



## It's Time for Cannabis Investors to Face the Elephant in the Room

### Description

It's not hard to get excited about what's happening in the cannabis industry in Canada. In the course of two years, **Canopy Growth Corp.** ([TSX:WEED](#)) and four other industry participants have seen their market caps blow past a billion dollars.

Early investors have gotten extremely wealthy or wealthier depending on their financial situation prior to the Great Canadian Weed Rush.

"*The Globe and Mail* looked at a sample of 27 top executives and directors at eight pot companies. Public filings reveal their combined shareholdings are worth \$1.2 billion, before factoring in options," David Berman wrote February 2. "This enormous wealth arguably makes these stakeholders the biggest beneficiaries of the move toward marijuana legalization in this country, expected this summer."

And while some insiders have taken some money off the table, most are letting their bets ride, confident that the future will deliver even sweeter returns.

I hope they're right.

However, a story flew across my screen the other day that got me wondering about the future profitability of these billion-dollar babies. Except for **Aphria Inc.** (TSX:APH), which I believe is the only genuinely [profitable](#) Canadian cannabis company, they're all a long way from delivering on the bottom line.

### The elephant in the room

*Canadian Business* recently did a good job explaining the forensic accounting mess that is the cannabis industry.

"Canadian reporting of marijuana growers sets a new low for integrity," stated forensic accountant Al Rosen in the January 24 article in *Canadian Business*. "It's a bloody mess."

I've stated on several occasions that the cannabis industry would someday face the music because the

lack of transparency in its financial statements combined with a growing supply of product would leave many companies struggling to keep investors happy.

“If and when a legal, recreational market opens up, that could change. But for now, if you do the math — and not enough investors do the math — we could see a huge drop in prices,” stated Chris Damas, author of the BCMI Cannabis Report in February 2017. “That alone could wipe out a good chunk of the companies out there.”

Aphria CEO Vic Neufeld’s approach always impressed me because I got the distinct impression early on that he understood that prices were going to fall, perhaps dramatically, as supplies increased; therefore, Aphria focused on being one of the lowest-cost producers of medical marijuana in the country.

Yes, I liked the fact Aphria was solidly in the black, but it was this foresight about marijuana prices that attracted me to the company.

Let’s face it; marijuana prices are the elephant in the room for both growers and investors. No one wants to talk about it.

*Bloomberg* discussed the issue at the end of January, making some interesting observations. “Falling marijuana prices will indeed pose a challenge to producers,” said Bloomberg Intelligence analyst Kenneth Shea. “In Colorado they have learned to diversify and add more value to the equation.”

Companies like Canopy are doing this, but in the end, unless Canadian producers can figure out how to export enough product to keep the domestic supply in balance with demand, prices will continue to drop, cutting into already razor-thin margins.

### **Bottom line on prices**

Over the past two years, the average cost of a gram of marijuana has dropped from \$8.43 in 2015 to \$7.43 in 2017. A dollar might not seem like a lot until you consider that the Ontario finance minister said at the end of December that legalized pot would sell for \$10 a gram with a \$1 tax attached on the first gram and 10% over that amount.

Does anyone find it strange that the Ontario government doesn’t have a problem with \$10-a-gram pot when you can already get medicinal marijuana for less?

I just don’t see this ending well for one or more of the stakeholders in the Great Canadian Weed Rush. You can be darn sure it’s not going to be the LCBO, which means producers had better be prepared for a retail price much lower than \$10.

How many producers are ready for this low-cost environment? Very few, I would guess.

### **CATEGORY**

1. Investing

### **TICKERS GLOBAL**

1. TSX:WEED (Canopy Growth)

## **PARTNER-FEEDS**

1. Msn
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### **Category**

1. Investing

### **Date**

2025/08/21

### **Date Created**

2018/02/18

### **Author**

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