



Cannabis Stocks: 3 Things to Know Before Buying

Description

Recent market action has shown that at least some [cannabis stocks](#) may be taking a breather. And while past performance in certainly exceptional, we need to focus on what we can expect for future performance.

Canopy Growth ([TSX:WEED](#))(NYSE:CGC) stock is down 6% in the last month and **Cronos Group** ([TSX:CRON](#))([NASDAQ:CRON](#)) stock is down 21%.

Let's look at three things you should think about before buying.

Big expectations are baked in

The expectations baked into cannabis stocks are big — so big that it is beyond reason, with most of them trading well beyond 100 times sales and at price-to-earnings multiples that are equally lofty.

Should marijuana companies disappoint from an earnings or sales perspective, the downside is pretty huge.

I like to minimize my downside and focus on [preservation of capital](#), so given this, these stocks look pretty unattractive to me.

Estimates falling

I know the argument that we should not be looking at earnings in such a high-growth industry that has a huge addressable market, but the fact is that these companies can only lose money for so long before they get into trouble.

For Canopy, consensus earnings estimates in the next two years have come down significantly. For this year, prior expectations were calling for a loss of \$1.47 per share; they are now calling for a loss of \$1.78 per share — that's 21% lower and pretty significant.

2020 and 2021 estimates have fallen significantly as well, which speaks to the lack of visibility and the over-optimism that exists.

Cronos Group stock opened down on the day of its fourth-quarter earnings release, as the company reported fourth-quarter 2018 results that showed a net loss of \$11.6 million, or \$0.06 per share, compared to a profit of \$2.1 million, or \$0.01 per share, in the same period last year, as soaring costs take their toll.

Just as important, revenue came in at \$5.6 million, up from \$1.6 million last year, but well below expectations.

So, for now, marijuana companies have sustained this, but looking ahead we can see that big investments in their businesses are still needed and a lot of the details, such as price, black market sales, and the ability to supply the market at these levels, remain fraught with uncertainty.

We have seen equity investors already pour in huge sums of cash into these companies, and we have seen the dilution that it has brought to existing shareholders.

Huge market

I would like to close this article off with the good news.

The cannabis industry remains a huge industry with a large addressable market.

With estimates putting the market size at up to \$150 billion, it is clear that this is a staggering number that will leave many companies and investors far richer than they could have ever imagined.

And it will leave many of the buyers of marijuana to ease their medical symptoms in a far better place.

The transformational qualities of this industry are far-reaching and here to stay.

From an investor viewpoint, the stocks are highly volatile and lack visibility, so I remain cautious.

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2. Investing

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