MedReleaf Corp. Returns to Growth — and Potential Acquisitions

Description

MedReleaf Corp. (TSX:LEAF) announced its latest financial results for the three months ended December 31, 2017 on Tuesday morning, showing some notable improvements in the marijuana giant's revenue growth rate after three consecutive quarters of range-bound cannabis sales performance.

The stock responded well by rising 6.80% by mid-day. While the other notable performance areas in the earnings results were discussed by fellow contributor Joseph Solitro here, there are two aspects I wish to highlight further.

Revenue growth

MedReleaf has finally broken free of the troubling revenue growth disturbance that was brought about by a negative change in the Veteran Affairs Canada (VAC) reimbursement policy, a development I discussed repeatedly last year. The marijuana giant made an impressive return to revenue growth during the last quarter.

Quarterly revenues grew sequentially by 15.57% from $9.82 million in the previous quarter to $11.35 million during the three months ended December 31, 2017, significantly boosted by premium priced cannabis oil sales.

The licensed producer riled under the VAC policy change scare, which limited covered patients' expenses reimbursement to $8.50 per gram and placed a strict daily consumption limit for covered patients.

Other licensed producers, including **Aphria Inc.,** managed to weather the storm earlier, but MedReleaf, with a huge client base composed of a significant proportion of the affected veterans, took far longer to break of the curse that curtailed its top-line growth rate for several quarters.

I expect MedReleaf to significantly improve sales generation going forward, and perform better in both the recreational and medical marijuana space after signing supply agreements with Shoppers Drug Mart and the Province of Quebec. MedReleaf may supply Quebec recreational marijuana stores with a guaranteed volume of at least 8,000 kilograms of high quality, adult-use cannabis per annum.

Potential near-term acquisition

The company has been keen on growing organically in Canada since its inception, and has not been as active in the acquisitions front as its strong competitors, Aphria Inc. and **Aurora Cannabis Inc**.

However, I think management may not be content competing in a potentially explosive recreational cannabis market with a planned 35,000 kilogram per annum productive capacity when a youthful Aurora is targeting over 270,000 kg per annum in in-house grown and contracted productive capacity by next year.

MedReleaf launched its adult recreational brand, San Rafael '71 recently, grossing about $192.5 million in new equity raises in December 2017 and January of this year. The company announced in the latest earnings press release that "the proceeds from these two equity financings will be used to finance the acquisition and/or construction of additional cannabis production and manufacturing facilities and expand the company's marketing and sales initiatives."

It is highly likely that MedReleaf may intend to acquire a smaller recently licensed marijuana producer to boost its productive capacity in preparation for recreational legalization by Canada Day 2018.

A speculative holding in the stock could generate some capital gains in the long term, but investors should be prepared for the high equity risk as valuations are severely stretched for the sector.

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