

Marijuana Legalization Will Be Good News for Pot Stocks. How to Play the Sector.

By [Max A. Cherney](#) and [Connor Smith](#)

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PHOTOGRAPH BY JAMIE CHUNG; SET STYLING BY DANIEL SEAN MURPHY

Russia, in the capital-starved, legal murk of the early 1990s, prepared Boris Jordan well for America's cannabis industry. Today, as the 54-year-old Jordan runs the biggest licensed marijuana company in the world, [Curaleaf Holdings](#), the challenges of the U.S. cannabis industry remind him of his days as a banker and investor on Russia's capitalist frontier. "It was a very tough environment to operate in," Jordan recalls of Russia's post-Communist chaos. Whole industries needed inventing, and the legal ground under businesses shifted constantly. "But that was the opportunity."

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MADE IN AMERICA



As the U.S. rapidly loosens its marijuana laws, domestic producers have an edge over their better-known Canadian rivals. We pick the winning stocks.

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American cannabis companies—such as Curaleaf (ticker: CURLF), [Green Thumb Industries](#) (GTBIF), [Trulieve Cannabis](#) (TCNNF), and [Cresco Labs](#) (CRLBF)—have licenses to operate in states that allow weed under their laws. Yet the industry has been bedeviled by marijuana's illegality under U.S. federal law. That's why Curaleaf has a \$9 billion market cap but still trades over the counter, with its lone listing on the small Canadian Securities Exchange.

Many investors know only Canadian producers such as [Canopy Growth](#) (CGC), [Tilray](#) (TLRY), or [Aphria](#) (APHA), whose wholly legal Canadian activities let them list on the Nasdaq, even as their sales trail the U.S. operators and they lose money.



Boris Jordan is CEO of Curaleaf, the world's largest licensed marijuana company. (ARSENIY NESKHODIMOV)

Now, events are breaking in favor of the American operators. On April 19, [the House of Representatives passed a bill](#) by a 3-to-1 margin that would allow the pot industry to use the federally regulated banking system. Senate Democratic leaders support a matching bank bill. Meanwhile, Covid-19 has left state governments desperate for tax revenue. New York, Virginia, and New Mexico recently joined the 13 states [that have allowed recreational sales](#) to adults. Over time, recreational sales will probably come to the 20 states that now allow sale by prescription. That could spur the remaining state holdouts to fall in line, if federal legalization doesn't happen first. So, sales can't help but grow.

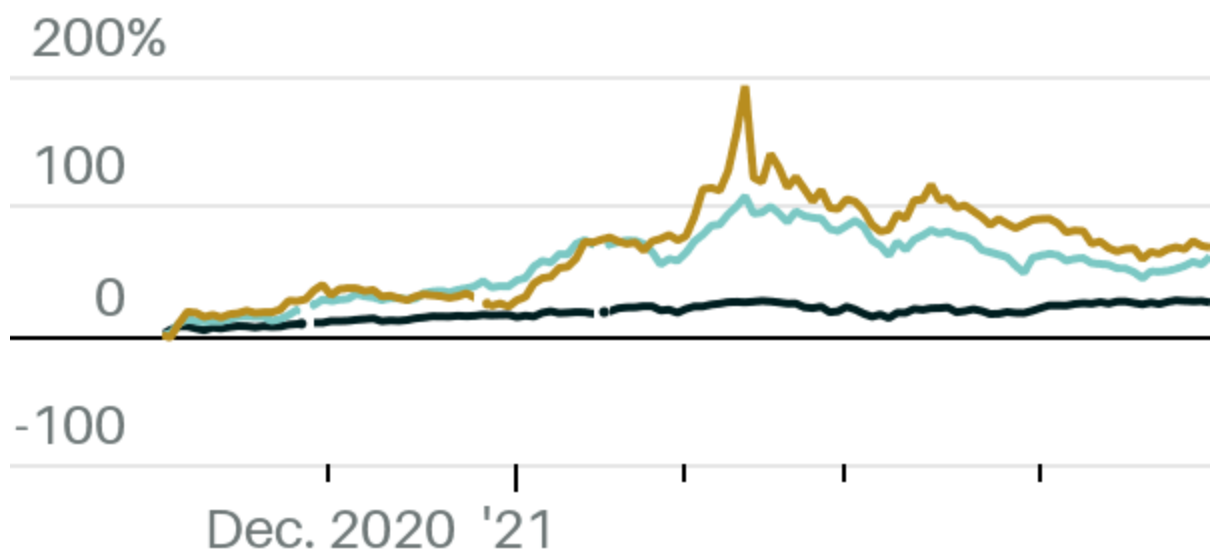
Sales at the U.S. cannabis chains are already doubling and tripling. The companies are profitable. At Trulieve, operating cash-flow margins were 46% in December's quarter. The multistate chains achieve these impressive results while still weighed down by federal laws that impose tax penalties, prevent interstate shipment, and keep exchange-traded funds and mutual funds from buying their stocks. When these impediments fall away, profits should get even better.

