



Pot Legalization Has Landed: What to Expect in the Markets

Description

The big day is finally here. After months of anticipation, cannabis is now federally legal across Canada. Although customers in some provinces will have to wait before they can buy in-store, all Canadians now have the right to buy recreational cannabis in principle.

The legalization story is as much a tale of the markets as one of changing social norms. While the social implications of pot legalization are considerable, the effect on Canada's economy may be even greater. Now, millions of dollars that previously went to black market vendors will be spent in legitimate stores and taxed appropriately. And this, among other things, has fueled a wild rally in cannabis stocks that raged through August and September.

With cannabis legal, it's just a matter of time until earnings statements reflect the effects of legalization. However, it's already possible to forecast some of them. We can start with the most obvious:

Revenue growth

Most of Canada's pot companies will see revenue growth as a consequence of legalization. Cannabis stores will need suppliers, and publicly traded pot manufacturers are raking in the lion's share of supply contracts. We're already seeing evidence of how this is playing out: in Q4, **Aurora Cannabis Inc** ([TSX:ACB](#)) posted sky high [223% revenue growth](#), in no small part because of the recreational supply contracts it has already earned. There's no doubt in my mind that other cannabis companies will post similar results in their upcoming income statements.

Price concerns

I've just touched on a major positive that legalization will bring for cannabis investors. Now it's time for a negative: downward pressure on prices. When cannabis was made legal in Colorado in 2014, prices almost immediately started falling as the market was flooded with new supply. Vendors cut their prices to compete with one another, and margins suffered all around.

It's fairly likely that something similar will happen in Canada unless the government steps in with price control. This could be bad for companies like **Canopy Growth Corp** ([TSX:WEED](#))(NYSE:CGC) that

are struggling to reach profitability.

Acquisition fury

Finally, it's reasonable to expect that legalization will lead to a lot of M&A activity, both within the cannabis sector and across sectors. We already saw this ahead of legalization with **Constellation Brands Inc's** \$5 billion investment in Canopy. And many cannabis producers, such as **Aphria Inc** (TSX:APH), are buying up smaller competitors at a fast pace, with Aphria's most recent acquisition being valued at over \$300 million.

As more and more cannabis companies earn lucrative supply deals, we can expect bigger companies to acquire them in a bid for larger market share. This may be a good reason to buy smaller-cap pot stocks like **Hexo Corp** that may be bought out at above-market prices.

Bottom line

Without a doubt, this is a historic day, not only for Canada but for the cannabis industry as a whole. After decades of being flat-out illegal and years of existing in a legal grey area, cannabis is now fully legal nationwide. Many other countries are sure to follow Canada's lead on this, which paints a rosy picture for cannabis stocks' future prospects. As for which stock will win, that's a trickier question, but [there are always ETFs](#) for those hoping to diversify and invest in the entire sector.

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