



2 Reasons Aphria Inc. Makes Sense

Description

Fool.ca contributor Chris MacDonald recently [explained](#) why investors of Canadian cannabis stocks should be very leery of their future potential. It seems there's a huge oversupply building in the marijuana market that will have a devastating effect on prices here in Canada.

Economics 101 states that when supply goes up, without a corresponding increase in demand, prices go down.

Canopy Growth Corp. ([TSX:WEED](#)), **Aphria Inc.** (TSX:APH), and **Aurora Cannabis Inc.** (TSXV:ACB) are in the process of adding two million square feet of production space to capture revenue in the hotly competitive Canadian medical marijuana marketplace. That's on top of the 1.5 million square feet of production that already exists.

Something's got to give.

"There are so many what if's and so many unknowns about the industry but the one thing we do know is supply and demand. And the way it's going right now, there's going to be way too much supply for the medical space," said BCMI Report editor Chris Damas in a February 2017 article in the *Ottawa Citizen*. "If and when a legal, recreational market opens up, that could change. But for now, if you do the math — and not enough investors do the math — we could see a huge drop in prices. That alone could wipe out a good chunk of the companies out there."

We now know that the Federal Government plans to legalize the recreational use of marijuana for those 18 and older by the end of June 2018. While this doesn't guarantee marijuana prices won't still drop once recreational use becomes legal, it does suggest the major players' ramping up of production shouldn't have an adverse effect.

However, just because pot will be legal within 14 months doesn't mean the major players will have a licence to print money once that happens. For example, **Tesla Inc.** is an unbelievable company with products in huge demand, and yet it struggles to make money seven years after going public.

Currently, the average price of a gram of marijuana from licensed producers is said to be \$9.12. In the

U.S., Washington and Oregon saw prices increase when marijuana was first legalized due to shortages, but prices fell once they fixed the supply issues. **Canaccord Genuity** expects initial demand for marijuana, once legalized, to go up, keeping prices here in Canada relatively stable. However, like the U.S., once demand cools, prices will likely come down.

So, here's why I like Aphria compared to the other major producers.

Aphria makes money

The Leamington producer of medical marijuana announced April 13 a fifth consecutive quarterly profit-generating \$1 million EBITDA (137.2% increase over the same period a year earlier) from \$5.1 million in revenue. For the first nine months of fiscal 2017, it has \$3.2 million EBITDA, considerably higher than the \$52,203 generated through the first nine months of 2016.

The average price of a gram in Q3 2017 sold for \$7.84 for a 70% gross margin based on an "all-in" cost of goods of \$2.23 per gram. Come July 2018, Aphria should be able to handle whatever market price at which marijuana is priced when it hits the streets and still make a profit. Its competitors can't say the same.

Strong management team

Aphria CEO Vic Neufeld spent 20 years as the CEO of vitamin maker Jamieson Laboratories Ltd. until it was sold to a private-equity firm in 2014. Co-founders Cole Cacciavillani and John Cervini have more than 55 years of combined agri-business and greenhouse industry experience.

Aphria is going to need every bit of talent as it negotiates its way through the legalization process over the next 14 months to maintain and grow its market share in Canada.

I believe it's got the people at the top to make that happen.

Bottom line

Fool contributor Joey Frenette [likes](#) Canopy over Aphria because of its branding initiatives. Given that the Federal Government is said to be eyeing the same strict packaging rules that cigarette manufacturers currently face, I'm not sure what that means as far as branding. However, Aphria is no lightweight where branding is concerned with Tokyo Smoke leading the charge.

While Canopy is the industry leader, I'm more impressed with Aphria's ability to make money in a very competitive business. That to me puts it way ahead of everyone else.

By this time next year. I guess we'll find out if I was right.

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