



## Aphria Inc. (TSX:APH) Will Be an Earnings-Growth King! Why the Marijuana Giant Looks Like the Biggest Winner for Year 1 of Cannabis Legalization

### Description

What's that smell?

With nationwide legalization of marijuana finally in the books, you may be smelling marijuana everywhere you'll go over the next several months, but it's not the smell of someone toking up that's in the air as we head further into the post-legalization environment; [it's money](#).

I know I'll never top the build-up made by Ryan Gosling's character in the *Big Short*, but it was worth a shot. Now that I have your attention, I'd like to draw your attention to the opportunity to be had with **Aphria** (TSX:APH) as we enter year one of legalized marijuana.

As you may have realized, the Federal Government has created an environment where the marijuana market will be perfectly competitive, whereby there will be minimal product differentiation and little to no way to tell one producer's bud from another.

As we learn more about specific cannabis rules that'll be put in the books over the next few weeks, I think we could witness somewhat strict enforcement measures placed in the initial stages of legalization to ensure everything goes smoothly. Some critics believe that PM Justin Trudeau "rushed" legal weed, and if that's the case, regulators are going to want to err on the side of caution as they tread carefully with regards to what'll be allowed and what won't be.

For now, we know that celebrity endorsements and brand packaging will be kept minimal, so not to entice minors to want to try cannabis. That means **Canopy Growth** ([TSX:WEED](#)) will lose its number one competitive edge as it possesses the [strongest portfolio of recreational brands](#) out there (Tweed, Tokyo Smoke, Snoop-endorsed products) and the greatest ability to differentiate itself from the pack.

With strict rules, enforcement and penalties (fines, potential loss of growth licence?) in place, all Canadian cannabis producers are going to be playing on a pretty even playing field. The market will be what economists refer to as “perfectly competitive,” whereby all producers will be offering a similar, fungible product that’ll be seen as nothing more than a commodity.

In such a commoditized environment, two traits will separate the big winners from the losers. The first (and most important) trait is the efficiency of production. The lowest-cost-per-gram producer will be able to profit the most for a given market price of marijuana.

Second, the producer with the largest production capacity will be the one that’ll reap major rewards in the early stages as demand overwhelms supply. This will be a short-lived window, I believe, so in the longer haul, the biggest winner won’t be who can grow the most weed. Rather, it’ll be who will enjoy the most significant economies of scale that’ll allow for low production costs as well as the ability to accelerate growth based on the price of weed at any given instance in time.

Aphria is arguably the most efficient marijuana producer in the entire marijuana market. The company has innovative growth tech, and CEO Vic Neufeld has made it clear that he desires to produce cannabis at the lowest cost.

Neufeld has taken a pass with sponsoring music events and excessive brand awareness initiatives, instead opting to treat his company like an incredibly efficient commodity producer. In the initial stages of legal weed, I think Aphria’s plan is prudent and could allow the company to pole vault over the competition, at least until regulators decide to give the green light to product differentiation (ads, celeb endorsements, eye-catching packaging, etc.).

In Q1, Aphria sold nearly 1,800 kilograms of weed with an average selling price of \$8.99 (wholesale price below market value per-gram of marijuana), with an applause-worthy \$1.83 per gram “all-in” cost and a cash cost of \$1.30 per-gram of dried marijuana.

Those are ridiculous gross margins that’ll make Aphria one of the biggest earnings-growth kings in the pot space over the first year of legalization. The company’s indoor cultivation tech is top notch and won’t just allow the company to produce cheaper weed, but higher-quality weed that’ll pass quality assurance tests with flying colours.

### **Foolish takeaway**

Moving forward, Aphria is ramping up with operational efficiency in mind, and should regulators emphasize higher standards of quality control and commoditization of cannabis, Aphria looks like the producer that’ll see the biggest earnings-growth numbers over the next year or so.

At current levels, Aphria is sitting at a \$4.46 billion market cap, well below Canopy Growth’s \$13.9 billion market cap. In the first year of legalization, I’d observe the throne closely. Although Canopy has the best branding prowess, Aphria looks to have the greatest ability to post the highest triple-digit EPS growth numbers over the near term.

Stay hungry. Stay Foolish.

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