Down 62% in 1 Year, Is This Marijuana Stock Doomed?

Description

Investors in **Green Organic Dutchman Holdings Ltd** (TSX:TGOD) have lost nearly two-thirds of their investment since September of last year. The company is the latest in a long line of cannabis producers that have seen their market value erode as the nascent sector matures.

But is the recent plunge a sign that the growth story is over or an indication of undervaluation ripe for contrarian investors? Here's a closer look.

Premiumization strategy

Green Organic Dutchman is betting that people's preference for quality and organic sources in food also applies to the nascent market for legal marijuana.

Once the industry matures, producers will have to differentiate themselves by access, price, or quality, just like any other consumer industry.

With this in mind, management has picked quality over quantity and has elected to focus on only certified organic products for the Green Organic Dutchman brand. This means their average selling price is $12.22 per gram of organic marijuana, as compared to $9.20 per gram for the ordinary variety. That represents a 32.8% premium.

However, the higher selling price also entails higher production costs. The best way to measure the company's premiumization strategy is to monitor the gross margin, which is currently at 48%, as the legal cannabis industry completes a full year of sales and the market matures.

Fundamentals

Similar to other marijuana companies, Green Organic Dutchman doesn't have much of a track record to base valuations or estimates on. Instead, let's take the management's forecast at face value and judge the company based on potential future revenue.

According to the company's investor presentation, the production run rate could hit 200,000 kilogram annually by the fourth quarter of 2020.

Assuming the company produces exactly 200,000 kilograms over the course of 2021 and sells the product at an average price of $12.22 per gram as described above, the company's annual sales could exceed $2.4 billion by that year.

The company's production is already spread far beyond Canada, with pilot facilities in Jamaica, Mexico, Poland, and Denmark, so reaching over $2 billion in annual sales is certainly a possibility.

At present, the company's market value hovers around $850 million, which may be justified given the spike in sales expected over the next two years.

Investors should also consider the fact that Green Organic Dutchman reported $174.5 million in cash and cash equivalents and $157 million in property, plant, and equipment assets.

Combined, these tangible assets contribute nearly 40% of the company's current market value. Reported book value represents 50% of market capitalization.

In other words, Green Organic Dutchman's valuation isn't as overblown as some of its peers.

Bottom line

By focusing on a premiumization strategy and swiftly expanding production to foreign countries, Green Organic Dutchman has positioned itself as a diversified and robust money-maker in an intensely competitive and nascent industry.

While valuations in the marijuana industry are often a game of blind guesses, I believe this company's current stock price is justified by its future sales potential, higher margins, wider geographic distribution, and underlying tangible assets like cash and property.

The Dutchman is far from doomed.

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