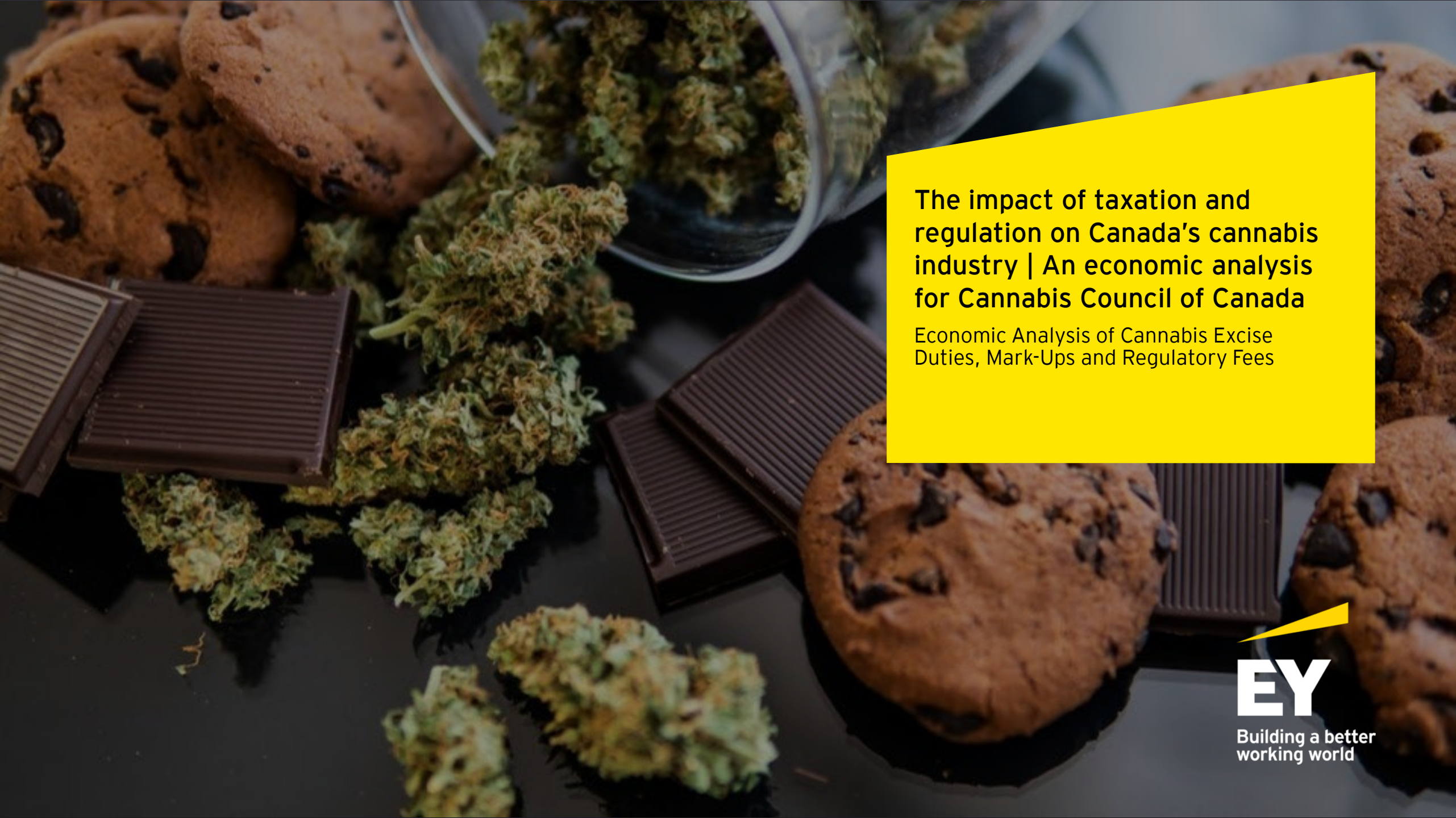


The impact of taxation and regulation on Canada's cannabis industry | An economic analysis for Cannabis Council of Canada

Economic Analysis of Cannabis Excise Duties, Mark-Ups and Regulatory Fees

EY
Building a better working world

Context and methodology

CONTEXT

Organizations that dive deep to understand cannabis' transformational market opportunities, and focus accordingly, can make agile moves now to position themselves as sector leaders over the long term. If you're not ahead of trends in the cannabis sector, you may feel you're already falling behind. But this evolving global industry is still in its first inning. Companies that will lead this space 10 years from now have not yet been decided. The Cannabis Council of Canada engaged EY to develop a report on the overall effects of regulation and taxation on the cannabis industry in Canada. This report will analyze and assess the impact of taxation and compliance costs on the legal industry's ability to compete effectively with unregulated and untaxed contraband products and thereby achieve the *Cannabis Act* objectives. The report will be used to engage in public debate over the optimal level of excise duties and related controls under the federal *Excise Act, 2001* and the *Cannabis Act*.

SCOPE AND PHASES OF WORK

- The work is segmented into two phases as summarized below.
- This document is the Phase 1 Report.

Phase 1	Phase 1 of the study is largely qualitative and focused on Ontario. The EY branded report will be used for presentation and distribution purposes.
Phase 2	Phase 2 of the study is quantitative. It will estimate the price elasticity of demand for cannabis and use this to estimate tax revenues lost to federal and provincial governments at current excise duty rates and the likely impact on the size of the contraband market and the profitability of industry licensees at alternative rates of excise duty.

PHASE 1 METHODOLOGY

- Collected three-year historical sales data (category, volumes, retail sales, retail purchase cost) from HiFyre IQ™, a real-time sales data analysis platform for the cannabis industry.
- Calculated various government taxes, markups applied by licensed producers, Ontario provincial distributor and retailers, and consumer pre- and post-HST prices.
  - We used midpoint Ontario margins and excise duties/provincial tax calculators to calculate key figures (provided by a licensed producer).
- We created a basket of legal cannabis products – comprising 1g flower, 1g pre-roll, 750mg vape and 10mg edible – to provide a summary of the industry in Ontario.

