



Cannabis Investors: 3 Reasons Why Your Profits Could Go Up in Smoke

Description

After some very impressive moves from stocks in the sector — including **Aurora Cannabis Inc.** ([TSX:ACB](#))(NYSE:ACB) shares [increasing 3,662% since 2014](#) — many marijuana investors are sitting on some sizeable gains.

Most are prepared to hold on for the long-term, convinced we've only scratched the surface of marijuana's potential. Remember, the drug has only been legal in Canada for less than a year, and shortages are still plaguing the market.

Edibles and topicals still aren't legal, and won't be until December. And pot producers still have huge potential to expand existing operations into other nations.

Then there's potential to serve the U.S. market. While marijuana is legal in certain states, the big prize will come when the drug is made legal nationally. Most observers feel this is only a matter of time.

Despite all these bullish signals, I'm not entirely sure cannabis investments will have a bright future. In fact, if I were forced to either go long or short the sector, I'd choose to bet against it. Here are three reasons why.

A commodity product

Marijuana isn't terribly hard to grow. This is part of the reason why it has earned the nickname *weed*.

Getting set up as a large-scale grower isn't very hard. Ultimately, all it really takes is money. Cash can buy the real estate, put up the greenhouse, equip the facility, and hire staff. All of these problems are hardly insurmountable.

The only real stumbling block is getting Health Canada approval to grow the product. These approvals have been slow going, but they should now start happening at a significantly faster rate.

Why?

Back in May, Health Canada told pot producers they needed a fully-built site before applying for their license.

There are dozens of suppliers all hitting the market at around the same time, with many trying to build brands recognizable to retail cannabis customers. We'll likely end up with a half dozen or so dominating the market. Which one will emerge as the winner is anyone's guess.

Shortages? Not for long

Much has been written about the [shortages plaguing the legal pot market](#). Consumers have been forced to go back to the black market because retailers can't keep them supplied.

According to several analysts, this supply/demand balance is about to get turned upside down. They predict oversupplies hitting the market as early as the latter part of 2019.

One analyst predicts product from the three largest marijuana suppliers will be enough to supply the entire recreational market in 2020.

Retailers, who were previously complaining about getting a fraction of the product ordered, are now reporting there's much more supplies out there. Governments are also approving more retail locations, which further demonstrates that the worst of the oversupply issue is behind us.

Poor balance sheets

There's no denying it. Canada's top pot producers are bleeding cash and there's little chance that changes anytime soon.

Take Aurora Cannabis's latest results as an example. It lost \$158 million in its most recent quarter after losing more than \$230 million in the quarter before that.

Investors were promised these companies would start approaching profitability after weed was legalized, but it's not happening.

At this point, a company like Aurora can easily stomach these losses. If it starts running low on capital, it just issues more stock. But what happens if investors fall out of love with the sector and the stock price plummets? This makes it much more difficult to raise cash.

On the surface, Aurora's balance sheet looks fine. It has approximately \$650 million worth of debt compared to a market cap of close to \$10 billion.

Aurora has \$5.5 billion worth of assets on its balance sheet. But most of those assets are made up of goodwill. The company's tangible book value is under \$500 million.

The bottom line

All the pot sector needs to move sharply lower is another bout of bad sentiment. Remember, the whole sector fell some 50% back in late 2018. This could easily happen again if investors sour on the industry. If my capital was at stake, I'd be very careful.

CATEGORY

1. Cannabis Stocks
2. Investing

POST TAG

1. Cannabis

TICKERS GLOBAL

1. NASDAQ:ACB (Aurora Cannabis)
2. TSX:ACB (Aurora Cannabis)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Cannabis Stocks
2. Investing

Tags

1. Cannabis

Date

2025/08/25

Date Created

2019/07/20

Author

nelsonpsmith

default watermark

default watermark