



3 Reasons to Avoid Marijuana Stocks in 2019

Description

2018 has been a rough year for stocks, and marijuana stocks have been among those hit the hardest. After an unprecedented rally in late summer, cannabis stocks have retreated to the point where many of them have erased their gains for the year. Now, it's time for investors to decide whether they want to give this sector another go in 2019.

Right now, it's looking like that's probably not a good idea. Although upcoming quarterly reports could reveal earnings surprises that would send cannabis stocks higher, I'm not overly optimistic. **Canopy Growth** has already released an earnings report that included recreational cannabis "test shipments," and the results weren't great. In Q2, Canopy posted its slowest revenue growth to date, despite the end of that quarter being right before legalization. We'll have to wait and see how three full months of legalization plays out, but for now, things aren't pretty.

In my estimate, there are three main reasons why cannabis stocks are not to be touched in 2019 — unless, of course, there is some earnings surprise on the horizon. I'll start with the most obvious.

They're overvalued

Cannabis stocks are generally [priced high](#) relative to sales and book value. For an example, look no further than **Tilray** ([NASDAQ:TLRY](#)). At the time of this writing, the company trades at 217 times sales and 37 times book value. It's normal for early-stage growth stocks to be a little expensive. And Tilray is indeed a fast-growing enterprise, with 85% year-over-year revenue growth. But this company's extraordinarily high valuation is totally beyond what we see in other high-growth sectors, like tech.

Shopify, for example, trades at 18 times sales and 10 times book value. This is within the realm of sanity. But Tilray is over **10 times** as expensive as Shopify in terms of price/sales, and its revenue growth isn't even that much higher.

Equity is being diluted

Another issue with cannabis stocks is the fact that their equity is constantly being diluted to fund acquisitions. The best example here would be **Aphria** (TSX:APHA)(NYSE:APHA), which did at least three major acquisitions last year, issuing new shares every single time. If these acquisitions don't pay off, then each Aphria share represents a smaller and smaller part of the pie. And many other cannabis companies are in the same boat.

They're becoming victims of bad press

Last but not least, we have the simple fact that cannabis stocks are becoming the victims of bad press. Last week's Aphria/Gabriel Grego [fiasco](#) wasn't the only time this year that marijuana stocks came under fire by a well-known money manager. Earlier in the year, none other than Andrew Left came out swinging against Tilray, saying that it was more of a "stock operation" than a real company. Granted, publicity is a fickle thing, and media sentiment can change on a dime. But in the short term, it can influence investor sentiment, which, at this late moment in 2018, makes a strong case for not taking short-term positions in cannabis stocks.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:TLRY (Tilray)
2. TSXV:EBM (Eastwood Bio-Medical Canada Inc.)

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