With Marijuana Legalization Around the Corner, Here's Why I Like Canopy Growth Corp. More Than Ever

Description

It's less than a year until marijuana is legalized for recreational purposes by the Canadian federal government.

Not only does that have tokers excited, but after what has been a pretty quiet couple of months for marijuana stocks, it looks like investors are starting to get in on the action again with several pot stocks beginning to take flight of late.

Estimates drawn from a combination of public and private sources suggest that between four and six million Canadians will smoke up next year.

That would mark a dramatic increase in the "official" participation rate compared to the 170,000 patients who currently receive medicinal marijuana from federally approved growers right now — an understatement to say the least.

It goes without saying then that you can expect producers such as **Canopy Growth Corp.** (TSX:WEED) are feverishly working around the clock to meet that oncoming demand.

The latest news on marijuana legalization came this week when Prime Minister Justin Trudeau suggested that provinces and territories would be subject to an excise tax — effectively creating a revenue-sharing agreement with the federal government.

This has many premiers up in arms, as the currently proposed framework makes them responsible for the bulk of the expenses when it comes to regulating and enforcing the new legislation.

But a revenue-sharing agreement between the provincial and federal governments shouldn't be expected to have much of an impact on the private market.

The big news for marijuana producers came last month when the Ontario government announced that sales and distribution will be controlled by the province and restricted to only medical marijuana producers licenced by Health Canada.

It's expected that other provinces will follow suit.

The proposed plan effectively gives existing medical producers like Canopy, **Aphria Inc.** (TSX:APH), **MedReleaf Corp.** (TSX:LEAF), and **Aurora Cannabis Inc.** (TSX:ACB) a head start on the competition.

That's because it typically takes anywhere from six months to three years to build a growing facility and bring it up to full production, say experts.

And now there are reports coming out suggesting that when legalization becomes official next year, the marijuana industry simply won't be able to expand fast enough to immediately supply all the Canadians who will want to purchase the drug.

This is where the first-mover advantage currently enjoyed by Canopy may become absolutely critical to the firm's long-term success.

If Canopy, as the largest medical marijuana supplier, can leverage the size, scale, and regulatory advantages it has in place today, and take advantage of an undersupplied market when pot becomes legal, it could pave the way to a very bright future for the company.

The potential opportunity for winners is huge

By examining tobacco companies, which operate in another "sin" industry, we can see clearly that the market has yet to fully appreciate what the winners of the marijuana market will look like even in just five years.

Tobacco, like marijuana, is also a plant that is relatively easy to grow and harvest. Despite this, tobacco giants like **Philip Morris International Inc.** and **Altria Group Inc.** are among the largest companies in the world, generating annual profit margins of 25% and getting a six times valuation multiple for their sales in what is a mature industry.

If Canopy can capture even 15% of the estimated $5 billion recreational market, it could mean yearly sales of more than $750 million. Applying a conservative six times price-to-sales multiple to these revenues implies a valuation close to $5 billion, not to mention that the growth prospects for marijuana are far superior to those of the tobacco industry.

When you consider that Canopy's market capitalization today is just shy of the $2 billion mark, maybe it's time to start thinking Foolishly about Canada's largest marijuana producer.

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