



Is This Beaten-Up Cannabis Stock Like Buying Aurora Cannabis (TSX:ACB) in 2016?

Description

Zenabis Global (TSXV:ZENA) is not a name that is usually on most marijuana investors' radars. Then again, in this post-legalization environment, it's easy to see how a company like Zenabis, which has yet to complete its initial cultivation ramp up, can be overlooked in lieu of a name like **Aurora Cannabis**, which is selling products and battling for market share.

That said, Zenabis, for the most part, was comfortable being the underdog, as it quietly ramped up capacity and inked supply agreements and LOIs with every provincial regulatory body across Canada. That is until last month, when the company announced a disastrous \$100 million raise consisting of convertible debt, warrants, and equity.

Normally, this would have been par for the course in an industry characterized by dilution, but for a company viewed as a late comer to the scene, and one whose stock had already lost half its value from its highs, this raise was condemned by the market, which responded by slashing a further 40% off Zenabis's share price following the announcement.

Now, with the stock trading at just \$1.73 as of last close, I believe that most of the risk has been priced in, and Zenabis deserves a closer look at these levels.

What does Zenabis have going for it?

Although you might not have heard about Zenabis, it's certainly no slouch when it comes to future capacity. Currently, the company is busy ramping up its 3.5 million square feet of production, which will give it a design capacity of 479,300 kg annually, placing it right behind Aurora in terms of production space. Moreover, owing to expected benefits of scale and B.C.'s temperate climate, Zenabis will be one of the lowest-cost producers on the market, with cost per dried flower expected to come in at \$0.75-1.10 from its Langley and Atholville greenhouses.

Finally, on the domestic front, along with provincial agreements, Zenabis can also boast a supply deal

with Shoppers Drug Mart and Pharmasave for its medicinal offerings, while internationally, Zenabis has signed international LOIs and supply partnerships with multiple European and South American players in the cannabis space.

Not without significant risks

Positives aside, Zenabis is not without risks. As mentioned, the company is a late comer, and the market no longer values companies based on capacity but rather on forward earnings metrics. In other words, if you're still trying to raise capital so you can convert your existing produce warehouses for cannabis production, don't expect investors to be keen on funding your ambitions.

Because Zenabis is the newcomer, I am concerned about the uphill battle for market share and coveted shelf space that is now facing Zenabis, (for instance, a company like **Canopy** already offers 170 SKUs for customers to select from).

Finally, Zenabis is also in need of serious cash, as converting warehouses is expensive business. For example, Zenabis's crown jewel facility in Langley, B.C. has yet to receive a cultivation licence and is expected to require an estimated \$150 million to get up and running.

However, even with all these risks, Zenabis is hard to ignore at these levels. Based on a back-of-the-envelope calculation and completion of its full facility ramp up, I expect Zenabis to end 2022 with \$1.67 billion in revenues based on 50% of its fully funded production being sold at a blended average price of \$3.50 per gram.

Based on an EBITDA margin of 28% (in line with the industry, though slightly below Aurora's) and assigning a forward six times earnings multiple, I get an valuation of \$5.20 per share, or a 200% upside from current levels. In other words, if you can stomach the volatility, Zenabis could return twice your investment (or more, if it works out its cash burn issues).

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