PHASE 1 LIMITATIONS

- Report provides a preliminary qualitative and quantitative view on the state of the industry based on underlying cannabis market data provided by HiFyre.
- Calculations and assumptions are based on input from Licensed Producers, provincial distributor margins and tax calculators.
- Deeper quantitative analysis will be performed in Phase 2.

KEY DATA SOURCES

HIFYRE

HEADSET
Real-time cannabis data

CANADIAN CANNABIS EXCHANGE



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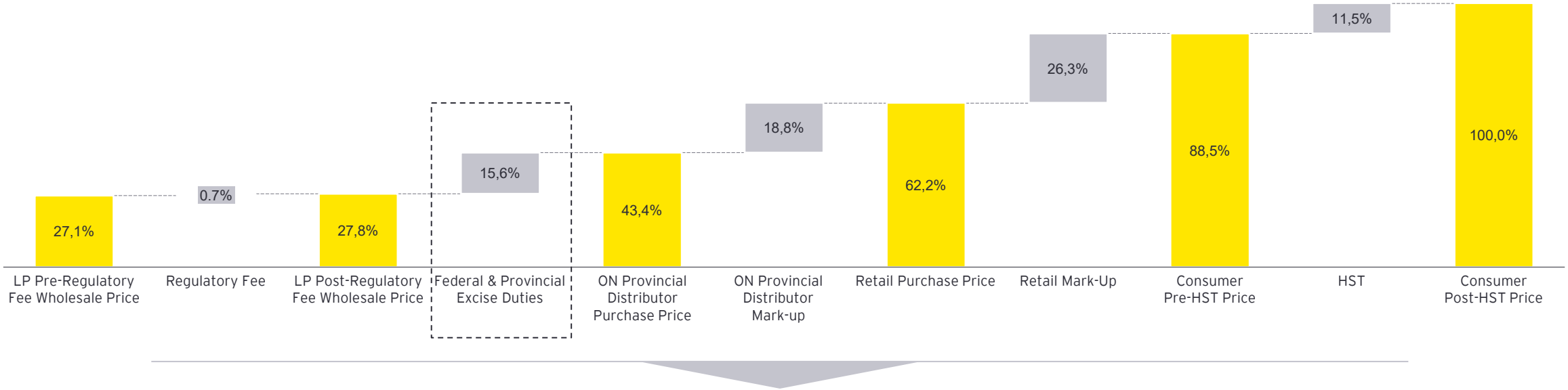
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Cannabis price markup structure in Ontario

Government taxes and provincial markups represent 46.6% of the price of a basket of legal cannabis products, including flower (1g), pre-roll (1g), vape (750mg) and edible (10mg). Licensed producers only capture 27.1% of the selling price in the value chain, while the illegal market would capture the full selling price.

Ontario legal products basket[1] markup structure – based on aggregated data, July 2022–April 2022

As a % of consumer post-HST price



Ontario legal products basket price share breakdown



[1] Includes regulatory fee, federal and provincial excise duties and HST.
Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

Cannabis price comparison in Ontario – legal vs. illegal market

The price of regulated cannabis products including taxes is not competitive with untaxed contraband products. The price difference is significant for vape and edible products.

Ontario legal vs. illegal product price comparison – based on aggregated data, July 2021–April 2022

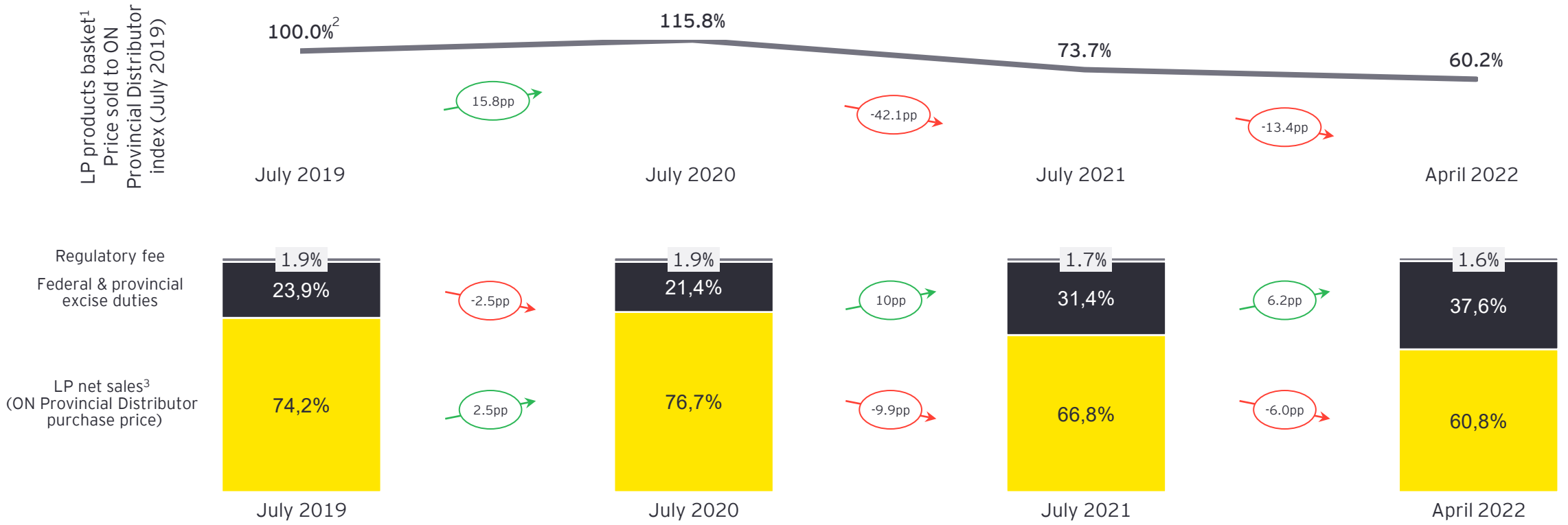


[1] Average illegal market price in April 2022.
Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

Cannabis price compression and share breakdown in Ontario

The legal cannabis industry continues to face significant price compression. Licensed producers' share of net sales decreased from 74.2% in July 2019 to 60.8% in April 2022, while federal and provincial excise duties increased from 23.9% to 37.6%.