By jumping in while the U.S. was still sorting out the rules for postprohibition cannabis, multistate operators, or MSOs, like Curaleaf gathered up scarce state licenses. The chains' licenses, facilities, and brands will be valuable barriers to entry when Canadian rivals and packaged-goods giants arrive, or consolidation begins.

Some Smokin' Stocks

November elections vaulted cannabis stocks ahead of the market—both U.S. shares and those in the Canada-heavy Horizons ETF.

- Horizons Marijuana Life Sciences Index ETF
- AdvisorShares Pure US Cannabis ETF
- NASDAQ Composite Index



Source: FactSet

While the stocks of most Canadian producers have fallen sharply in the past two years, the shares of U.S. operators have gained. Upside remains. The market caps of the eight biggest U.S. cannabis companies add up to \$33 billion. That's a reasonable four times the \$7.5 billion in aggregate sales that analysts forecast for next year, and 10 times the expected cash flows. The overall U.S. market is several times larger than the leading companies, and market researcher BDS Analytics foresees sales topping \$40 billion by 2026. The illicit market is perhaps twice that size. If the history of the alcoholic-beverage industry is any guide, customers will eventually come over to the legal market.



Customers wait outside a Curaleaf dispensary in Phoenix.

COURTESY OF CURALEAF

“I think multistate operators are right now best-positioned to capture the growth in demand,” says Greg Heyman, who runs the cannabis-focused hedge fund Beehouse Partners.

The company that’s now known as Curaleaf was a medical-device business when Jordan took a minority stake in 2012. Unhappy with its direction, he bought control in 2014 and turned his sights on securing licenses in the states that were legalizing cannabis. From a single dispensary in New Jersey in 2015, Curaleaf has expanded to 105 stores in 23 states. “It was difficult to get these licenses,” says Jordan. “I like industries that have high barriers to entry.”

When Canada became the first developed country to fully legalize marijuana in 2018, companies like [Aurora Cannabis](#) (ACB) [built sprawling greenhouses](#) there, with plans to become the world's supplier.

Curaleaf [eclipsed Canada's early leaders](#) to become the world's biggest legal seller. Revenue grew more than 160% in 2020 to \$650 million. It had a net loss of \$62 million, but earnings before interest, taxes, depreciation, and amortization, or Ebitda, were \$144 million, after adjusting for one-time and noncash expenses. The company is expected to turn a net profit of \$65 million this year, as sales double to as much as \$1.3 billion.



Inside a Curaleaf dispensary in Ware, Mass.

COURTESY OF CURALEAF

In over-the-counter trading, Curaleaf's stock is up more than fourfold from the March 2020 market bottom to a recent \$13. Sell-side analysts expect the stock to rise another two-thirds in the next 12 months.

The SAFE Banking Act recently passed by the House would let big banks service cannabis companies, when lawful. The legislation has bipartisan support in the Senate and an amenable White House. A related bill assures insurers that they can legally serve the industry. But those bills wouldn't relieve cannabis operations from a section of the U.S. tax code known as 280E. As illegal businesses under federal law, says 280E, cannabis companies can't claim normal business expense deductions and credits, such as payroll and rent, on their federal tax returns.

This hits cannabis companies hard. Curaleaf's 2020 taxes of \$83 million represented an effective tax rate of 378%. Section 280E is "borderline unconstitutional," complains Jordan. "The federal government is basically discriminating against a major industry in this country." Chicago-based Green Thumb paid an effective tax rate of 81% in 2020, while Florida's Trulieve paid 60%.

Growing Like Weeds

Despite cost burdens from pot's federal illegality, U.S. cannabis sales yield nice profits.

