Six under-the-radar U.S.-focused cannabis picks

SHIRLEY WON
SPECIAL TO THE GLOBE AND MAIL
PUBLISHED MAY 19, 2021

Open this photo in gallery

Legal U.S. cannabis sales surged 46 per cent last year from 2019 to more than US$17.5-billion and are forecast to hit US$41.3-billion by 2026, according to cannabis research firm BDSA.

U.S. cannabis stocks have taken a beating, providing a buying opportunity for investors looking to bet on a pot boom south of the border.

Optimism for marijuana legalization pushed by top Senate Democrats helped fuel a rally until February, but the sector sold off amid market concerns about rising interest rates and owning riskier securities as well as tightened financing by some brokerages to hedge funds.

Although federal reforms may be slower in coming, the U.S. industry is growing with more states legalizing medical and adult-use cannabis and some companies on the road to profitability.

Legal U.S. cannabis sales surged 46 per cent last year from 2019 to more than US$17.5-billion and are forecast to hit US$41.3-billion by 2026, according to cannabis research firm BDSA.

Furthermore, the SAFE Banking Act, which would let banks deal with cannabis firms without fear of penalty, will now be debated in the Senate. The bill was passed by the House of Representatives with bipartisan support.

We asked three portfolio managers for their top under-the-radar U.S. cannabis stock picks.

NAWAN BUTT, PORTFOLIO MANAGER, PURPOSE INVESTMENTS INC.

His fund: Purpose Marijuana Opportunities Fund

MJJ-NE

The pick: Verano Holdings Corp.

VRNO-CN

Range from Feb. 17: $20.32 to $33 a share

Verano, a top-five U.S. multi-state operator (MSO) by revenue, is compelling because of its ability to generate cash flow, while its stock trades at an attractive valuation, Mr. Butt says. The Chicago-based cannabis firm, which went public in February via a reverse takeover, has its core operations in Illinois, Florida, New Jersey, Pennsylvania, Arizona, and Maryland. Other than Arizona, these states have tight limited-licensing regimes, so Verano can grow with less competition, he adds. The company, which produced revenue of more than US$350-million last year, has a strong balance sheet and generated about US$150-million in cash from operations. So, it can fund its own growth, he says. Verano's stock trades at about 15 times 2021 enterprise value (EV) to earnings before interest, taxes, depreciation, and amortization (EBITDA) and almost 10 times for 2022 – cheaper than most peers, he says. "It is running a 48-per-cent EBITDA margin which is very strong. … Its business model is very de-risked compared with competitors."

The pick: Ayr Wellness Inc.

AYR-A-CN

52-week range: $9.10 to $47.14 a share

Ayr Wellness is a smaller MSO but has a strong management team, which has been able to pivot its business to grow sales during the COVID-19 pandemic, Mr. Butt says. Its chief executive officer, Jonathan Sandelman, is a former Bank of America Corp. executive, while its chief operating officer, Jennifer Drake, is a former managing director at Goldman Sachs Group Inc. The New York-based company, formerly known as AYR Strategies Inc., has licensing and operations in Nevada, Massachusetts, Pennsylvania, and Florida, as well as pending acquisitions in Arizona, Ohio, and New Jersey, he says. This year, it acquired Liberty Health Sciences Inc., which has a strong presence in Florida, a state that has only legalized medical cannabis so far, he adds. Ayr's shares trade at about 13 times 2021 EV/EBITDA and almost 7 times for 2022, which is cheaper than the average MSO, he says. One of the risks is whether this cannabis consolidator can integrate its acquisitions successfully.

CHARLES TAERK, PRESIDENT AND CEO AT FAIRCOURT ASSET MANAGEMENT INC.

