

## The Little Pot Company That Could: Why Hydropothecary Corp. (TSX:HEXO) Stock Will Run Over its Competition

### Description

In a cannabis market which has speculators trying to guess who will be able to produce the most weed or acquire existing producers with small medical marijuana patient lists to grow their consumer base at exorbitant prices, [valuations have gotten out of control](#).

However, one factor that everyone in this space should be focusing on (in my opinion) is supply contracts with provincial governments. After all, the cannabis sector in Canada is being set up as a monopoly-run business, with one buyer controlling the distribution of cannabis to primarily government-run stores throughout the nation.

In Quebec, **Hydropothecary Corp.** ([TSX:HEXO](#)) has secured a [five-year preferred supplier agreement](#) with the Société des alcools du Québec (SAQ). SAQ is the monopoly buyer in Quebec, meaning Hydropothecary has secured sales volumes for five years at what may turn out to be pretty significant numbers for the relatively small firm.

As per details of the agreement, Hydropothecary is set to supply 20,000 kilograms of cannabis products to SAQ for the first year, with volumes increasing to 35,000 kilograms in year two, and 45,000 kilograms in year three. The company has noted that while year four and five of the agreement are yet to be negotiated, factoring in a 10% growth rate year over year, Hydropothecary expects this agreement to amount to a total volume of more than 200,000 kilograms over the five-year period. These numbers assume an increase in the number of value-added products sold in the latter years of the contract, with more conventional dried flower sold in the earlier years.

Based in Gatineau, Quebec, it makes sense that Hydropothecary has secured this contract with SAQ. The ability of Hydropothecary to produce the amounts required by SAQ is without question — the company's 1.3 million square feet of production space will result in an ability to grow an estimated +100,000 kilograms of cannabis per year, covering this contract by a significant margin.

### Bottom line

Securing production capacity is one thing, but companies like Hydropothecary that have secured a partner down the supply chain will be paramount in becoming profitable in short order. While I remain skeptical as to the economics of the cannabis industry at this point in time, it appears Hydropothecary has done what it needs to do to lower its risk of over-production, with plans to utilize its production capacity appropriately and sell at a (presumably) reasonable profit margin over at least the next five years.

This sector is still highly speculative, and every investor ought to act with extreme caution when considering adding a cannabis position to an existing portfolio. That being said, I believe Hydropothecary has some of the best fundamentals in the industry.

Stay Foolish, my friends.

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