



Cannabis Council of Canada

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

Phase 1 Report

June 2022

Presented to

Cannabis Council of Canada



Context and Methodology

Context

- ▶ Cannabis Council of Canada (“C3”) engaged EY to develop a report on the **overall effects of regulation and taxation** on the cannabis industry in Canada.
- ▶ The 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 **ON**. 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 **3-year historical** sales data from **HiFyre** (category, volumes, retail sales, retail purchase cost).
- ▶ Calculated **various Government taxes, mark-ups applied by licensed producers, OCS, and retailers and consumer pre- and post- HST prices**.
 - We used midpoint ON margins and excise duties / provincial tax calculators to calculate key figures (provided by a Licensed Producer).
- ▶ We created a **basket of legal cannabis products** – comprised of 1g flower, 1g pre-roll, 750mg vape and 10mg edible – to provide a summary of the industry in ON.

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



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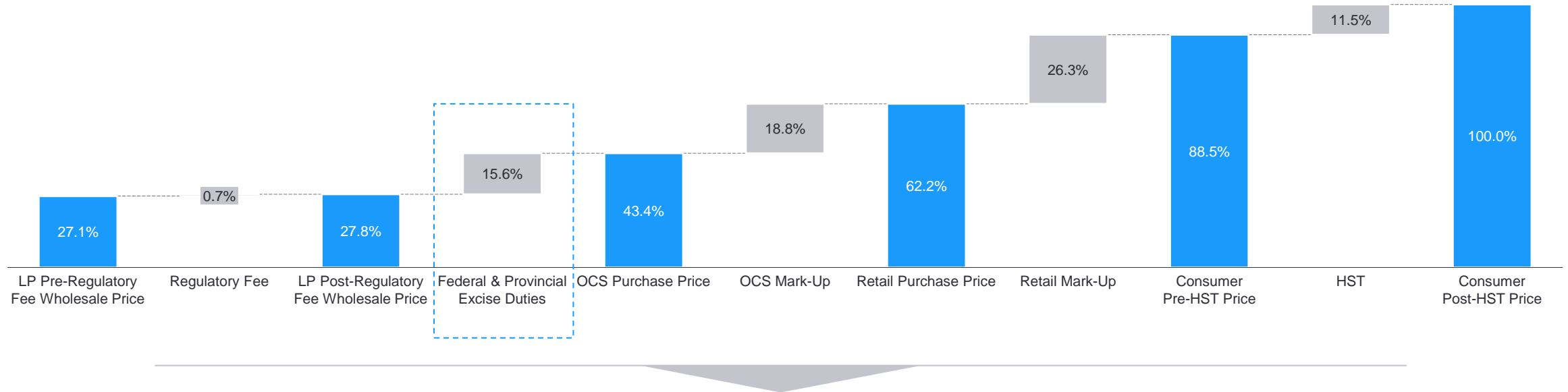


Cannabis Price Mark-Up Structure in Ontario

Government taxes and provincial mark-ups 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

ON Legal Products Basket¹ Mark-Up Structure – Based on Aggregated Data from Jul 2021 to Apr 2022

As a % of Consumer Post-HST Price



ON Legal Products Basket¹ Price Share Breakdown



¹Note: ¹Basket includes flower (1g), pre-roll (1g), vape (750mg) and edible product (10mg) based on their weighted sales; ²Includes Regulatory Fee, Federal and Provincial Excise Duties and HST
Source: HiFyre

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

ON Legal v. Illegal Product Price Comparison – Based on Aggregated Data from Jul 2021 to Apr 2022

Flower (Price Per Gram)



Pre-Roll (Price Per Gram)



Vape (Price Per 750MG)



Edible (Price Per 10MG)



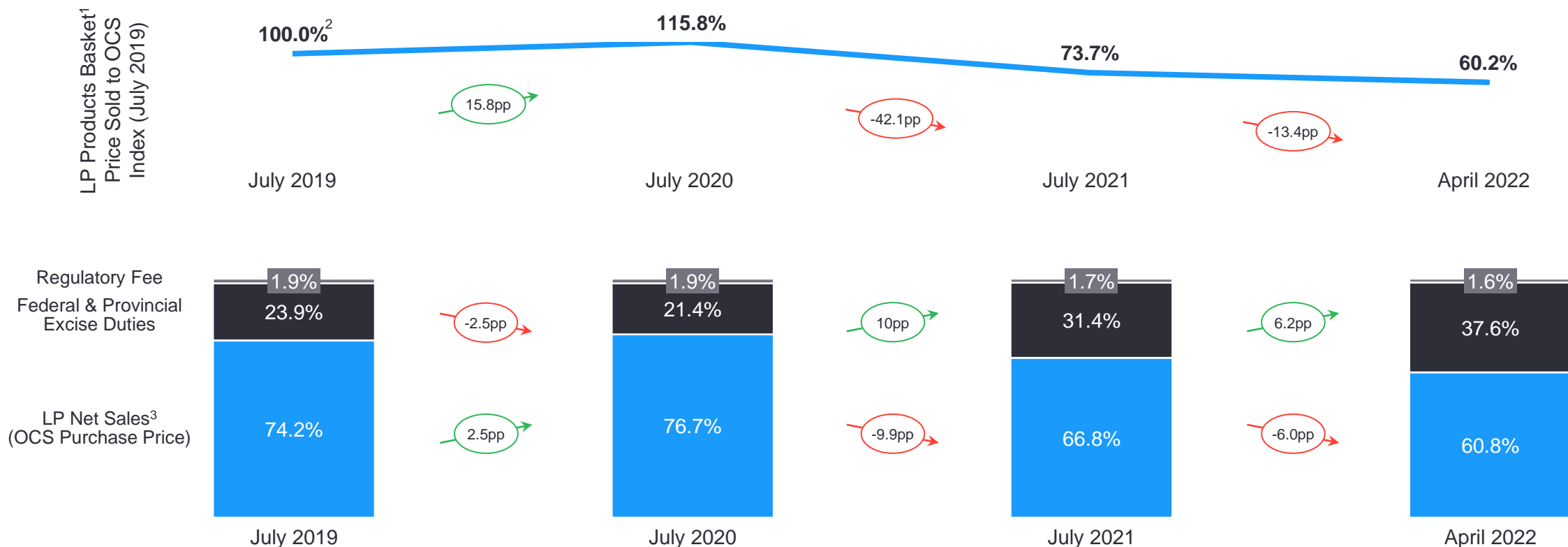
Note: ¹Average illegal market price in April 2022

