

The High Cost of Illegal Cannabis

Executive Summary

California's legal adult use cannabis market — the world's largest — is eight months old, but first quarter sales and tax revenues were lower than forecast. The Eaze Insights report reveals new empirical evidence that explores the corrosive impact of the illicit market on licensed retailers.

While cannabis consumers want to support and purchase from the legal market; high prices, taxes, and lack of access to legal cannabis continues to fuel a thriving illicit market. Simply stated, California has done a great job of telling consumers that cannabis is legal but has a long way to go in making it easy to get safe, legal and affordable cannabis.

Unlicensed retailers do not have to comply with worker protection laws, test products for pesticides and processing chemicals, or remit taxes. That results in a large pricing benefit. However, in a trend that may play to the long-term benefit of the legal market, consumers who are increasingly focused on the wellness benefits of cannabis indicate a strong preference for products that deliver reliable results and high quality.

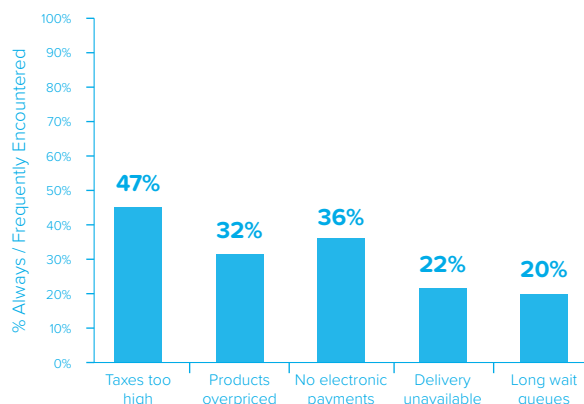
Key Findings

- The majority of Californians (84%) are very satisfied with the legal market.
- 1 in 5 Californians have purchased cannabis from the illicit market in the past three months.
- 84% of those are highly likely to repeat that behavior in the future due to the illicit market having cheaper products and no tax.
- A 5% decrease in the overall tax rate in CA could drive 23% of illicit market supporters into the legal market.
- Consumers purchasing most often from licensed businesses are highly satisfied with labeling (85%) and testing (75%), with their counterparts citing they're less satisfied with the illicit market's labeling and testing (57% and 45%, respectively).
- 9 in 10 California consumers (90%) have some medical use for cannabis, indicating cannabis' strong position as a wellness product.
- Southern California consumers are more likely to purchase from an unlicensed source than Northern California consumers (21% vs 16%, respectively).

1. Continued Desire for a Legal Market

Consumers are satisfied overall with licensed businesses, however data indicates there are still some frustrations that could be addressed.

- 84% are completely or very satisfied with their purchase experience from a licensed source.



Over the past 6 months, how often did you experience the following issues or frustrations when purchasing cannabis from a licensed business?

Q: Now please think about the licensed business that you purchased cannabis from most recently. How satisfied were you overall with your purchase experience?

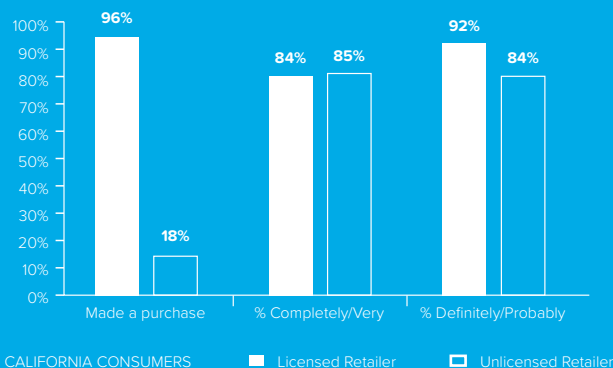
2. Old Habits Die Hard

A significant portion of California consumers who still purchase cannabis from unlicensed sources are satisfied with those sources, and are not incentivized to change.

- Nearly 1 in 5 consumers (18%) have purchased from an unlicensed source in the past three months.
- 85% of those are completely or very satisfied with their purchase experience.
- 84% of those consumers are highly likely to purchase from the same unlicensed source again.

Q: please think about the licensed business that you purchased cannabis from most recently. How satisfied were you overall with your purchase experience? Q: Now please think about the unlicensed source that you purchased cannabis from most recently. How satisfied were you overall with your purchase experience?

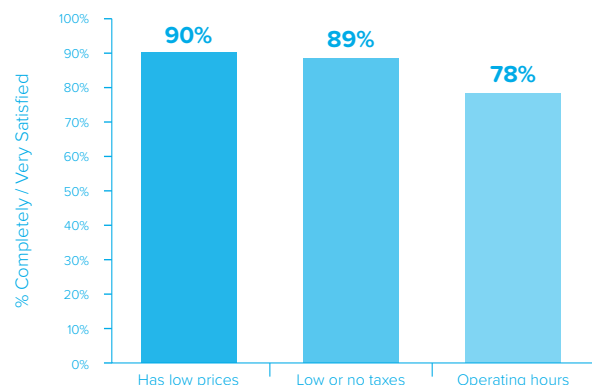
Q: Thinking of the same licensed business, how likely are you to purchase cannabis from them again in the future? Q: And thinking of the same unlicensed source, how likely are you to purchase cannabis from them again in the future?



