Buy These 3 Mid Caps for the Price of 1 Cannabis Stock

Description

There's no denying that cannabis stocks were the number one story for investors in 2017, and they'll likely be the hottest topic in 2018 as well.

The discussion revolving around the valuations of cannabis companies such as **Canopy Growth Corp.** (TSX:WEED) is intense on both sides of the argument.

Fool.ca contributor Chris MacDonald believes that irrational exuberance, the phrase made famous by former Federal Reserve Board chairman Alan Greenspan, has set in with investors. Fundamentals, he reckons, have entirely left the building.

"While cannabis valuations may continue to rise pre-legalization in early 2018, I expect investors will come to their senses and begin taking profits off the table following legalization as valuations normalize," MacDonald stated in late December. "The problem is, for valuations to normalize, a significant correction is in order."

Supporting the upside argument for cannabis stocks is the Fool.ca's Joey Frenette, who believes WEED could be a $50 stock by July, because it's got the best management team in the business. I take exception to that, believing **Aphria Inc.** (TSX:APH) CEO Vic Neufeld to have assembled an equally impressive leadership team.

However, given the hysteria building up to July 1, I wouldn't be shorting WEED at the moment.

I believe that the best investments are companies that make money and generate free cash flow. Period. That's why I prefer Aphria to Canopy. Ultimately, I might be proven wrong, but if you operate under the same approach, you might want to consider these three mid-cap stocks, whose enterprise values combined add up to Canopy's at $6.9 billion.

Kinaxis Inc. (TSX:KXS)

The Ottawa cloud-based supply-chain management software company has been on my buy list for a couple of years, because its Rapid Response product continues to find its way into the hands of more supply-chain managers in the U.S. and Canada.

With no debt and $150 million in cash on the balance sheet, Kinaxis's $1.8 billion enterprise value is trading at 46 times adjusted EBITDA, but at least it makes money. In Q3 2017, its adjusted EBITDA was 32% of revenue — a 900 basis point increase over the previous year.

Perhaps that's why its stock gained 23% in 2017, and that's on top of a 33% gain the year before. Last July, I doubled down on my bet from July 2016. Since then, it's gone sideways.

At current prices, I wouldn't have a problem recommending its stock once more. At under $70, I'd be backing up the truck.

Great Canadian Gaming Corp. (TSX:GC)

Anything or anyone that **Brookfield Asset Management Inc.** gets involved with peeks my interest. So, when it was announced that Brookfield's private equity business, **Brookfield Business Partners LP**, was partnering with Great Canadian Gaming to operate several casinos in the Greater Toronto Area, I was very intrigued.

The company is rapidly expanding into the Ontario gaming market, and that's good news for Ontario taxpayers, who will benefit from its excellent management.

Gaming stocks aren't for everyone, but if you can stand a little sin, Great Canadian Gaming's $2.3 billion enterprise value is going to get a lot bigger over the next three to five years.

Morguard Corp. (TSX:MRC)

It was a crazy ride for Morguard shareholders in 2017. On two occasions — May and October — it came close to going over $200, only to drop back to $180 or lower.

I recommended this Mississauga-based real estate owner in both 2016 and 2017, and so far its stock has done very little. However, trading at less than 10 times free cash flow and possessing an earnings yield of 10.7%, you're getting Morguard for a reasonable price.

By comparison, **RioCan Real Estate Investment Trust** (TSX:REI.UN) has an earnings yield of 8.6%, and it's in the middle of a transformation that will see it shed most of its retail assets outside Toronto, Montreal, and a handful of other major Canadian cities.

CEO Raj Sahi built a beautiful real estate business from nothing, but you would never mistake it for Canopy; that's for sure. However, add in the 56% ownership interest in **Temple Hotels Inc.**, and you've got an interesting buy.

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2. TSX:REI.UN (RioCan Real Estate Investment Trust)
3. TSX:WEED (Canopy Growth)

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