His fund: Ninepoint Alternative Health Fund

The pick:

CCHW-CN

52-week range: $2.27 to $9.95 a share

Columbia Care's shares offer more growth potential now that the company has expanded into the adult-use cannabis market from its former medical focus, Mr. Taerk says. The New York-based firm founded by former executives with Goldman Sachs Group Inc. operates in 18 U.S. states, including some with limited licences and has the second-largest national footprint after Curaleaf Holdings Inc., he says. Although five of those 18 states only allow medical cannabis use, they could legalize adult use in two to three years, he says. Sales growth can be three to five times higher with the recreational market. Columbia Care acquired Colorado-based The Green Solution and California-based Project Cannabis last year, while its deal to buy Green Leaf Medical LLC closes this year. A risk stems from whether it can successfully integrate its acquisitions. Columbia Care's stock recently traded at 11 times 2022 EV/EBITDA – close to its U.S. peer average – but below 37 times for Canadian cannabis companies, he says.

The pick: Terrascend Corp.

TER-CN

52-week range: $2.49 to $20.50 a share

Terrascend is a North American cannabis operator, but most of its business is in the U.S. market with its higher growth potential, Mr. Taerk says. The Mississauga-based firm operates in California, Pennsylvania, and New Jersey. It will benefit when legal recreational cannabis sales begin next January in New Jersey, he adds. Terrascend holds a medical cannabis processor licence in Utah; it recently acquired operations in Maryland; and it owns the Apothecarium dispensary chain. Terrascend, which has "a very strong EBITDA margin," recently raised more than $200-million to help pay for its Maryland acquisition and for other capital requirements, he says. Its shares trade higher than the average 12.5 times 2022 EV/EBITDA multiple for U.S. peers, but at about a 40-per-cent discount to the combined Canadian and U.S. cannabis peer group, he says. Risks stem from competition in the unlimited-licensed California market and uncertainly as to who will fill the CEO role after Jason Ackerman stepped down recently.

BRUCE CAMPBELL, PRESIDENT AND PORTFOLIO MANAGER, STONECASTLE INVESTMENT MANAGEMENT INC.

His fund: StoneCastle Cannabis Growth Fund

The pick: Lowell Farms Inc.

LOWL-CN

52-week range: $1.30 to $2.20 a share

Lowell Farms, a California cannabis operator, is an appealing investment because of its new management team that has re-capitalized the company and refocused its strategy, Mr. Campbell says. The Salinas, Calif.-based company was formed this year after Indus Holdings Inc. acquired Lowell Herb Co. Lowell Farm's chairman George Allen, formerly president of U.S. cannabis operator Acreage Holdings Inc., invested in Indus with the goal of combining its cannabis-growing expertise with Lowell Herb's branding skills to produce high-quality, low-cost products, Mr. Campbell says. The new entity is also a potential takeover target for a cannabis operator to gain access to the lucrative California market, he adds. Its recent quarterly results were not as strong as the market expected because cultivation yields were hurt by wildfires, he notes. Its stock trades attractively, at about 2 times sales versus about 4.6 times for U.S. peers, he says. The risk is competition in the unlimited-licensed California market.

The pick: Vibe Growth Corp.

VIBE-CN

52-week range: 0.125 cents to $1.45 a share

Vibe Growth, a California-focused cannabis operator, is a compelling investment because it reports "positive EBITDA" unlike many peers, and could be a takeover candidate too, Mr. Campbell says. The Sacramento, Calif.-based company, formerly known as Vibe Bioscience Ltd., has dispensaries, production facilities, and a distribution licence, he says. Vibe Growth, whose brands include Vibe by California, has been growing by acquisition, but it could be attractive for any firm trying to enter California – the world's largest cannabis market, he says. For example, Nevada-based Planet 13

Holdings Inc., which is opening a cannabis dispensary in California this year, is a possible acquisitor, he says. “It could buy Vibe and Lowell Farms and have a really strong California and Nevada presence.” Vibe Growth’s shares trade at almost 2 times sales versus 4.6 times for its U.S. peers, he says. The risks stem from being able to integrate acquisitions and dealing with competition in its unlimited-licensed market.