Ontario licensed producer products basket[1] price trend and share breakdown, July 2019, July 2020, July 2021, April 2022



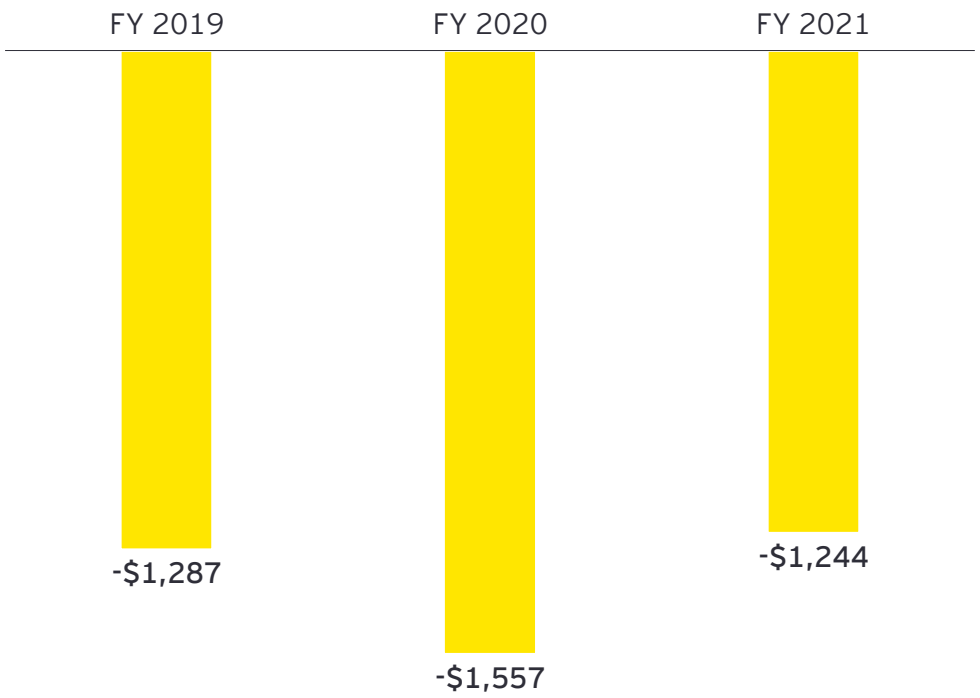
[1] Basket includes flower (1g), pre-roll (1g), vape (750mg) and edible (10mg). 2 No edibles were sold in July 2019. 3 Licensed producer net sales is the price at which licensed producers sell to provincial distributors net of regulatory fees and federal and provincial excise duties.

Sources: HiFyre IQ.

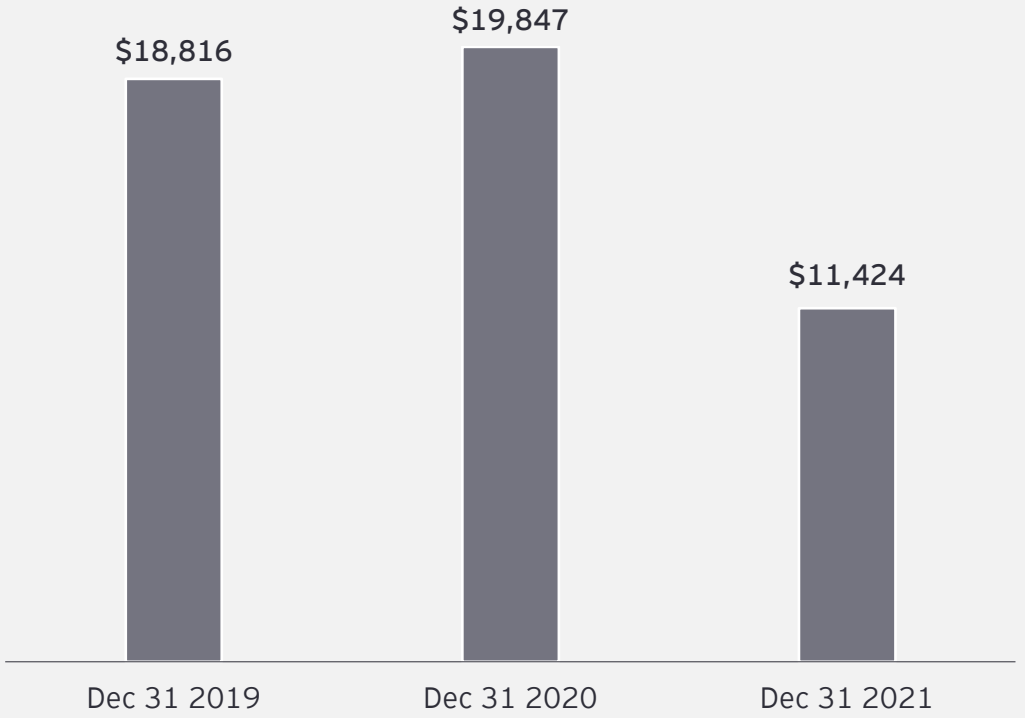
Cannabis companies' operating cash flows and market capitalization

The sustainability of the legal cannabis industry is at substantial risk. Licensed producers remain unprofitable and on the verge of bankruptcy. Investors continue to exit the Canadian market.