Source: HiFyre; 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%

ON LP Products Basket¹ Price Trend and Share Breakdown – Jul 2019, Jul 2020, Jul 2021, Apr 2022

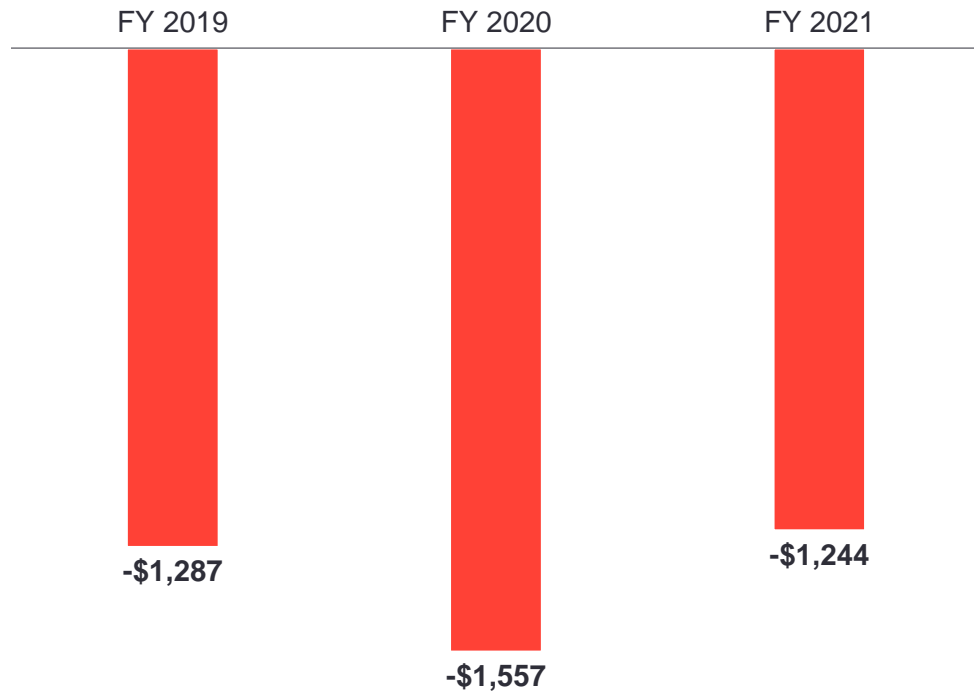


Note: ¹Basket includes flower (1g), pre-roll (1g), vape (750mg) and edible (10mg); ²No edibles were sold in July 2019; ³LP Net Sales is the price at which LPs sell to provincial distributors net of Regulatory Fees and Federal and Provincial Excise Duties
Source: HiFyre

