Should You Buy the Recent Marijuana Spin-Offs of Aurora Cannabis Inc. (TSX:ACB) or Canopy Growth Corp. (TSX:WEED)?

Description

The only thing hotter than pot stocks right now are the venture cannabis spin-offs of **Canopy Growth** (TSX:WEED)(NYSE:CGC) and **Aurora Cannabis** (TSX:ACB). Both **Canopy Rivers** (TSXV:RIV) and **Australis Capital** (TSXV:AUSA) were spun off from Canopy and Aurora, respectively, this month and have since gone bust in the trading sessions following their respective IPOs.

When the new issues went hot, I'd warned investors to wait for the dust to settle, as the trade would quickly go bust after hungry speculators had a chance to get their fill. This is indeed what happened; both Canopy Rivers and Australis Capital plunged 30% and 83%, respectively, from peak to trough in under a month's time. If you'd bought shares on the first day it hit the public market, then odds are you've lost an exorbitant amount of money.

The boom-and-bust nature of IPOs is to be expected, especially when we're talking about anything marijuana related, but as the dust begins to settle on the two recent spin-offs, is there any opportunity to be had as volatility has a chance to calm down? Or are they simply a means for an unscrupulous few to make a quick buck from the pumping and dumping of shares?

Australis: A vomit-inducing IPO meltdown

Usually, IPOs are priced lower than what management deems it's worth. The underlying entity behind the IPO wants to get positive momentum going from the get-go, and it's also in the best interest of investment bankers (who play a key role in the issuance and underwriting of IPOs) to have an IPO priced at a discount to its intrinsic value. This allows Mr. Market to correct for the difference gradually over time, negating any initial discount, which is typically short-lived.

In the case of Aurora's Australis IPO, however, the security was priced at 50 times more than the $0.20 private placement! And as you'd expect, retail investors who didn't participate in the private offering got crushed when shares fell back down to Earth. At the time of writing, Australis is priced at $2.46, and the negative momentum still appears to be going strong. While shares may seem cheap after such a massive decline, the fact remains that shares are still 12 times more expensive than the private offering, leaving them vulnerable to even further downside.

Australis's U.S. cannabis and real estate spin-off venture may seem worthy of your investment dollars, but the IPO was destined for a jaw-dropping collapse off the bat. I think it was a blatant cash grab, and the market reacted accordingly in spite of the excessive euphoria surrounding the entire sector.

What about Canopy Rivers?

Canopy Rivers appears to be the more investable spin-off when compared to the likes of Australis, but the security is still poised to endure rough waters in the coming months, so investors ought to be prepared for a further hurricane of volatility.

Moreover, I do like Bruce Linton's venture capitalist (VC) take at prudently consolidating the industry. Rest assured, Canopy Rivers won't be diluted to the same magnitude of Aurora and its past moves. The Canopy family has a few hand-picked venture pot plays (Agripharm, Canapar, LiveWell) in its portfolio, and as they continue to grow inside Canopy's incubator, one has to expect that a low-risk scoop-up may be in the cards in the future.

Foolish takeaway

For now, I'd err on the side of caution when it comes to Australis. It's still really expensive, and I'm not as trusting of management's moves which have been pretty darn aggressive in the past.

Canopy Rivers, however, looks like a marijuana play to add to your radar. Both the portfolio and strategy show promise, but the price isn't quite right yet. Given the massive amounts of trading volumes, I suspect the post-IPO hype swamp will be drained over the next month, as speculators are drawn to other more opportunistic plays in the space.

Stay hungry. Stay Foolish.

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Author
joefrenette