Cannabis Investors: This High-Quality Stock Is Worth 30% Less Than CannTrust (TSX:TRST)

Description

The third calendar quarter of 2019 proved to be a difficult one for the cannabis companies. Many companies reported lower-than-expected revenue and lowered guidance going forward.

This caused a number of the stocks to be sold off, and **Horizons Marijuana Life Sciences Index ETF**, which tracks the sector as a whole, was sold off by more than 10% during the earnings season.

A number of factors contributed to the major headwinds in the quarter, such as political uncertainty, tougher competition from the black market, and lack of retail stores to help get the products to consumers.

Even as the companies ramped up their operations for Cannabis 2.0, it looks like nothing will help the cannabis sector except for time.

The industry needs time to get over its growing pains, but that doesn't mean there isn't still some value available in the sector.

One stock in particular that looks extremely cheap is **WeedMD** (TSXV:WMD).

WeedMD reported earnings on Friday afternoon, and although the market didn't react well, I think there are a number of positives to take from its statement.

For starters, we are already seeing its vertical integration paying off, as more than half of its revenue in the quarter came from business-to-business sales, which almost exclusively means selling extract products to companies that don't have their own in-house brand like WeedMD.

CX industries, WeedMD's own cannabis extraction company, will be key to the business's success going forward. It led the way for WeedMD in the third quarter, as companies got ready for Cannabis 2.0, which is pretty incredible considering extracts and edibles weren't even legal yet.

Going forward, it's going to be a big driver of growth, and a main part of WeedMD's business to diversify its operations.

Taking WeedMD’s own extract capacity and coupling it with its own retail store network, which it’s building with the introduction of Pioneer Cannabis, is going to make a strong combination.

Subsequent to the third quarter and actually so recent that the earnings call was delayed, WeedMD announced it’s buying up Starseed, a union-backed medical cannabis company.

Its acquisition of Starseed has a number of positive synergies the company will realize, but, most importantly, it helps WeedMD to continue to solidify the distribution portion of its business, which was one of the only things it needed to improve.

Some of the main improvements WeedMD will see as a result of the acquisition are higher margins, a more improved customer reach, and roughly $10 million in selling and general administration expenses savings, to name a few.

It’s now very strongly vertically integrated with high-quality and low-cost cultivation operations, its own in-house extraction company, and a number of distribution deals and operations to help get its products to market.

Going forward, WeedMD is committed to continuing to lower its growing costs while maintaining its high-quality product. In the most recent quarter, its average costs were down another 22% to $1.42 per gram for all-in sales costs.

It continues to be one of the most well-managed and forward-looking cannabis companies that is building its business the right way and not rushing to do anything that may put the company in an undesirable position down the road.

What’s crazy is that when WeedMD was initially sold off after its earnings last week, it was nearly half the price of **CannTrust** and had a market cap of just $80 million.

Its stock has since recovered slightly but still sits at a market cap of just $106 million as of Monday’s close, which is roughly 30% cheaper than CannTrust — a company with an extremely uncertain future.

It’s clearly undervalued when compared to a company that has a strong likelihood of being delisted from the TSX and losing its production licences in addition to being undervalued based on some key metrics in the sector.

Due to the growing pains in the sector, though, investors have to be committed to owning the stock for the long term, as it’s unclear when the industry will finally turn the corner and begin to realize all these gains investors are anticipating.

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