

The Problems With Investing in Cannabis Companies

Description

Cannabis is the latest craze in stocks, specifically in Canada. Some of the most popular stocks are in the new industry, and new ones continue to pop up. There is definitely a lot of hype for the new industry, and it seems like everyone wants to get in before things take off when marijuana becomes legalized in Canada. However, there are still many question marks about the industry and a lot of uncertainty surrounding it.

Lack of moat

How one Cannabis company is going to be able to differentiate itself from another is going to be crucial. **Canopy Growth Corp.** ([TSX:WEED](#)) has been able to acquire its way to revenue growth and is the most well known in the new industry. The company's sheer size is what makes it different, but that might not be enough. If a new entrant makes its way into the industry and has the capital to expand faster, then Canopy could be eclipsed.

The industry has low barriers to entry, making it easy for anyone to open a shop and start growing. Unless a company can come up with a proprietary smoking device or patent a unique way to efficiently create cannabis, the companies will be a dime a dozen. That should be a big concern for investors, because a stock that has no way to set itself apart from the pack will be easily substituted for whatever is cheaper or closer.

Legal uncertainty

There is a strong confidence that marijuana will be legalized in Canada with expectations of the date tentatively set for next July. However, recently, the provinces have raised important questions regarding how the industry is going to be regulated that are still unanswered. For instance, issues related to safety, education, taxation, among many others, still need to be sorted out before legalization happens.

Rules for advertising

There is also the issue of advertising and what will or won't be allowed. Many marijuana producers in Canada have reached out to Advertising Standards Canada to determine what companies will be able to do to promote themselves. There will certainly be restrictions on advertising given the risks of impairment and health concerns that are involved with consuming the product. I imagine it might be similar to what we see now for tobacco, which is very limited and comes with warnings on its packages.

Increasing supply

Aurora Cannabis Inc. ([TSX:ACB](#)) is just the latest entrant to the TSX that produces marijuana. Certainly, many more are still to come. With the hype and expectation that sales will explode when marijuana is legalized, it seems everyone wants to get in early. With many different competitors and

difficulty differentiating themselves, the market could be flooded, making for tight margins and profits. A good comparison might be the restaurant industry, which is very competitive, and many companies struggle to turn a profit.

Local appeal

Cannabis users might not want to buy product from big corporate entities. If someone across the street is able to get a licence to grow and isn't a big corporate outfit, it might be more appealing to users to purchase from a local grower instead. Many marijuana users have been long opposed to corporate cultures and may prefer to buy from black markets.

Bottom line

With a lot of uncertainty still to be sorted out, it is difficult to know whether Canopy, Aurora Cannabis, or yet another player in the industry will reign supreme.

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Date

2025/08/27

Date Created

2017/07/28

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