain with another strain.

**Indica:** One of two cannabis strains that are used for psychoactive qualities, indica is shorter and denser than sativa. Indica generally has a higher cannabidiol content than sativa strains and it is faster growing than sativa. Often, users report it provides a laid-back, body-type high.

**Infused Products:** A generic term referring to any product that has been injected or imbued with marijuana, CBD or THC. The most common infused products are marijuana edibles; however, beverages and lotions also fall under this category.

**Kief/Keef:** The resin glands (or trichomes) of the marijuana plant that sometimes break loose from the cannabis flowers and accumulate inside bags, bottles or other containers used to store cannabis flowers. Kief contains a much higher concentration of THC, and it can be vaporized or smoked.

**Kind Bud:** Slang for high-quality marijuana flowers. Kind bud does not contain leaves, stems or seeds.

**Kush:** A generic term referring to a subset of high-grade cannabis Indica strains that originated in Afghanistan, Northern Pakistan and Northwest India.

**MMJ:** An acronym for medical marijuana.

**Mother Plant:** The donor plant that a clone is taken from to produce a new plant genetically identical to the original.

**Ogden Memo:** A 2009 memorandum from Attorney General Eric Holder that gave guidelines for federal prosecution in states that authorized medical marijuana. The memo effectively said that the Justice Department would make some allowances for the use of medical marijuana, so long as its patients and distributors are in compliance with state laws.

**Organic:** Growing a plant by using only compounds produced by other living organisms, rather than chemical fertilizers.

**Oils:** The fatty, THC-rich byproduct of a process in which marijuana buds are blasted with solvent and then left to evaporate. Commonly referred to as “honey oil,” “hash oil” or “red oil.”

**Paraphernalia:** Products used to consume marijuana: bongs, pipes, rolling papers, hookahs, etc.

**Recreational (also see: Adult Use):** Legal marijuana use that is not specific to medical marijuana. Also commonly called “adult use” marijuana by those in the cannabis industry. Currently, Colorado and Washington are the only states with recreational marijuana laws.

**Sativa:** One of the two species of cannabis consumed for its psychoactive and therapeutic qualities. Sativas tend to be tall, thin plants with narrower leaves. They grow quite tall, but have a longer maturation time than indica strains. The high from sativas is most associated with laughter and enhanced audio-visual experiences.

**Seedling:** A young plant that has been grown from a seed.

**Seed-to-Sale:** The term used for tracking a marijuana plant from its inception as an independent plant to the retail sale of the plant’s production. Seed-to-sale tracking includes plants created from clones, in addition to plants grown from actual seeds.

**Shake:** The crumbs left over from processed or bagged marijuana. Often, shake is composed of dried leaves, parts of broken flowers and stalks. Shake is often collected and sold to be made into hashish, edibles or dabs.

**Tetrahydrocannabinol (THC):** The main psychoactive ingredient found in cannabis that provides the “high.” THC is glassy and opaque when hard, and a sticky oil when heated. It is produced by resin glands most commonly found in the flower of the female marijuana plant. THC stimulates cells in the brain to release dopamine, creating euphoria.

**Tincture:** A liquid concentration of marijuana that is usually applied via an eye dropper to, or under, the tongue. A tincture is made by soaking parts of the cannabis plant in alcohol.

**Topicals:** Marijuana-infused creams or lotions that are applied to the skin and absorbed into the blood stream. Topicals often have little or no psychoactive benefits and are used for a variety of health reasons, such as treating burns or rashes or relieving joint pain.

**Trichomes:** Sticky resin glands on cannabis plants that contain THC, CBD and other cannabinoids. By monitoring trichomes, which often look like tiny hairs, growers can determine the ideal time to harvest the plants.

**Wellness Center (also see: Dispensary):** A term used in some states to refer to a medical marijuana dispensary.