



Why Aphria Inc. Is the Only Pot Stock I'll Buy

Description

There is no doubt that the lifting of prohibition could result in a massive recreational marijuana market. However, with absurd valuations and the industry's future significantly dependent on the government, should investors be steering clear of pot stocks?

Clearly, companies within this industry are not core holdings; however, I do believe there is a significant opportunity for growth. The question is, which company is best positioned to capture this growth and realize significant returns for investors once marijuana becomes legalized?

Although it's difficult to quantify the intrinsic value of these stocks, management's performance can be evaluated within these companies and provide insight towards its future performance. In order for businesses to be successful over the long term, a company needs a CEO who is a disciplined capital allocator, and **Aphria Inc.** (TSX:APH) certainly has one in Vic Neufeld.

Here's a look at two moves Neufeld has done to separate Aphria from the pack.

Reinvesting in the company

In December 2016, the largest player in the marijuana industry **Canopy Growth Corp.** ([TSX:WEED](#)) acquired the second-largest producer at that time, Mettrum Health Corp, for \$430 million. Mettrum's shares were trading at \$5.92, and Canopy essentially paid \$8.42 per share. Not only were Mettrum's shares overvalued, but Canopy paid an additional 42% premium on top of that!

In my opinion, this clearly a poor management decision. Yes, Canopy did acquire the second-largest producer, but it grossly overpaid. This goes against one of Warren Buffett's biggest rules in capital allocation: to never overpay for shares in a company.

Instead of trying to grow by acquisition, Neufeld has made it clear that he plans to grow Aphria organically and reinvest the cash flows into the company for now. Neufeld is aware that Aphria would have to pay a significant premium for another Canadian producer; therefore, Aphria has been making conservative investments into producers in the United States instead.

No brand ambassadors

Both Canopy and Organigram Holdings Ltd. have each teamed up with Snoop Dogg and Trailer Park Boys, respectively, to enhance each company's brand. One may think this would be a great move; however, both companies may not even have the opportunity to benefit from these branding partners.

The government has made it clear there will be restrictions on advertising of cannabis. Producers may be required to use plain packaging, which could result in both of these partnerships becoming essentially useless.

How has Aphria approached branding?

Neufeld has stressed from the beginning that Aphria is one of the lowest-cost producers. This strategy should resonate with consumers since they will probably stop buying from the illicit market if they can buy cannabis from a legal producer at a lower price.

Foolish bottom line

Obviously, there is still much uncertainty regarding the recreational market, but I firmly believe investors have the highest chances of success by acquiring shares in Aphria. The only thing certain is who makes the decisions within these companies, and I have the utmost confidence that Neufeld will continue to make the right moves for Aphria.

Fool on!

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Date

2025/08/18

Date Created

2017/06/07

Author

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