



## 3 Reasons Why Now Is the Best Time to Get Into the Cannabis Sector

### Description

The past two months have been trying, to say the least, for marijuana investors. Owing to bloated valuations, regulations surrounding advertising and distribution, tax-loss selling, and accusations of fraud from short sellers, the overall sector has faced a pullback unlike any we've seen yet; as of writing, the North American Marijuana Index is well off its highs, down over 20% for 2018.

However, for those who have been waiting on the sidelines for a pullback in Canada's biggest growth sector, the recent buying opportunity could be your best bet for double-digit gains going into 2019. Here are three reasons why now is the best time to buy the marijuana names.

### Reason one

The valuation picture has changed. Before the sell-off, Canada's major cannabis names were trading north of 30 times their forward 2020 EBITDA. Post-sell-off, the multiples have contracted by 15% or more — or in the case of **Aphra** (TSX:APHA)(NYSE:APHA), [by over 50%](#) from its September peaks. While this is not exactly cheap, say compared to an oil producer, let's face it: there is no other sector in Canada whose growth prospects look as rosy as cannabis.

Furthermore, a lot of this multiple contraction occurred on the back of the latest quarterly filings, which showed sector-wide top-line growth, coming in below analyst expectations. However, I would argue that this has been a market overreaction, since we knew well ahead of time that recreational sales would have little to no impact on revenues this early in the game.

At the same time, this quarter will prove to be transitional, as medicinal sales continue slowing down going forward in lieu of recreational sales, since there is no hard classification from the end user's perspective, between what constitutes a medical product versus a recreational one.

### Reason two

Cannabis stocks are largely insulated from macroeconomic noise. As we are aware, a lot of the fear

that is currently present in the equity markets can be attributed to a global economic downturn, stemming from rising interest rates and trade wars between major super powers. However, these fears should have little to no impact on cannabis earnings going forward, since the industry in Canada is isolated from international channels and future capex is now more or less fully funded on the back of equity as opposed to debt.

Even in the event of an outright recession, cannabis demand should remain resilient, mirroring the alcohol and tobacco industries. For those of who are mathematically inclined, correlations since inception of the Marijuana Index versus the TSX and the S&P 500 are 0.42 and 0.30, respectively.

## Reason three

The smart money will rotate into the sector. There really has been no greater source of returns on the TSX during the past two years, than the marijuana space. With the recent blockbuster investments from legacy [alcohol](#) and tobacco names, there should be no further questions on the cannabis industry's legitimacy.

At the same time, we are seeing financial institutions begin to soften their tone towards investments in the sector, with many of the major banks launching research coverage on the sector leaders. This should also have the added benefit of a decrease in the pace of equity raises from the major LPs, as Canadian banks will now be more inclined to underwrite debt offerings, which will provide a much-needed tax shield once earnings ramp up. With so little opportunities in Canada, the recent sell-off should prove to be a source of alpha for value-oriented institutional money managers.

## Bottom line

Based on these three factors, the question now becomes, what name should you use to gain sector exposure? I would recommend that investors stick to the majors such as **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) or even an ETF such as **HMMJ** ([TSX:HMMJ](#)); the former name is the clear industry leader.

### CATEGORY

1. Investing

### TICKERS GLOBAL

1. NASDAQ:CGC (Canopy Growth)
2. TSX:HMMJ (Horizons Marijuana Life Sciences Index ETF)
3. TSX:WEED (Canopy Growth)

### PARTNER-FEEDS

1. Msn
2. Newscred
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