3. The Price Is Right

The illicit market lacks the regulatory requirements and restrictions which provide a safety tested, environmentally conscious, pesticide free product for consumers. This gives unlicensed sources strong market advantages like overall lower cost of production, and unlimited operating hours and locations.

- Consumers who most often purchase from unlicensed sources are overwhelmingly satisfied with low prices and lack of taxes.



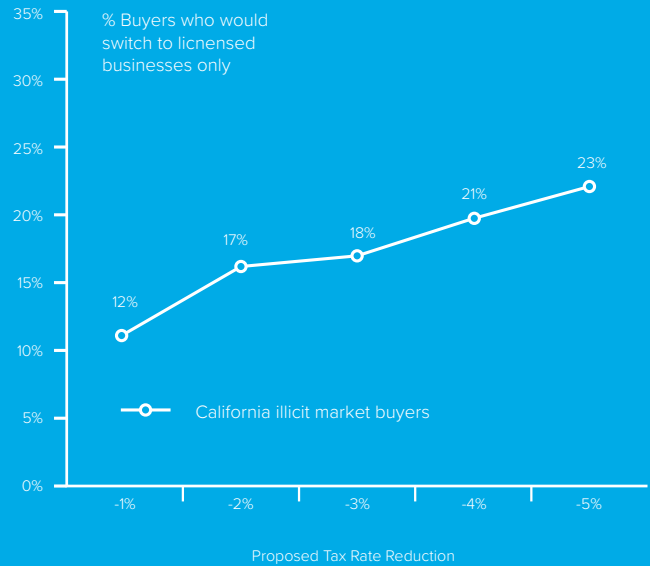
Q: Please think about the unlicensed source where you purchase cannabis most often. How satisfied are you with their performance on each of the following items?

4. How We Should Defend A Legal Market

4a. Taxation

Data shows tax rates are important factors for consumers when deciding to purchase on the legal or illegal market.

- A 5% reduction in the overall tax rate in California could move nearly a quarter of illicit market supporters (23%) to make only legal market purchases.
- Conversely, a 5% increase in the overall tax rate in California could drive nearly a third of exclusive legal market consumers (32%) to unlicensed sources.

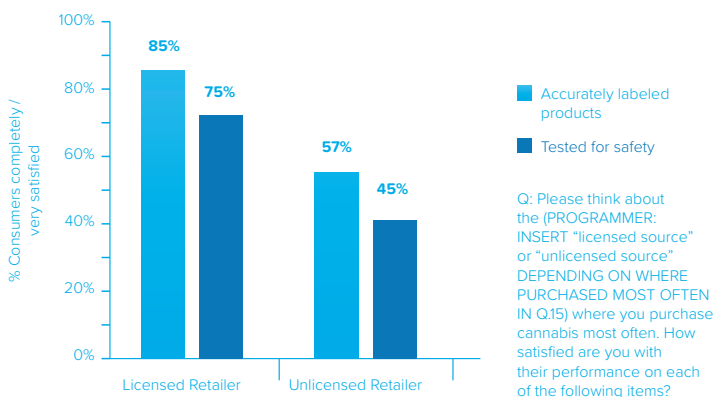


The average tax rate on cannabis in CA is currently 34%. How likely would you be to only buy cannabis from legal businesses if the tax rate was [33%, 32%, 31%, 30%, 29%]?
Q: What would the tax rate need to be for you to only buy cannabis from legally licensed businesses?

4b. Product Information

Similar to other consumer product industries, data show cannabis consumers are much more satisfied with licensed businesses when it comes to accurate product labeling and safety testing.

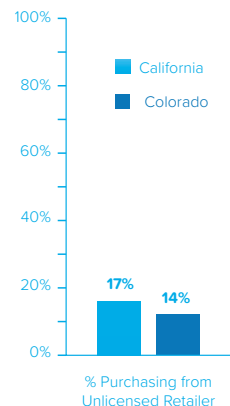
- Consumers purchasing most often from licensed businesses are highly satisfied with labeling (85%) and testing (75%).
- Consumers purchasing most often from unlicensed businesses are less satisfied with labeling (57%) and testing (45%).



4c. Legal Access

While California voters approved cannabis state-wide, many local governments currently restrict access via local laws or regulations, which has driven a significant portion of consumers to purchase from unlicensed sources.

- 1 in 6 California consumers (17%) purchased from an unlicensed source after state legalization due to local laws that restricted access to legal cannabis.