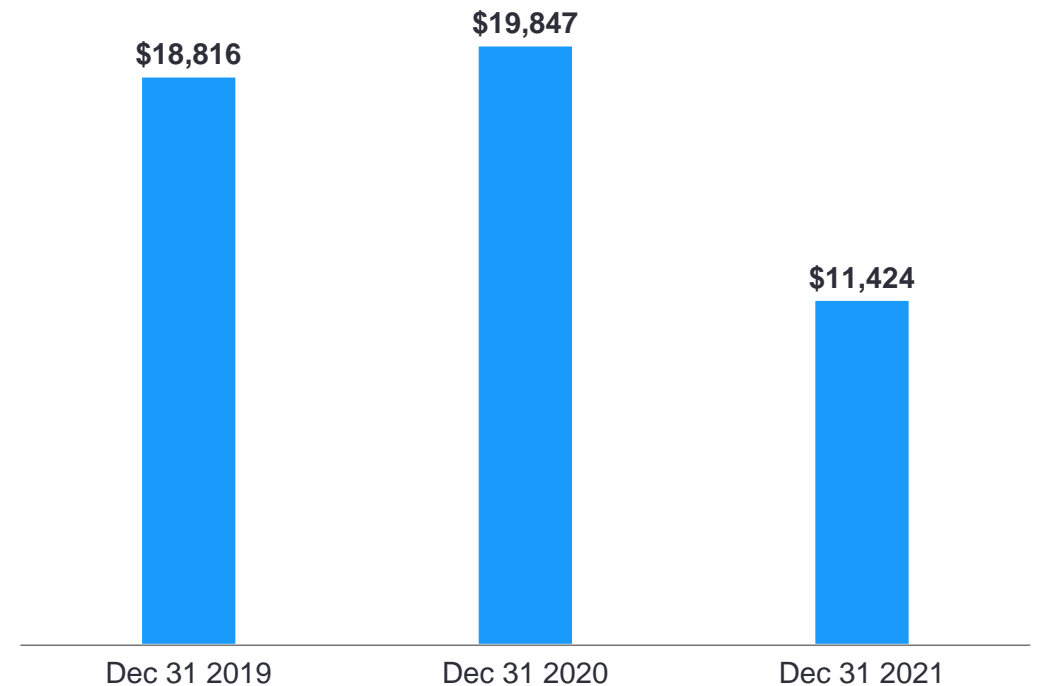
Cannabis Companies Operating Cash Flows and Market Capitalization

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



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.**



CANADA

Cannabis Act
S.C. 2018, c. 16

- 1 Keep cannabis out of the hands of youth.
- 2 Protect public health and safety by allowing adult access to legal cannabis.
- 3 Keep profits out of the pockets of criminals.



● Goal Met
○ Goal Unmet

Key Illustrative Facts

There are **several reasons**, including but not limited to:

- ▶ **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 to **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 Considerations¹

- 1 Reduce Federal and Provincial excise duty rates**
- 2 Harmonize federal and provincial excise duty rates** and move to a single national excise stamp eliminating provincial / territorial stamps
- 3 Reduce or eliminate cost recovery of government regulatory fees**
- 4 Reduce taxation on cannabis 2.0 products** to incentivize the shift to healthier consumption forms
- 5 Revisit / increase potency limits** on edible products, including beverages
