Will There Ever Be Another Bull Market in Weed Stocks?

Description

It’s been over a year since the summer 2018 cannabis bull market reached its peak, and most marijuana stocks are far cheaper than they were during that period. After a brief recovery in the first few months of this year, cannabis stocks started tanking in March; many are now trading near 52-week lows. Along with the generally lacklustre performance in the TSX, the bear market in cannabis stocks was due to a rash of bad news, including **Canopy Growth’s** $1.28 billion loss and **CannTrust’s** Health Canada scandal.

Despite all this, many cannabis bulls remain optimistic. Pointing to weed stocks’ extremely high growth rates, they claim that the sector’s best days are still ahead of it. That may be the case, but there’s just as strong a case to be made that there will never be another massive bull market in weed stocks. The following are two main reasons why.

Present growth rates unlikely to continue

One of the main reasons for the bull thesis on marijuana stocks is revenue growth. These stocks are posting three-figure year-over-year growth rates, the theory goes, so price-to-sales ratios north of 30 can easily be justified.

The only problem is that these growth rates probably *won’t* continue. The main reason for the huge jump in cannabis revenue this year is legalization. Legalization created an entirely new revenue stream for marijuana producers, and whenever they release earnings this year, they compare a period where this revenue stream existed to one when it didn’t. By 2020, they’ll be comparing one post-legalization period to another post-legalization period from the prior year; once that starts to happen, then revenue growth rates will presumably slow.

There’s already evidence that this will soon occur. In its most recent quarterly report, Canopy revealed that $60 million of its $100 million in revenue came from recreational sales. This $60 million is compared to $0 in the same quarter a year before, so, of course, revenue growth was going to be staggering. Once Q1 2020 comes around, however, the company will have to beat $60 million in recreational sales, which will be a lot harder.

Extremely high valuations

Another big problem for marijuana stocks is that their valuations are extremely high, even if you assume that revenue growth will remain high. **Aphria**, for example, has a price-to-sales ratio of 8.94, which is extremely high, and Aphria is one of the cheaper large marijuana stocks. Aphria's revenue growth rate in its most recent quarter was 969%, and actually got most of its boost from sources other than recreational sales. It alone may be reasonably valued. But other producers, whose price-to-sales ratios are north of 30 and can't boast of Aphria's growth and profits, are going to have a harder time justifying their asking price.

Foolish takeaway

Over the past three years, marijuana stocks have had an incredible run — both in the markets and in the press. With many of them having risen over 1,000% since their IPOs, they've collectively been a massive market success story. Now, however, with the post-legalization boost fading into view, the best may be behind them. Personally, I'm not betting on another marijuana bull market anytime soon.

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Author
andrewbutton