



## Expecting a Cannabis Recovery? Don't Bet on Canopy Growth (TSX:WEED)

### Description

Last year was painful for cannabis investors. Most of the major pot stocks plunged, as the cannabis bubble popped because of fears that many will struggle to become profitable in an undetermined market.

**Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) reported a slew of losses, which, coupled with regulatory investigations and the increased likelihood of marijuana being removed as a U.S. federal schedule one substance, weighed on the outlook for Canadian cannabis stocks. Even Canada's legalization of cannabis beverages and other derivatives in October 2019 did little to lift the industry's prospects.

Marijuana stocks have been decimated, causing the largest industry exchange-traded fund and indicator of industry health, **ETFMG Alternative Harvest ETF**, to lose 44% over the last year. The ETF is a credible indicator for the industry's health, because its holdings cover all of the cannabis supply chain, including cultivation, processing and distribution.

Its largest holding is Canopy, with other leading Canadian cannabis stocks, including **Cronos**, **Aurora Cannabis**, and **Aphria** (TSX:APHA)(NYSE:APHA) rounding out its top 10 stocks.

### Growing uncertainty

Most legal cannabis cultivators have struggled with profitability in what is an uncertain market, where predictions concerning the value of sales constantly change. In 2018, Canopy founder and former co-CEO Bruce Linton claimed the legal cannabis industry could be worth an eye-popping US\$500 billion. Industry consultancies have been throwing around a variety of figures, including Meticulous Research, which in 2019 claimed it would be worth almost US\$76 billion by 2025.

What is increasingly clear is that the variable forecasts regarding the size of the global legal cannabis market are declining in value. In a 2019 consultancy, Arcview estimated spending on legal marijuana globally would reach almost US\$32 billion by 2022, whereas other analysts have taken a more conservative approach estimating US\$50 billion by 2026. Those numbers highlight the considerable uncertainty surrounding what sales will be worth in the legal cannabis market.

This weighs heavily on the outlook for cannabis stocks, because many are still trading at nosebleed valuations, despite declining sharply in value. Canopy, even after losing 46% over the last year, is still trading at an incredible 32 times sales in a highly uncertain operating environment where true market size is unknown. That, along with Canopy's mounting losses, including a first-half 2020 net loss of a whopping \$1.7 billion, will weigh on its stock.

It is difficult to see how Canopy can [ever rebound](#), and there is likely further downside ahead. There is significant speculation that cornerstone investor **Constellation Brands**, which pumped around \$5 billion into Canopy and has seen that investment decline by around a third, will take control of Canada's largest legal cannabis cultivator. That doesn't bode well for many smaller investors who bought Canopy stock at the height of the cannabis bubble.

However, Aphria has only lost 29% and is trading at around a realistic four times sales, which, when coupled with a first-half 2020 net profit \$8.5 million, indicates that it is fairly valued. Aphria's price-to-sales ratio is commensurate with similar industries, including packaged liquor, where Constellation is trading at just over four times sales, and tobacco giant **Altria**, which has a ratio of almost five times.

Aphria finished its fiscal first half of 2020 with \$498 million in cash, indicating that there is enough capital to fund its planned expansion, including the multifaceted strategy to become a market leader in medical cannabis products in Germany.

The company has also established a solid presence in Latin America, where Colombia is its regional hub. The equatorial nation legalized medical cannabis in April 2017 and possesses the potential to become a leading jurisdiction for cultivating legal marijuana.

Aphria's Colombian subsidiary Colcanna reached an agreement with the Colombian Medical Federation to develop an education curriculum on the medical uses of cannabis. In a controversial 2018 deal, Aphria acquired 50 hectares of land in Colombia, which could potentially produce 30,000 kilograms of cannabis annually.

## Foolish takeaway

Despite recent glimmers of hope, there is a difficult path ahead for cannabis stocks. Growing uncertainty regarding the true size of the global legal marijuana market combined with many like Canopy struggling to become profitable is weighing on their outlook.

Nonetheless, Aphria, with its low price-to-sales ratio, proven profitability, and growing global distribution and cultivation network, is among the most promising plays in an [uncertain industry](#).

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