Has Colombia's Legal Pot Boom Reached an Abrupt End?

Description

The legalization of cannabis for medical use in Colombia and its licensing for cultivation was heralded as a monumental breakthrough that along with the world's legal marijuana boom would see the equatorial nation become a leading global cultivator.

Colombia undeniably possesses a competitive advantage over many countries for cannabis cultivation. A unique combination of a favourable climate, rich soils, an established agricultural industry and low costs endow it with considerable advantages over many other jurisdictions.

This sparked a veritable green rush as **PharmaCielo** and **Khiron Life Sciences** began operations while Canadian cultivators **Canopy Growth** (TSX:WEED)(NYSE:CGC) and **Aphria** acquired local assets.

While there has been considerable hype over the emergence of a legal cannabis industry in Colombia, it has thus far failed to live up to its potential.

Impediments abound

Very few companies have been able to successfully navigate the maze of regulations and licensing requirements that govern the industry, with a mere handful being fully registered cultivars.

There are no companies operating in Colombia that are engaged in fully-fledged commercial sales or exportation of legally cultivated marijuana.

Industry heavyweight Canopy, which has come under considerable pressure from investors after reporting a slew of massive losses, is even winding down its exposure to Latin America.

For its fiscal second quarter 2020, Canopy reported a massive net loss of almost $375 million and an even bigger loss of $1.3 billion for the previous quarter.

In an environment where the cultivator is bleeding cash and facing significant pressure to become profitable, it makes sense to wind back non-core operations.

That pressure is being magnified by growing doubts over the true size of the legal global marijuana market. For this reason, Canopy has yet to make any significant investment to develop its 126-hectare property in the Colombian department of Huila, despite investing in expanding its Canadian operations.

Accessing capital is also a significant problem for many cannabis cultivators in a nation still bearing the scars of the U.S. sponsored war on drugs, which some sources estimate led to the deaths of over 200,000 people.

Cocaine production and illicit marijuana cultivation have been responsible for fueling Colombia's decades long low level asymmetric conflict which shows no signs of ending.

The stigma this has created combined with the potential for U.S. civil and criminal sanctions makes financial institutions extremely reticent to provide funding to Colombian cannabis growers.

Civil unrest and growing insecurity in Colombia coupled with Bogota's moves to modify key aspects of the regulatory framework have ratcheted up the degree of uncertainty for foreign investors, further reducing the nation's attractiveness for cannabis cultivation.

First mover advantage

While there are certainly significant and emerging risks that could bring Colombia's legal pot boom to an abrupt halt, first mover PharmaCielo continues to advance its operations.

The cultivator, the only licensed exporter of CBD isolate in Colombia, is expanding its operations and facilities after the proposed acquisition of Australian cannabis grower **Creso Pharma** fell through.

This includes significantly increasing its cultivating capacity and establishing a distribution agreement with Laboratorios Adler, giving PharmaCielo access to the legal cannabis markets in Uruguay, Paraguay, Bolivia and Southern Brazil.

Creso Pharma has repaid a $3.9 million loan to PharmaCielo which**,** when combined with almost $21 million in cash and short-term investments at the end of the third quarter**,** provides it with considerable financial flexibility. That will allow PharmaCielo to continue expanding its operations and achieve expected commercial production in 2020.

Colombia was expected to become a leading jurisdiction for legal cannabis cultivation, and PharmaCielo has reduced its all-in sustaining costs (AISCs) per gram of dried flower produced to as little as $0.04 per gram.

That's well below production costs for major Canadian cultivators, including Canopy, which has been struggling to reduce expenses and reported production costs over just over $2 per gram for its second quarter 2020.

Foolish takeaway

The hype surrounding Colombia's potential as a superior location for legally growing cannabis appears overbaked. Despite climatic advantages coupled with a long generational history of illegal marijuana cultivation and agricultural production**,** there are a range of barriers holding back the industry's development. This means that there is still considerable risk associated with investing in legal cannabis cultivators operating in Colombia.

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