

Random walk

Cannabis stocks go ever higher

The value of grass is growing



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There has not been anything like it since the waning days of prohibition in America in the early 1930s, when Canadian distillers, already enriched by the banning of legal alcohol sales south of the border, readied themselves for the end of restrictions and a guaranteed boom. On October 17th retail cannabis sales became legal in Canada, offering its cannabis firms a certain chance to expand at home and the potential to capitalise abroad.

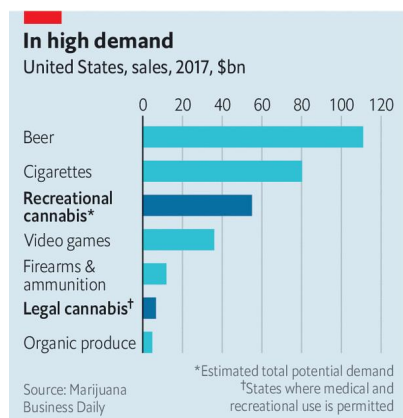
Financial markets are giddy at the prospect. Ten cannabis-related firms are listed on American exchanges, with one more in the process of applying; several dozen have listed on Canadian exchanges and scores more trade over the counter. Two American etfs (exchange-traded funds) cover the sector: the Horizons Marijuana Life Sciences Index and the etfmg Alternative Harvest (whose ticker, *mj*, is one of many to capture cannabis-industry slang). Both are up by around two-thirds since mid-August.

Deciding if all this reflects market intoxication or the start of something bigger is a matter of decidedly unmellow debate.

The industry is not particularly lucrative yet. Some of the 100 cannabis-related firms tracked by Bloomberg, a data provider, make money, but together they lost \$1.2bn last year. Profits are often thin during an industry's growth stage. But the same group of companies has revenues of only \$2.5bn, and their combined market value is \$76bn. Consumer-goods firms typically trade at only two to three times turnover. America's primary market regulator, the Securities and Exchange Commission, in September issued a rare overt warning about the risks of "investment fraud and market manipulation" around listed cannabis firms.

Implicit in the high valuations is anticipation of extremely rapid growth as sales shift from existing illegal channels to legal ones. Canada is the latest and biggest example. But other countries are opening up, too. Marijuana Business Daily, a trade website, estimates the total demand for recreational cannabis in America, if fully legalised, at \$55bn, or about half the size of the country's beer market. Already, 31 American states have made cannabis legal for medical uses and recreational use is permitted in eight. There is no shortage of bills in Congress for expanded use and if the Democrats do well in the mid-terms, the prospects of passage appear bright.

Large companies see value in the market. In October 2017 Constellation Brands, brewer of Corona Beer, bought an initial 9.9% stake in a major



Canadian firm, Canopy Growth (ticker: weed), effectively valuing it at C\$2.5bn (\$1.9bn). In August it upped its holding to 35% in a deal that valued Canopy at C\$19bn. Despite an enormous spike in its public share price, Canopy's market valuation is under C\$16bn, suggesting that investors may be too pessimistic (or that Constellation overpaid). Diageo, Coca-Cola and Altria, a tobacco giant formerly known as Philip Morris, are all rumoured to be discussing deals with some of the more highly valued firms.

They have much to do, including standardising products and developing distribution. Then firms can turn to dreaming up new products for uses such as pain management and treating conditions like sleep deprivation. That would further transform the main cannabis-user group from the young (a large existing market) to the old (a big new market). The prospects for cannabis firms may well be alluring. But the stocks, unlike the products, will do nothing to help stress.

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