



The Best Cannabis Play May Not Be a Cannabis Producer

Description

Canada's cannabis producers have seen valuation multiples expand to incredible, eye-watering levels of late. Continued consolidation among producers has driven the equity valuations of marijuana producers, big and small, to higher levels, as Canada approaches legalization of the green commodity. With valuations for many cannabis producers increasing by double digits on what feels like a daily basis, the attraction toward quick and easy short-term gains can be hard to ignore for conservative investors watching their portfolios flat line, as cannabis-forward investors double their money in as little as weeks or months.

That said, an increasing number of analysts are warning of the astronomical equity valuations in this sector as indicative of a potential [bubble](#), given the lack of profitability shown and concerns about the top- and bottom-line growth rates ascribed to Canada's largest marijuana producers such as **Canopy Growth Corp.** ([TSX:WEED](#)).

I'll discuss why the recent debt financing led by **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)) for Canopy may prove to be a significant catalyst for the bank long term, as Canadian financial institutions weigh the pros and cons of lending to cannabis producers.

Debt financing likely to increase in importance relative to equity issuances

One of the most significant concerns I have voiced in the past with the rise in valuation multiples sector wide for Canada's cannabis producers is the [lack of debt financing](#) relative to equity issuances. With BMO now stepping up to the plate and signifying it is open to debt financing for companies such as Canopy, I believe that BMO may actually have more to gain from legalization than its cannabis clientele looking to raise money.

The ability of banks such as BMO to generate fees and revenue via new debt issuances and interest from money lent to cannabis firms can be viewed as a much less risky proposition than many of the potential risks cannabis producers face. Banks such as BMO will be able to increase and diversify their loan books and increase capital markets-related revenue accordingly, providing a potential boost to earnings over the mid to long term.

Fellow Fool contributor Will Ashworth has noted in a recent [article](#) that BMO has remained “open for business” with respect to the Canadian cannabis sector, noting, “according to the *Globe and Mail*, BMO has banking relationships with at least a dozen companies, including **Aphria Inc.** (TSX:APH).” The fact that BMO has increased its exposure to Canadian cannabis firms should be viewed as a positive catalyst long term for BMO, in my opinion.

BMO’s breakthrough in the financing of Canadian cannabis firms is only one breakthrough investors should consider:

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