

THE STATE OF THE MEDICAL MARIJUANA MARKETS 2011



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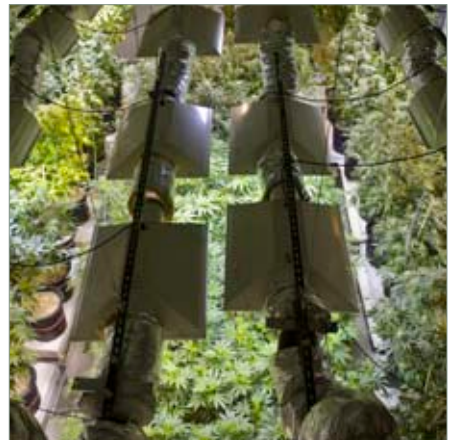


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The State of the Medical Marijuana Markets 2011

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EXECUTIVE SUMMARY



For many decades, all marijuana transactions in the United States were conducted under implicit or explicit prohibition. Recently, however, states have moved to legalize marijuana for medical purposes, as well as implement regulations for organizations which produce and distribute marijuana. In the last two years, the federal government has signaled its tacit acceptance of these state actions. This has produced the first de facto legal U.S. marijuana market in modern times.

This emerging market presents unique opportunities to entrepreneurs and investors as well as unique risks. To examine both, See Change Strategy has produced this report, *The State of the Medical Marijuana Markets 2011*.

A nascent national medical marijuana industry, fueled by legalization in 15 states plus the District of Columbia, is in the midst of unprecedented development and growth.

See Change has conducted a first-of-its-kind analysis of these emerging markets. See Change concludes:

- ◆ A national market for medical marijuana is worth \$1.7 billion in 2011 and could reach \$8.9 billion in five years.
- ◆ Two states, California and Colorado, dominate this nascent industry, combining to represent 92% of the wholesale and retail sales across the country. California enjoys the largest market size at \$1.3 billion, while Colorado hosts the fastest growing and most business-friendly market.
- ◆ Nine other states and the District of Columbia with medical marijuana laws have or are forming active markets. Arizona, Michigan and Washington are particularly well-positioned as the industry matures in the next few years.
- ◆ There are 24.8 million potential patients eligible for medical marijuana under current state laws.
- ◆ Medical marijuana businesses face significant challenges including unfavorable tax status and downward pricing pressure but can expect high growth driven by rising new patient adoption.
- ◆ State regulations and federal policy uncertainty are the largest determinants of market activity and investment around the country.

Background

In 1970, capping decades of policy, Congress placed marijuana in Schedule I of the Controlled Substances Act, declaring its high potential for abuse and stating that it was without therapeutic value. This move cemented marijuana's de facto prohibition.

Despite this, marijuana use has continued. The black market for marijuana has thrived with an annual market size estimated at \$18 billion.

Since 1996, marijuana proponents have pushed for individual states to recognize marijuana as a treatment for a range of illnesses. New medical research and changing public opinion have propelled these efforts.

Over the past 15 years, led by California, 15 states plus the District of Columbia have adopted laws permitting some form of marijuana consumption or distribution for medical use. These laws have been adopted by public referendums as well as legislation.

In late 2009, the U.S. Justice Department instructed federal prosecutors in states with medical marijuana laws not to prioritize prosecuting individuals and businesses complying with state laws.

These conditions have combined to produce the first legal marijuana markets in modern times



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An Industry Flowers

Since marijuana remains a Schedule I substance, doctors cannot legally prescribe marijuana to patients. Instead, most states dictate that doctors may only recommend marijuana to patients with qualifying illnesses. To receive that marijuana, patients have not gone to traditional pharmacies or hospitals. Instead,



patients choose one of three methods to receive the marijuana, depending on state law and personal preference:

- ◆ They can grow marijuana themselves.
- ◆ They can designate a caregiver, normally an individual allowed to grow marijuana for a certain number of people.
- ◆ They can assign this right and/or visit a company or cooperative organization that provides marijuana to patients.

This third option has proven to be the most popular method of receiving marijuana among customers as well as the key driver of business growth in this industry.

Today, medical marijuana markets exist in 12 of the 15 states plus the District of Columbia where medical marijuana is legal. Emerging markets, excluding the more developed in California and Colorado, fall into one of two categories:

- ◆ **MARKET-LED STATES** are places where entrepreneurs began conducting business prior to statewide regulation and guidance. Subsequent regulations

are generally reactive to existing market conditions. These states include Michigan, Montana, New Mexico, Oregon and Washington.

- ◆ **REGULATION-LED STATES** are places where business activity is being determined by the pace and efforts of regulators to define and control a market. These states include Arizona, the District of Columbia, Maine, New Jersey and Rhode Island.

First-of-its-Kind Operator Survey

As part of its analysis, See Change conducted a first-of-its-kind survey of more than 300 retail and wholesale operators in states with an active medical marijuana market. This survey revealed:

- ◆ 63% have been in business for less than a year.
- ◆ Owners range from the unsophisticated to the highly experienced.
- ◆ 34% cite regulatory compliance, not customer demand or securing supply, as the number one challenge.
- ◆ 24% cite securing financing as the most pressing business challenge.

Opportunities and Risks

The growing acceptance of medical marijuana is providing business operators and investors with unprecedented opportunities. See Change expects these markets to enjoy 99% growth in the next five years just in existing markets, with more than 20 potential new markets opening. However, investment and business development will continue to be dampened until the federal government definitively changes its position on the legality of medical marijuana.

Demand for marijuana has produced a number of business opportunities. Wholesale marijuana cultivation and retail distribution are the primary business opportunities. Other entrepreneurs are providing marijuana infused products including edibles, tinctures and salves. Development and sales of smoking and non-smoking paraphernalia for consumption are on the rise. Less obvious but



significant business opportunities have emerged in ancillary businesses including software development, insurance products, hydroponic equipment, security services, editorial products, advertising and real estate, to name a few. Businesses face significant risk and hurdles. The possession and distribution of marijuana remains illegal under federal law. Many businesses operate with the ever-present risk of being shut down or experiencing a property seizure without notice. Many businesses cannot make standard deductions for business expenses and have difficulty securing standard banking and financial services. The industry suffers from inadequate capital investments, lack of experienced executives and operators, changing local regulations and interactions with illegal marijuana markets.