Top 10 Canadian cannabis companies operating cash flows
In millions



Top 10 Canadian cannabis companies market capitalization
In millions



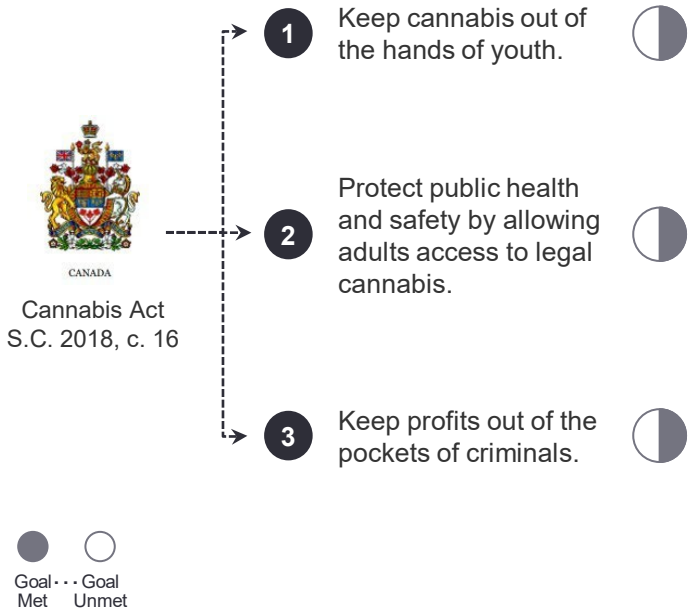
Source: S&P Capital IQ.

Key takeaways and implications

The legal cannabis industry faces serious structural issues. Government tax and regulatory burdens hinder full realization of *Cannabis Act* objectives and threaten the industry's survival.

CANNABIS ACT OBJECTIVES ASSESSMENT

Despite the legal cannabis industry's best efforts, the **three primary objectives of the *Cannabis Act* are not fully met.**



KEY ILLUSTRATIVE FACTS

- **Unregulated** products remain **widely** available in the marketplace, presenting **significant health risks** to consumers due to contamination.
- **Price** of regulated products including taxes is **not competitive** with untaxed contraband products.
- **Current taxation is disincentivizing the shift to regulated products** and **healthier consumption forms**.
- **Current health** of the regulated cannabis industry is not **sustainable**; companies remain **unprofitable** and on the **verge of bankruptcy**.

KEY TAKEAWAYS

- The legal cannabis industry has **worked hard to enhance its competitiveness**, but there are **limits** to what industry can do on its own.
- **Change is required** to achieve the objectives of the *Cannabis Act* and build a vibrant and sustainable legal cannabis industry in Canada.
- **Federal and provincial governments** now need to do their part to combat illicit contraband.

Government policy considerations

Federal and provincial governments could consider future policy changes to achieve the *Cannabis Act* objectives and enable the legal cannabis industry to be competitive against the illicit market and sustainable in the long-term.

FUTURE POLICY CONSIDERATIONS[1]

- **Reduce federal and provincial excise duty rates**.
- **Harmonize federal and provincial excise duty rates** and move to a single national excise stamp eliminating provincial/territorial stamps.
- **Reduce or eliminate cost recovery of government regulatory fees**.
- **Reduce taxation on cannabis 2.0 products** to incentivize the shift to healthier consumption forms.
- **Revisit/increase potency limits** on edible products, including beverages.
- Revise **promotional prohibitions** that prevent licence holders from communicating with consumers about the characteristics, effects and qualities of cannabis products.
- **Revise promotional prohibitions, packaging and labelling restrictions** that preclude the ability of licence holders to develop brands that connect with consumers and attract illicit cannabis consumers into the legal market.

[1] The policy considerations must be appropriately weighed against the public health objectives



- **Revise packaging restrictions** that add to the cost of legal cannabis products but don't contribute to the *Cannabis Act*'s public health and safety objectives (e.g., childproof packaging for non-psychoactive products).
- **Increase enforcement resources** devoted to the interdiction of illicit cannabis and enforcement of *Excise Act, 2001* provisions.
- Launch a **public awareness campaign** on the health risks and danger of purchasing **contraband cannabis products**.
- Launch a **public awareness campaign** on the **harm reduction benefits of non-combustible** cannabis products/cannabis 2.0 products.

APPENDIX





APPENDIX A

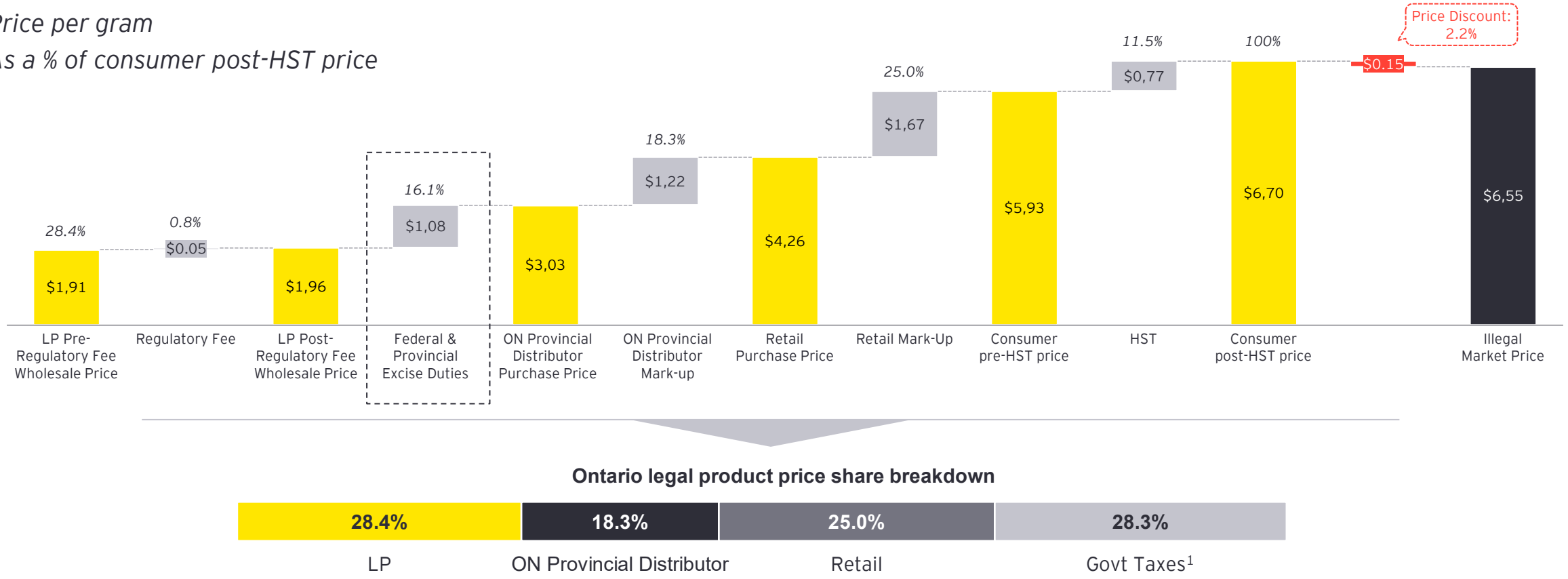
Cannabis price analysis by category and province

