Is it Time to Bet on Canada’s Cannabis Giants?

Description

A few cannabis stocks made a strong comeback in May 2020. This consistent upward surge in the last month has garnered investor attention. Does this mean pot stocks are poised to move higher in the second half of 2020 and crush market returns? Or is the recent uptick a temporary recovery?

Let’s see if the time is ripe to invest in Canada’s marijuana giants such as **Aurora Cannabis** (TSX:ACB)(NYSE:ACB) and **Canopy Growth** (TSX:WEED)(NYSE:CGC).

Aurora Cannabis stock is up 150% in the last month

Shares of Aurora Cannabis are trading at $19, which is 150% higher than its 52-week low of $7.5. It gained momentum on the back of better-than-expected fiscal third-quarter results. Aurora Cannabis announced its Q3 results on May 15 and reported net revenue of $78.4 million, a sequential growth of 18%.

Aurora’s revenue was above analyst revenue estimates of $66.7 million, driven by recreational and medical marijuana sales. Aurora also announced its acquisition of Reliva, a top-selling cannabidiol (CBD) brand, providing the former with a way to enter the U.S. CBD market.

This acquisition deal is expected to close this month and will help Aurora improve profitability. The news cheered investors due to Aurora’ less than impressive profit margins and cash burn.

Canopy Growth announced Q4 results

Another marijuana leader, Canopy Growth announced its quarterly results in May. It reported revenue of $107.9 million, well below estimates of $128.9 million. Canopy’s sales were up 15% year-over-year but fell 13% on a sequential basis. Further, it posted a net loss of a staggering $1.3 billion or $3.72 per share.

The net loss was primarily driven by impairment and restructuring charges of $743 million. Canopy’s selling, general and administrative costs rose 17% sequentially as well which further impacted the bottom line.

Canopy depends on business-to-business sales of adult-use marijuana products for revenue growth. In Q4, B2B sales were down 31% sequentially at $36.7 million. As retail stores were closed, its business-to-consumer sales declined 14% from Q3 to $13.1 million.

Canopy's less than impressive Q4 results drove the stock lower. Shares are currently trading at $22.4 which is close to 70% below its record highs.

Why are cannabis stocks not out of the woods?

Cannabis stocks have burnt significant investor wealth in the last 15 months for several reasons. While the total addressable market continues to expand at a rapid pace, there are a lot of uncertainties for investors.

Over the last few years, Aurora, Canopy, and peers paid a premium to acquire companies. This overvaluation is coming back to haunt them, resulting in massive write-downs and goodwill impairments . Aurora Cannabis still has $2.42 billion in goodwill that accounts for 51% of its total assets.

These acquisitions have also had an impact on the cash reserves of Aurora Cannabis. The pot leader had to raise equity capital, which has diluted shareholder wealth considerably.

The Foolish takeaway

Aurora Cannabis and Canopy Growth are two stocks that still seem a risky buy at their current levels. Their mounting losses and a tepid demand environment make them unattractive to investors. Though cannabis stocks are high-risk they will also reward investors if the market manages to rebound.

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