Should You Invest in Marijuana Stock IPOs?

Description

Almost no industry has seen more IPOs in recent years than marijuana. Although big tech IPOs like **Shopify** have gotten the most attention, marijuana IPOs have been, by far, the most numerous on the TSX. In the past five years, at least half a dozen weed producers have gone public, with many more having plans to do so in the near future.

With the wave of legalization sweeping Canada and many parts of the States recently, it was inevitable that entrepreneurs would cash in. So, it should come as no surprise that marijuana companies have been going public at a rapid pace. The more the legal cannabis market grows, the more marijuana companies will come to exist. The more marijuana companies exist, the more of them will seek investors' help to fund expansion.

In the wake of marijuana IPO mania, a lot of investors are buying into the hype. Weed sales are growing at 44% CAGR, after all, so naturally, there are huge profits to be grabbed in this space.

Or so it would seem.

Because with all the growth being observed in this sector, marijuana stocks have hardly made all of their investors wealthy. In fact, many of them have done just the opposite. To understand why that's the case, we can look at the case of a recent marijuana stock IPO that left many investors in the cold.

The case of Tilray

Tilray (NASDAQ:TLRY) is a marijuana company that seemed to have everything going for it. Backed by well-connected Silicon Valley VCs and born during the summer of 2018 cannabis frenzy, its IPO was initially a resounding success. Within two months of its IPO, it had risen 755%. At the time, investors were positively euphoric about the stock.

That was then; this is now.

Since its IPO, Tilray has taken a beating. At $26.73, it's still higher than its offering price, but it's lower than its closing price on its first day of trading. A stratospheric valuation (nearly 200 times sales at one point) made a major selloff inevitable. It was a classic example of what happens when marijuana stocks get priced beyond reason. What's worse is that Tilray isn't even the biggest disaster among its peers.

Tilray not the worst of the pack

If you want an example of a failed cannabis IPO, look no further than **CannTrust Holdings** (TSX:TRST)(NYSE:CTST). After an initial rally, the stock started tumbling in 2019 and then got a double whammy of trouble later in the year when it was caught growing pot in unlicensed rooms.

After the scandal broke, the stock *really* started falling, and it now trades for just $1.50 — less than its *offering* price.

Although Tilray is often cited as an example of a cannabis IPO that failed to deliver, CannTrust's performance is worse in the sense that it fell below not only the closing price on the first day of trading, but also the price for which it was initially sold. Granted, it's an extreme situation: not all marijuana stocks are going to be forced to stop selling their product because of regulatory problems. However, CannTrust's story is a textbook example of exactly what happens when investors buy into a shiny, new, unproven thing without thinking about the risks.

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