

## Nova Cannabis and High Tide--- Monopoly/Oligopoly won't work.

Just like the liquor industry, Canadian provinces (except Manitoba and Saskatchewan) have made sure that a retail monopoly in cannabis retail cannot be established. They created a government owned distributor monopoly where all the products go through before being sold to private retail stores. They sell to private retail stores all the same products and at all the same prices, regardless of the volume sold. This distinction is important to make because that's what separates it from the retail grocery oligopoly in Canada. Retail grocery was able to establish an oligopoly because as more volume was bought from its manufacturers (skipping the distributor step), the cheaper per unit price it was able to secure from its manufacturers. Combined with its economies of scale for its distribution, transportation, and low overhead cost for operating larger stores, it was able to beat all competitors in price. As the competitors went into bankruptcy, the retail chain store was able to purchase more volume from its manufacturers (that once was purchased by its competitors), further strengthening its control over suppliers, and obtaining better pricing. Now they can increase prices as they like, with little to no resistance since it is an inelastic demand, and new entrants are faced with higher per unit costs from manufacturers as they lack the volume (in some cases large retail stores will prohibit the manufacturer from selling to other competitors,) and since the new entrant would lack economies of scale for transportation and distribution, it won't be able to compete on price. The retail grocery oligopoly has tight control over both its suppliers and customers, a nasty combo.

However, this cannot happen in retail liquor and cannabis in Canada because the government owned provincial distributor monopoly sells its products to all private retail stores at the same price, regardless of volume sold. This way any one retail chain will not get leverage over prices just because they buy more volume—effectively prohibiting any retail monopoly/oligopoly to be established in the province. Also, the delivery cost is the same regardless of volume sold (nullifying any economies of scale achieved via distribution and transportation.) Also, the cannabis store size and location are regulated. This ensures all retail stores operate on the same playing field.

Additionally, the BC government limits any one company from owning more than eight retail cannabis stores. In Ontario that number is 150. In Alberta there is no limit. Quebec has only government owned retail cannabis stores (no private corporation in the distribution and retail supply chain.) In both Manitoba and Saskatchewan, cannabis licensed producers (LPs) can sell directly to retail; the government is not part of the supply chain. Therefore, retail and/or distributor monopoly/oligopoly can very easily be established in these provinces.

Also in most provinces the government owned distributor prohibits retail stores from selling cannabis products below distributor cost therefore the argument that these corporate chains can sell below cost to bankrupt competitors can be thrown out. And even if they were allowed to, since the retail chain couldn't have established price control with the distributor via large volume sold, there is nothing stopping from another independent retailer popping up if the corporate chain ever decides to raise prices again. This is an endless cash burning cycle for the retail chain. It is impossible for them to win.

**So then, how are High Tide and Nova Cannabis able to make money when independent retailers are struggling? The answer: kickbacks.** (For the FY ended 2023, Nova Cannabis reported free cash flow of \$7MM CAD → all of which came directly from kickbacks.)

These corporate owned are receiving kickbacks from the LPs under the guise of “data programs,” where the corporate chain sells information about the popularity of the products sold in return for receiving compensation directly from the LP. But this is just a method of circumventing the law; kickbacks are illegal in Canada. Essentially, LPs that want their products shelved in High Tide and Nova Cannabis pay for these “data programs.”

High Tide and Nova Cannabis have the power to command remuneration for this because they have so many stores in Canada (and growing.) If an LP wanted to accelerate sales or have clear visibility of their products in retail stores, they could just pay them their data program fees. High tide has 168 stores and Nova Cannabis will soon have 100. Therefore, more LPs buy into their “data programs” further enriching the corporate stores and the corporate stores can expand their footprint with more stores. It’s an endless cycle. By now you must’ve heard High Tide opening a new store at least every week.

High Tide and Nova Cannabis sell their products at, or at very near cost to drown their competitors, while making profits from the LPs directly (via data programs.) Once the competitors die out, these corporate chains have the option of raising prices. New entrants will not be able to emerge because the corporate chain can again drop prices to bleed out the competition, all the while collecting revenues from the LPs to make their business practice sustainable. With the free cash flow, they can go onto acquiring more retail stores, further reinforcing the reach of their data programs.

I am all for low cannabis prices, but I know that High Tide and Nova Cannabis won’t be able to help themselves from raising prices once they kill their competitors. And this is bad for consumers. Not only will they charge consumers more, but they are also siphoning money from LPs for “data programs,” which will only get worse and more expensive once the retail chains have a larger share of the market. If one LP decides not to indulge in their data programs, the LPs’ products will be boycotted and since there would be very few retail stores left to stock their product, it’s game over for the LP. This way these cannabis retail oligopolies can hold both their suppliers and customers by their necks; it will be as nasty as retail grocery.

The key thing to note is that this tactic that High Tide and Nova Cannabis are employing only works when you have many LPs tripping over each other to sell their products in their stores, not when there are only a few LPs left. \*\*\*

I see two things happening in Canada that will dismantle this forming monopoly/oligopoly:

- 1) The easy answer is that at one point in time the government can step in and stop this practice of kickbacks. They can go as far as fining these companies and/or dissolving them outright.
- 2) However, even if the government doesn’t step in, because of the heavy consolidation that is taking place among LPs, there will not be many LPs to trip over each other to list their products with these retail chains. **On a side note, the large players that I expect to**

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**remain by mid-2025 are Village Farms International and Cannara Biotech because of their low cost of production. And combined they have 250,000 kg of production capacity per year, which is approximately half of the current market. I expect Entourage Health, Auxly Cannabis, Aurora Cannabis, Canopy Growth, Organigram, and Cronos Group all to bleed out and die because their cost of production is too high. All of them are running losses while the two former ones I mentioned are already profitable. Some of these larger companies I mentioned have fortified balance sheets so it will take some time for them to bleed out, that's why mid 2025.**

The reason that the retail cannabis monopoly/oligopoly cannot be sustained if there are only a couple of large LPs left in the space is because of the following:

E.g. If a retail chain refuses to stock products of Village Farms International because they refuse to pay their data programs, then a smaller independent retail store will be able to stock their product, and because of the cheaper price point of the product relative to other competitors on the market, consumers will have no choice but to buy from the independent retail chain. The same thing applies for slightly more expensive, but higher quality products like Canara Biotech. Large LPs can very easily deny paying for data programs, and if the large retail cannabis chains refuse to stock their products, it will hurt them more. Currently this is not the case with the surplus number of LPs fighting for shelf space in this environment where there is an extreme oversupply of cannabis. Furthermore, this is amplified because many LPs are losing money at current cannabis prices and are desperate to sell anything possible so will pay for shelf space.

I am a hard-core economist and a fanatic of the free market; however, as a citizen of Canada and when it comes to regulating intoxicants (liquor and cannabis), I strongly believe what Quebec is doing by monopolizing provincial distribution and retail is the right thing to do. Apart from the LPs of cannabis, the only people that should be making money is the government (so that hopefully the money collected can be recycled back to the healthcare system where it will be needed in the future.) I wouldn't want private companies like High Tide and Nova Cannabis to take a cut of the pie, without contributing anything meaningful.

Nova Cannabis and High Tide can stick to Manitoba and Saskatchewan for trying to establish a monopoly/oligopoly.

A large chain of stores can be established, but they will not have pricing power like High Tide and Nova Cannabis expect. It will be just like Alcanna (acquired by Sundial) where it owns around 200 liquor stores, with very similar margins as independent retailers and will trade at a boring multiple.

Regards,

Stonk Slayd Capital Management.

