Colombia: The Next Major Threat to Canada’s Burgeoning Cannabis Industry

Description

Being the only developed jurisdiction to legalize the recreational consumption of cannabis has seen Canada become the global leader in cultivation, processing, and distribution of marijuana. This has been a boon for companies such as **Canopy Growth** (TSX:WEED)(NYSE:CGC), **Aurora Cannabis**, and **Cronos Group**, which have seen their stocks soar by 578%, 393%, and 1,074%, respectively, over the last two years.

Analysts believe that considerable potential exists for Canada’s leading marijuana cultivators, with it anticipated that the global legal cannabis industry will expand by a compound annual growth rate (CAGR) of around 24% between now and 2025. This, it is believed, will spark a significant increase in sales, justifying the nosebleed valuations of any marijuana stocks like Canopy, which is trading at 81 times sales and has yet to report a net profit.

That valuation gap is expected to close significantly, as demand for legal cannabis for recreational consumption and medical applications grows. It is anticipated that the legalization of marijuana edibles, extracts, and topicals, which is scheduled to occur no later than October 17, 2019, is worth almost $3 billion in sales.

Growing risk

Despite the steps taken by major cultivators, including Canopy, Cronos, Aphria, and Aurora, to expand their productive capacity, bulk up cultivation facilities, and grow their distribution networks, they have been unable to meet demand. This, along with the high costs associated with legal cannabis cultivation, has seen a surge in the sale of illegal marijuana and a burgeoning black market supply.

Data from Statistics Canada shows that on average it costs close to $10 to produce a legal gram of marijuana compared to between $5 to $7 per gram for illegally cultivated cannabis. Those high costs can be attributed to energy-intensive, climate-controlled greenhouses and the substantial regulatory costs associated with growing marijuana legally.

While expanding black market supply in Canada poses a threat to the legal marijuana industry, the rise of Colombia as a preferred jurisdiction for cannabis cropping is another key threat. Leading Colombian licensed marijuana company **PharmaCielo** (TSXV:PCLO) has claimed that it can produce cannabis oil for as little as $0.05 per gram. Analysts believe that on average it will cost around $0.50 to produce a gram of dried flower in Colombia**,** roughly a 20th of the average industry cost in Canada.

Even leading cultivator Canopy is struggling to reduce costs, reporting production costs of $5.47 per gram of cannabis harvested for the fiscal fourth quarter 2019. While this was 15% lower than a year earlier, it is still around 11 times greater than average production cost in Colombia.

While those are only estimates, it is easy to see Colombia's potential to become a leading low-cost jurisdiction for cannabis cultivation. The equatorial nation contains a range of temperate climate zones with long periods of even sunlight, making outdoor cultivation feasible. Start-up and operational expenses including labour are also lower than in Canada; Colombia has a large skilled workforce with a long history of cut flower and coffee cropping.

Those attributes give Colombia a distinct comparative advantage over other jurisdictions, which is further enhanced by the Andean nation's clear regulatory environment. For those reasons, Canopy acquired a 126-hectare farm with 4.5 million square feet of licensed production capacity in the Colombian department of Huila.

They will also allow PharmaCielo to produce marijuana at a significantly lower cost than Canadian cultivators. PharmaCielo recently entered a $133 million agreement to buy **Creso Pharma**, which has a portfolio of shelf-ready cannabis products and a 24,000-square-foot cultivation facility in Nova Scotia capable of producing 4,000 kilograms of marijuana annually. That broadens PharmaCielo's global reach and positions it to benefit from the legalization of edibles in Canada.

Foolish takeaway

The legal cultivation of marijuana could also become a powerful tool in the ongoing war against drugs, because it could become a viable legal substitute for coca, which reached record cropping levels in 2017. This, coupled with Bogota's need to raise additional sources of fiscal revenue and foreign investment, creates a powerful incentive for the government to promote legal cannabis production. Colombia potentially could become the Saudi Arabia of legal marijuana.

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