



3 Reasons to Avoid Canopy Growth Corp.

Description

Canopy Growth Corp. (TSX:CGC) shares surged this week, gaining over 73% in value in just the past five trading days. Investors are clamouring for a story like Canopy Growth, but some are keen to take a very cautious look at the fundamentals supporting the business to assess if a wait-and-see approach may be more sound than catching the tail end of the upward momentum swing in the stock price.

Here are three reasons why prospective investors should be very careful with Canopy Growth.

Reason #1: Tremendous, fast growth in customers and revenue, but long-term growth may be constrained

Any long-term investor in a company like Canopy Growth needs to see sustained growth over long periods of time, and Canopy Growth's track record is simply too narrow. The fact is, the industry is in its infancy right now with few existing competitors. There's a slew of customers who have yet to be marketed to by Canopy Growth or other potential entrants, who are slower to getting in the game.

Future cash flows from operations may be delayed to the extent that new entrants have time to figure out how to get into this business, eating up Canopy Growth's market share of before it can truly go national with its product.

Questions of future market share, market penetration, and whether or not a first-mover advantage exists in this space are not trivial.

Reason #2: The political environment remains very uncertain, domestically and globally

Significant uncertainty remains as to whether the current political environment in Canada and around the world will remain favourable to companies like Canopy Growth. In Canada, political promises have been made, but legislation is still pending and slow to be enacted federally.

The speed of getting legislation passed in Canada is largely a function of how the country plans to get around the fact that legalizing marijuana is in contravention of three international treaties Canada has signed. These treaties specifically criminalize marijuana and essentially make it impossible in the

current political environment for marijuana to be traded internationally any time soon.

Even if pot could be traded internationally, only four countries of the G20 have officially legalized marijuana, meaning the market is sufficiently small so as not to be a significant fundamental factor in the stock price.

Reason #3: Canopy Growth's stock price factors in a market much bigger than what currently exists

The domestic Canadian economy will not be big enough to support the growth that investors are pricing into the stock. The current price levels Canopy Growth is trading at imply that investors assume some probability that the U.S. market (Federally) or other global markets may legalize marijuana to the same extent as Canada. This is a dangerous assumption, especially in the short term.

The stock is currently trading at a 2018 forward price-to-earnings (P/E) ratio of 448—a staggering number.

If, and this remains a big if, the U.S. government were to legalize marijuana and allow it to be traded as a commodity, similar to oil or gold, the possibilities for Canopy Growth are massive. The current political landscape in the U.S. suggests such an idea to be more unlikely now that president-elect Donald Trump is at the helm.

A war on drugs would not provide the ideal “growing conditions” for Canopy Growth Corp.

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