

# Old-School Dealers Are A Threat to Pot Sector

Traditional drug dealers are still formidable competitors in U.S. states where cannabis is legal. Governments planning for huge tax windfalls and investors expecting rapid market-share gains have to adjust to a slower burn.

California is the prime example. Restrictions on adult use were lifted in January 2018 and the state legislature projected \$1 billion in annual state and local taxes from cannabis sales within a few years. However, the actual windfall is proving underwhelming. Pot excise taxes are now forecast to generate \$360 million in the 2019-20 budget year, down from the \$514 million projected at the start of 2019.

Several factors are stymieing legitimate sales. Although legal at the state level, a majority of municipalities have banned retail sales of cannabis—an unforeseen complication.

However, the main barrier is the markup on legal cannabis from high taxes and the cost of complying with complex regulations. Consumers pay 77% more for the same product from a legal vendor, according to BDS Analytics. Unless taxes are cut, the research house expects almost half of California's cannabis spending to remain in the illegal market in 2024.

Canada, which legalized recreational cannabis use almost one year ago, is having similar issues. The country's gross-domestic-product data, which includes cannabis sales, estimates that just 27% of total pot sales were made through licensed channels in the first quarter.

The implication is that taxes on pot won't be the panacea that many states hoped. New York, for example, wants to use revenue generated from cannabis levies to repair the city's creaking subway system.

The black market also will loom large for investors. The United States Marijuana Index, which tracks 24 cannabis stocks including **Curaleaf Holdings** and **Green Thumb Industries**, has lost almost one-quarter of its value over the past six months.

The U.S. cannabis market is huge. The bigger question is how much business remains in the shadows.

—Carol Ryan

