Canopy Growth Corp.: The Pros and Cons of Owning This Stock

Description

Canopy Growth Corp. (TSX:WEED) has captured the imagination of Canadian investors across the country.

Let's take a look at the reasons to own the cannabis producer as well as some of the risks.

Pros

Canopy is firing on all cylinders, and it appears the company is making all the right moves in a rapidly expanding industry.

What going on?

In recent months, Canopy has secured its position as the dominant force in the Canadian medical marijuana market through a series of takeovers.

The largest and most significant is the acquisition of Mettrum Health Corp., which added two national brands and significant production capacity. The deal, which closed at the end of January, also brought Canopy to the point where it now supplies nearly half of the registered medical marijuana patients in Canada.

In addition to acquisitions, Canopy has entered an agreement with a real estate company, the Goldman Group. The arrangement will see Goldman buy or build facilities and outfit the sites to meet Canopy's production requirements. Canopy will then lease the locations from Goldman.

The move is key to ramping up production capacity as fast as possible and doesn't require as much upfront capital as would be required if Canopy acquired the properties itself.

In January, Canopy also acquired the property that houses its head office location. The deal gives Canopy 472,000 square feet of space that could be used to triple current production and processing capacity.

Canada is the core focus for the moment, but Canopy sees international opportunities emerging. The company purchased a German pharmaceutical distributor in November and has a joint venture based in Brazil.

To top things off, a memorandum of understanding was signed recently with Namaste Technologies, which is a business that provides cannabis accessories through its e-commerce retail operations in more than 20 countries.

Canopy reported impressive numbers for the quarter ended December 31, 2016. Revenue was $9.75 million — up 180% year over year and 15% higher than the previous quarter.

So, the company is on track to be a dominant player in a rapidly growing segment.

Cons

The big knock on the stock is the company’s valuation.

At the time of writing, Canopy has a market capitalization of $2 billion. That’s pretty steep for a business with quarterly revenue of less than $10 million.

What’s the reason?

Investors are hoping Ottawa will make good on its plans to open the recreational marijuana market in 2018.

The government received its task force report at the end of November and is expected to table legislation in the coming months.

If all goes as investors hope, Canadians could have the opportunity to buy recreational marijuana sometime next year, and Canopy would be positioned well to get a large piece of the pie.

Estimates vary, but some analysts believe the market is worth at least $5 billion per year.

The risk for investors lies with any delays coming out of Ottawa. The government has to get the roll-out right, and some of the details might start to hold up the process.

One issue is taxes. Ottawa and the provinces are probably looking at the industry as a revenue gold mine, but taxes that are too high could drive consumers to the black market.

At the same time, not enough tax could result in companies reeling in all the profits and taxpayers left holding the bag for all the costs related to policing the market.

To put things into perspective, tiny Uruguay took about five years to sort out its legalization structure, so it seems a bit ambitious to think Canada can wrap it up in a year.

Should you buy?

Canopy is doing all the right things at this point in the game and is positioned well to dominate the industry.

That said, the stock appears priced for perfection, and relying on Ottawa to deliver the goods next year might be a bit optimistic. If the legalization of the recreational market hits a speed bump, or gets halted altogether, Canopy and its peers would likely take a big hit.

As such, I would avoid the stock at the current price.

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