



Profit From Pot Legalization by Buying Small Financial Firm Stocks

Description

The upcoming marijuana legalization is benefiting other companies than marijuana producers. Indeed, to expand their operations, marijuana companies need funding.

Equity offerings made by Canadian cannabis companies tripled to a record high of nearly US\$1 billion in 2017, with about two-thirds of the offerings realized in the last quarter of the year.

Many banks are not ready to lend to pot producers because of the risk associated with the industry. So, many marijuana producers get funding from smaller financial firms.

Those firms receive underwriting fees and can sometimes receive warrants as well. Growing pot companies that need cash can lower their cost of financing by compensating the underwriters with warrants. When the underlying marijuana companies' stocks gain in value, which has been the case during recent months, warrants become more valuable.

Financial firms benefited from increased underwriting and from the potential increased in value of warrants they hold in the most recent quarter.

Canaccord Genuity Group Inc. ([TSX:CF](#)) and **GMP Capital Inc.** (TSX:GMP) are two small financial firms that are profiting from the marijuana buzz and that are seeing strong increases in their revenue.

Canaccord is one of the biggest underwriters of cannabis deals in Canada. The investment bank raised nearly \$719 million from 22 deals last year on a total of \$1.68 billion raised in 56 deals.

Canaccord's revenue generated by investment banking activities almost doubled in fiscal 2018 as compared to fiscal 2017 to \$125.1 million. Excluding one-time items, net income reached \$37.3 million in 2018 compared to \$32.7 million in 2017.

In the fourth quarter, Canaccord participated in many significant investment banking transactions. The financial firm acted as an advisor to **MedReleaf Corp.** on the \$3.2 billion stock deal between [Aurora Cannabis Inc.](#) and [MedReleaf](#) — the largest merger in the cannabis industry.

GMP Capital is a small financial firm that has also helped raise money for cannabis producers as well as for blockchain companies, which have soared in recent months.

The diversification of the investment bank beyond energy and resources to cannabis and blockchain are paying off, as shown by GMP's latest quarter. GMP's investment-banking revenue nearly doubled to \$30.2 million in its first quarter, and its profit was up 17% from a year ago to \$4.1 million, driven by investment banking.

Big banks are taking their first steps in the pot industry

While small investment firms have dominated underwriting and advisory work since the cannabis sector exploded, this could change eventually as bigger banks are making their way in. Smaller firms could be hurt by banks trying to steal some of the cannabis business.

[Bank of Montreal](#) entered the cannabis sector in January by co-leading a \$200 million share sale for **Canopy Growth Corp.** More recently, BMO lent a \$200 million credit line to Aurora Cannabis, which provided the pot producer an access to relatively cheap debt. This is the first substantial bank loan in the cannabis sector.

On a smaller scale, **Canadian Imperial Bank of Commerce** extended in April a credit line of \$20 million to MedReleaf.

Canaccord's CEO Dan Daviau is not worried about a potential threat coming from bigger banks, because Canaccord is helping little companies to become larger ones, while banks tend to focus on larger clients.

However, it looks like BMO's involvement already has an impact on the firm. When Aurora took over MedReleaf, BMO acted as Aurora's advisor. Before that, Canaccord had been Aurora's banker in many important transactions.

We'll have to wait to see if other banks get involved in cannabis deals and their impact on smaller firms. What is sure is that more financing and mergers and acquisitions will take place as the number of licensed pot producers keep growing, and that will bring business to financial firms.

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Date

2025/08/24

Date Created

2018/07/19

Author

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