Flower price markup structure in Ontario

Ontario legal product markup structure and comparison with illegal product price, based on aggregated data from July 2021–April 2022

Price per gram

As a % of consumer post-HST price

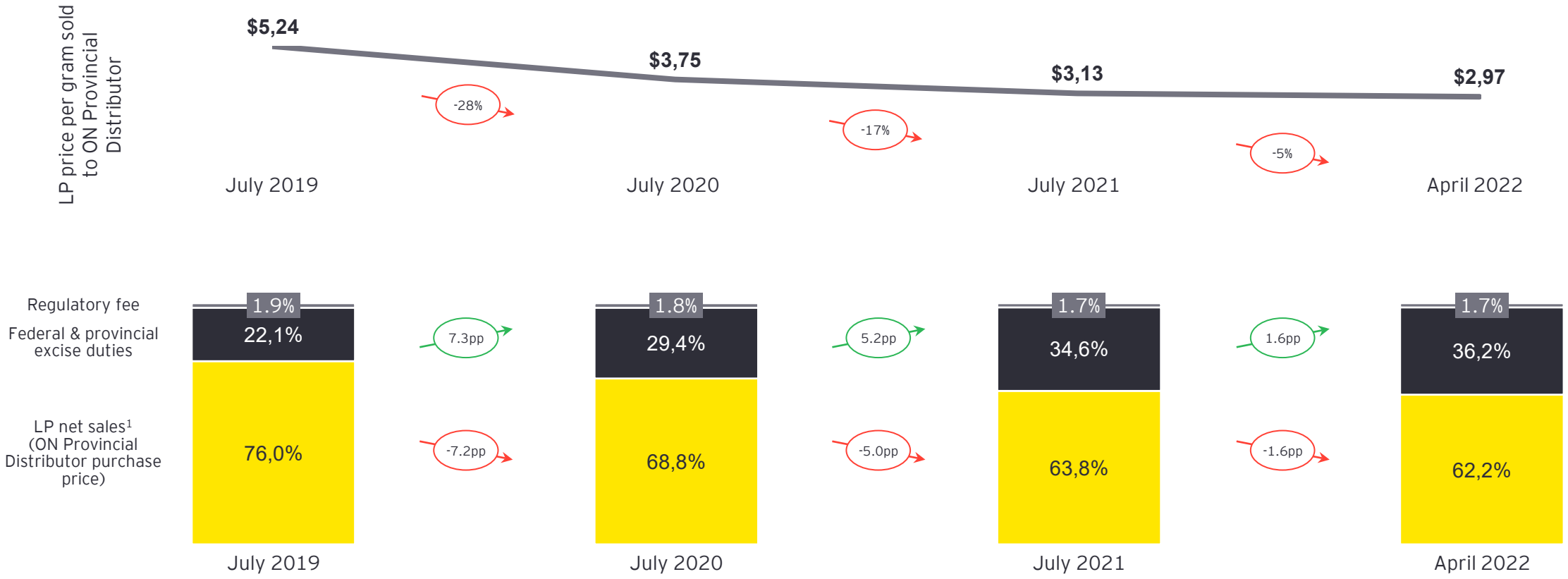


Ontario legal product price share breakdown

[1] Basket includes flower (1g), pre-roll (1g), vape (750mg) and edible product (10mg) based on their weighted sales. [2] Includes regulatory fee, federal and provincial excise duties and HST.
Source: HiFyre IQ.

Flower price compression and share breakdown in Ontario

Ontario licensed producer price trend and share breakdown, July 2019, July 2020, July 2021, April 2022



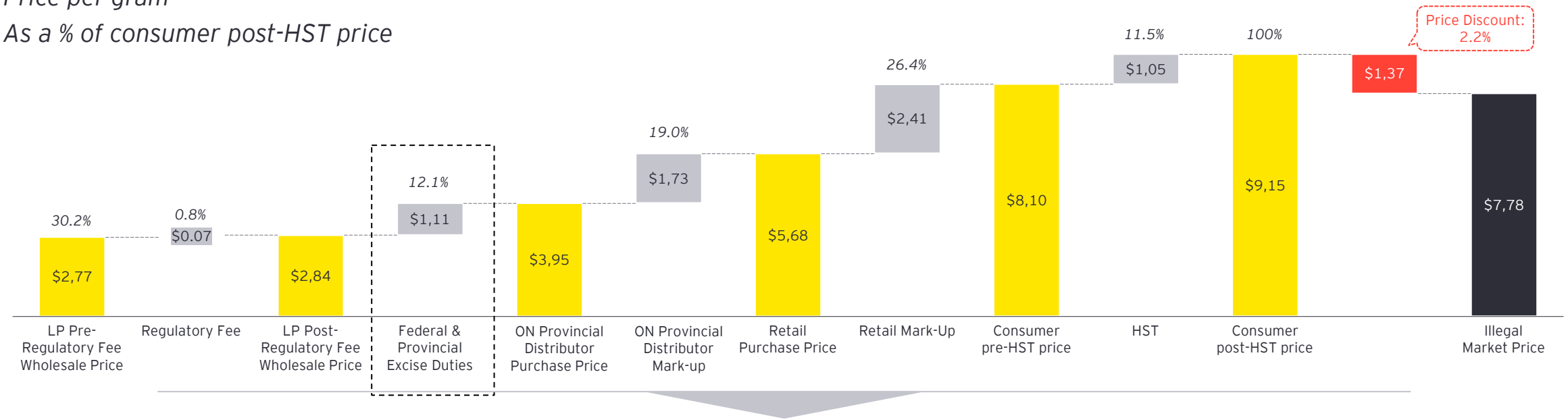
[1] LP net sales is the price at which licensed producers sell to provincial distributors net of regulatory fees and federal and provincial excise duties.
Sources: HiFyre IQ.