Company / Ticker	Recent Price	Market Value (bil)	2021E Revenue (mil)	2021E Adjusted Ebitda (mil)	2021E Adjusted EPS
Curaleaf Holdings / CURLF	\$13.36	\$9.1	\$1,260	\$370	\$0.06
Green Thumb Industries / GTBIF	30.55	6.6	860	320	0.47
Trulieve Cannabis / TCNNF	40.57	5.0	850	380	1.48
Cresco Labs / CRLBF	12.29	4.5	810	260	0.16
TerrAscend / TRSSF	11.08	3.5	300	120	0.11
Columbia Care / CCHWF	6.28	1.8	510	100	0.02
Ayr Wellness / AYRWF	29.18	1.5	380	140	0.39
Harvest Health & Recreation / HRVSF	2.83	1.2	390	80	0.01

E=estimate; Ebitda=earnings before interest, taxes, depreciation, and amortization

Replacing 280E's tax burden with a more modest cannabis excise tax is among the moves planned [by supporters in Congress](#), such as Senate Majority Leader Chuck Schumer (D., N.Y.), who has championed comprehensive reform of federal marijuana laws, along with Sens. Cory Booker (D., N.J.) and Ron Wyden (D., Ore.). On April 20, the informal national day for weed-reform advocacy, Schumer said that he hoped for full legalization before the next anniversary.

Inch-by-inch changes have made cannabis legalization resemble a slow-motion version of the repeal of alcohol's prohibition, which took all of a year in 1933. The ensuing rise of the distilled-spirits industry is family history for Green Thumb CEO Ben Kovler. His great-grandfather Harry Blum put down \$5,000 in 1935 to back a newly built Kentucky distillery that went on to make Jim Beam bourbon. The James B. Beam Distilling Co. was a publicly held company when Kovler's grandfather Everett Kovler sold it to American Tobacco in 1967.



Ben Kovler, chairman and CEO of Green Thumb Industries, at the company's Rise Mundelein dispensary in Mundelein, Ill. (left); a photo of Ben Kovler's father, Jon Kovler, and grandfather, Everett Kovler, in front of the 600,000th barrel of Jim Beam.

(LEFT) DANIEL ACKER/BLOOMBERG; (RIGHT) COURTESY OF MATTIO COMMUNICATIONS

"It's the rhyme of history," says Kovler, of his role in building the legal cannabis industry. He started Green Thumb in 2014, and it had 53 cannabis licenses by the time it went public in 2018 through the reverse takeover of a publicly registered shell company in Canada. U.S. cannabis operators had to go public this way because the Securities and Exchange Commission wouldn't register their stock offerings, and big exchanges wouldn't list their stocks.

While federal law made it hard to tap public capital markets, Green Thumb won early fans in the investment community. On its debut conference call as a public company, the first question came from Leon Cooperman, founder of hedge fund manager Omega Advisors, who praised Kovler's "professional handling" of the business.

Green Thumb executives have kept a close eye on profits and cash flow while growing the business into [the world's No. 2 licensed cannabis seller](#). The company has 56 stores and

licenses for 97, with sales in 12 states. It also markets brands like Beboe and Dogwalkers through the stores of other operators.

In 2020, Green Thumb turned a \$15 million profit, or seven cents a share, as it increased sales 157%, to \$557 million. This year, analysts expect that net profit will grow to \$102 million on sales of \$860 million. Since the shares started trading over the counter in 2018 at less than \$8, Green Thumb stock has reached as high as \$39 before settling back to a recent \$30.

Heyman, the hedge fund manager, has held Green Thumb since May of last year. “Green Thumb is cheap, period,” he says. “If you showed the numbers that Green Thumb generates to any securities analyst without telling them that it was a cannabis company, it would have a higher valuation.”



Employees help customers with recreational-marijuana purchases at Green Thumb’s Rise Mundelein dispensary. **(DANIEL ACKER/BLOOMBERG)**

Shunned from U.S. capital markets, Green Thumb and other American cannabis operators raised early capital at a high cost—paying credit-card rates on debt, sweetening equity deals

with warrants, and selling properties and leasing them back. But Green Thumb has steadily whittled away at its capital costs, and in February the SEC allowed it to make [the first registered stock offering by a U.S. cannabis business](#). Without an underwriter, Green Thumb placed the entire \$100 million deal with an institutional investor.

[Capital market access](#) is another step in federal reform that the industry hopes Congress will allow. Underwritten public offerings, broad institutional ownership, and New York Stock Exchange or Nasdaq listings would boost valuations.

“They can’t go to capital markets directly on major U.S. exchanges,” says Needham analyst Matt McGinley. “So, it’s still more expensive to fund growth in this space than it is for most other industries.”

