

Why Consolidation May Be Necessary for Cannabis Producers Long Term

Description

Consolidation has seemingly become a part of every Canadian investor's life. With a number of Canadian industries in heavy consolidation mode (in the case of the Canadian cannabis industry, acquisitions have been happening almost daily for the past week or so), investors have perhaps gone blind to the headlines that have permeated their news feeds.

The discussion among many contributors and analysts following the Canadian cannabis sector has been focused on the comments of the various CEOs, who have gotten a lot of practice at how to spin the announcement of an overpriced acquisition as a good thing.

Some of the best quotes I would like to highlight from this past week are as follows:

"The [Nuuvera] [transaction](#) is expected to be accretive to **Aphria Inc.'s** (TSX:APH) shareholders in the first full fiscal year after closing."

"You see this a lot in the tech industry, but sometimes [acquisitions](#) [Aphria's buyout of Broken Coast Cannabis Inc.] are less about the company and more about the talent working there."

"At a \$1.1 billion valuation, **Aurora Cannabis Inc.** ([TSX:ACB](#)) has paid a multiple of ~73 times **CanniMed Therapeutic Inc.'s** (TSX:CMED) annual sales, which is actually not high for a cannabis industry, where we've seen multiples north of 100."

It appears the Canadian cannabis sector may eventually become similar to the Canadian telecommunications sector, utilities sector, railroads, newspapers, banking industry, grocery retail industry, dairy industry, movie industry, airlines, airplane/train manufacturing, forestry sector, and so many others with a handful or less of major players controlling the vast majority of sector revenue and profitability, supported in some way by the Canadian government.

While the cannabis sector is still tiny in comparison with financials or telecommunications companies (a merger in these sectors would likely constitute an anti-competition review), continued consolidation where three or four major cannabis producers control effectively 90% or more of the marijuana production domestically appears to be exactly where we are headed.

Perhaps the only way to combat the [high bargaining power of provincial buyers](#) (a significant headwind for the Canadian cannabis production industry, which I have highlighted on various occasions) is to create a situation where suppliers also have high bargaining power. By joining forces, Canadian cannabis producers have the potential to increase profitability long term (without outright colluding, of course, which would be against the law, as **Loblaw Companies Limited** has found out the hard way).

While I believe that the current consolidation happening in the Canadian cannabis sector is being done at premiums that [don't make fundamental sense](#) when compared to the all-in production cost of a new facility (if we're talking about the primary driver of acquiring firms being production capacity and

clientele growth in today's pre-legalization environment), I also can take a look at a myriad of other sectors and see that consolidation is the only way a handful or less of companies will be profitable long term.

Stay Foolish, my friends.

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