Pre-roll price markup structure in Ontario

Ontario legal product markup structure and comparison with illegal product price – based on aggregated data, July 2021–April 2022

Price per gram

As a % of consumer post-HST price



Ontario legal product price share breakdown

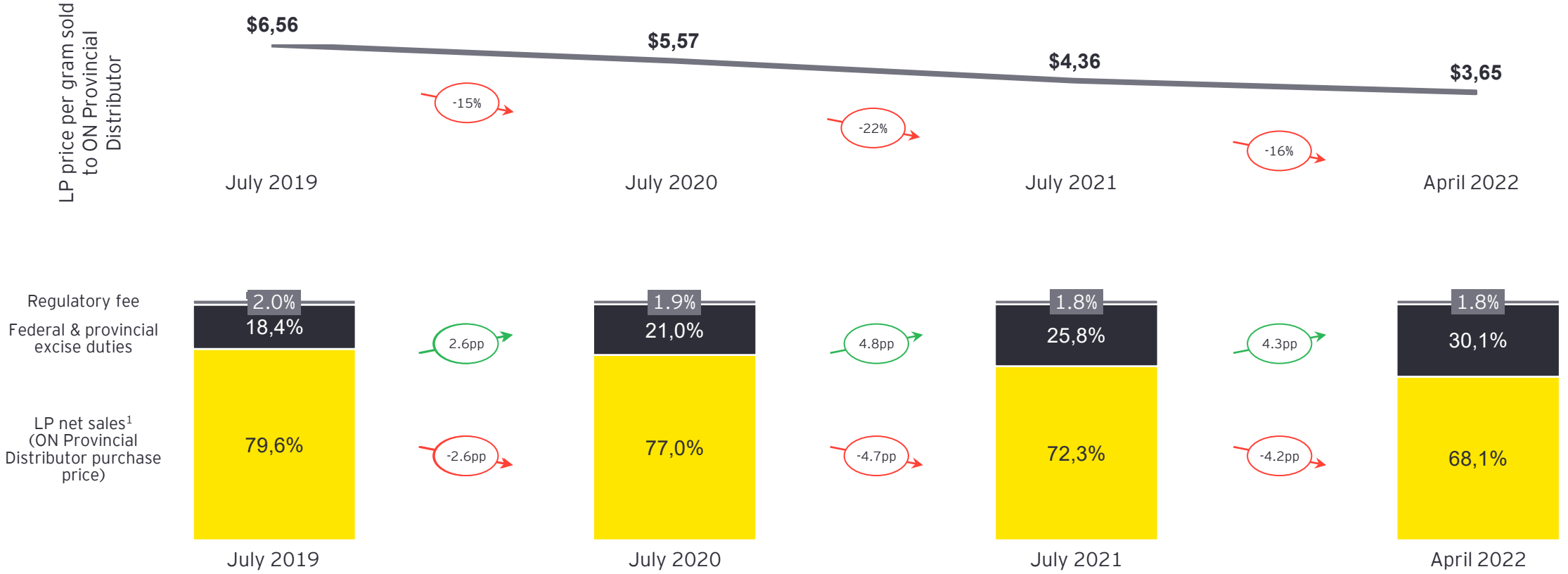


[1] Includes regulatory fee, federal and provincial excise duties and HST.

Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

Pre-roll price compression and share breakdown in Ontario

Ontario licensed producer price trend and share breakdown – July 2019, July 2020, July 2021, April 2022



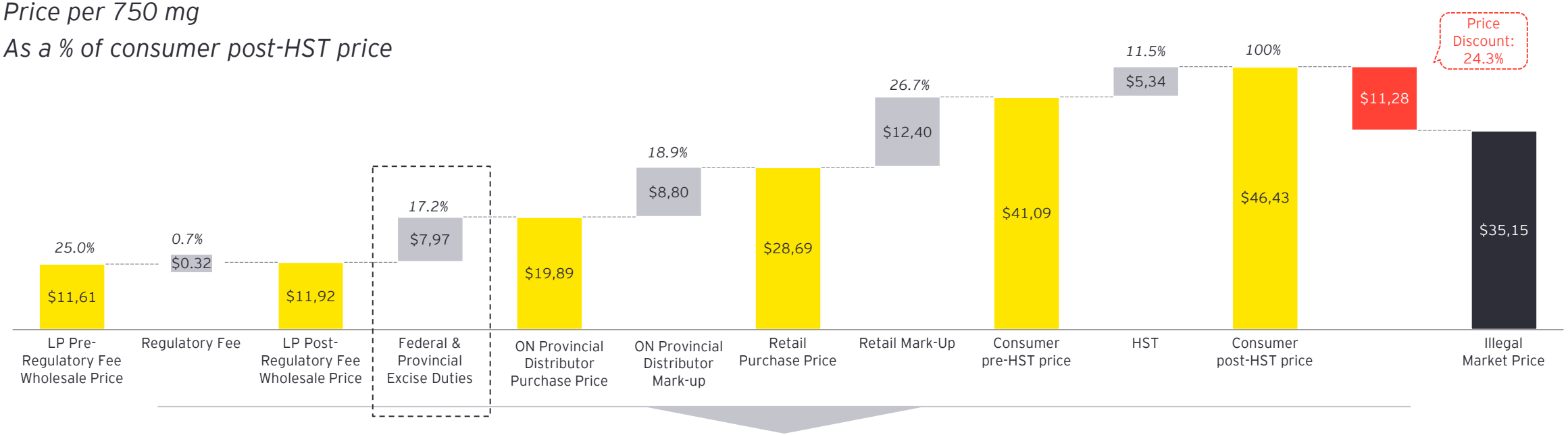
[1] LP net sales is the price at which licensed producers sell to provincial distributors net of regulatory fees and federal and provincial excise duties.
Sources: HiFyre IQ.

