



Pot Stocks: Uncertainty Is the Only Certainty

Description

This past week, **Canopy Growth Corp.** ([TSX:WEED](#))(NYSE:CGC) posted disappointing earnings. The company missed analysts' estimates on both the top and bottom lines by a significant margin. Analysts were expecting Canopy to post a loss of \$0.08 per share, but it posted a loss of \$0.31 per share. Ouch.

Although revenues increased 55% year-over-year, the company missed expectations by approximately 6% or \$1.39 million. On Wednesday, the day it announced earnings, Canopy lost approximately 8% of its value. Investors were in full-blown panic mode. How could the company post such poor earnings? Is this a harbinger of things to come?

Canopy's earnings dragged the entire pot sector down. Time to run for the hills? Not a chance. Canopy more than rebounded the following day. In fact, the company's share price is now up 3% over where it was before it announced fourth quarter results.

There is an important lesson to be learned from Canopy's earnings. Investors who are invested in the pot sector should expect volatility over the next year.

Analyst estimates

If you've been following the sector, one thing is abundantly clear: analysts have no idea how to value these companies. It's no fault of their own; the pot sector is speculative and is undergoing significant consolidation. Companies are expanding capacity at a blistering pace as they try to catch up to the expected demand. The result? Extra costs. As such, it is difficult to predict earnings.

What does this mean for you? Take the estimates with a grain of salt. Until pot stocks start booking revenues and profits against recreational marijuana, it will be very difficult to value these companies. Canopy Growth has an \$8 billion market cap, which is tops in the industry. Is this too high of a valuation? I can't say.

The size of the recreational marijuana market in Canada is tagged to be anywhere between \$4 and \$9 billion. This is a wide range. The problem is, no one can accurately predict how big the market will be.

At this point, they are all guesstimates.

Speculative buy

At this point, an investment in the sector is a speculative buy. Don't agree? Investors are betting on a market of unknown size and demand. Estimates vary widely and the future is full of uncertainty. Case in point: the Province of Ontario is already demanding that suppliers cut prices so that it can compete with the black market.

I have confidence in the sector. However, I am not naive enough to think that there is no risk involved. If you are risk averse or can't handle the roller coaster ride, best to stay on the sidelines.

To quote John Allen Pollos, "*Uncertainty* is the only *certainty* there is, and knowing how to live with insecurity is the *only* security."

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