Should Philip Morris International Inc. Buy Canopy Growth Corp.?

Description

There are currently eight U.S. states, including California, where the use of both recreational and medical marijuana is totally legal. A bunch more allow for the use of medical marijuana; it's a given that more states will legalize recreational use in the future. And why not, when 60% of Americans and 70% of Canadians feel it should be legal?

It's a big reason why **Canopy Growth Corp.** (TSX:CGC) stock has risen exponentially over the last three years—up almost 500% on an annualized basis. Everyone on Bay Street is talking about CGC stock with good reason; it has the potential to be a dominant player in the growing and distribution of marijuana both in Canada and elsewhere.

I've long held the belief that as soon as the U.S. federal government legalizes the recreational use of marijuana and removes it from the list of Schedule 1 drugs, which includes heroin and LSD, big tobacco will get into the manufacture and sale of cannabis for the recreational market.

They've avoided publicly discussing the idea, worried about the potential blowback from federal, state, and municipal governments that already oppose their cigarette products.

But it's a very real possibility.

"[The legal U.S. marijuana products industry] is so sizable now that consumer products companies can't ignore it," said Ken Shea, a food, beverage, and tobacco analyst for Bloomberg Intelligence. "It's such a compelling opportunity for the tobacco companies."

Now, here's why I believe **Philip Morris International Inc.** (NYSE:PM) is the ideal cigarette company to buy Canopy Growth.

Philip Morris was spun-off from **Altria Group Inc.** in 2008, so each company could focus on their particular markets—Altria in the U.S. and Philip Morris outside the U.S. Its Canadian business is combined with Latin America, one of four segments operating around the world. Together they generated US$7 billion in the third quarter ended September 30. That compares to US$5.2 billion in Q3 2016 revenue for Altria in the U.S.

There's been some talk of the two companies recombining to save on R&D, etc., but that's just talk at the moment. In the meantime, Altria generates almost $19 billion annually from cigarette sales in the U.S., and Philip Morris is locked out of the market.

Getting into the cannabis business allows them to diversify away from a product that's slowly dying to one that's sitting on the launchpad ready for takeoff. Recreational cannabis is going to generate far greater revenues than either smokeless tobacco or vaporizers could ever hope to do.

There's only one hitch in my idea.

Philip Morris doesn't grow tobacco. It buys it from growers and then uses it in the production of cigarettes. Canopy Growth grows cannabis and sells directly to clients, but it doesn't produce the end-user marijuana cigarette (it does produce cannabis oils as part of the production process), creating a few gaps in a vertically integrated operation between the two.

However, those are issues I'm sure can easily be worked out.

At the end of the day, Canopy Growth is going to continue to require deep pockets if it wants to be a global player in this business. Right now, "bought deals" and bank loans are covering expansion costs; those are only going to grow, especially if it wants to participate in the enormous market to the south.

Philip Morris might not buy Canopy Growth, but it definitely should consider it.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:WEED (Canopy Growth)

Category

1. Investing

Date
2025/07/01
Date Created
2016/11/25
Author
washworth