- 6 Revise promotional prohibitions** that prevent Licence Holders from communicating with consumers about the characteristics, effects and qualities of cannabis products
- 7 Revise promotional prohibitions, packaging and labeling restrictions** that preclude the ability of Licence Holders to develop brands that connect with consumers and attract illicit cannabis consumers into the legal market
- 8 Revise packaging restrictions** that add to the cost of legal cannabis products without contributing to the Cannabis Act public health and safety objectives, e.g., childproof packaging for non-psychoactive products
- 9 Increase enforcement resources** devoted to the interdiction of illicit cannabis and enforcement of Excise Act, 2001 provisions
- 10 Launch a public awareness campaign** on the health risks and danger of purchasing **contraband cannabis products**
- 11 Launch a public awareness campaign** on the **harm reduction benefits of non-combustible** cannabis products / cannabis 2.0 products

¹Note: The policy considerations must be appropriately weighed against the public health objectives

APPENDIX

APPENDIX A

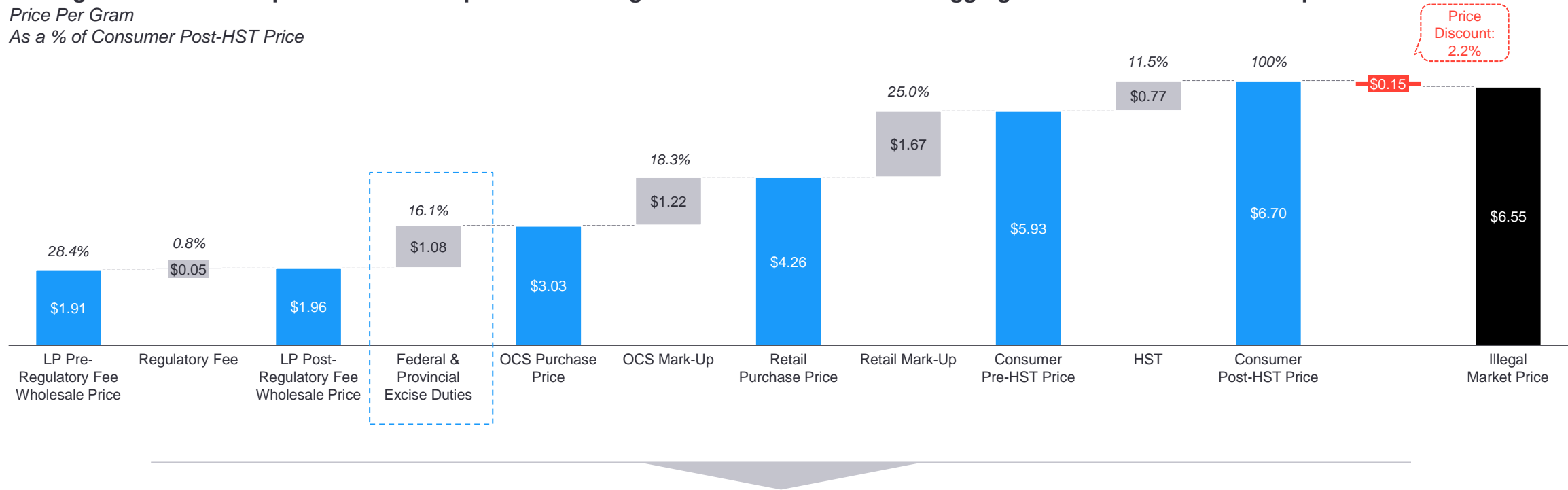
Cannabis Price Analysis by Category and Province

