Why Shorting Marijuana Stocks May Be the Best Trade of the Year

Description

After another substantial move upwards, the marijuana sector is back in the news and the good graces of investors. The story about institutional ownership, however, has yet to change: the "smart money" is staying away, and potentially with good reason!

Although U.S.-based **Constellation Brands, Inc.** (NYSE:STZ) recently took a 9.9% ownership stake in Canada's biggest marijuana producer **Canopy Growth Corp.** (TSX:WEED) at a premium, the momentum that came from that deal may be starting to run out. In spite of having investors getting very excited from making a lot of money, the truth is that in spite of a lot of potential, investors are paying too high a price at current values.

Over the past month, **Aurora Cannabis Inc.** (TSX:ACB) announced that a secondary offering would be taking place in the amount of $50 million, which would allow the company to expand capacity and drive revenues higher. The crux of it all is that with this latest round of financing, shareholders are no longer lining up to purchase the shares.

The company needed to sweeten the deal by offering warrants alongside the equity raise. Essentially, for each share that was purchased at a price of $3, the buyers were allocated a warrant to purchase one share of the company at $4 per share at a later time. Although that price seemed significantly out of reach only one month ago, investors have seen a 33% increase as the company's stock crossed the $4 mark last week.

For investors who have been following this story from the beginning, this is not the first time that the market has experienced such exuberance. Close to one year ago, the Canadian federal government announced that marijuana, used for medical purposes only, would be made legal for everyday use, resulting in a temporary "pop" in share prices at that time. In November 2016, shares hit an intra-day high in excess of $14, which was short-lived, as shares failed to close above the $12 mark until February 2017. As Yogi Berra once said, "It's deja vu all over again."

With the potential for shareholders to be diluted again in the future, either through warrants, new share issues, or the issuance of other financing securities, such as convertible debentures, retail shareholders need to remain extremely cautious about what they are buying.

In spite of increasing revenues and a product which will be legal next year, there remains a number of challenges for the industry when it comes to the cost of customer acquisition and the ability for each company to operate in a cash flow positive manner when competing with the black market and the ability for each consumer to grow the substance in their own homes. With the potential for a large pullback between now and the end of the year, investors may want to strongly reconsider their long positions in this industry.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:STZ (Constellation Brands Inc.)
2. TSX:ACB (Aurora Cannabis)
3. TSX:WEED (Canopy Growth)

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