Is This the End for Marijuana Stocks?

Description

2018 has been a volatile year for the marijuana industry. And as we approach the new year, it's starting to look like through all the ups and downs, the bears have pretty much won.

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Although there have been plenty of opportunities to profit from pot this year, the returns on the whole have been negative. **Horizons Medical Marijuana Life Science ETF**, which tracks the marijuana industry as a whole, is down 21% year to date. Some specific stocks are down even more than that. After the legalization drama and increasingly negative publicity, investors seem to be souring on the marijuana sector. And to think: all this after an event — legalization — that was supposed to send marijuana stocks higher than ever.

It was already looking bad for marijuana stocks in November. But after a controversial newsletter was published alleging that **Aphria** (TSX:APHA)(NYSE:APHA) was involved in highly unethical activity, some are wondering if marijuana has been an unsound bubble all along. To understand whether it is, we need to take a look at what was said in last week's controversial newsletter.

The allegations

On December 3, activist hedge fund manager Gabriel Grego released a newsletter saying that Aphria was running a "scheme" to "divert funds away from shareholders" (direct quote). More specifically, the newsletter accused Aphria insiders of buying up shares in "worthless" companies to sell them to Aphria at outrageous prices. If these claims are true (I take no position on whether they are), then Aphria insiders are probably involved in illegal activity.

Grego's claims against Aphria are extreme. And he appears to have walked them back in an interview with *Bloomberg.* But he wouldn't be the first activist shorter to make such claims against marijuana companies. In fact, an even higher-profile shorter sounded the alarm much earlier — on two of the biggest companies in the industry, no less.

Andrew Left chimes in

A few months ago, activist investor Andrew Left said in an interview that he was shorting **Canopy Growth** (TSX:WEED)(NYSE:CGC) and **Tilray** (NASDAQ:TLRY). He reserved particularly harsh criticism for Tilray, which he accused of being more a “stock operation” than a real company — a claim similar to Grego’s, but without the direct allegation of misconduct. Since Left made those claims, Tilray shares have fallen about 14%, which does not prove his claim but does lend credence to it.

Growing losses

A final point against marijuana stocks is the fact that they continue to burn through cash. Almost every licensed marijuana producer has been posting negative operating income. Although some have positive net income, very few have positive free cash flow. And many cannabis stocks are seeing net losses grow wider. Canopy, for instance, saw its net loss balloon to $330 million in its most recent quarter — compared to revenue of just $23 million. Granted, losses are normal for early stage growth stocks, but with Canopy’s revenue growth having slowed to 33% in Q2, it’s doubtful whether that label still applies to the company.

We’ll have to wait for next year to see how post-legalization earnings look for Canopy, Tilray, and Aphria. But as for me, I’ll be avoiding marijuana stocks for the foreseeable future.

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