Why Cronos (TSX:CRON) Stock Fell 14% in August

Description

Cronos Group (TSX:CRON)(NASDAQ:CRON) was one of the best-performing pot stocks in history. In 2016, shares were worth just $0.20 apiece. This March, shares surpassed the $29 mark. A $10,000 investment would have been worth nearly $1.5 million.

Over the last six months, however, shares have struggled, falling as much as 50%. Last month, the declines continued, with the stock losing 14% in value, even as the **S&P/TSX Composite Index** remained flat.

Still, analysts anticipate sales to *quadruple* next year, which could add a ton of fuel to this beaten-down stock. If you missed your chance during the cannabis bull market, now looks like your opportunity to get in at a discounted price.

Here's what happened

Cronos had a rocky August. The month started upbeat after **Aphria** posted impressive quarterly results which outpaced analyst predictions.

A few days later, Cronos reported similarly impressive results. Quarterly EPS of $0.22 beat consensus estimates by an astounding $0.24. Quarterly sales hit $10 million, which was up roughly 200% year over year. In total, Cronos sold 1,584 kilograms of cannabis last quarter — a 232% annual increase.

"We're excited to continue the momentum as we set our sights to the U.S.," said CEO Mike Gorenstein. "Our accomplishments this quarter continue to lay a strong foundation for Cronos Group and our business objectives."

Solid quarterly results couldn't insulate Cronos from an industry-wide selloff in mid-August. On August 13, **Tilray** reported second-quarter results which showed huge revenue gains. Of major concern, however, was profitability.

The average price per gram sold dropped 28% to $4.61, suggesting the market is oversupplied. With every producer racing to grow production, supply woes may worsen considerably further.

Recently, **Cowen** lowered its price target for Cronos shares to $17. In a falling price environment, Cronos doesn't have a clear path to profitability in Canada, Cowen argued, especially considering the company lacks the scale of its larger rivals.

What to expect

Earlier this month, I revealed the biggest risk every cannabis investor faces today: commoditization. "In the end, most cannabis production is not differentiated," I argued. "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."

Industry-wide commoditization seems well underway. Many growers believe they can continue to slash production costs by 50% or more. This will undoubtedly lead to big reductions in selling prices.

If you want to avoid the pain, you need to stick with companies that can differentiate their production. That's why you need to pay close attention to the upcoming Cannabis 2.0 cycle. By the end of this year Canada will allow producers to add vapes, edibles, beverages, and CBD to their lineups. That could add billions of dollars in high-margin sales to the industry. Because these products are easier to brand, differentiation will be easier than ever.

The pot industry is in rough shape after a tough August, but there's value to be had. Just make sure your cannabis stocks can take advantage of the impending Cannabis 2.0 boom.

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