Vape price markup structure in Ontario

Ontario legal product markup structure and comparison with illegal product price – based on aggregated data, July 2021–April 2022

Price per 750 mg

As a % of consumer post-HST price



Ontario legal product price share breakdown

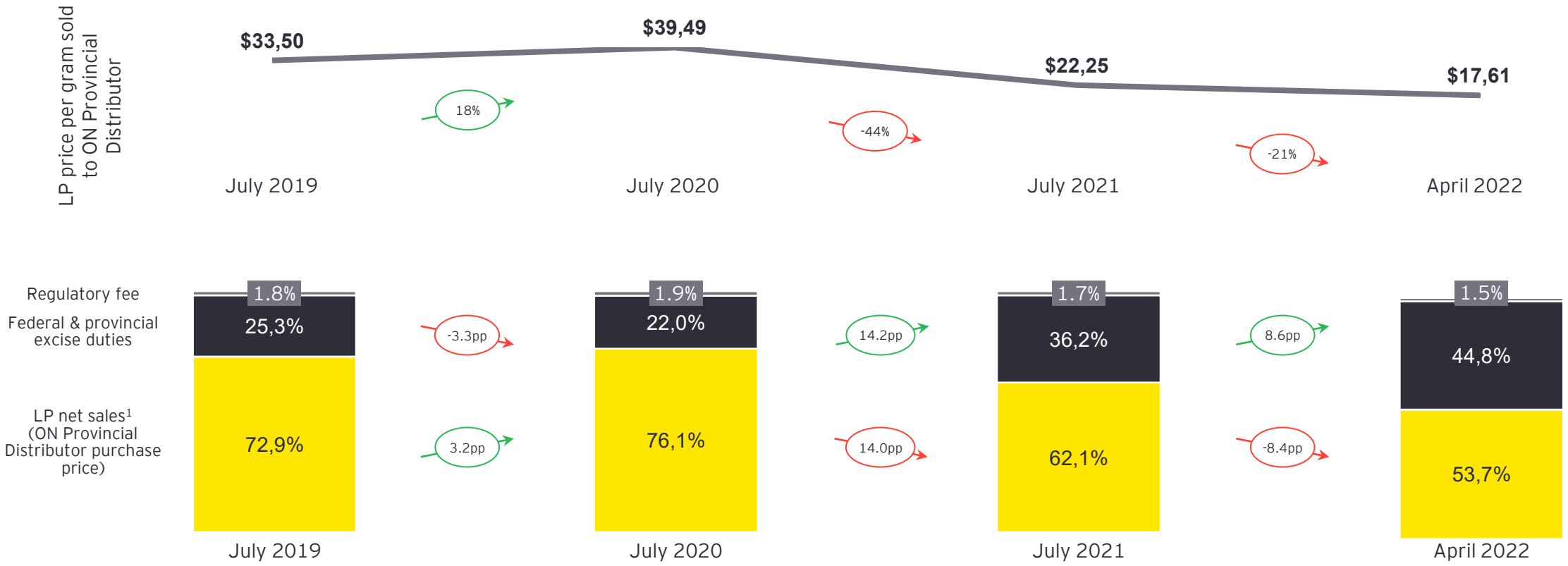


[1] Includes regulatory fee, federal and provincial excise duties and HST.

Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

Vape price compression and share breakdown in Ontario

Ontario licensed producer price trend and share breakdown – July 2019, July 2020, July 2021, April 2022



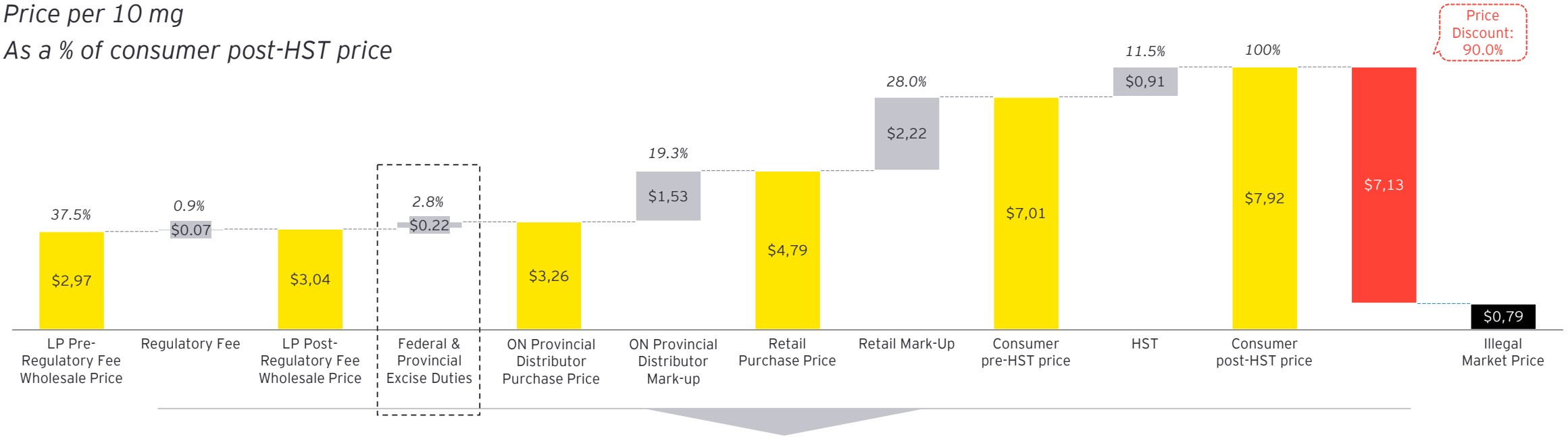
[1] LP net sales is the price at which licensed producers sell to provincial distributors net of regulatory fees and federal and provincial excise duties.
Sources: HiFyre IQ.