Flower Price Mark-Up Structure in Ontario

ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022

Price Per Gram

As a % of Consumer Post-HST Price



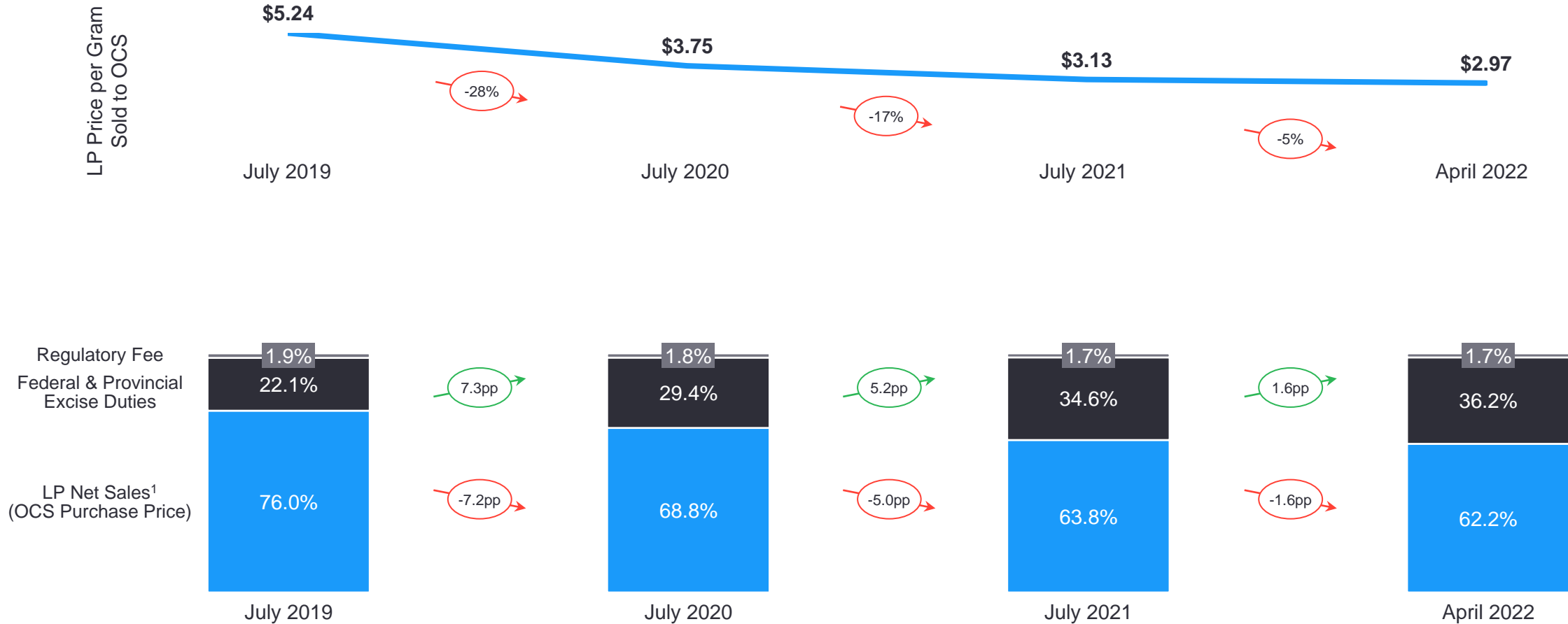
ON Legal Product Price Share Breakdown



¹Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

Flower Price Compression and Share Breakdown in Ontario

ON LP Price Trend and Share Breakdown – Jul 2019, Jul 2020, Jul 2021, Apr 2022



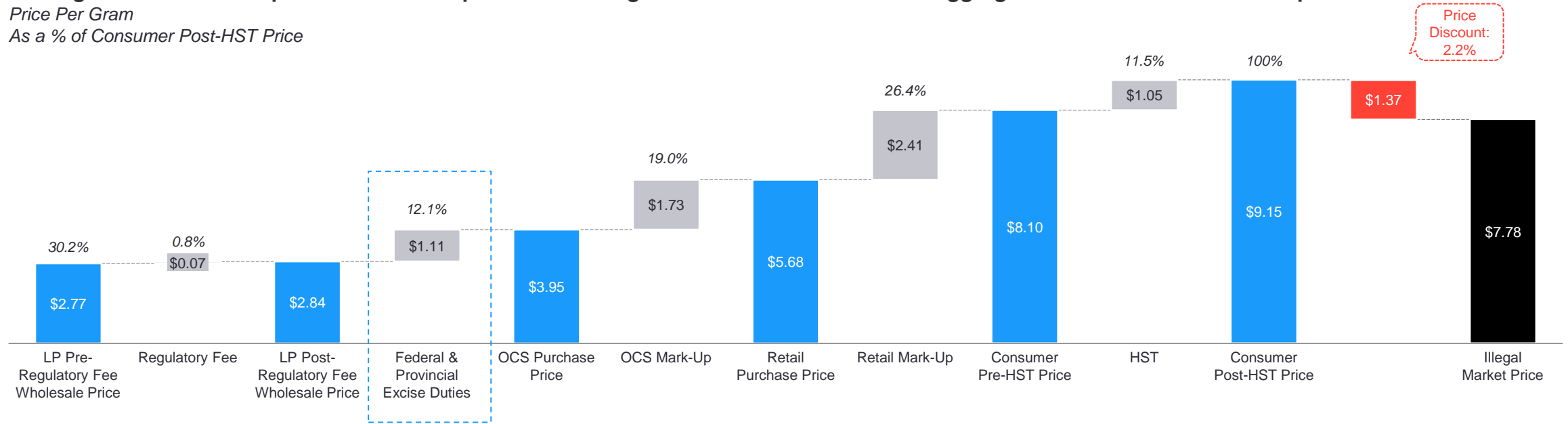
Note: ¹LP Net Sales is the price at which LPs sell to provincial distributors net of Regulatory Fees and Federal and Provincial Excise Duties
 Source: HiFyre

