Why Canopy Growth Corp. May Still Be Worth 89 Cents

Description

Correction: The original version of this article stated that “not even a single gram of marijuana has yet to be exported to Germany”. The author has since acknowledged that the company’s most recent quarterly financial statements shows that the first shipment of cannabis from Tweed occurred at the end of July.

Many investors who are short **Canopy Growth Corp.**(TSX:CGC) and analysts (including myself) are asking the question, what is the potential downside of Canopy Growth for next year? The company’s spectacular stock price ride to a peak of $17.86 (a day before my first bearish piece was published on November 17) was amazing, considering initial investors in Tweed (the primary company consolidated in Canopy Growth) were able to get their money in at a private placement in March of this year at $0.89–that’s in Canadian currency.

Is Canopy Growth, which convinced private investors to invest their money at $0.89 per share in March, a fundamentally different company than the company we see today?

Private money is a pretty good and conservative measure of the fundamental value of a business

One thing that any free-market economist will tell you is that a gauge of what something is worth is very simply what people are willing to pay for it. For companies at the venture capital or angel investment stage, this is often the case. A company is worth what investors are willing to pay for a share of the future growth potential.

Qualified, professional investors did their own analysis of Canopy Growth (Tweed) and determined a fair market value of $0.89 in March. The company, at the time, had gained approval to wholesale its product in Canada.

Let’s take a look at what has changed.

Canopy Growth has expanded to the German, Brazilian, Australian markets

Canopy Growth has expanded its partnership base to service international markets. The company has partnered with AusCann in Australia, Bedrocan Brazil S.A. in Brazil, and MedCann GmbH Pharma and Nutraceuticals in Germany to provide medical marijuana to these markets.

While Australia, Germany, and (to some extent) Brazil have approved marijuana for medicinal purposes, recreational marijuana usage has not been given the green light. Marijuana markets (including Canada) are thus limited, and investors have baked a large portion of the future cash flows into the price, including the recreational markets. While recreational markets may materialize, they pose a risk due to uncertainty as well as the timing of the future cash flows.

These partnerships increase the value of Canopy Growth because they provide the potential for future earnings growth from these regions. That said, these potential future cash flows are very uncertain and difficult to value considering that the company's percentage ownership in AusCann is relatively small (15%), and the legalization of medical marijuana is still questionable in Brazil.

Initial private placement built in some expectation of legalization happening in 2017

In Canada, Canopy Growth's primary market, the medical marijuana industry will amount to approximately $1.3 billion in 10 years, according to Health Canada. Canopy Growth estimates the recreational market for marijuana to be approximately $9 billion in Canada, and investors seem to be assuming this market will open with certainty in the spring of 2017. This expectation is based on campaign promises made by Prime Minister Justin Trudeau.

This declaration, however, stands in contrast to the most recent 2017 fiscal budget, which shows no line item for revenues related to the taxation of marijuana.

Speculation has abounded as to why this line item was "missed"; however, many analysts seem to think that the fiscal budget did not include revenues from marijuana taxation due to regulatory hurdles which may delay or even nullify Canada's bid to legalize marijuana.

The Trudeau government also appears to be having trouble crafting legislation to hammer out the details of what legalization would look like for the average person. These legislative burdens will likely provide another hurdle that may push the Canadian government past their spring 2017, self-imposed deadline into 2018 or beyond.

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