Edible price markup structure in Ontario

Ontario legal product markup structure and comparison with illegal product price – based on aggregated data, July 2021–April 2022

Price per 10 mg

As a % of consumer post-HST price



Ontario legal product price share breakdown

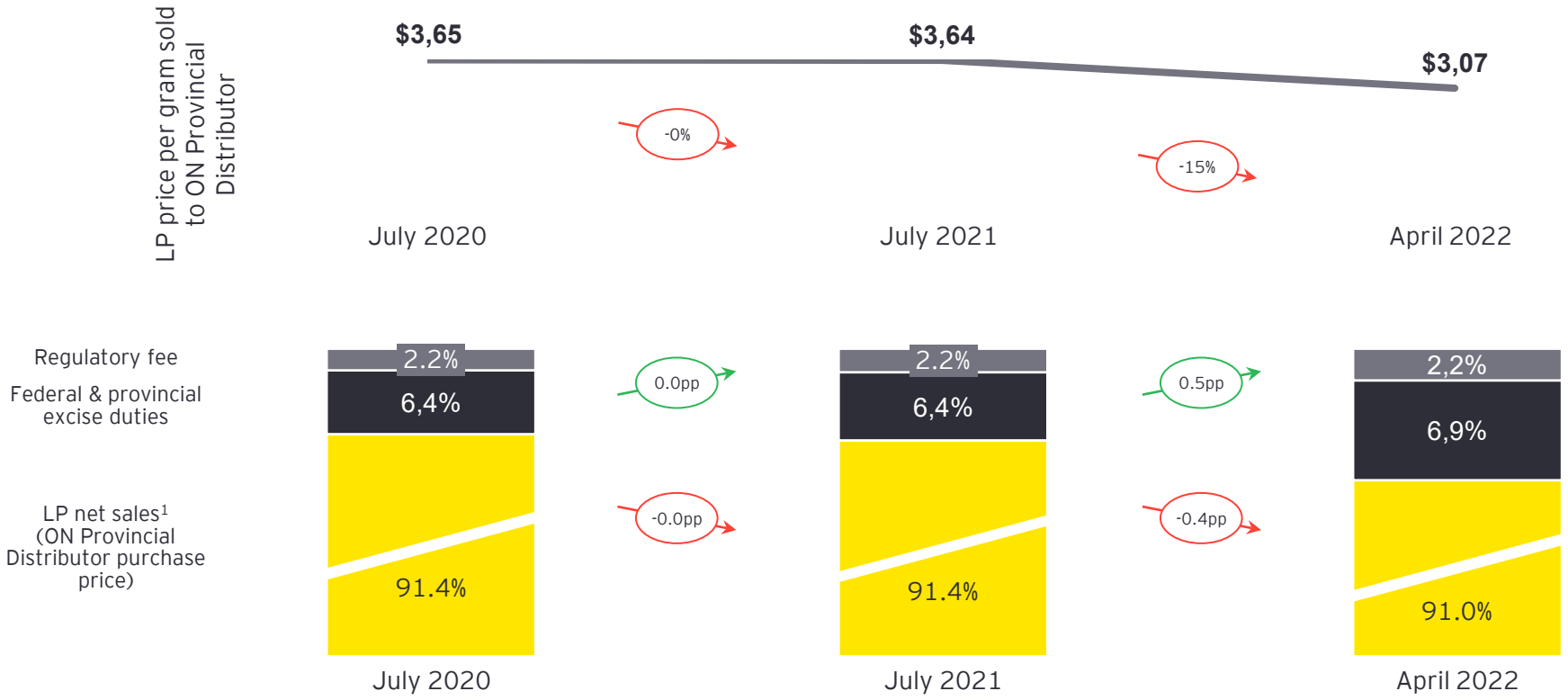


[1] Includes regulatory fee, federal and provincial excise duties and HST.

Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

Edible price compression and share breakdown in Ontario

Ontario licensed producer price trend and share breakdown – July 2020, July 2021, April 2022



[1] LP net sales is the price at which licensed producers sell to provincial distributors net of regulatory fees and federal and provincial excise duties.
Sources: HiFyre IQ.



APPENDIX B

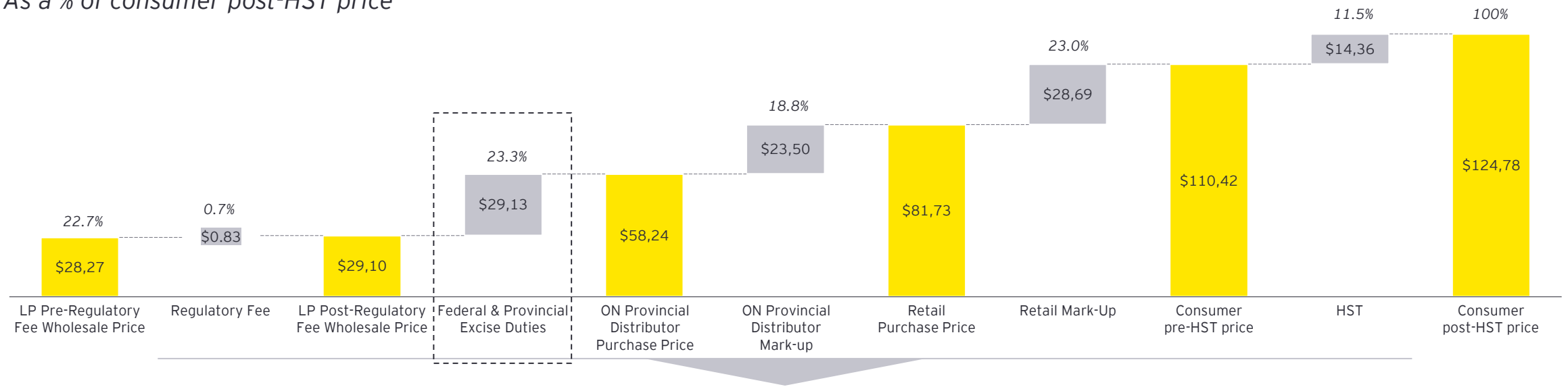
Excise duties, markups and regulatory fees for 28g flower package in Ontario

28 g flower package price markup structure in Ontario

Ontario legal product markup structure and comparison with illegal product price – based on aggregated data, July 2021–April 2022

Price per gram

As a % of consumer post-HST price



Ontario legal product price share breakdown



[1] Includes regulatory fee, federal and provincial excise duties and HST.

Sources: HiFyre IQ; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com.

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