Pre-Roll Price Mark-Up Structure in Ontario

ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022

Price Per Gram

As a % of Consumer Post-HST Price



ON Legal Product Price Share Breakdown

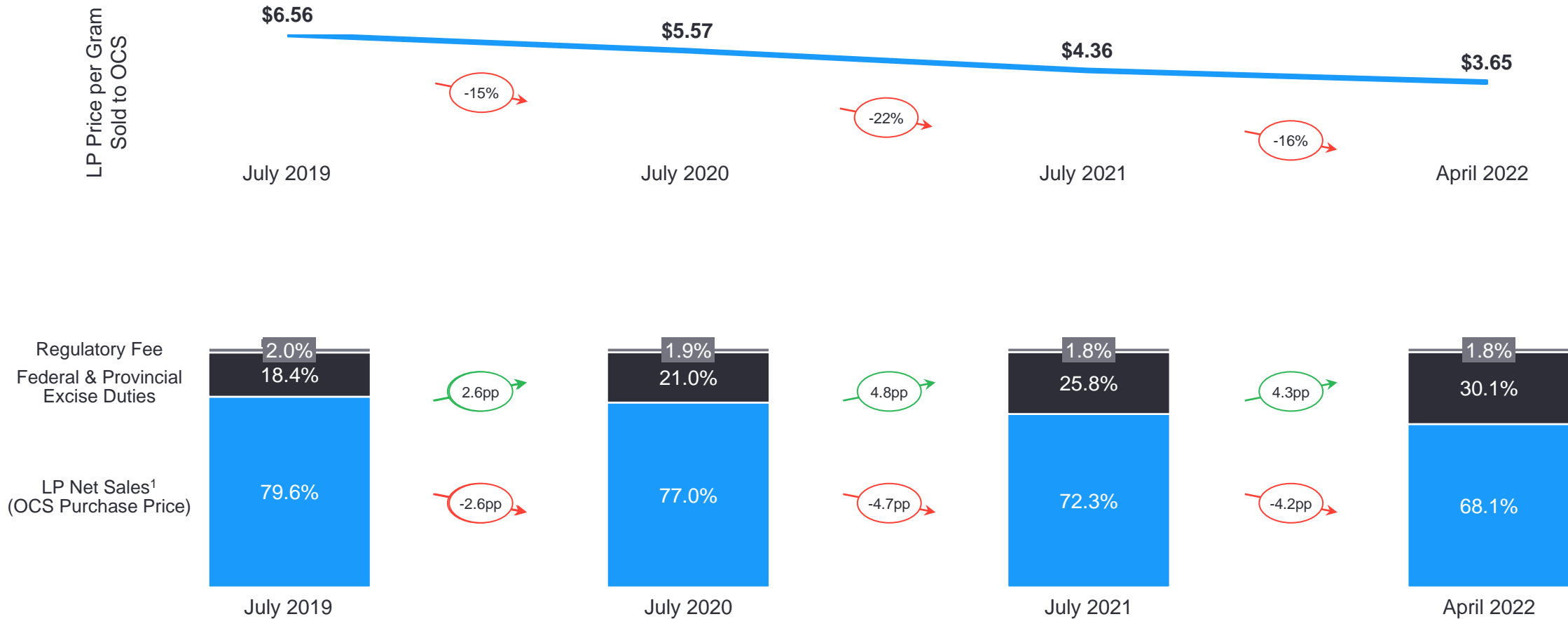


¹Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

Source: Hifyre; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com

Pre-Roll Price Compression and Share Breakdown in Ontario

ON LP Price Trend and Share Breakdown – Jul 2019, Jul 2020, Jul 2021, Apr 2022



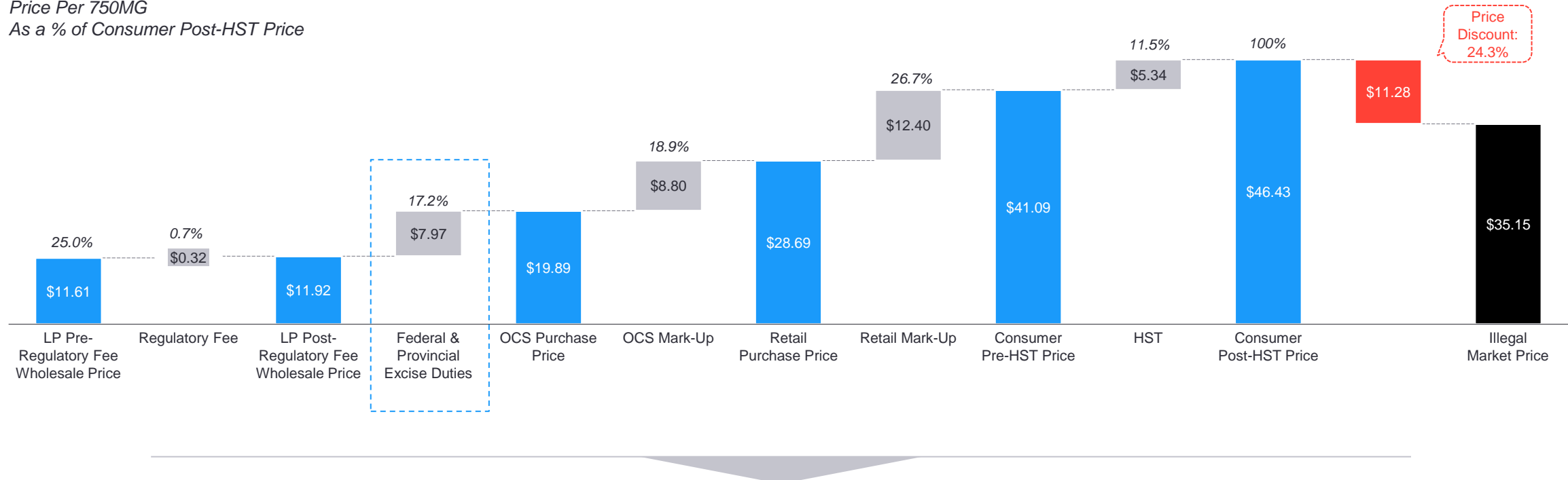
Note: ¹LP Net Sales is the price at which LPs sell to provincial distributors net of Regulatory Fees and Federal and Provincial Excise Duties
 Source: HiFyre

