



Fortunately, there is a flip side. The uplisting should enable institutional investors, hedge funds, and large family offices to take a position in Village Farms. It may become a key holding in cannabis-related ETFs on the US markets. There have been several recent filings (three) for new cannabis ETFs. Those ETFs should have no problem finding dollars, and those dollars will go into most, if not all, of the names on the big boards.

#### An anti-dilutive philosophy

Cannabis is a growth industry in need of aggressive expansion to keep pace with demand that currently overwhelms supply.

Despite growing a plant, a weed really, that is thousands of years old, the newly legal side of the business requires intensive capital. Already, we've seen large cash infusions by legacy companies Constellation Brands Inc (NYSE:STZ) and Altria Inc (NYSE:MO) as well as several convertible bond issuances and secondary stock offerings from cannabis.

It's good news for those in need of capital, but often dilutive to shareholders.

Village Farms has adopted an anti-dilutive philosophy. That doesn't mean they will never raise capital, but with insiders holding some 22% of shares, they aren't likely to pursue a dilutive capital strategy unless it offers significant benefit to shareholders in the long run.

The company currently has 47.6 million outstanding shares, a paltry number compared to the "knights":

- Aphria : 250 million shares
- Aurora: 965 million shares
- Canopy Growth: 232 million shares
- Cronos Group: 179 million shares
- Tilray: 94 million shares (vast majority of shares currently held private)
- Village Farms: 47.6 million shares

When the institutions come for the stock after the uplist, and they will, supply may not meet demand until prices appreciate significantly. This could spell trouble for those traders using Village Farms' newly uplisted stock as a hedge.

After a lackluster financial performance through the first nine months of 2018 in which Village Farms burned cash, perhaps future dilution can't be avoided. It is worth noting the current financials are pre-cannabis, so it's more a discussion of the financial positioning entering the transition than on the cannabis business itself.

Fortunately, the company enters the cannabis market with several decided advantages over even its more substantial competition.

#### Converting Canadian assets

Many companies enter the cannabis space with a pipe dream and some cash -- no pun intended. Village enters the space with a partnership in Canada, partnerships outside of Canada, and a significant amount of existing grow-space.

Few companies can rival the 10 million-plus square feet of greenhouse grow-space in Canada and the US along with a partnership in Mexico that Village Farms has to offer. This isn't land they need to acquire, nor greenhouses they need to build. While most of their greenhouses cultivate tomatoes, cucumbers and peppers, the transition to cannabis isn't terribly time-consuming. The company anticipates being able to convert existing greenhouses within a six- to eight-month time frame.

Thus far, they've converted their 1.1 million square foot Delta 3 facility in Delta, BC, Canada. That facility is run under a 50-50 joint venture with Emerald Health Therapeutics Inc (OTCMKTS:EMHTF) (TSE:EMH). It's called Pure Sunfarms, and it's the last joint venture I envision the company making in the cannabis space in which it doesn't have control.

When examining the two companies, Emerald Health doesn't bring enough to Village. It's not to say anything negative about Emerald Health, but the vision of the two companies doesn't mesh: research versus retail.

READ: Harvest One shakes up the global cannabis space with a full house of brands

I'll stop short of calling it a mistake on Village's part as it offered a viable entry into the Canadian cannabis space; however, don't expect to see a continuation of this partnership outside of the Delta greenhouses. Call this one what it is: a learning experience. There are better partners for Village Farms, but they don't know it. (I know it, and I'll address it shortly.)

As Delta 3 comes fully online, annual production should reach an annual run rate of 75,000 kg on the conservative side. Although this number is lower per square foot than some larger competitors, it anticipates the potential surprises mother nature and the savage nature of a new industry can bring. It's likely a conservative number; therefore, if nothing surprising occurs, then Village should deliver a solid beat on production numbers.

Don't look for Village Farms to spin off Pure Sunfarms. Instead, it would be best served to buy out Emerald Health as quickly as possible and move on.

Adjacent to Delta 3 is another 1.1 million square feet of greenhouse grow-space in Delta 2. Next to that greenhouse, Village holds another 2.6 million square feet in Delta 1.

Although these facilities have not been converted yet from growing crops like tomatoes, peppers, and cucumbers, they can be. While these facilities are currently 100% owned by Village Farms, it is Pure Sunfarms that holds the option to convert the greenhouses to cannabis. Additionally, these utilize sustainable and environmentally responsible methods of cultivation.

The potential net margins from the sale of the crop from Delta 3 could turn Village Farms' lackluster financial performance in 2018 into a cash flow machine during 2019. The crops of last year carry razor-thin, low-single-digit margins. The company is lucky to see margins of 4% to 6%, but Village should be able to increase those as much as ten-fold through a shift to cannabis.

Financially, I believe 2018 is reflective of the challenges US and Canadian produce companies face when competing with countries like Mexico. It is not representative of the cannabis and/or hemp industry.

The dip in cash on Village Farm's balance sheet occurred as the company implemented the first phase of its transition to cannabis cultivation. As the company benefits from the strong margins of its new product, expect management to leverage that cash flow into the conversion of Delta 1 and 2.

Waiting on CBD in Texas

Village Farms' most valuable physical assets may lie south of the Canadian border in Texas.

Nearly 6 million square feet of prime greenhouse grow-space sits ready for industrial hemp production. With the passage of the 2018 Farm Bill, the US government legalized hemp and hemp products as well as permanently removing hemp from the Federal Controlled Substances Act.

This move has opened the CBD market including extracts, derivatives and cannabinoids within the US. Unfortunately, Village Farms needs Texas to remove hemp from Texas' controlled substance list. Expectations are this could happen in the early part of 2019, but there is no guarantee.

If Texas were to take the same action as the federal government, Village Farms is poised to take advantage of one of the best growing climates for hemp. The company stated in December that they intend to aggressively pursue hemp and CBD opportunities in the US. While the current focus has been greenhouse growing, management has hinted they would be willing to entertain outdoor growing if the financials support the effort.

With 5.7 million square feet available for growing, Village has the potential to produce significant harvests. The company could squeeze as many as 7,500 plants per acre in its facility, but for practical purposes, I would estimate the number closer to 6,000.

With approximately 130 acres and 6,000 plants per acre, Village could harvest 780,000 plants with each plant offering about \$30 worth of CBD. Over the course of one year, the company should be able to obtain at least three, if not four, harvests. That equates to approximately \$23.4 million per harvest and a range of \$70.2 million to \$93.6 million per year in revenue.

These are conservative numbers for midgrade hemp.

Village Farms CEO, Michael DeGiglio, has discussed the idea of developing strains of hemp to treat specific ailments, conditions, and diseases, as well as targeting health and wellness benefits of individual strains. This could drive prices into the \$250 to \$350 per plant range as seen in Nevada less than a year ago, or ten times the previous estimate of \$31.2 million in revenue.

The second part of this deep dive into Village Farms/ management team, its strategies and partnerships can be read [here](#).

--Adds that share hve been approved for Nasdaq uplisting

--At the time of publication, Tim Collins had no positions in the stocks mentioned.

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