The 4 Biggest Questions Investors Need to Answer Before Investing in Marijuana Stocks

Description

The marijuana, or cannabis, industry is a long-term growth industry; that's something that I think we can all agree on.

Where it gets tricky is when we look at the various players and weigh the dangers and opportunities of volatility, valuation, and competitive advantage.

Volatility

Volatility is a hard one to wrap our heads around.

Because while price swings have brought about some great buying opportunities, it is always easier to recognize these in hindsight. I mean, marijuana stocks are trading off many things, but one of the biggest factors right now is investor psychology, which means that it is a big challenge to forecast where the stock is headed, at least in the short term.

Let's take **Canopy Growth Corp**. (TSX:WEED)(NYSE:CGC). These highly volatile shares have been some investors' dreams — and the stuff of nightmares for other investors.

I mean, the shares have fallen 22% since the end of June 2018 after more than doubling from April 2018 to June 2018.

Aphria Inc. (TSX:APH) and **Aurora Cannabis Inc**. (TSX:ACB) have not fared as well, however, as at the time of writing, both are currently trading at roughly half of what they were trading at in January of this year. It's sobering for those investors who got in at the highs.

How can we look past the volatility and make it work in our favour?

Valuation

When we consider the financials of these stocks in order to make sense of these stock price movements, it doesn’t help us all that much.

I mean, if the stocks are pricing in unrealistically lofty growth projections, it stands to reason that they will stall as the market sees that these growth projections may take more time to come to fruition.

As a case in point, Canopy Growth has not been able to sustainably generate a profit, with only one quarter in the last five showing a net profit. The stock trades at more than 70 times 2020/2021 earnings projections.

And Aphria has generated a profit, but only because of selling different subsidiaries. As far as operating profit goes, they have come up short.

When will the results grow into the stocks’ valuations?

With the amount of money that has been raised through share issuances, we see shareholders’ interest in the businesses being diluted. For example, in fiscal 2018, Canopy raised more than $500 million through issuing shares.

But the aggressive growth plans have not stalled, with companies still entering the marijuana market in other parts of the world, the latest being Latin America.

So how much more money will be raised to what effect on shareholders?

Competitive advantage

Marijuana companies are all striving to achieve first mover advantage in order to create a lasting competitive advantage, which is evident in the aggressive growth plans of most of the players.

At this point, Canopy plans to eventually produce more than 750,000 kilograms of cannabis a year, which is significantly more than Aurora or Aphria and thus indicates a real size advantage.

Can this competitive advantage be maintained?

Conclusion

In conclusion, I am advocating for thoughtful caution with respect to marijuana stocks. How does this look?

Attributing a small percent of your overall portfolio to marijuana stocks is reasonable. This way, you can participate in the upside and not lose your shirt if and when the downside hits.

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2. TSX:ACB (Aurora Cannabis)
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Author
karenjennifer