



Canopy Growth Corp. vs. Aphria Inc.: Profitability in an Ontario Recreational Marijuana Framework

Description

The Ontario provincial government announced its proposed form of recreational marijuana legalization and distribution framework on September 8, which was a welcome development for the budding marijuana sector in Canada. Two top cannabis growers, **Canopy Growth Corp.** ([TSX:WEED](#)) and **Aphria Inc.** (TSX:APH), were quick to release press statements soon afterwards.

There were some stark differences between the two companies' reactions to the province's new marijuana policy.

On one hand, Aphria's management was evidently thrilled with the announcement. In a press release, Aphria claimed to be "uniquely positioned to meet the expected surge in demand from Ontarians."

On the other hand, Canopy commended the Ontario provincial government "for its leadership" and for having the right policy objectives in mind, but the statement from the leading cannabis giant seem highly qualified, identifying areas that may potentially require some attention before the policy is deployed by July 2018.

While Canopy was happy with the policy's inclusion of an e-commerce platform, the company seems worried about the lack of clarity in Ontario's statement on whether or not licensed producers will still be allowed to run their own e-commerce platforms for recreational sales in the province.

Canopy has invested millions into its marketing and distribution system. The company has incurred huge expenses in designing and deploying its "**Amazon-like**" Tweed Main Street e-commerce platform during the previous two quarters and suffered significant opportunity costs during the last quarter, when it slowed client-acquisition efforts and suspended client orders during the migration to the new advanced e-commerce platform.

It would surely hurt Canopy if Ontario had to suspend e-commerce platforms, or worse, if other provinces would render the investments obsolete just when Tweed Main Street is about to catapult Canopy's branded product sales revenues into the stratosphere.

The second issue Canopy cautioned on was Ontario's proposed client-education policy, which Canopy believes should not only include public health education, but cover product education as well. This would enable informed client choices on brands, potency, and the form in which they wish to consume cannabis.

Ontario's government-run cannabis stores are expected to sell marijuana as a commodity in plain packaging behind the counter, and Canopy believes this would lead to "unfavourable and potentially unsafe consumer choices, while encouraging consumers to return to the illicit and unregulated market."

The commodity-like sales framework would fetch lower prices and arguably favour the lowest-cost producers, making Aphria and **MedReleaf Corp.** (TSX:LEAF) some of the best-positioned growers to profit from recreational sales.

Aphria is currently the most cost-efficient grower among those reporting production costs per gram.

Canopy did see its cash costs per gram reduce last quarter, but royalty payments for acquired intellectual property put a higher floor to its production costs per gram. **Aurora Cannabis Inc.** ([TSX:ACB](#)) is still mum on its cash costs per gram.

Allowing licensed growers to have their packaging and brands marketed in the recreational market could evidently allow Canopy's Tweed and other leading differentiated premium brands to maintain their premium price points and maintain high gross margins on higher sales volumes.

Is Aphria the best marijuana play?

If other Canadian provinces emulate Ontario's current framework, Aphria may outperform peers in the profit generation front, as long it keeps production costs low while expanding growing capacity. However, there is still a significant risk to the stock from its U.S.-oriented international expansion program, where marijuana still remains a heavily controlled illegal substance at the federal government level.

However, Canopy remains a solid high-volume grower that is already "invading" several emerging international medical marijuana territories. Canopy is conquering the world market at a faster rate than most peers, while its production costs fall.

The recreational market may become a volumes game, and Canopy has the biggest cannabis-growing capacity in the world coming online in a few quarters. There could be significant economies of scale and huge profits to Canopy's operations as the group matures in Canada.

I would consider investing in both speculative stocks.

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