



Why Are Traders Shorting Pot Stocks like Canopy Growth Corp (TSX:WEED)?

Description

It's been a wild few months for the cannabis industry. Between **Canopy Growth's** ([TSX:WEED](#)) (NYSE:CGC) \$5 billion deal, a late summer mega-rally, and October's sharp sell-off, there's been more news about this sector than any other as of late.

But now, a lot of traders think the party is over. According to research by S3 partners, total short positions in pot stocks rose to \$3.53 billion since the middle of the year, indicating dimming investor sentiment toward this asset class. While some pot stocks remain up this year, most are approaching 12-month lows. The list includes Canopy, which traded for \$45.14 at the time of this writing — frighteningly close to its pre-summer peak of \$42.07.

What explains the rise in traders shorting pot stocks?

Sharp losses

Pot stocks have been falling since early October, and there's no end in sight. Canopy is down 38% since its October 15th high. **Aurora Cannabis** has fallen 50% in the same period. Some of the smaller-cap pot stocks fell less dramatically, but I can't find a single TSX-listed pot stock that's up since October 15. Granted, some of this can be explained by a broader TSX sell-off. But cannabis stocks are down even more than the TSX average. What's going on here?

Continued financial woes

One major problem in the cannabis sector lies in the earnings department. Although most pot stocks are growing revenue, their expenses are growing even more. This was the case in Canopy's recent earnings report, where revenue was up 33%, but the net loss ballooned to over \$300 million. Some pot stocks, like Aurora, have posted positive net income. But, in most of these cases, the majority of earnings were [unrealized non-cash gains](#) on derivatives and securities. In operational terms, they're still losing money.

Legalization: uncertainties abound

A final concern area for pot stocks is the way legalization was handled. Although legalization most likely increased pot producers' revenue, the first week of legal pot was marred by [supply shortages](#) and fulfillment issues. Many customers reported returning to black market dealers after being disappointed in stores. While it's likely that supply issues will eventually be sorted out, the fact that many customers are returning to the black market is concerning. It suggests that black market vendors may be able to undermine legitimate cannabis sales in the future, especially if they can offer lower prices. If that turns out to be the case, then cannabis companies may need to start cutting prices to stay competitive.

Bottom line

Cannabis is a fast-growing industry that's not going anywhere anytime soon. Despite concerns about earnings, most cannabis producers are actually highly profitable as measured by gross profit; the losses we're seeing come from acquisition costs and bloat elsewhere in the business. The question is whether the fat can be cut enough to turn pot stocks into lean, mean, moneymaking machines. For now, though, it appears the shorters may be on to something.

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