Don't Bet on Cannabis Stocks

Description

In the space of less than two years, cannabis stocks have lost billions in market value. Many of the nascent industry's top players have lost half their market value or more. Leading Canadian cannabis stock **Canopy Growth** has plunged by a whopping 63% over the last year. The largest industry ETF, the **ETFMG Alternative Harvest ETF**, has lost 62%.

Despite some improved results from marijuana cultivators, such as **Aurora Cannabis**, [reporting significantly](), there is further pain ahead for cannabis investors. While the budding global legal marijuana industry is here to stay, it won't be exactly how industry pundits postulated it would be.

Cannabis stocks facing headwinds

The global cannabis industry is undergoing a massive rationalization. Similar to what occurred after the dotcom bubble burst in 2000, that will see many cannabis companies fall by the wayside; they'll either be acquired by larger competitors or cease to be going concerns. It is those cannabis companies with weak balance sheets that are bleeding red ink that are the most vulnerable.

That vulnerability is being magnified by the coronavirus pandemic, which has forced the closure of many dispensaries. The pandemic is also making it even more difficult for marijuana companies to access capital in an industry starved of funding.

There are also signs that the global legal cannabis market is not as large as originally believed. Some analysts put the total market value at somewhere around US$40 billion by the end of 2023. The expansion of world demand for legal cannabis and derivative products is threatened by the reluctance of many jurisdictions to fully legalize its medical and recreational use.

This bodes poorly for the earnings of cannabis stocks, which is a bad omen for an industry struggling with profitability.

Will this cannabis stock survive?

The challenging operating environment that now exists saw cultivator **HEXO** (TSX:HEXO)(NYSE:HEXO) flag in its second-quarter 2020 results that it lacked the financial resources to remain a going concern. Consequently, HEXO was pounded by the market, losing a whopping 92% over the last year. There could very well be worse ahead for the cannabis cultivator.

For its fiscal second quarter 2020, HEXO reported a $298 million net loss, which was around 75 times greater than its $4 million net loss a year earlier. That was despite revenue from sales soaring 47% year over year to almost $24 million. The large loss can be blamed on significant impairment charges against HEXO's intangible assets and goodwill, which totalled $218 million for the quarter.

A culmination of ongoing losses and concerns over liquidity saw HEXO management issues a statement warning that the business may not remain as a going concern, unless it could raise additional funds. HEXO flagged that it lacked enough capital to meet funding requirements for debt, operations, and working capital requirements.

Since those results, HEXO tapped the market for $46 million through a full subscribed equity offering. While that gives HEXO some breathing room, it hasn't solved the underlying problems: a lack of profitability and high rate of cash burn. HEXO does find itself in the enviable position of having the backing of brewer **Molson Coors**, which will help to ensure its survival.

Foolish takeaway

Cannabis stocks aren't for faint-hearted investors. The industry's ongoing problems, mostly related to a distinct lack of profitability, means there is a reckoning ahead for many marijuana cultivators. For these reasons, it is best to avoid Canadian cannabis stocks.

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