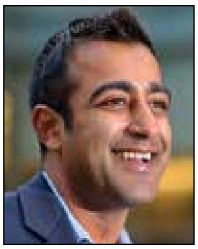
What opportunities are the best bets in legal cannabis?

Washington processors aren't tied to canopy limitations

By Neil Juneja



A friend living in Uruguay recently reached out to me with the intention of entering the marijuana industry. He wanted to know how to be successful in a country basking in post-prohibition, yet filled with poor-quality cannabis. I explained that the true key to doing well in the marijuana industry, or any new industry, is to understand the market, the legal and regulatory landscape, and to remain quite nimble in entrepreneurship direction.

As Washington's system for legalized cannabis continues to develop with new legislation, new license possibilities, and a slightly-settled market, the question becomes: what area of the recreational marijuana market is the best bet?

PRODUCTION

Growing weed was always profitable prior to the implementation of Initiative 502 in Washington and Amendment 64 in Colorado. Much of the profit was due to the risk of criminal prosecution — the so-called "prohibition premium." The risks also created a barrier to entry, thereby reducing competition. Further, the market was not fluid because access to the product was limited. Finally, some of the ordinary costs of doing business didn't exist as they do today, including taxes, insurance, advertising and marketing expenditures.

Now that the cultivation of cannabis is in full swing, with all of the lovely regulations and taxation that comes with it, the economics are rather different. Cannabis is still the most expensive crop in the world, pound-for-pound, but it is not as profitable as it once was. With only about 400 of a possible 2,300 producer licenses issued in Washington at the time of this printing, we are already seeing the effects of excessive agricultural supply. The economics don't work as they once did and now cultivators must conduct some difficult accounting and work toward economies of scale. Even worse, drought, mites and other unpredictable events have the potential to wipe out an entire crop.

The only way to beat the average commodity price is to develop a brand that customers desire. Yet, the limited canopy allowed under a license hampers a producer's ability to maintain a supply in many stores. The marijuana brand loses value if the product isn't available on store shelves at all times.

Growing a commodity like apples is a great gig if you can get your costs down. Now, so is marijuana.

GROWING A COMMODITY LIKE APPLES IS A GREAT GIG IF YOU CAN GET YOUR COSTS DOWN.

This is not to say that there aren't some people doing well in the current market and many more will come and do well, like any business, but with a low bar to entry and so many competitors swarming into the bubble, competition is fierce.

PROCESSOR

Processors can package flower, process oils and make infused products. Edibles are the fastest-growing segment of this license type. It makes sense. When a cannabis novice enters a store, they are assaulted with a diversity of products. Figuratively, a kid in a candy store. There are many flowers, oils, vape pens and dabs. Oils look rather similar on the shelf. So do vape pens. Even flowers become a sea of indistinguishable green.

But in edibles, there is true diversity in products. So many options — candy, cookies, fruits, lozenges, tonics, breath-strips, energy shots, chocolates, teas, and even an infused coffee pod! There is a healthy markup and a uniqueness to many of the products.

Processors are not limited to a finite amount of product they can grow — a licensee can process unlimited quantities of products. Theoretically, with enough raw materials, a processor could have an ample supply of product in every recreational store in the state. And there are even gaps in the current product offerings, meaning opportunities for entrepreneurs. In addition, the brand truly carries well here. Name brand Cheerios are twice as expensive as the generic O's, yet the two products are exactly the same.

RETAILER

The availability of retail licenses, unlike producer and processor licenses, is very limited. A government-designed oligopoly creates an interesting set of economics. And yet, recreational marijuana retailers are analogous to liquor stores. The main difference is price and location, so profit margins will be squeezed. One may travel an extra mile for a liquor store with a better selection and a knowledgeable and pleasant staff, but it is doubtful one would travel far outside of their neighborhood. The right shop in a population center or with limited regional competition will do well. The rest will divide the market into roughly equal portions.

A retail license allows for predictability in revenue, once the market settles down. However, a person can only be on the license of three retail stores. No empire was ever built on three liquor stores. And with Senate Bill 5052 allowing for additional retail licenses to be issued, this market will be further fractured with the entry of additional shops.

CONCLUSION

In the Washington market, if you want to build an empire, concentrate on unique edibles. However, the key to any business rising above the competition is to develop a quality brand and develop an excellent reputation with your customers.

Neil Juneja is the founder and managing partner at Gleam Law, a full-service cannabis-law practice with offices in Washington and Oregon. He is a registered patent attorney and focuses on intellectual property and cannabis law. He can be reached at Neil@GleamLaw.com.