Will Ontario Bungle Private Cannabis Retail?

Description

The drama of the Ontario election in early June brought about some measure of anxiety and optimism in the cannabis sector. Ontario is Canada's most populous province, and it will be a gigantic source of revenue for Canada's cannabis producers after recreational legalization comes into effect in October. There are still serious questions lingering over the structure of its cannabis retail system.

In July, the PC government announced its intentions to allow private cannabis retail sales rather than cede control to the Liquor Control Board of Ontario (LCBO). Some readers will remember that I was optimistic about the move. Producers and industry backers had been pushing for private sales since recreational legalization became a political reality. Leadership at **Canopy Growth** (TSX:WEED)(NYSE:CGC) and **Aurora Cannabis** (TSX:ACB) had both advocated for at least some privatization going forward.

Canopy Growth, Aurora, and other cannabis stocks were up on the news that Ontario announced a number of supply agreements. Ontario announced agreements with 26 licensed producers, which included Canopy Growth and Aurora Cannabis.

Buyers will only be able to complete legal recreational cannabis sales from the Ontario Cannabis Store (OCS) online retail channel after October 17. The Ontario government recently confirmed that it will not establish a wholesale distribution network through private stores until April 2019. Some of the finer details should come as a concern for investors.

For example, the government will provide municipalities with a one-time opportunity to opt out of permitting cannabis retail stores within their boundaries. One of the chief concerns with public control was the slow roll-out of OCS stores that the LCBO had planned. Demand is expected to surge after legalization, and the small number of stores at roll-out seemed to underestimate the potential consumer response. This measure introduced by the PCs could present similar problems where consumers in certain municipalities could be frozen out of the market or forced to travel long distances to purchase recreational cannabis.

The promise of private retail has already drawn some major players into the fray. **Alcanna**, which is partially owned by Aurora Cannabis, has reportedly expressed interest in moving aggressively into the Ontario market. Leadership at **The Second Cup** retail coffee chain has also said that it will look to convert several of its coffee shops into cannabis stores. It has a relatively strong retail footprint across Ontario, which could give it a leg up.

The takeaway for investors is that there is still a good deal of uncertainty in the largest cannabis market in Canada. Fortunately, this should not impact the major producers like Canopy Growth and Aurora in a major way. It will impact consumers on the ground, especially if certain municipalities elect to take up the opt-out offer that Ontario has provided. They will be forced to sweat out several more months of deliberation and consultations before the picture becomes clearer.

Retailers looking to make a splash in the market are riskier buys. Companies like Alcanna and The Second Cup are enticing speculative additions, but the competition among Ontario dispensaries will be intense. Investors should take this into account if they are eager to bet on these stocks long term.

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