

Executive Insights

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CBD: This Cannabis Extract Is Creating a Different Kind of Buzz

The farm bill that President Trump signed in December 2018 renewed a wide range of existing agricultural programs, from price supports to conservation and food aid. But buried in the bill's 807 pages was something rather less routine. It was a set of provisions that cleared the way for a new cash crop in the U.S.: industrial hemp.

Shortly after the farm bill's passage, a trio of Wall Street analysts covering a little-known startup called Charlotte's Web Holdings recommended the company's stock as a "buy" or "strong buy."

What does one event have to do with the other? Charlotte's Web makes wellness products with cannabidiol (CBD) as the active ingredient. The CBD in the products comes from hemp.

An evolving landscape

CBD is a chemical that reportedly offers relief from anxiety, inflammation and chronic pain, among other therapeutic applications. It's found in both hemp and marijuana, two different strains of the cannabis plant. But hemp doesn't contain enough tetrahydrocannabinol (THC) to produce marijuana's euphoric high, a distinction that has fueled the growing acceptance of hemp as a commodity crop. By removing hemp from the federal list of controlled substances, the farm bill made hemp-derived CBD legal in all 50 states. Beyond that, the bill made it possible for hemp farmers to obtain credit, crop insurance and other benefits of the government's agricultural programs.

But raising hemp is one thing; making the CBD from hemp available to consumers is something else altogether. The Food and Drug Administration (FDA) <u>doesn't allow</u> the interstate sale of CBD in food, beverages and dietary supplements. The agency also has <u>clamped down</u> on companies that made claims about the therapeutic benefits of the CBD in their products or were less than explicit about how much of the derivative the products contained. To support its watchdog position, the FDA points to the recent authorization of Epidiolex, made of highly purified CBD, as a prescription anti-epileptic drug.

Proliferating products

Nonetheless, murky regulatory waters have done little to dim consumers' enthusiasm. Even after the Drug Enforcement Administration (DEA) released a new drug code for marijuana extract in December 2016, raising uncertainty around CBD's status, public interest in the additive continued to rise. An analysis of social media mentions in recent years reveals the trend (Figure 1).

To avoid FDA run-ins, CBD brands and manufacturers tend to be circumspect about their claims. The result is a confusing melange of products that requires some effort to sort out. In L.E.K.

CBD: This Cannabis Extract Is Creating a Different Kind of Buzz was written by **Maria Steingoltz**, Managing Director, and **Erin Connor**, Consultant, in L.E.K.'s Consumer Products practice. Maria and Erin are based in Chicago.



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Figure 1 U.S. social media posts related to CBD, by sentiment (2015-18)

Source: DEA, TechCrunch, L.E.K. analysis of Twitter data

Consulting's analysis, they appear to break down across four types of benefits:

- Restoration and recovery via antioxidants, alleviation of skin conditions and reduction of signs of aging
- Calming and mental wellness by combating insomnia, anxiety, stress and depression
- Relief from pain due to conditions such as muscle tension, arthritis and injury
- **Productivity and performance enhancement** from energizing the body and focusing the mind

An examination of 639 products that contain CBD (but not THC) shows they span a range of types, formats and brands (Figure 2).

In the absence of regulatory clarification, CBD-infused consumer products often rely on product type to signal the properties on offer. Although tinctures and dietary supplements are the most common CBD products, beauty is rapidly catching up with a growing portfolio of lotions, balms, bath products and more. Food and beverage producers are also staking their claim, catapulting CBD-infused food and drink to the top of a list of <u>culinary trends for</u> <u>2019</u>. As though the market weren't complex enough, products can further vary by flavor, dosage, package size and other attributes. All this activity is fueling expectations of significant growth. Cannabis research firm Brightfield Group estimates CBD product growth exceeded <u>80% in 2018 alone</u>. By 2026, according to Transparency Market Research, the global CBD hemp oil market will hit <u>\$2.5 billion</u>. Meanwhile, deal-making is also on the rise (Figure 3).

