Canopy Growth Corp.: Is it Just a Bubble or a Real Growth Play?

Description

Canopy Growth Corp.'s (TSX:WEED) share price has doubled during the past month. Investors rarely see this kind of jump in share prices, especially when many analysts are raising the red flag and calling Canadian marijuana stocks a classic example of an asset bubble.

But despite these warnings, it's hard to resist temptation when there's a chance to double your investment in just a few weeks. Let's see if Canopy Growth, Canada's largest pot producer, is still a good buy or if we need to be careful on these extremely high valuations.

Prospects for 2018

The momentum you're seeing in Canada's cannabis stocks is mainly coming from the potential legalization of the recreational sale of pot as of July 1, 2018.

Canada will become only the second country in the world (after Uruguay) to legalize the production, sale, and consumption of recreational marijuana.

To make this happen before its self-imposed deadline, the federal government has made a great deal of progress. During the past six months, we have witnessed some major developments that were enough to assure investors that the federal government and provinces are serious about putting together a legal and operational framework before the summer.

An agreement between the federal government and the provinces over sharing tax revenues from pot sales in the recreational market was reached last month, effectively removing one of the major roadblocks. Earlier, Canada's House of Commons passed a bill that will allow the recreational consumption of cannabis in the country. This bill is now up for debate in the Senate.

Risks to demand forecast

Despite these positive developments, many analysts believe that after the triple-digit gains of 2017, Canopy stock has entered a bubble territory, as there is still a lot of uncertainty surrounding the scale of expected demand and selling prices. There are also execution risks, which very few investors seem to be concerned about.

The market for recreational pot is estimated to reach between $5-10 billion by 2021. However, these forecasts assume that the black market will simply disappear and that the majority of buyers will turn to the legal channels.

This assumption, however, is too optimistic. There will still be a cost incentive for illegal sellers, as they will keep their costs low by avoiding taxes, regulations, and quality checks.

Despite the Canopy's leading position in Canada's marijuana sector, the risks are rising for a sustained pullback after these massive gains in its stock price. I think almost all the positive news has been factored into the current valuations and that the gains we're now seeing are purely speculative.

The bottom line

Investors who are thinking to make a quick buck in this space should be very careful before jumping on the bandwagon, as fundamentals don't justify these prices and any negative news might bring a sharp correction.

For long-term investors, I still recommend Canopy Growth stock, which has all the ingredients to become the largest player in the recreational market. Canopy, through acquisitions and partnership, has positioned itself to lead the pack once the market is open.

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