Vape Price Mark-Up Structure in Ontario

ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022

Price Per 750MG

As a % of Consumer Post-HST Price



ON Legal Product Price Share Breakdown

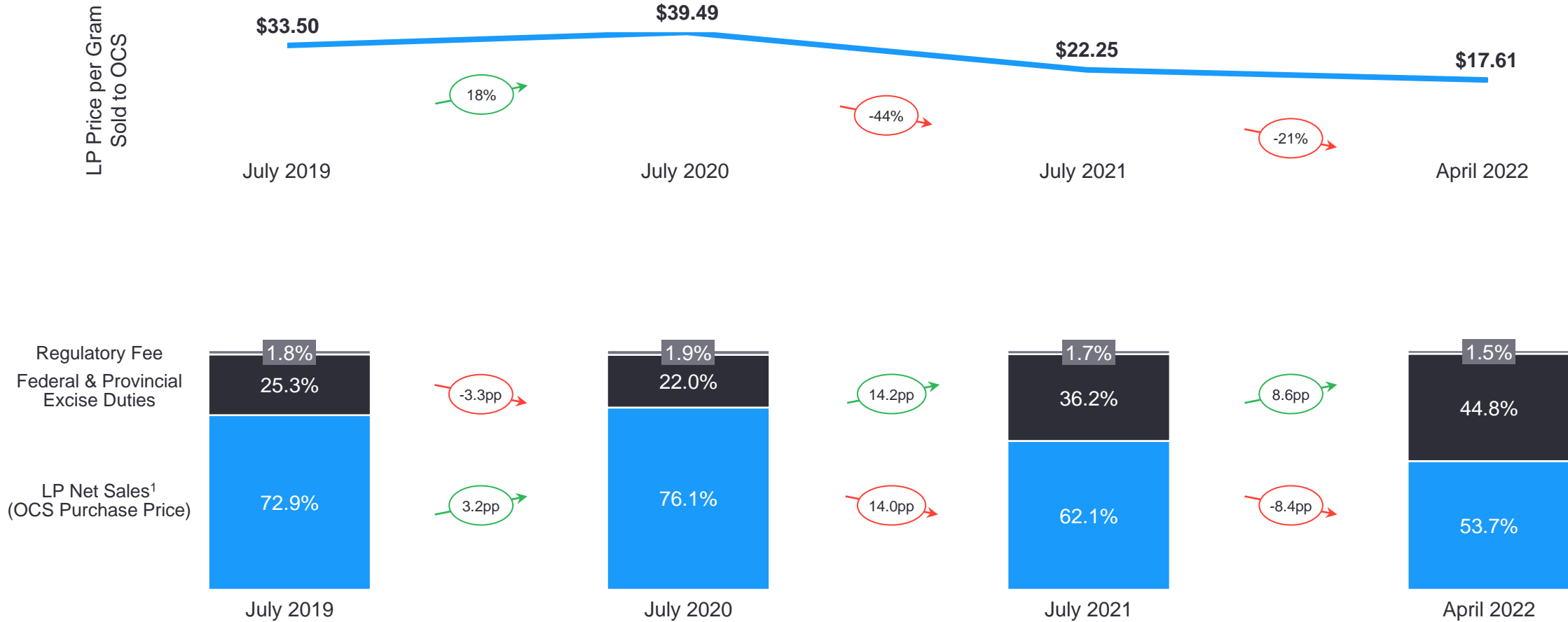


¹Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

Source: Hifyre; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com

Vape Price Compression and Share Breakdown in Ontario

ON LP Price Trend and Share Breakdown – Jul 2019, Jul 2020, Jul 2021, Apr 2022



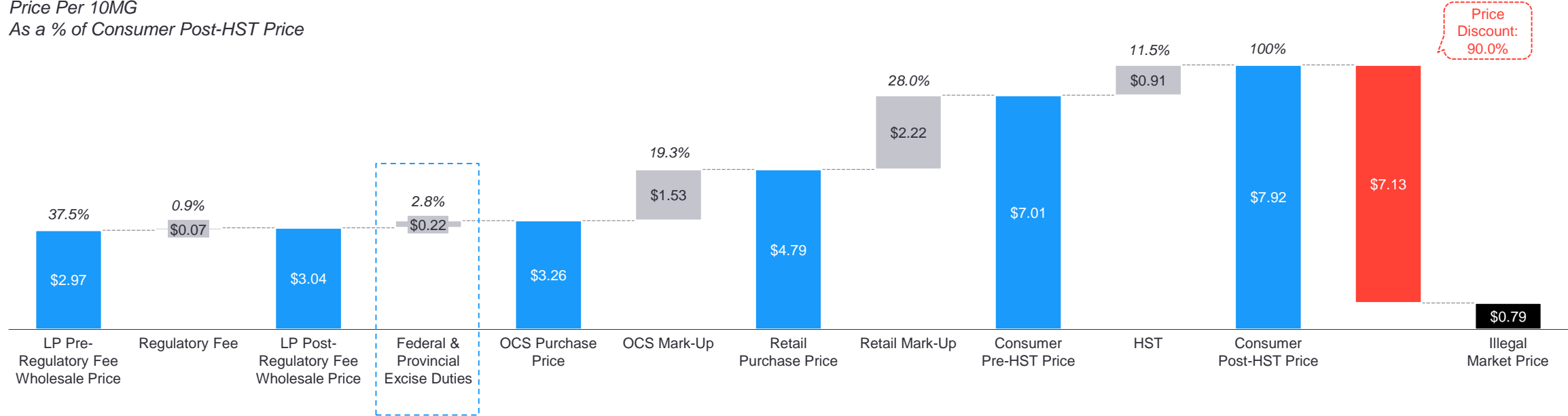
Note: ¹LP Net Sales is the price at which LPs sell to provincial distributors net of Regulatory Fees and Federal and Provincial Excise Duties
Source: HiFyre

Edible Price Mark-Up Structure in Ontario

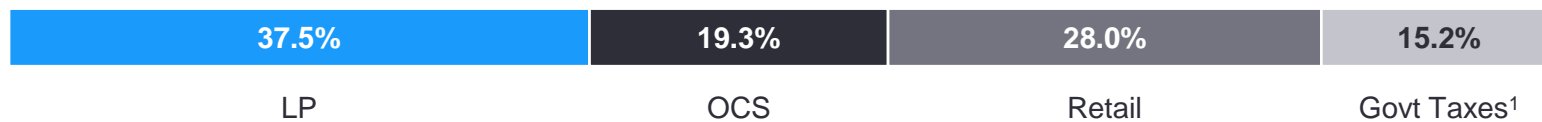
ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022

