Is Canopy Growth Corp. a Must-Own Stock?

Description

Allow me to start this off by being as clear as possible. An investment in **Canopy Growth Corp.** (TSX:CGC) today is nothing more than speculation.

The logic goes something like this.

Shares of Canada's leading marijuana grower currently have a market cap of $1.35 billion, despite posting recent quarterly revenue of just $8.5 million. That gives it a price-to-sales ratio of 47.7, which is insane. Investors aren't paying 47 times earnings. They're paying 47 times revenue.

The company has lost money over the last year too, posting a loss of $0.08 per share. Even after adjusting for various non-cash expenses, it still isn't cash flow positive. It bled $14 million in cash last year from operations alone, while also spending $12 million in capital expenditures.

Even the company's management knows shares are overvalued, although they'd never admit such a thing publicly. Canopy recently announced it would acquire German marijuana distributor MedCann for nothing more than Canopy shares. In total, if the newly acquired company hits a number of milestones, its owners will receive 1.17 million Canopy shares in the next two years.

When we look at Canopy from every possible investment angle, the conclusion is obvious. Shares are terribly expensive. There's no correlation between the value of the company today and the share price. Shareholders are blinded by the size of a potential market for legal weed in Canada.

The logic of owning shares anyway

Despite all that, I still think there's a case for buying Canopy Growth shares today.

When **Wal-Mart Stores, Inc.** (NYSE:WMT) first hit the public markets in 1970, shares traded hands at $16.50 each. What were profits in 1970? They were just $0.23 per share. The company traded at a price-to-earnings ratio of 71.7–a valuation that seems laughable today. But remember, it was a sexy growth stock back then.

In 1997, **Amazon.com, Inc.** (NASDAQ:AMZN) had its IPO, raising $48 million at $16 per share. It wasn't profitable then, and it's barely profitable now. We all know how an investment in Amazon in 1997 would have worked out.

There are a million other examples where a high valuation worked out very well in the long run, where companies grew so much that paying a premium so early in their lives didn't matter.

According to reports, the recreational marijuana market in Canada could be worth as much as $10 or $12 billion a year. If Canopy can capture even just part of that, it has the potential to be a truly huge company.

Investors are banking on this hope. Hope isn't a viable investment strategy. A million things could get between Canopy and its domination of the market. The threat from the world's tobacco giants is very real, for instance.

But at the same time, it was easy to argue against owning Wal-Mart in 1970 and Amazon in 1997. Each had headwinds. Each conquered those headwinds.

A risky stock like Canopy shouldn't be a core position in anyone's portfolio. It's just too volatile. But there's certainly a case for making it a tiny, speculative position–a maximum of 1% of assets. If it works out, it would be very profitable. And if it doesn't, it's not hard to bounce back from a 1% loss.

The bottom line

When I invest, I try to buy assets worth $1 for 50 cents. Canopy Growth Corp is the exact opposite of that. It's a loonie that people are happy to pay $5 or $10 for.

There's the possibility that loonie could be worth so much in the future that it justifies paying $10 for it today. However, investors need to realize that is hardly a sure thing and place their bets accordingly.

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1. NASDAQ:AMZN (Amazon.com Inc.)
2. NYSE:WMT (Wal-Mart Stores Inc.)
3. TSX:WEED (Canopy Growth)

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