



Betting on a Cannabis Comeback? Buy Organigram (TSX:OGI)

Description

The cannabis bubble has [finally burst, witnessing](#) many industry stocks harshly handled by the market and declining significantly in value over the last year. Many marijuana stocks have rallied considerably over the last week, spurred higher by bargain hunters who believe that many are undervalued.

Among the best-performing was **Organigram** ([TSX:OGI](#))([NASDAQ:OGI](#)), which reported some strong fiscal first quarter 2020 results. Those results were responsible for sparking the latest rally, triggering a renewed sense of optimism regarding the legal cannabis industry's outlook.

Beaten-down industry heavyweight **Canopy Growth**, which reported a slew of massive losses over the last year, has rallied by a whopping 21% over the last month, sparking considerable confidence among investors that a cannabis recovery is underway.

Uncertain outlook

While a short-lived recovery appears likely, there are signs of further pain ahead for the industry, so it's important for investors seeking exposure to cannabis stocks to focus on those companies with quality assets and reasonable valuations.

The uncertainty surrounding the long-term outlook for marijuana stocks can be attributed to many unknowns surrounding the demand for legal cannabis and derivative products globally.

This means that many companies, Canopy among them, are sporting nosebleed valuations and continue to struggle with becoming profitable even after the legalization of cannabis beverages face an uncertain future.

Nonetheless, Organigram has demonstrated that it can improve its performance. For the fiscal first quarter, the cultivator's revenue more than doubled year over year to just over \$25 million.

That came on the back of strong sales growth because of the legalization of recreational consumption of marijuana in Canada, which has now been available since October 2018.

While Organigram's quarterly adjusted EBITDA and net income declined by a worrisome 29% and 103%, year over year respectively, it wasn't as bad as it initially appeared, as the reduction in earnings was primarily driven by adjustments to the value of biological assets and inventory rather than higher costs or a sharp decline in sales.

Organigram's appeal is enhanced by the fact that it's one of Canada's lowest cost legal cannabis cultivators. For the fiscal first quarter, it reported a cash cost of \$0.87 per gram harvested compared to \$1.11 for Aphria and Canopy's \$2.13 per gram.

This indicates that Organigram's operations are more profitable than the larger cultivators, making it a more attractive play on the burgeoning global legal marijuana industry.

As well, given that Organigram is trading at 6.5 times sales compared to Canopy, which has a nosebleed price to sales ratio of 32 despite losing a whopping 46% over the last year.

Organigram's price-to-sales multiple is appropriate for a rapidly expanding but speculative industry, particularly given that it's similar to those of companies operating in comparable industries.

Packaged liquor giant **Constellation Brands**, Canopy's cornerstone investor, is trading at three times sales and tobacco giant **Altria's** share price is around nine times sales.

Organigram received its licence for cannabis-infused chocolate production, which is expected to commence during the first half of 2020. This will give sales a solid lift, especially if the introduction of cannabis edibles in Colorado where marijuana infused candies and chocolates have become the most widely consumed cannabis product.

Foolish takeaway

There is still considerable uncertainty surrounding the legal cannabis industry, and what sales are truly worth that certainly doesn't bode well for marijuana stocks.

While many, [including Canopy](#), are struggling to deliver value for investors, Organigram has demonstrated that it can grow sales at a solid clip and deliver value for investors.

The company's attractiveness is further enhanced by it being one of the lowest cost cultivators in Canada, making it an attractive play in what is a risky industry.

CATEGORY

1. Cannabis Stocks
2. Investing

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