Should You Stay Away From Pot Stocks in 2020?

Description

After booming for more than three years, the marijuana bubble started to burst in 2018 following legalization. The downhill move continued in 2019. Marijuana companies failed to meet expectations on revenue, as they had to face oversupply problems. It looks like the demand for cannabis was overestimated, and the hype has faded.

With the sharp decline in stock prices, we could think that it’s time to buy pot stocks on the dip. However, I don’t think it’s the right time to buy pot stocks, as there are many problems still going on in the industry. Let’s take a closer look at the reasons why you should stay away from pot stocks in 2020.

No money coming in and oversupply

We could see a slew of bankruptcy this year, as small- and medium-sized companies struggle to raise cash to fund their operations. The little interest from institutional investors means there’s not enough money coming in. Companies with low cash balances might thus be in trouble. Huge levels of debt, big losses, and inflated stock prices are unsustainable.

There are currently more than 200 cannabis companies in the cultivation, processing, or extraction businesses, primarily supplying a domestic market that hasn’t reached yet the billion-dollar mark in annual sales.

Although cannabis sales have increased every month since legalization in October 2018, stocks have increased much faster, resulting in oversupply and lower prices.

This dynamic, along with a slow deployment of cannabis stores in Ontario, has resulted in consecutive quarters of low revenue for many licensed producers.

“Companies that don’t have a good cost structure will be in a really difficult position. It’s not about growing cannabis anymore, it’s about how efficient you are as a consumer packaged goods producer,” said in a statement Greg Engel, CEO of **Organigram Holdings**.

The case of HEXO

HEXO (TSX:HEXO)(NYSE:HEXO) is a great example of a cannabis company that is struggling.

HEXO's share price lost 54% of its value in 2019. The stock has fallen by 21% during the holiday season after the pot company announced a discounted equity raise of US$25 million on December 26. HEXO issued 15 million new shares at a price that was around 14% below its closing price before the markets close on Christmas Eve.

The company had previously raised $70 million through a convertible debt agreement and introduced a new low-cost dried flower product called Original Stash (priced about 50% below market value) in an effort to strengthen its cash position.

HEXO announced in October that it was cutting 200 jobs to adapt to future expected revenues and ensure the long-term viability of the business.

In mid-December, HEXO reported a loss of $62.4 million for the quarter ended October 31. The loss was $12.8 million in the same quarter a year earlier. Net revenue increased from $5.7 million to $14.5 million.

Cannabis edibles might not save the day

The deployment of new major product lines as part of the legalization of edible products presents a significant risk for producers.

Most of the major licensed producers — **Canopy Growth**, **Hexo**, and **Tilray** — have invested heavily in cannabis-infused drinks that will hit the market in the first quarter of 2020, but some industry observers predict that the drinks could be a failed business. The impact beverages will have on overall sales seem to be overstated.

We don't know yet which products will work well; it's too early to say. The real test for the industry will be to see which companies can survive as consumer packaged goods companies. They need to be focused on how to deliver the best consumer experience. These are the companies to invest in.

Growing health concerns are hurting the pot industry

What also doesn't help the cannabis sector are growing health concerns. While you can find statements that marijuana, CBD in particular, has many health benefits, such as reducing pain, calming anxiety, and even curing cancer, many of those claims haven't been proven scientifically.

There is growing evidence that cannabis in all its forms comes with health risks. The benefits might be overstated while the risks might be understated. This doesn't encourage people to invest in the cannabis sector.

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