Price Per 10MG

As a % of Consumer Post-HST Price



ON Legal Product Price Share Breakdown

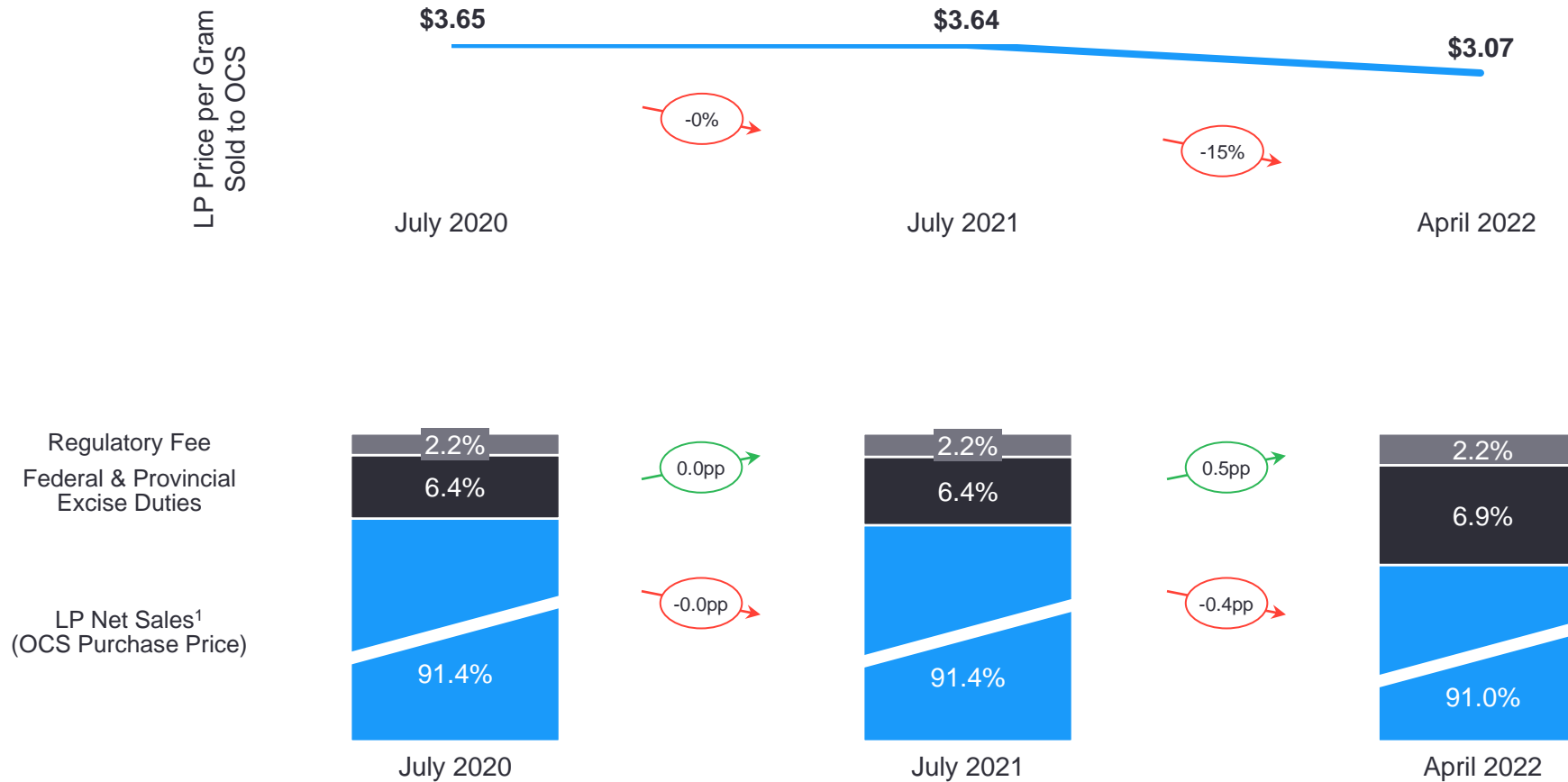


¹Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

Source: Hifyre; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com

Edible Price Compression and Share Breakdown in Ontario

ON LP Price Trend and Share Breakdown – Jul 2020, Jul 2021, Apr 2022



Note: ¹LP Net Sales is the price at which LPs sell to provincial distributors net of Regulatory Fees and Federal and Provincial Excise Duties
 Source: HiFyre

APPENDIX B

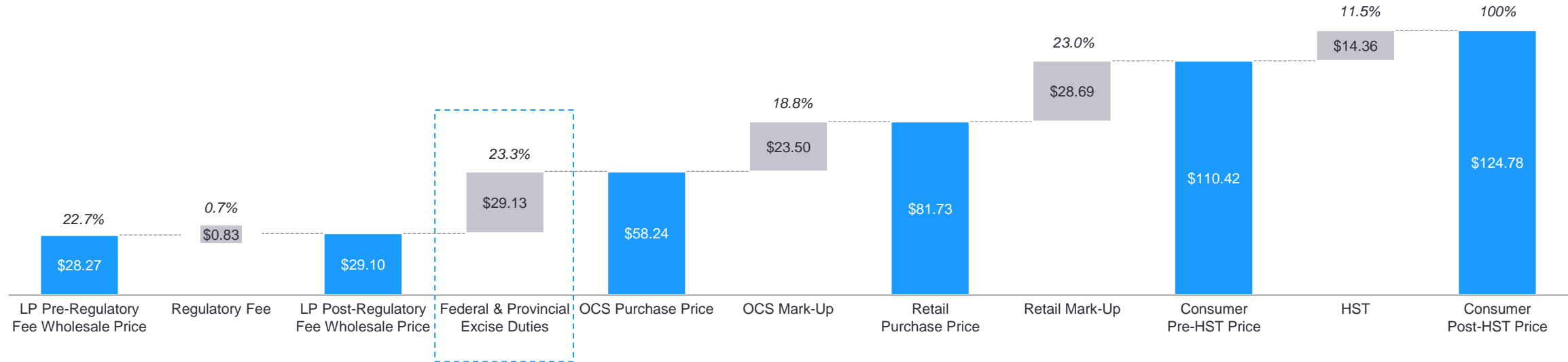
Excise Duties, Mark-Ups and
Regulatory Fees for 28g Flower
Package in Ontario

28g Flower Package Price Mark-Up Structure in Ontario

ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022

Price Per Gram

As a % of Consumer Post-HST Price



ON Legal Product Price Share Breakdown



Note: ¹Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

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