Is Now the Time to Buy Marijuana Stocks Such as Canopy Growth Corp (TSX:WEED)?

Description

Last week was a big one for cannabis stocks, as the majority of big players released quarterly results. What made this past week different? It was the first earnings announcements post-legalization. Unfortunately, the market didn't take too kindly to company earnings. In fact, most dropped by double digits immediately following results.

Was the sell-off overdone?

Cannabis quarterly earnings

The three companies we'll focus on are **Canopy Growth** (TSX:WEED)(NYSE:CGC), **Aurora Cannabis** (TSX:ACB)(NYSE:ACB), and **CannTrust Holdings** (TSX:TRST). For starters, I don't put much stock into earnings. For high-growth companies, earnings contain many one-time outflows and as a result they can fluctuate wildly. This is especially true of companies that are in their infancy. I prefer to focus on sales.

That being said, it is worth noting that Canopy and Aurora both missed big on earnings. CannTrust was one of the few marijuana companies that actually met earnings-per-share estimates. If fact, CannTrust was also one of the few that beat on both the top and bottom lines. Revenue of $12.59 million beat by $0.79 million, exceeding estimates by 7% and representing 105% growth year over year.

On the flip side, Aurora Cannabis posted sales of $29.67 million. Although it represented growth of 259% over the third quarter of 2017, it missed estimates by 25%! Not to be outdone, Canopy was arguably the biggest disappointment of all. Revenue of $23.33 million missed by estimates by 62%, or $38.35 million. Ouch.

Early warning signs

The post-earnings drop was not surprising. Pot stocks have been, and are, for the most part, still trading at extremely high valuations. Canopy is trading at 177 times sales and 20 times forward 2020 sales. Aurora is slightly better valued at 146 times sales and 10 times forward 2020 sales. CannTrust is the best valued of the trio trading at only 29 times sales and six times forward 2019 sales.

It's important to note that these valuations imply perfect execution on the part of marijuana companies. Any supply chain disruption, as we have seen in the early days of legalization, or lower-than-expected demand will result in significant misses. As we saw this past week, this can lead to significant price volatility and a drop in share price.

Analysts have already begun to revise estimates downwards, making their valuations that more suspect. Consensus is that the current logistical issues facing the industry will persist well into next year.

Another red flag — falling prices. **Tilray** and the **Cronos Group**, two companies that also reported last week, warned of falling marijuana prices south of the border. Is this a precursor to what may happen in Canada? It certainly appears that way. At the moment, recreational marijuana is overpriced and will not deter regular users from dropping their current suppliers.

Foolish takeaway

Valuations continue to be stretched for a good number of marijuana stocks. Big revenue misses and downward revisions are most likely to continue until logistics can be sorted out. In the meantime, it's best to focus on those that provide better value. Of the three mentioned, CannTrust is by far the most reasonably priced. In fact, one might dare to say it's cheap.

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