



## Why Are Cannabis Stocks Like Aphria Inc (TSX:APHA) Starting to Recover?

### Description

The cannabis stock recovery is in full swing. After a brutal October, pot stocks are climbing up once again. While industry darlings like **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) are still far from their 12 month highs, the sector as a whole is recovering well from the post-legalization beating — up over 15% since the start of November. **Aphria** (TSX:APHA)(NYSE:APHA) has made a particularly sharp comeback, having gained over 30% since its October low of \$12.77.

It's all well and good to note that cannabis stocks are recovering. The question is, why is it happening? And, even more importantly, will it continue? To answer that question, we need to look at the reason stocks slid in the first place.

### Why pot stocks fell

The general consensus is that two factors explain the pot stock sell-off: profit taking on the eve of legalization and the broader TSX sell-off. The “profit taking” explanation was offered by Canopy CEO Bruce Linton when asked what he thought of his company's shares retreating. The “TSX sell-off” explanation is a reasonable inference from the fact that large sums of money exited the TSX in October, affecting virtually every industry.

There is a third factor that may explain why cannabis stocks fell after legalization: negative investor sentiment stemming from the supply chain issues that plagued the industry at that time. However, this factor may be less significant than some think.

### Positive signs post-legalization

While it's true that [supply shortages](#) and fulfillment issues abounded after legalization, they need to be considered in context. The fact that such shortages occurred means that demand was very high. Assuming even a fraction of this demand holds after the initial “euphoria” of legalization wears off, then cannabis companies will see strong revenue growth. However, the rate of growth may taper off after the initial wave of novelty-seeking early customers dissipates.

## Profitability

There are some signs that cannabis companies are slowly moving toward profitability. Aphria, for example, has posted positive net income for three of the past four quarters and posted gross profit of \$13 million in Q1 fiscal 2019. Other examples of cannabis producers that are profitable or nearly profitable include **CannTrust Holdings** and **Aurora Cannabis**. Granted, these companies' earnings track records are spotty, but they are generally trending in a positive direction.

## Bottom line

Legal cannabis is a rapidly growing industry with a bright future ahead of it. While not all pot stocks will be winners, many will continue to grow for the foreseeable future. Profitability remains an issue for the industry as a whole, but that's not unusual for young growth stocks. The really interesting thing to watch here will be [earnings announcements](#) that factor in the sales boost from legal cannabis. These will start coming out between November of this year and January 2019 and will give investors a clearer picture of how cannabis producers are faring in the era of legal weed.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. NASDAQ:CGC (Canopy Growth)
2. TSX:WEED (Canopy Growth)

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