



Marijuana Stocks: Is the Recent Dip a Buying Opportunity?

Description

Marijuana producers in Canada have had a rough last week as their stock prices plunged amid some negative press coverage, raising doubts about the potential of their investments.

The biggest uncertainty dragging down the shares of the top producers, such as [Canopy Growth Corp. \(TSX:WEED\)](#) and **Aurora Cannabis Inc. (TSX:ACB)**, is about the market potential once the federal government allows the recreational use of pot, which is expected this summer.

The uncertainty regarding the actual demand, potential supply glut, and price pressures once the recreational market is open for business is forcing investors to pause and question the extremely rich valuations of these producers. In Canada, at least 89 companies have been given the go-ahead to grow pot since February 1, and another 244 applications are under review, according to Health Canada.

Wholesale producers like Canopy will only be able to generate a couple of billion dollars in cash flows if Canada's pot retail market can reach the most bullish forecast of \$9 billion in annual sales in a few years, according to a recent research by *Barron's*.

"So today's investors are effectively paying 15 times the industry's cash flow five years from now, a generous multiple. Moreover, there's reason to believe these revenue forecasts are overly optimistic," the report stated, adding that investors have ignored the possibility of steep price declines once the new supply hits the market.

After the legalization of marijuana in such U.S. States as Colorado and Washington, supply gluts pushed cannabis prices down more than 10% in each of the past two years.

These negative reports have sent the shares of the largest producer Canopy tumbling 17%, and Aurora Cannabis tumbling 14% in the past five trading days. In the past three months, Canopy is down 31%, while Aurora is down 43%, massively underperforming the **S&P/TSX Composite Index**, which has lost 6% during this period.

So what's the best course of action for investors who want some exposure to Canada's marijuana industry? Is this recent plunge in share values a buying opportunity?

I don't think so. As I've highlighted in [my earlier articles](#), cannabis stocks will remain under pressure until we see top producers start generating enough sales in the post-legalization era and justify their current market capitalization.

The bottom line

There is no question that there is a huge opportunity out there once Canada and other nations allow the recreational use of pot. But these expectations are not enough to fuel another sustainable rally in pot stocks in 2018. The market focus has shifted to the execution and the companies' ability to turn investment dollars into meaningful sales. Until then, it's better for risk-averse investors to wait on the sidelines.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ACB (Aurora Cannabis)
2. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

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Date

2025/08/19

Date Created

2018/04/07

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