Ontario Marijuana Store Cutbacks: Will Cannabis Stocks Suffer?

Description

Ontario sent a shock wave through the Canadian marijuana sector last week with the announcement that the province will only issue 25 retail licenses for brick-and-mortar marijuana stores ahead of the opening of the market in April 2019.

Big surprise

The news came as a big surprise to pot stock investors, as well as the hundreds of entrepreneurs who are planning to open cannabis retail locations across the province.

Many operators of previously illegal stores have shut down to go through the process of preparing for the legal market. In some cases, leases have been signed and significant funds have been invested to ensure all the proper steps have been taken to qualify for a licence.

The new Ontario government originally said it would not limit the total number licences for the initial phase of the pot stock market. Last month the Progressive Conservatives outlined the rules in more detail, saying the province would limit the number of stores to 75 per each operator, but didn't cap the number of licences it would issue.

Last week, however, the province significantly scaled back the rollout plan, saying it will issue just 25 permits in the first phase.

The previous Liberal government had planned to allow 40 stores in the first phase with a ramp up to 150 in 2020.

The winners will be decided through a lottery process in February.

Supply concerns

Ontario says supply shortages are the reason it is taking a more cautious approach to the opening of the market.

Legal recreational cannabis sales began in October. The first two months have not gone as smoothly as anticipated as provinces found demand outstripped supply and delivery delays caused frustration for customers.

Producers with supply contracts with the provinces are scrambling to meet demand and Ontraio isn't the only province that is facing shortages. Quebec cut back the number of days its physical stores would open, due to a lack of product.

Cannabis companies are scaling up capacity and the supply situation should eventually get sorted out. For example, **HEXO**, which is Quebec's leading marijuana company with the largest supply contract for the province, is completing the construction of a new one-million square foot production site. The company's current capacity is just over 300,000 square feet.

Impact on your marijuana stocks

The decision is more likely to hurt entrepreneurs who had planned to open cannabis retail shops, rather than the cannabis producers. The industry is scrambling to scale up production and I wouldn't be surprised if the province made the decision after consultation with the Canadian producers.

The setback is unfortunate, but the overall impact on Canadian cannabis stocks should be minimal. As they catch up with demand, the provinces will allow more retail licences and the overall effect of the more measured approach will likely be better for the industry.

The larger players, such as **Canopy Growth**, have a global perspective on the cannabis market, so the delay in the Ontario rollout shouldn't be a major issue for investors.

Should you buy today?

Pot stocks still appear expensive, even after the pullback in the past two months. The Ontario announcement is another reminder to investors that volatility should be expected as the market tries to get itself established. If you are positive on the long-term potential for the emerging cannabis industry, a small position in the market leaders, such as Canopy Growth, might be warranted on further downside, but I would keep the investment small at this point.

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