Will Canada’s Cannabis Market Really Be 40% Larger Than California’s in 2018?

Description

As I’ve previously discussed in recent articles delving into the increasingly obscene valuations investors are placing on Canadian cannabis firms, the estimates placed on Canada’s prospective market size for cannabis post-legalization has my mind (and the minds of numerous analysts covering the industry) boggled. Whether the estimates provided by the Canadian Parliamentary Budget Office were based on poor data or extreme revenue growth assumptions from new users, what is certain is that when investors begin digging into the numbers, questions begin to arise as to the efficacy of the market analysis done.

According to the Canadian Parliamentary Budget Office, the expected total revenue to be generated in Canada from the medicinal and recreational cannabis market in 2018 is between $4.2 billion and $6.2 billion. Taking a midpoint of $5.2 billion, the total market size for marijuana sales in Canada may seem, at first glance, to be very lucrative; indeed, should a cannabis shortage will take place, federal and provincial taxation remain relatively low, and black market sales meet their demise, the future may look just peachy through some rose-coloured glasses.

But if we remove the glasses and look at perhaps one of the best comparable markets to that of the Canadian market, California, we begin to see a different picture emerge.

Data from BDS Analytics, an independent research firm providing market research data on the soon-to-be-legalized recreational market of California estimates that the entire Californian market for cannabis will be $3.7 billion in 2018 and $5.1 billion in 2018.

That’s right, sales of pot in California, a state which will legalize recreational marijuana on January 1 (at least one full quarter before Canada), and with a total GDP larger than that of Canada, will have a cannabis market which is 40% smaller in 2018, and won’t even catch up to the average 2018 estimated Canadian consumption rate in 2019!

With Canadian cannabis firms such as **Canopy Growth Corp.** (TSX:WEED) initiating a number of global partnerships and acquisitions aimed at broadening their total available market outside Canada, it is possible that Canadian cannabis firms will be able to achieve a greater combined market share than that of California; that said, the reality remains that the battle for domestic market share, and the consequences of such a battle, have yet to play out and have not been factored into the valuation multiples that Canada's largest players have had this year.

Bottom line

California's value as a comparable market to the Canadian cannabis market cannot be overstated; a similar population size, GDP, and medicinal/recreational market dynamics make California an excellent benchmark to be used by the Canadian Parliamentary Budget Office in making taxation/budget decisions. While many of the assumptions made in the model used to predict the Canadian cannabis market size factoring in "pot tourism," a reality experienced by Colorado as one of the early adopters of legalization, I remain skeptical as to many of such assumptions, given the fact most northern states have legalized marijuana either in a medical or recreational capacity.

Cannabis investors banking on a massive increase in marijuana revenues need to consider the assumptions underlying the rhetoric spewed by cannabis firms and marijuana bulls in today's obscenely overvalued Canadian pot industry.

Stay Foolish, my friends.

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