

US Cannabis Industry

May 5, 2020

IL REC market resilient in face of COVID in April

The IL government reported REC cannabis sales for April 2020, showing good growth in our view, given COVID headwinds and ongoing supply constraints.

April growth solid despite COVID headwind. IL REC cannabis sales were \$37.3m for April 2020, up 4% MoM and higher for the second straight month. Adjusted for selling days, growth for April was even stronger at ~7% MoM, equating to an annualized REC market size of ~\$450m and regaining the prior peak level of run-rate sales reached in Jan. 2020. This highlights resilient growth in our view, given the headwinds from IL's shelter-in-place orders due to COVID, combined with continuing supply constraints and relatively low retail penetration with no new store openings during the month (total ~43 stores open for REC today). While IL's April MED sales are not yet reported, we note they would need to decline by ~20% MoM (most in recent history), for the total IL market to reach a run-rate of ~\$750m, well positioning the state to exceed our 2020 forecast of \$750m.

Store productivity improving, with high growth potential. Store productivity showed some improvement in April, with annual sales per store reaching an estimated \$10.4m/year on avg., up from a low of \$10.0m/year in March, with no new stores opened. In our view, this is due to the strongest growth to-date in local traffic with sales to IL residents up 10% MoM in April. This is encouraging given still limited in-store selection (an important driver of local traffic in our view), and our expectation that IL's REC market supply challenges should alleviate in H2/20. This should provide strong potential for store productivity to rise in H2/20, potentially to that seen in MA at avg. ~\$20m/year (pre-closure).

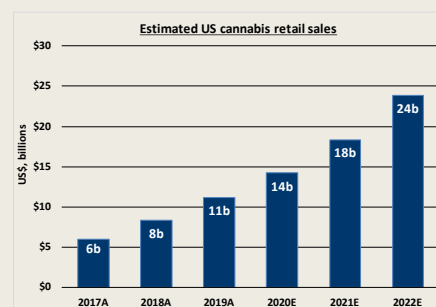
COVID impact ring-fenced to new store openings. With April sales showing solid growth despite shelter-in-place orders likely reducing store traffic levels, we note the negative impact from COVID should be ring-fenced to a delay in new store openings. On April 29th, Gov. Pritzker announced licenses for 75 new REC stores slated to be issued on May 1st would be delayed. While this could slow IL's market growth temporarily, we expect a substantial offset from rising store productivity levels through H2/20, and note that our covered US operators with existing infrastructure stand to benefit from longer preferential market access.

Out-of-state purchases down, but fare well. Given COVID travel restrictions, IL's April REC sales to out-of-state customers were unsurprisingly down -15% MoM to \$7.5m. However, we believe this still demonstrates a good performance with visitor purchases accounting for 20% of total REC sales (vs. 25% in March). With several of IL's surrounding states (IA, MO, IN) initiating re-openings currently, solid visitor traffic levels should be sustained going forward, in our view.

Bottom line. April was the first full month of COVID-impacted sales in a major US REC market without the benefit of stockpiling. Given media conjecture that March's sales spikes would reverse, or that lower throughput at stores would hurt retail, we view April's positive comps for IL's REC market as refuting these theories, and cementing the strong secular growth trend inherent to cannabis.

Synopsis:

The US cannabis sector currently has ~35 states with legal access to either medical or recreational-use cannabis. Similar to Canada, the US cannabis sector allows investors to leverage the strong, secular growth trends which are characteristic of the legalization of cannabis, except in end-markets which are ~5x-10x larger. In aggregate, we project sales from currently legal US states to grow by a CAGR of ~30% over the next four years to reach ~US\$24b.



Source: Stifel GMP

The US cannabis industry is highly fragmented due in part to restrictions on interstate trade, and historical challenges to access capital. This results in a competitive supply environment overall, but also a robust M&A opportunity for well-capitalized, experienced industry players.

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