



Why Aphria Inc. Is a Much Better Long-Term Play Than Canopy Growth Corp.

Description

Taking a long-term perspective on marijuana stocks, or any stocks for that matter, is something all investors looking for abnormal returns should do. Getting in early and holding great companies for long periods of time is the way legendary investors have managed to beat the market year after year. It's not rocket science — just good old-fashioned prudent investing.

I'll be looking at why **Aphria Inc.** (TSXV:APH) may be a better long-term play for a marijuana investor than **Canopy Growth Corp.** ([TSX:WEED](#)).

Company fundamentals

One of the first things I look for in companies I'm considering as long-term positions are solid fundamentals. In growth businesses such as the cannabis production and distribution business, free cash flow generation and solid margins (top and bottom line) will play a large role in allowing the large players to be able to achieve a long-term competitive advantage.

As marijuana eventually becomes a commodity good, the ability for large producers to manage costs and achieve higher margins will be a primary metric to determine the long-term success of the enterprise.

Looking at the numbers, we see the two companies differ significantly in free cash flow generation. Aphria currently generates positive free cash flow of \$2.2 million (approximately 14% of revenue), while Canopy continues to operate at a loss, with free cash flow listed at -45.6% of revenues.

We can see that top- and bottom-line margins appear to be mixed. For top-line growth and operating margin, Canopy has outperformed Aphria. The gross operating margin for Canopy stands at 13.5%, compared to Aphria's 7.9% operating margin. Looking at the bottom line, however, we can see that Aphria stands out: Aphria's profit margin is almost 21%, while Canopy continues to lose money with a -2% net margin.

Sustainable growth

As the numbers above show, top-line growth and revenue generation may work in the short term; however the longer-term issue of creating solid free cash flow and profit will ultimately be the deciding factor in deciding which company is the better long-term play.

The recent announcement of a voluntary recall of over \$1 million of cannabis by Canopy's subsidiary Mettrum Ltd. is one of the perils companies in a consolidating industry face: investor demands for growth at an ever-increasing pace means acquisitions ... lots of acquisitions.

Canopy's acquisition of Mettrum has just recently received court approval, and within a month of the announcement, the announcement of a wide-scale recall has the company reeling back bottom-line expectations. Growth is one thing, but manageable and sustainable growth is an entirely different animal.

For the time being, I believe the smaller, but more stable, Aphria will be a better long-term play for investors looking to add a marijuana stock to their portfolio.

Stay Foolish, my friends.

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