Is it Too Late to Invest in Marijuana Stocks?

Description

Over the past three years, marijuana has been the biggest success story on the TSX. With stocks like **Canopy Growth** (TSX:WEED)(NYSE:CGC) up thousands of percentage points since 2015, the marijuana sector has been leading the index in overall gains. If you'd invested $10,000 in Canopy Growth at its IPO and held, you could cash out for $200,000 today — and Canopy isn't the only weed stock that has delivered those kinds of returns.

However, more recently, marijuana stocks have been stalling out. Although recent earnings have been stronger than ever, many individual producers have missed analyst estimates; as a result, marijuana stocks as a class have fallen 22% since March. Although the TSX as a whole has performed poorly in the same period, weed stocks have lost more value than others, which raises the question of whether the weed party is over.

The answer is not as simple as it seems. Although marijuana stocks have been losing value, they're growing revenue more than ever, and valuation metrics are actually getting fairly low. To see whether marijuana stocks are still worth investing in, we'll need to look at the incredible growth they've experienced.

Unbelievable growth

If marijuana stock gains look hot to you, remember that the price increases are not much greater than the underlying revenue gains. In its most recent quarter, Canopy grew net revenue at 280% year over year, while **Aphria** grew at 600%. These growth rates are practically unheard of in any industry that's not cannabis, and, as we're about to see, they're increasingly accompanied by profits as well.

Increasingly profitable

For a long time, marijuana stocks were not even close to being profitable, with net losses running over 100% of revenue. Lately, however, that's been changing. In its most recent quarter, Canopy posted $75 million in net income, up 4,000% from a year prior. At the same time, the company still had an operating loss, but at $152 million, it was down $60 million from the prior quarter.

Marijuana stocks are no longer insanely expensive

Prior to legalization, marijuana stocks were trading at insane valuations, with some costing as much as 136 times sales. However, as a result of the insane growth they're experiencing, marijuana stocks are no longer so dear. For example, after growing revenue by 600%, Aphria got its price-to-sales ratio down to 18 and its price-to-book ratio down to 1.36. Although that's a fairly high price per dollar of revenue, the price-to-book ratio is actually on the low end, which shows that marijuana stocks needn't necessarily be insanely pricey

Foolish takeaway

Over the past three years, marijuana stocks have been on an incredible run. Given current revenue growth rates, there's no reason this trend can't continue. As we've seen, companies like Canopy are not only growing revenue but also becoming increasingly profitable. Should this trend continue, mid-2019 may someday prove to have been a great time to buy marijuana stocks.

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1. Cannabis Stocks
2. Investing

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Date
2025/08/27
Date Created
2019/06/17
Author
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