Are Cannabis Stocks Cheap After Dropping Heavily in Value?

Description

Pot stocks have struggled so far this year, and for opportunistic investors, it might be a good time to buy before the hype picks up again ahead of legalization, which is slated for later this year.

Aurora Cannabis Inc. (TSX:ACB), which saw tremendous growth last year, has crashed more than 30% this year. **Canopy Growth Corp.** (TSX:WEED) has also seen a large, but a bit more modest, 13% decline year to date.

Why are pot stocks down after doing so well last year?

It's hard to pick a specific reason as to why cannabis stocks have struggled so far this year given there hasn't been negative news pertaining to the industry, nor is there an underlying commodity price that would have had a significant impact on stock prices.

Instead, the markets have overall been very bearish in 2018, and we've seen speculative buys see the biggest corrections. Bitcoin, which is perhaps the most speculative investment to make, has lost around 40% of its value in just the first four months of trading this year.

The markets as a whole have not been good this year, but speculative investments have taken even bigger hits.

Share prices remain expensive

Most cannabis companies are not profitable, and that makes assessing their value a little challenging. Canopy Growth has seen significant growth year over year in its top line, but that hasn't translated into a strong bottom line, as it hasn't been able to consistently stay in the black, and when it has, it's been a very modest profit.

For cannabis stocks, the best metric to compare values would be sales, given the growth we've seen and the focus on market share in the industry. Price to sales (P/S) is a useful ratio in this case, and it tells us that Canopy Growth trades at nearly 80 times the sales that it accumulated over the past four quarters.

This is an alarming multiple when you consider that even the top tech stocks south of the border trade in the single digits and multiples of four are relatively high. However, as high as Canopy Growth's multiple is, it still doesn't compare to the more than 130 times sales that Aurora trades at.

Even though we've seen cannabis stocks fall heavily this year, their values are still very high, and investors would be paying a big premium to own these stocks as well as others in the industry.

Why the stocks might still have a lot of upside

Pot stocks are not appropriate for value or risk-averse investors — that much is clear. However, the one thing we saw last year push cannabis stocks was excitement and expectation of future growth.

It’s unlikely that we’ve seen the peak for marijuana just yet, especially since the industry hasn’t had a chance to disappoint investors just yet, since we don’t know how much growth will come in versus what’s expected. Until that happens, we won’t have an accurate picture of how strong the industry will be.

As pot gets back into the news and takes centre stage as we approach legalization, we’ll likely see stock prices rise in value once again, and that’s why cannabis stocks could have a lot of upside from their current prices.

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