Cannabis Investors: Buy Private Deals, Not TSX-Traded Equities

Description

With the stock prices of many of Canada's largest cannabis producers seemingly in free fall this past week, investors pondering putting their money to work in this sector have perhaps begun to have second thoughts. After all, at current valuation multiples (price-to-sales ratios near the triple digits for most producers), this bubbly sector is certainly not looking too peachy for long-term investors itching to get into this sector today.

One of the recent equity raises that struck me as an interesting alternative to buying the larger TSX-traded cannabis producers was the issuance of new shares by **Newstrike Resources Ltd.** following failed acquisition talks with **CanniMed Therapeutics Inc.** (TSX:CMED). The acquisition failed after **Aurora Cannabis Inc.** (TSX:ACB) announced that it would not proceed with acquiring CanniMed if the company continued to pursue Newstrike. The acquisition of CanniMed by Aurora for more than $1 billion seemed to provide a steep enough premium for CanniMed to pay Newstrike a breakup fee of $9.5 million, leaving Newstrike on the sidelines to pursue other deals.

It has been reported that within minutes of receiving notice that the CanniMed acquisition would not go through, Newstrike was fielding calls from investment bankers looking to help Newstrike raise money. Almost immediately, the company agreed to partner with such firms such as **Cormark** and Eight Capital to raise $80 million at a slight discount to Wednesday's closing price of $1.47 (shares were issued at $1.32), providing private investors with a meaningful discount as an incentive to take risk in this sector.

For private investors looking for such deals, private placements, convertible debenture deals, and other equity issuances that have been made prior to companies going public or for companies currently trading on venture exchanges have turned out to be much better deals in recent years for investors; early money has cashed out nicely as companies such as Newstrike became publicly traded or actively traded on secondary markets.

This whole ordeal highlights my belief that investors who are currently piling into high profile publicly traded cannabis securities are getting in at prices that are far too high to make meaningful long-term investments. Investors who have already increased the value of their investment 10 times, i.e., the investors who bought in at pennies on the dollar, can afford to be patient in the long term and see how this whole scenario plays out. Those who are trading based on the idea that valuation multiples of cannabis producers will continue to climb are playing a much riskier game.

An early Tweed investor who bought shares for $0.89 less than two years ago is currently laughing — with the ability to sit tight and wait. Investors who bought Canopy at $44 per share, however, may not be so patient.

Stay Foolish, my friends.

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