Marijuana Stocks: Is the Bottom Near After 2019 Selloff?

Description

After an eight-month rout that wiped out almost two-thirds of their market value, marijuana stocks have become a no-go area for many investors.

The slump has been so quick and deep that it has made it tough to call a bottom after the bubble burst.

One of the major reasons that crushed marijuana stocks this year was producers' inability to correctly foresee the execution risks that almost hit all major producers after Canada allowed the recreational use of marijuana a year ago.

During that time, I warned our readers many times of those risks and cautioned against overly aggressive investing approach in pot stocks.

As the year went by, many investors realised that it wouldn't be easy for these companies to become profitable without clear visibility on the demand-supply situation and when the government regulations are still evolving.

In addition, earnings disappointments by some of the largest producers, including **Canopy Growth Corp**. (TSX:WEED)(NYSE:CGC), **Aurora Cannabis Inc**. (TSX:ACB)(NYSE:ACB) and **Cronos Group Inc.** (TSX:CRON)(NASDAQ:CRON), made the situation worst. These producers also failed to communicate to the market about their future growth path.

In the latest earnings report, Aurora Cannabis said it will still reach profitability before "any of its peers," but Chairman Michael Singer didn't say exactly when that will happen. The news sent its stock plunging by more than 18% that day.

Earlier, Canopy's Chief Executive Officer Mark Zekulin said the company is still on track to achieve its targets, including positive adjusted earnings before interest, taxes, depreciation and amortization in Canada by fiscal 2021 and full profitability in three to five years.

Its expectation for gross margins above 40% by the end of the current fiscal year is “under pressure” but still “achievable,” Zekulin said in an interview with Bloomberg.

Funding freeze for marijuana stocks

The final shock that broke the camel’s back came when financial markets stopped providing funding to these companies.

As long as the capital markets remain closed, some bankruptcies are inevitable, **Cowen & Co.** analyst Vivien Azer said last week in a *Bloomberg* article last week.

“I think over time having a shakeout and seeing some companies go bankrupt is going to be very helpful to the industry,” Azer said. “In the near term that’s probably another leg down but ultimately that’s what gets us to the positive catalyst. We need to see the marketplace get cleaned up.”

After this painful year for marijuana stocks, I see a buying opportunity only in the big names, such as Canopy.

The company is unlikely to see the kind of financial difficulties that smaller and mid-cap producers are facing due to its strong ties with an alcohol giant **Constellation Brands,** which holds about 36% of stake and a majority of its board seats.

At this stage of correction, I don’t think it’s a good strategy to buy mid-cap and smaller producers, such as Aurora Cannabis.

These producers will continue to struggle and may have to close their shops if the funding markets don’t reopen for them.

Bottom line

After a drastic correction in marijuana stocks in 2019, I don’t see a major rebound in their stock values next year.

Only big producers, such as Canopy, can sustain this extreme bearish phase and could emerge unscathed because of their leading position and their partnership with the deep-pocketed backers.

CATEGORY

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TICKERS GLOBAL

1. NASDAQ:ACB (Aurora Cannabis)
2. NASDAQ:CGC (Canopy Growth)
3. NASDAQ:CRON (Cronos Group)
4. NYSE:STZ (Constellation Brands Inc.)

5. TSX:ACB (Aurora Cannabis)
6. TSX:CRON (Cronos Group)
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