Could Canopy Rivers Inc. (TSXV:RIV) Beat Aurora Cannabis Inc (TSX:ACB) to This Trade?

Description

The recent spin-off from **Canopy Growth's** pro-incubation investment platform, **Canopy Rivers** (TSXV:RIV), is a new cannabis stock to grace the TSX Venture exchange with a stated mandate to pursue investment opportunities in the emerging global cannabis sector. I find the business model closely resembles **Aurora Cannabis's** (TSX:ACB) strategic investments model. Could the new investment company achieve the same returns as Aurora's portfolio?

It's a venture capital fund?

Canopy Rivers collaborates with Canopy to identify strategic counter-parties seeking financial and/or operating support. It has "developed an investment ecosystem of complementary cannabis operating companies that represent various segments of the value chain across the emerging cannabis sector," explains the company's press statements.

I would somehow view this new entity just as a listed incubatory venture capital fund with strong links to a leading firm in the marijuana industry and portfolio constituents that will be accorded opportunities to work with Canopy and collaborate among themselves to maximize investment value due to synergies.

Similar to Aurora Cannabis's investment portfolio

Aurora has been very active in the strategic investments area since late 2016 and has created a portfolio of at least 10 strategic holdings in nine listed companies and one privately held manufacturing firm, Capcium, which is doing contract manufacturing of soft-gel capsules, a new product line in Aurora's portfolio.

In Aurora's latest earnings report on September 24, the company listed strategic investments in 10 operating companies in which a total of $326.6 million has been invested to date.

The fund has performed well, generating an unrealized return of 114% on invested capital over the period to June 30 this year. The implied annual growth in the fund is just impressive, especially considering that only a few holdings are pure-play cannabis stocks, like **Green Organic Dutchman**, whose valuations have been spurred by the obtaining market hype; the rest, like **Micron Waste Technologies**, **Radient Technologies**, and **Hempco Food and Fibre** are scattered around the marijuana sector value chain.

Will returns be similar too?

Canopy Rivers's connection with Canopy will be a critical success factor, as the company creates a diversified portfolio of investments in the cannabis value chain, but tracking its portfolio returns in real time will be close to impossible, as it may hold various private equity positions in the future.

That said, since the company is a pure growth-focused investment that will potentially participate in the higher-risk infant-stage financings, returns to such investments have been phenomenal during the past few years.

Further, unlike Aurora, which was making "strategic" investments, where pricing models allow for strategic value premiums, the new investment firm's mandate is clearly to invest for profit, hence its entry prices will likely be at lower valuation points than those for Aurora, allowing for higher portfolio returns.

However, I am concerned about Canopy Rivers's timing.

Venture capital returns benchmarking is significantly influenced by the time the fund deploys capital, especially its vintage year; hence, comparing the two firms' portfolio performance is going to be a challenge.

The periods in which the funds are being deployed may prove critical in determining returns performance. Aurora made its investments during a period of elevated market hype in the marijuana sector, and that period may be ending soon as the markets demand execution.

Cannabis companies are way too richly valued today, and many may not generate revenues and profits high enough to justify their values. Canopy Rivers may likely build a new portfolio just when investor interest in the sector begins to wane, as several producers fail to grow into their valuations, hurting its investment returns.

Investor takeaway

There is so much potential for growth in Canopy Rivers's investments portfolio, as the company's mandate is very similar to that of a private equity venture capital fund. Investors may try to mimic its investment activity, but the company's large fund, highly placed connections, and well-researched insights allow it to participate in early stage financings where most retail investors may have significantly limited access and the due-diligence costs may be prohibitive.

Just a simple investment in the stock may be a better option.

That said, whether portfolio returns will perform as well as those of earlier-established companies remains to be seen, and vintage-year differences may influence investment performance.

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