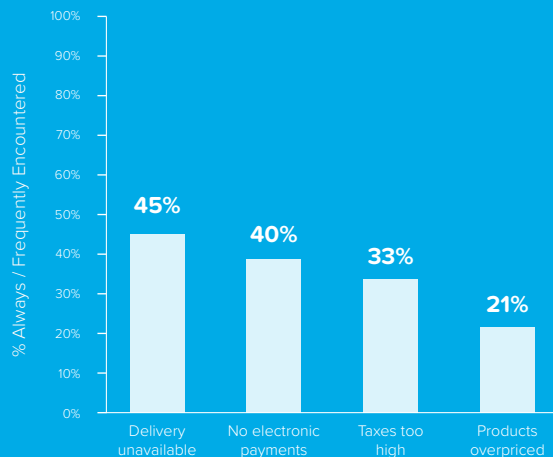


Q: Have you ever purchased cannabis from an unlicensed source because of these city or town laws that restricted your access to cannabis?

5. Oldest vs Largest: Lessons from Colorado

Colorado's cannabis marketplace has had years to mature and consumers are generally compliant and satisfied with the legal market. Comparing Colorado's market with the largest legal cannabis market, California, finds consumers that share motivations and frustrations like product price, quality, and convenience.

- Only 5% of Colorado consumers indicate they purchase most often from an unlicensed source, compared to nearly 10% of California consumers.
- 84% of California consumers are highly likely to purchase from the same unlicensed source again.
- However, 1 in 6 Colorado consumers (17%) have used a cannabis delivery service in the past 3 months, despite a state-wide ban on cannabis delivery services.

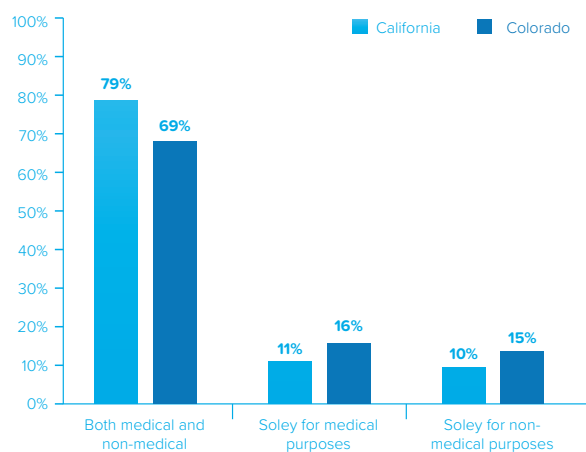


Q: Thinking about your typical cannabis purchases, what percent of your purchases would you say you pick up in store and what percent would you say are delivered? Please make sure your total adds up to 100%. Q: And thinking of the same unlicensed source, how likely are you to purchase cannabis from them again in the future? Q: Over the past 6 months, how often did you experience the following issues or frustrations when purchasing cannabis from a licensed business?

6. Evolving Attitudes

Most consumers in California and Colorado have a medical or wellness purpose for consumption.

- 9 in 10 California consumers (90%) have some medical use for cannabis.



Q. Why do you consume cannabis?

7. Products Like Any Other, For a Consumer Like Any Other

The factors influencing consumer purchasing decisions around cannabis parallel those around mainstream consumer products. Despite stereotypes in popular culture, the cannabis consumer base is quite diverse.

Top factors influencing individual cannabis purchase decisions are:

- Consistent product quality
- Affordability
- Great customer support
- Safety tested products
- Accurately labeled products
- Accepts electronic payments
- Carries preferred cannabis brands

Demographics of California cannabis consumers:

- Average Age: 38 years
- Parents: 33% have children
- Education: 85% have some college

8. Regional Differences

As more consumers discover their personal benefits from cannabis, data reflects some regional differences even between northern and southern California.

Northern California Consumers...

- are more likely to consume frequently* (72% vs 67%)
- are more likely to purchase from a licensed business (91% vs 88%)
- use delivery more often over pick up (69% vs 63%)
- have tried edibles (65% vs 59%)
- enjoy edibles frequently* (13% v 9%)

Southern California Consumers...

- are more likely to purchase from an unlicensed source (21% vs 16%)
- purchase more frequently (4.7 avg. transactions / mo. vs 3.5)
- enjoy prerolls more frequently* (16% vs 10%)
- say they know more about the plant and it's uses (49% know a lot, vs 42%)

* = Four or more occasions per week

Methodology

Path-to-purchase research was conducted online among a random sample of males and females 21+ who live in California and Colorado, and have used cannabis in any form in the past 30 days.

In addition, surveys were conducted among a separate sample of current Eaze customers. The data has been weighted to reflect the gender and age proportions of the California and Colorado census population, and Eaze customers have been weighted to reflect the customer profile. Survey was in field July 6-12th 2018. Data points were tested at the 95% and 90% confidence level.