2 Canadian Marijuana Stocks to Avoid in 2020

Description

Marijuana stocks have been on a downward spiral for close to 18 months now. The pot industry has been impacted by structural issues that include oversupply, a thriving black market, tepid demand, mounting losses, regulatory issues, and many more.

The bull run that ended when marijuana was legalized for recreational use in Canada seems like a distant dream right now. While the lower valuation multiples of pot stocks might be attractive to contrarian investors, there are a few companies that are weak fundamentally and remain risky buys, despite the massive declines.

We'll look at two such cannabis stocks investors need to avoid, at least in 2020.

Aurora Cannabis stock will be range bound

Aurora Cannabis (TSX:ACB)(NYSE:ACB) is one of the largest cannabis companies in the world. It's trading at a market cap of $1.03 billion and has lost 95% since touching a record high in October 2018.

Aurora Cannabis was widely expected to lead cannabis production and exports given its huge production facilities and market presence. However, the company has had to stop production in two of its largest projects to reduce cash burn and improve profit margins.

In the last few years, Aurora has raised significant equity and debt capital to keep operations running, which has diluted shareholder wealth and pressurized financials. Further, over 50% of the company's assets are classified as goodwill, indicating the company paid a hefty premium for its acquisitions over the years.

Aurora expects fiscal Q4 net sales between $70 million and $72 million with net cannabis sales between $66 million and $68 million. This was below the company's net cannabis sales of $69.6 million in the third quarter. ACB said it will record $1.8 billion in goodwill impairment charges in Q4 and $140 million in impairment charges related to the carrying value of inventory.

Aurora Cannabis had previously said it expects to report an adjusted EBITDA profitability in the first quarter of fiscal 2021, ending in September. It has now delayed its EBITDA profitability expectations to Q2 of 2021.

Hexo stock is down 85% from 52-week highs

Shares of **Hexo** (TSX:HEXO)(NYSE:HEXO) are trading at $0.89, which is 85% below its 52-week high and 92% below its record high. Similar to Aurora Cannabis, Hexo is also grappling with widening losses and massive cash burn. The company recently raised $34.5 million after floating an at-the-market stock issue.

In order to cut costs, Hexo sold off its Niagara grow farm that it acquired via the Newstrike acquisition last year. Hexo also had to lay off its workforce to reduce costs and improve its bottom line amid the COVID-19 pandemic.

Another reason for concern is Hexo's share price has been trading below US$1 for several months, which might compel the New York Stock Exchange to delist the stock. Hexo will most likely have to engineer a reverse stock split to keep trading on the NYSE.

The Foolish takeaway

We can see why the two companies are not out of the woods as yet. Cannabis is highly regulated in Canada and is illegal at the Federal level in the United States. This makes it difficult to raise debt capital at traditional rates.

The high cost of capital combined with negative profit margins and slowing revenue growth for Aurora and Hexo make them high-risk bets right now.

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