Forging a path

This brings us back to CBD's regulatory limbo. Many of today's products are in a gray area of the law. Although neither the FDA nor the DEA has made it a priority to police the commercialization of CBD in food and cosmetics, certain brands have created their own downside by simply winging it in the absence of standards. For example, some CBD-infused products omit an explicit listing of the ingredient on their labels. Others misstate the amount of CBD in their products. Left unchecked, this could foster misgivings among consumers and retailers alike.

So where does this leave manufacturers and investors? Consider the following steps for a CBD game plan:

1.Forge relationships with national retailers. For CBD, online or direct-to-consumer has traditionally been the distribution channel of choice. But specialty stores such as Sephora and GNC — not to mention luxury retailer Neiman

100 Other** Other Other Other-7% 2% 5% Other 7% 15% 11% Bars Cosmetics 9% 11% 1% 80 Snack bites 21% 32% 60 23% 23% Percentage 27% 40 Tinctures and Oils and edible oils Coffee Topicals spreads 59% Oils and and tea 50% 47% 20 balms 45% 40% 0 VMS Beauty Food Beverage Other Decreasing prevalence of CBD products

Figure 2 CBD product formats across end markets* (January 2019)

Source: L.E.K. research and analysis

*Edible CBD formats that are one-bite servings (such as gummies) are classified as vitamins, minerals and supplements instead of food. Sample size covers different product types/formats across multiple brands and excludes any CBD products also containing THC. Additional market complexity exists in the form of flavors, dosage, package size, etc. **Other products include those that are not ingestible or cosmetic.

Marcus and mass merchandisers such as Target — have shown interest in selling CBD products despite the FDA's position.

- 2. Proactively develop an Amazon strategy. Some brands have already found ways to bypass Amazon's restrictions on CBD. Players should develop their strategy now so that they can be at the forefront of Amazon's inevitable entry into CBD distribution.
- **3.In beauty, go beyond skin deep.** The beauty industry has been relatively quick to jump on the CBD trend, primarily through anti-aging, antioxidant and corrective skincare products. However, many other categories think haircare, cosmetics and fragrances could take advantage of these same restoration and recovery claims.
- **4. Arm consumers and channel partners with information.** For all its publicity, CBD remains unfamiliar to much of the market. Plan on educating consumers, distributors and

retailers so they can rationally evaluate CBD products and make their choices with confidence.

5. Expect competition from Big CPG. Coca-Cola and other deep-pocketed food and beverage brands are already exploring investments in this area. To win, make authenticity part of the consumer engagement strategy. Then focus on distribution channels where Big CPG isn't as strong — such as specialty retail, convenience stores and Amazon.

For a category that didn't even exist just five years ago, consumer CBD products have become a phenomenon. Now, they're poised to enter the mainstream. A wait-and-see approach may seem sensible to incumbent firms looking for certainty from the FDA before taking the plunge. But with competitors already crowding the field, the better bet may be to start planning a market move now.

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Figure 3

M&A transactions (announced or closed) related to CBD (2013-18)



Source: S&P Capital IQ

About the Authors



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specialty direct-to-consumer e-retailers such as Eaze and Leafly.

Accelerating growth

inroads into channels like these:

Dispensaries. In legal states, many medical dispensaries offer hemp-based CBD products that don't require physician certification for purchase.

CBD products are expanding their footprint. They're making

Ecommerce sites. Today, most CBD products are sold through

Small brick-and-mortar stores. Hemp-derived CBD products can be found in small, offline shops specializing in vitamins and nutrition or smoking goods, and in apothecaries.

Specialty retail. Sephora began offering <u>CBD beauty brands</u> in 2018. Large nutrition and supplement store chains, such as The Vitamin Shoppe and GNC, carry a variety of hemp extract products but not yet those containing CBD specifically.

Mass merchandisers. Target's online store briefly sold <u>CBD oils</u> in 2017 before pulling the plug due to regulatory concerns.

Department stores. In January 2019, Neiman Marcus announced the rollout of its <u>CBD collection</u> in select stores. Barneys New York soon followed suit, revealing plans to offer Flora + Bast's line of CBD beauty products.

