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Pot Stocks Find a Bear With Analyst Eyeing 'End of Cannabis Rainbow'

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Canada's legalization of marijuana rolls out next week, yet one analyst is warning that the "tail end of the cannabis rainbow may be approaching much faster than investors realize".

Veritas Investment Research analyst **Stuart Rolfe** initiated coverage Friday on four of Canada's largest cannabis stocks, carrying the only sell rating on each, saying "the market still lacks perspective when it comes to the size, shape and sustainability of Canada's proverbial pot of gold." He initiated coverage of Aphria (price target C\$19), Aurora Cannabis (C\$13), Canopy Growth (C\$30) and Cronos (C\$4.50) giving them all sell recommendations.

Rolfe cites structural problems facing producers as the reason for his bearish view and points out uncertain pricing in the sector. "Canada's eight largest listed firms are trading at more than 21x forward sales," he writes, "assuming a 50 percent EBITDA margin, their multiple reaches an incredibly expensive 42x 2020 EBITDA."

With the anticipated legalization in Canada next week, there will be steady price declines, low black market conversion rates and supply pressures, **Rolfe** warns. He sees the need to "crowd out a hyper-competitive black market" as a major risk. The firms are already overbuilding capacity and **Rolfe** predicts 2020 capacity could exceed demand by 70 percent or more.

The sell ratings are doing little to dampen market enthusiasm, however. Canopy, Cronos and Aurora all traded about 5 percent higher on Friday, while Aphria fell less than 1 percent after the CEO cautioned producers may not be immediately able to keep up with demand.