WARNING: The Day of Reckoning Is Coming for Cannabis Stocks

Description

One day before recreational legalization in October 2018, I'd discussed the state of the cannabis industry and what it meant for investors. At the time, I'd warned that a backward retail rollout across Canada's provinces and other inefficiencies threatened to derail the sector before it could even get off the ground. Cannabis stocks had a brief stint as the darlings of the Canadian market, but their reputation has shifted dramatically.

A day of reckoning is on the horizon for Canada's many cannabis companies. When legalization kicked off, experts and analysts warned that small- and medium-sized producers would experience a flurry of failures. After that, consolidation was likely. The past year and a half showed us that the largest producers are not at all immune.

Canopy Growth (TSX:WEED)(NYSE:CGC), the largest cannabis producer on the TSX, has seen its stock drop 68% year over year as of close on March 10. **Aurora Cannabis** (TSX:ACB)(NYSE:ACB), the second-largest cannabis stock by market cap on the TSX, has fallen 87% from the prior year. The broader market bloodbath has played a minor role in their respective retreats. Both companies are facing huge challenges in the beginning of this decade.

Chasing profitability

In the summer of 2019, Canopy Growth conceded that it would need another three to five years to turn a profit. One of the biggest hurdles for Canopy and its peers has been the slow growth of Canada's retail footprint. In populous provinces like Ontario and Quebec, the retail footprint has expanded at a snail's pace. This lack of availability has driven consumers back into the arms of the black market.

Canopy Growth reported net revenue of $123.8 million in the third quarter of fiscal 2020. This exceeded analyst expectations. Its adjusted EBITDA loss of $92 million was $64 million narrower than its Q2 FY 2020 results. The improvement was powered by higher sales and cost-cutting measures that lowered operating expenses.

Aurora Cannabis expected to achieve profitability in the previous fiscal year. It suffered a sharp drop when the company conceded that it would not reach this milestone. The company's fortunes have worsened since then. Aurora lost a whopping $1.3 billion in the second quarter of fiscal 2020. Net revenue dropped 26% year over year to $56 million. Its management has been vocal about the slow pace of retail openings across Canada.

Cash concerns

Both companies have reason to be anxious about their cash situation. Canopy Growth has burned through $548 million in cash from operations in the first three quarters of FY 2020. Fortunately, the company has made progress with its cost cutting, even if it still has a long way to go. Canopy Growth got a huge cash boost from its **Constellation Brands** partnership, and now it needs to slash cash burn to survive and reach profitability.

The situation has been more dire at Aurora Cannabis. As it stands today, Aurora has less than one year of cash runway. Investors have been hoping for that elusive partnership and injection of cash, but such a deal appears remote, as larger investors have soured on the sector. In early February, Aurora was one of the worst-positioned Canadian producers with 2.3 months of liquidity.

These are risky assets right now, but I prefer Canopy Growth with its preferable cash position in early March. Aurora still has high growth potential, but it is in a fight for survival right now, and there are no guarantees in this disappointing sector.

CATEGORY

1. Cannabis Stocks
2. Investing

POST TAG

1. Cannabis Stocks

TICKERS GLOBAL

1. NASDAQ:ACB (Aurora Cannabis)
2. NASDAQ:CGC (Canopy Growth)
3. TSX:ACB (Aurora Cannabis)
4. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Cannabis Stocks

2. Investing

Tags

1. Cannabis Stocks

Date
2025/08/14
Date Created
2020/03/11
Author
aocallaghan