



2018 Could See Headwinds Slow the Canadian Cannabis Sector

Description

The list of tailwinds for Canadian cannabis producers has remained robust through 2017 – a year that saw significant volatility in this sector, yet one that ended drastically higher as the sector gears up for legalization in mid-2018.

From improving revenues (typically triple-digit year-over-year increases for most producers) to international growth and partnerships abroad, continued growth in the medical marijuana segment of the market and increased consolidation in the industry that led to higher valuation multiples for Canada's largest producers, 2017 certainly offered a long list of positive catalysts for investors to jump on.

In this article, I'm going to discuss why I believe that 2018 will provide more negative catalysts than positive – and why investors should consider taking some of their hard-earned money out of the bong and place it into value investments this year.

International growth may become more difficult

As with most Canadian industries, assessing the size of the U.S. market is typically done by most early-stage/venture companies as a means of gaining a true picture of a company's "total available market." A significant percentage of Canada's largest companies have most of their operations outside Canada (typically in the U.S. market), so this is the first place most investors look for long-term growth and stability.

Last week's recent ruling by U.S. Attorney General Jeff Sessions in which he announced plans for tighter federal controls on the cannabis supply chain (retailers, distributors, producers) in all States, including those in which marijuana is considered legal at the State level, has resulted in a significant amount of backlash across the U.S. by producers and retailers alike.

The ripple effect into Canada is likely to be both positive and negative, as many U.S. investors may look to Canadian cannabis companies as a safe investing option; however, Canadian cannabis investors will now need to assess what the impact these new controls will have on Canadian marijuana companies with significant interests in the U.S. market, namely **Aphria Inc.** (TSX:APH).

The price of the taxed cannabis commodity is unlikely to remove Canada's black market

The Ontario government's recent announcement that legal marijuana will sell for approximately \$10 per gram in Canada's most populous province, with other provinces setting prices for legal weed that are very close to, or exactly \$10 per gram, should be concerning to investors off the bat.

Studies have shown that the "street price" for black market weed varies in Canada; however, according to a recent study by Statistics Canada, the average price for legal weed in Canada is likely to be approximately 13% lower than the black market price currently.

With key Canadian provincial markets outlining a retail/distribution plan that will be costly and heavily unionized, with less selection and a significant taxation rate, rest assured that the black market will not disappear anytime soon, a fact that will likely eat into the top and bottom line projections for Canada's cannabis producers accordingly.

Stay Foolish, my friends.

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