



Canopy Growth Corp's (TSX:WEED) Stock a High Potential Play on U.S. Hemp Growth

Description

Leading cannabis producer **Canopy Growth Corp's** ([TSX:WEED](#))(NYSE:CGC) planned entry into a freshly federally legalized U.S. hemp market could usher in a new growth driver for the stock, as the marijuana giant could soon announce another acquisition south of the border.

Canopy commented on the recently signed U.S. Farm Bill of 2018 on Thursday, calling it a “transformative piece of legislation.” The bill federally legalizes industrial hemp as a crop. Hemp is a sister species to the cannabis plant, which is rich in non-psychoactive cannabidiol (CBD), an important cannabis extract that’s trending for its health and wellness benefits around the world.

The company had strictly avoided engaging in any cannabis-related business in the U.S., as the product is a federally illegal Schedule 1 controlled drug south of the border, but became one of the first local marijuana producers to quickly announce its bold intent to “participate in the American market now that there is a clear federally-permissible path to the market.”

Could it start from scratch?

Hemp is a cheap-to-produce marijuana plant that can be contract farmed, and Canopy could easily establish itself from scratch in the U.S. if it chooses to. But the company was the first to ignite a wave of marijuana industry consolidation when it made the record acquisition of competitor Mettrum Health, and its methodical growth-through-acquisitions strategy got amplified at **Aurora Cannabis**.

The company has promised to update the market on its manoeuvres in the U.S. in the new year, and I am already looking forward to an acquisition announcement after management touted the “landmark US\$4 billion investment from **Constellation Brands**” as ammunition, enabling the company to “enter the U.S. market *quickly*.”

Who is up for acquisition?

The marijuana giant is already way ahead in implementing a hemp growth strategy after [consolidating other hemp operations](#) in its portfolio, the latest being the \$450 million acquisition of Colorado-based research firm ebbu Inc. in October, which gave the company a deep hemp-specific portfolio of intellectual property assets.

Canopy could move to acquire a CBD oil manufacturing and distribution operation down south, which has wide contract farming capabilities. The company has promised to “participate in ways that support American farmers,” and so may largely depend on sourcing hemp from local farmers (and not rely on any CBD imports from Canada).

The first class of potential acquisition targets that comes to mind includes the largest publicly traded hemp companies like **Charlotte’s Web**, which has generated \$48 million in revenue in the first nine months of 2018, 75% higher than last year and with healthy operating margins of 34% on adjusted EBITDA basis.

CV Sciences generated the faster sequential revenue growth of 10% in the third quarter, and its strong positive operating cash flow during the quarter was impressive, just as its wide retail distribution channel of more than 2,093 stores, but its 29% adjusted EBITDA margin was weaker than that of Charlotte’s Web.

Australia listed but U.S.-focused **Elixinol Global Limited** could have been another target due to its aggressive global growth stance, but its sourcing of raw material from joint ventures could make it ineligible for the criteria to support local farmers

Foolish bottom line

Canopy could most likely attempt to replicate the grow platform it created in Canada (where it sources product from smaller licensed producers for sale on its online store) in the U.S. by contracting with local farmers, as Aurora’s **Hempco Food and Fiber Inc.** does here and this is a low-investment, low-cost, but high-margin strategy as CBD oil manufacturers enjoy more margin power in the hemp value chain than the farmers.

Cannabis companies’ scramble for a piece of the newly liberated U.S. hemp CBD market could just have been ignited with the signing of the Farm Bill of 2018 by President Trump this week, and Canada’s largest marijuana growth operation is well equipped and ready to pounce.

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brianparadza

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