GROWERTALKS

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Ant Wisdom

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In the United States, state-legal production of cannabis began with the first medical cannabis legislation in California in 1996, then medical in Colorado in 2000. However, it really wasn't until about five or six years ago when things really took off with more states authorizing production, expanding uses and especially relaxing some regulations. The same thing happened in Canada—medical use of marijuana was legalized in 2001, but the legislation in late 2018 allowing general adult use was the real game changer for commercial cannabis businesses.

This all happened while public opinion was becoming more accepting of marijuana use, by a large majority for medical use and a smaller majority for general adult use.

This all resulted in companies seeing nothing but unlimited potential; untapped markets and often limited competition due to restricted licensing for production, processing and distribution. No amount of money was too much to spend to acquire a license, build out facilities and hire staff. These first movers spent millions of dollars, often tens of millions, to start their companies.

When these companies built an indoor growing facility or a cannabis-specific greenhouse (or retrofitted an existing structure), nothing but the best was good enough for the cannabis plants—dehumidification, lighting, ventilation, air purifiers, etc. No matter the cost.

It was all extremely expensive. Capital was expensive due to banking restrictions, the newness of the industry and a general sense of risk.

But high costs didn't matter to these pioneers; there were mountains of money to be made. The news was all about partnering with Martha Stewart and investments by Constellation Brands (Mondavi wine, Corona beer, Svedka vodka, etc.).

But now it's 2020 and the party isn't quite what it was.

While the percentage of cannabis companies that are publicly traded is low, what's happening with share prices of those that are isn't encouraging.

The ETFMG Alternative Harvest exchange traded fund is a fund of about 40 cannabis-related companies allowing investors to invest in the marijuana industry without purchasing stocks of individual companies. This fund dropped approximately 40% in 2019.

Individual companies haven't fared much better. Companies like Tilray, MedMen and Aurora have all taken a hit. Mergers and acquisitions have collapsed, like the acquisition of PharmaCann by MedMen initially valued at $682 million (all stock).

And that Constellation Brands investment? Lost $54.3 million in the third quarter of 2019.

What's going on? Lots of things, of course. There rarely is just one thing that depresses an industry.

As mentioned in a previous column, oversupply contributes, especially when field-grown cannabis is an option, for either THC or CBD products.

Demand constrictions contribute. High taxes have made legal cannabis often more expensive than black-market alternatives. Limitations on approved medical conditions have limited eligible patients in some markets. Distribution is constrained by legal restrictions. For example, although Michigan has legalized general adult use, it also has a 20-page list of municipalities that have declined to allow the sale of marijuana. Canada has also restricted retail locations. Quebec and Ontario combined have about 50 retail locations for a population of about 23 million.

All this is important, but in the view of your humble correspondent, the profitability problem is more fundamental, connected to unreasonable expectations leading to unreasonable expenses, both capital and operational, all leading to production inefficiency.

Further, labor rates at cannabis production facilities are often higher than a comparable flower or vegetable production site. Salaries are becoming more reasonable, but this week I saw a job announcement for a "Master Grower" with a salary of $150,000 to $200,000 per year. That would be unusually high for most producers of traditional crops, especially since the greenhouse size is small.

All this inefficiency is not new. Cannabis was initially grown in enclosed buildings with whatever equipment could be acquired without raising suspicion and could remain hidden. And inefficiency was acceptable when everyone had stars in their eyes. But reality has arrived.

Two large Canadian producers are facing that new reality. In November 2019, HEXO announced that it would be cutting 200 jobs and CannTrust was reducing its labor force by as many as 140 jobs. Not only that, but HEXO was taking production off-line in Quebec and Ontario, totaling over 1 million sq. ft.

But there's good news and I'm not talking about cannabis-infused gravy (yes, it's a thing).

Many cannabis producers started production by spending only as much capital as necessary, not a penny more. They expand production when they can pay for it from profits. They have lean and hard-working teams, adding additional people just when needed. They have built in states, provinces and counties where regulations, energy costs and labor costs are reasonable.

And many companies that have taken a hit and are shedding employees and production area will emerge stronger, as there's nothing like a little pain to teach a lasting lesson.

Henry David Thoreau, that notable efficiency expert, said, "It's not enough to be busy; so are the ants. The question is, what are we busy about?" There are plenty of outstanding cannabis companies who designed their production to be operationally efficient and others are learning. Those are the ones that know what they're busy about and will be the superstars to come. **GT**

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