



Will Cannabis Stocks' Earnings Be Lower Than Expected?

Description

On October 17, the day that cannabis was legalized in Canada, there was chaos nationwide. Supplies fell short. "Sold out" signs appeared on stores. Customers formed hours-long lineups just to buy their first gram of legal pot. That all of this would be good for cannabis stocks was taken as a given...

... But should it have been?

It's been almost three weeks since cannabis was legalized, and the markets aren't rewarding pot stocks with strong returns. On the contrary, on the date that cannabis became legal, a major selloff in pot stocks began. Prices have stabilized somewhat since then, but the point remains: there is no post-legalization rally in sight.

Canopy Growth Corp ([TSX:WEED](#))(NYSE:CGC) CEO Bruce Linton attributed the October selloff to [profit taking](#) by long-term holders. That may partially explain it, but with prices still way off their 12-month highs, the time has come to ask whether there are more fundamental problems at play. And indeed, some, such as GMP Securities Analyst Martin Landry, are starting to suggest that there are. Chief among them are, distribution issues, fulfillment problems and supply shortages.

No brick and mortar sales in Ontario

Some provinces have seen massive problems with cannabis distribution—Ontario chief among them. Ontario did not opt to open cannabis retail stores immediately on October 17, choosing instead to push the date back to April. This limited customers' buying options and may have put a dent in sales. With online ordering taking weeks, there is no reason to believe that cannabis users favoured legitimate vendors over black market options.

Fulfillment issues

Fulfillment issues were another pain point in the weeks following legalization. Because Ontario's online cannabis stores were so backlogged, there were many issues with delayed shipments. Customers vocally complained about waiting too long to get their pot. While this suggests that initial sales were strong, customers' negative experiences may have pushed them back to black market vendors, who

offer lower prices and a quicker buying experience.

Supply shortages

Last but not least, there's the matter of [supply shortages](#). In provinces that were ready for legalization with brick and mortar sales, the problem was not fulfillment but a lack of product. Simply put, the stores sold out. Of course, this means that first day sales were strong.

However, the presence of sold out signs on cannabis shops is another factor that could drive customers to black market dealers. If cannabis stores gain a reputation for unreliable supply, why would customers keep visiting them when the local dealer is fully stocked?

Any day a cannabis store is sold out, its customers are not spending money there. So while these "sold out" signs do indicate high sales volume, they also indicate lower sales volume compared to what would have been had the supply been adequate. So if cannabis stocks had been priced in such a way that assumed steady, seamless sales, then the earnings statements we'll start seeing this month may well disappoint.

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