



1 Risk Every Cannabis Investor Must Avoid

Description

Cannabis stocks have made countless investors rich. They've also destroyed countless portfolios. If you want to succeed at cannabis investing, you need to keep your eyes on both the upside *and* the downside. To prevent your portfolio from blowing up, pay close attention to the risk factor below. The more you understand it, the better prepared you will be.

State of affairs

Before we get to the number one risk factor cannabis investors face today, it's critical that you understand what's happening in the industry. If you can wrap your head around the current trends, you're more likely to appreciate the magnitude of the downside potential. But don't worry: there's still plenty of money to be made with cannabis stocks as long as you successfully navigate these hurdles.

Last year, the cannabis industry went gangbusters. Canada became the first major power to legalize recreational cannabis. States including Oregon, California, Washington, Nevada, Colorado, Maine, and Vermont added to the growing list of legal weed jurisdictions. Analysts and media pundits began speculating that the U.S. could legalize cannabis federally as early as 2020. To capitalize on this growth, investors piled into stocks like **Canopy Growth**, **Village Farms**, and **Green Organic Dutchman**.

There's only one problem: rapid demand growth for a commodity (like cannabis) is nearly always met with rapid supply growth. If supply surges, prices plummet. If you want proof, just look at Oregon. In 2018, Oregon was reportedly "drowning in one million pounds of excess weed." Prices in the state fell to historic lows. Growers were struggling to survive. It's important to note, however, that demand for cannabis continued to surge. The problem wasn't *demand* growth; it was *supply* growth.

It's getting dangerous

This brings us to the number one risk every cannabis investor must avoid: commoditization. In the end, most cannabis production is not [differentiated](#). That means it will sell at the same price per volume as

any other cannabis. Importantly, commoditization also means that if prices get too attractive, new supply will be added to the market, pushing prices down over the long term. Most importantly, it also means that suppliers will push hard to reduce costs; the only way to reliably make money in a commoditized market is to have a low-cost position.

For example, Village Farms's CEO recently commented on the company's extreme production cost reductions. "All-in cost of goods sold were \$0.65 per gram in Canadian currency. Again, that is all-in production costs. That's down meaningfully from approximately \$1.35 in Q1 and works out to \$0.82 for the first half of the year." The company essentially slashed prices *in half* in under a year. Canopy Growth's CEO also believes its production costs will plummet. "With the scale we have and the cost of goods sold we will be able to drive down, we can play quite aggressively," he said.

On an individual level, falling production costs seems like great news. But if it's a commoditized market, that means selling prices will fall in suit. It really is a race to the bottom. How can you avoid commoditization in your portfolio? Stick to differentiated players like Green Organic Dutchman.

According to **Bank of America** analyst Chris Carey, "organic should be a yielding a higher price" versus conventional production. While production costs are also a bit higher, it's worth the trade-off. "There's a little bit of incremental costs on the organic side," says Green Organic Dutchman CFO Sean Bovingdon, "but that's more than covered on a return on investment perspective from the 30% margin that we get on the sales profit per gram going forward."

If you want to survive cannabis commoditization, stick with differentiated production (like organic marijuana) that can fetch higher prices and profits.

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