Why Shorting Marijuana Stocks Is Becoming Hugely Profitable

Description

When it comes to investing in marijuana stocks, one thing is becoming quite clear: these companies are facing a crisis of confidence.

The hype that was created after the legalization of recreational use in Canada is losing its steam fast, while investors await a clear path to profitability. Unfortunately, not many companies have been able to show that path as their earnings miss estimates, while the future doesn't look quite promising.

The latest example that proves this point is **Aurora Cannabis** (TSX:ACB)(NYSE:ACB), the second-largest cannabis company by market value. This marijuana producer, early this month, missed its own revenue target and reported a loss, despite an earlier promise that it would be profitable by the quarter ended June 30.

Aurora said last month that it expected to report net revenue of $100 million-$107 million for its fiscal fourth quarter. Instead, Aurora reported revenue of $98.9 million and an adjusted EBITDA loss of $11.7 million.

Industry bottlenecks

According to the company's chief corporate officer Cam Battley, the revenue miss "shouldn't have happened," but he noted that it stemmed from some of the company's non-core cannabis revenues, such as analytical testing and patient counselling.

He added that while the company had earlier anticipated it would reach positive EBITDA in the latest quarter, it will likely be in the fiscal 2020 year given that fewer-than-expected retail outlets have opened their doors.

"If there were a broader retail infrastructure, and more stores available in Canada and open, that pretty likely would have made the difference toward us reaching that milestone," he said in an a TV interview with *BNN*.

Earnings misses from some of the largest marijuana producers are making this trade very profitable for at least one sector of the market, and those are the short-sellers.

Weaker-than-expected quarterly results from some of the biggest names in cannabis have contributed to the recent slump in their stocks, with the **BI Global Cannabis Competitive Peers** index down about 40% from its 2019 high on March 21.

Positions in the 20 most-shorted pot stocks have made $1.17 billion so far in the third quarter, according to an analysis by **S3 Partners**, *Bloomberg News* reported. These trends make it quite clear that buying marijuana stocks probably won’t be a good idea unless there are signs that these companies are turning the corner.

But that may not happen soon, given many hurdles that the industry is facing, including opening of new retail stores in Canada and the introduction of new value-added products.

“We consider that potential challenges associated with the value-add product roll-out may not be fully recognized at this point,” said Tamy Chen, an analyst with **BMO Capital Markets**. “We believe there will likely be bottlenecks in industry distribution channels that would limit the sell-in of these products to provinces and retailers in H1/20.”

Bottom line

Many marijuana stocks are trading much below than their highs this year. High-risk investors can take advantage and pick some big stocks on these depressed prices. But the trade in marijuana stocks is looking more lucrative for short-sellers at this point than for value investors.

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