How Things Just Got Much Worse for the Cannabis Industry

Description

This week, the Ontario government announced plans to have an offshoot of the LCBO (Liquor Control Board of Ontario) sell marijuana to the public (once it becomes legal). Although the announcement provides a significant amount of clarity for consumers, the truth is that this is actually terrible news for investors.

Given that the Ontario government, through the LCBO, is one of the biggest buyers of wine in the world, the people of Ontario have greatly benefited from the large purchasing power of the Crown corporation and have enjoyed the revenues from the sale of alcohol. Marijuana will clearly be no different. With the Ontario government legislating that the province be the only buyer of the product, suppliers or growers such as **Canopy Growth Corp.** (TSX:WEED), which are more plentiful in numbers, will have to compete with each other to be the supplier of choice.

The reason this is such bad news for investors is, the one buyer in the province is now of critical importance and will hold a significant amount of power. According to Michael Porter's "five forces framework," the bargaining power of buyers is one of the most important factors when determining the long-term potential for profit in any given industry. In this industry, where a number of producers continue to be cash flow negative, the competitive landscape will be of critical importance.

The decision-making process is actually very easy to understand. If there are numerous suppliers/sellers to one buyer, then the buyer has the opportunity to ask the sellers to make concessions. When the buyers are numerous and the suppliers are fewer, then the shoe is on the other foot, and the sellers are in a position to enter negotiations with much more power. Effectively, no one client is so important that the company cannot walk away from a bad deal.

In addition to the single government-owned provider, many medical marijuana dispensaries may be forced to close, altering the long-term profitability of this industry in a permanent way. Currently, in Canada, the distribution of both alcohol and marijuana will be dealt with on a provincial level with only the province of Alberta opening the sale of liquor to function as a free market.

In the case of the marijuana industry, there may be very little difference in the distribution of the product. The challenge for investors, however, will be the perception of product differentiation. With very strict rules around advertising, and the ability to produce something that tastes different (such as with beer or wine), marijuana producers may be the ones left out in the cold.

On Monday morning, following the announcement, shares of Canopy Growth Corp. traded near $9.25, opening without much movement in either direction. Given that the industry remains in high-growth mode, investors are potentially simply shaking off this announcement without realizing the long-term ramifications.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/24
Date Created
2017/09/16
Author
ryangoldsman