



Nova Scotia Joining Provinces Selling Cannabis Through Liquor-Distribution Model

Description

In my recent article on the potential headwinds [government-run distribution and retail channels](#) could provide cannabis producers, I spoke at length about the risks investors face when attempting to forecast margins over the long term in the cannabis sector, citing the liquor industry as a great example of profitability at the producer level.

A recent announcement by the Nova Scotia justice minister Mark Furey that the Nova Scotia Liquor Corporation will sell cannabis at government-run liquor stores and through an online model with home delivery has been met with a mixed response. This announcement follows a similar trend of other Canadian provinces opting for a highly controlled government-operated distribution and retail model.

While many investors may have hoped for more provinces to approve a privately run distribution and retail model, relying on the current dispensary and mail-order system, which has worked relatively well thus far, the reality is that the political risk with enabling the private industry to handle the entire supply chain for cannabis remains far too great for many provinces to go with this option.

Public officials in charge of keeping the Canadian population safe and staying on course with the prime minister's goal of keeping cannabis out of the hands of minors would be faced with a much more difficult endeavour in policing in the private sector. The reality is that the liquor-distribution boards, while often not profitable and result in a "taxation by other means" scenario in which Canadians pay far too much for "sin" goods, is the only practical solution for politicians at this point in time given the potential political risk of unleashing a legalized cannabis product on the Canadian private sector.

I'll repeat my ongoing concerns that margins will simply not be what investors expect over the long term for Canadian cannabis producers. The [multiples](#) currently being paid for acquisitions, which are happening on an increasingly more frequent basis, are largely based on current volumes and demand forecasts — numbers which I do not believe accurately reflect the long-term reality for Canadian cannabis investors.

For those keen on owning a Canadian cannabis producer, I would encourage a deep dive into the

global export markets available to said producers, as I believe this is where the future profitability will really lie. With centralized government procurement at the provincial level likely to stifle margins, an export-related rush is what I believe will be the most likely outcome in the near term.

That said, even with export markets potentially opening, the ability of Canadian producers such as **Canopy Growth Corp.** ([TSX:WEED](#)) to sell abroad and compete with other low-cost medical marijuana produced in other countries will be tough, as Australian producers and others from around the world are already competing for global market share.

A race to the bottom in terms of operating and net margins is likely in the long term, and these headwinds are simply not being priced in to current valuation levels, which remain extreme.

Stay Foolish, my friends.

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chrismacdonald

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