The profit margins at Florida’s Trulieve Cannabis show the earnings potential of cannabis, even in a state that still only allows sale by prescription. After a start in real estate development around the state capital of Tallahassee, Kim Rivers took charge of a nursery that received one of the state’s first cannabis licenses in 2015. When Trulieve was ready to sell Florida’s first grams of legal pot, she recalls, the company realized that there weren’t any patients. After a frantic search, the company transported a patient two hours to make its first sale. “Then, the next day came,” she says, “and I just said, ‘Oh my gosh, what are we going to do?’ ”

Trulieve attracted more customers. Today, [it commands half of Florida’s cannabis sales](#), with 480,000 registered patients at its 79 dispensaries. Sales doubled in 2020 to \$522 million, with earnings of \$63 million; adjusted to exclude one-time charges and noncash items, Ebitda was \$251 million, a remarkable 48% of revenue. Analysts project that sales will grow more than 60% this year to about \$850 million, with net income around \$170 million.

That performance hasn’t gone unnoticed, and Trulieve stock is up fourfold in the past year to a recent \$40. Rivers and other early investors registered 75 million shares of their stock for sale in March. The company raised \$230 million in an April offering and will use the proceeds to expand beyond its Florida stronghold. It has beachheads in Massachusetts, California, Connecticut, Pennsylvania, and West Virginia. Rivers now says that New York’s newly legal recreational sales opportunity looks intriguing.



A Weed Maps truck sits near a Cresco Labs dispensary as recreational marijuana sales begin in Chicago on New Year's Day, 2020. (DANIEL ACKER/BLOOMBERG)

Like the other MSO founders, Cresco Labs CEO Charlie Bachtell was attracted to the cannabis business by what scared away other investors. The law was evolving and uncertain, but Bachtell had been general counsel of a large Chicago mortgage lender in the wake of the subprime mortgage crisis. He could handle heavy scrutiny and regulation. "I felt like I'd read the book before," he says. "I knew within 24 hours that this is the most fascinating thing I'd ever seen."

Across 12 states, Cresco has 32 stores and licenses for 12 more. Its branded products sell in hundreds of third-party dispensaries. Sales nearly quadrupled last year to \$476 million. It had a net loss of \$37 million but an adjusted Ebitda of \$116 million. The practice of reporting adjusted earnings is common in the cannabis industry—like seemingly everywhere else these days—and investors should pay close attention to each company's adjustments.

Cresco reported adjusted Ebitda margins of 31% in its December 2020 quarter, but its adjustments excluded the expense of discounts and samples involved in expansion, plus relaunching and rebranding activities that followed a California acquisition. Some analysts

[wondered if those would prove to be the one-time events](#) that Cresco claimed. Without those adjustments, Ebitda margins would have been 24%.

Cresco's stock has risen from \$2.45 in March 2020's market bottom to a recent \$12, as [revenue boomed in Illinois after that state legalized recreational sales](#) last year. Crucial to cannabis reform's passage in the Illinois legislature were provisions that address the inequitable history of drug enforcement, by offering business and employment opportunities to communities of color. For many U.S. cannabis businesses, correcting past injustices has become an important part of their mission ([see box, below](#)).



People wait to buy recreational marijuana at the Cresco Labs dispensary in Chicago on Jan. 1, 2020. (DANIEL ACKER/BLOOMBERG)

The industry's midtier ranks include [Columbia Care](#) (CCHWF), [Harvest Health & Recreation](#) (HRVSF), [Ayr Wellness](#) (AYRWF), and [TerrAscend](#) (TRSSF), which is chaired by [hedge fund manager and early cannabis investor](#) Jason Wild. They all have footprints in multiple states and are expected to have sales this year ranging from \$250 million to \$500 million. If they don't grow into first-tier operators on their own, their local strongholds could make them attractive acquisition targets as the industry eventually undergoes consolidation.



A Cresco Labs greenhouse in Kankakee, Ill.

COURTESY OF CRESCO LABS

While the U.S. pot producers wait for Congress to allow their shares to join Canada's marijuana stocks on the big exchanges and in the portfolios of mutual funds and pension plans, it can be a hassle for investors to buy into the U.S. weed industry.

A recently launched ETF devised a clever way to let U.S. investors bet on the American industry: The Advisorshares Pure U.S. Cannabis ETF (MSOS) holds stock-swap positions in the U.S. operators, keeping the fund on the right side of federal law.

With nearly \$1 billion flowing into the ETF since its September launch, the fund's trading activities have probably contributed to recent gains in the thinly traded stocks.

For now, an ETF such as the NYSE-listed Pure U.S. Cannabis might be one of the easiest, and safest, ways to invest. "In a fast-growing, very volatile area like cannabis," suggests its portfolio manager Dan Ahrens, "a diversified portfolio and professional management make a lot of sense."

What makes less sense is the lopsided attention that investors pay to Canadian pot producers, who may be listed in the U.S. but mainly have Canada's tiny market for their sales. The real action is right under their nose.



Trulieve's Mandarin Dream cannabis strain

COURTESY OF TRULIEVE