Canopy Growth Corp. Is Down 20%: Is it a Buy?

Description

Canopy Growth Corp. (TSX:WEED) has dropped about 20% from right around $12 a share to under $10 since the beginning of March, demonstrating an unfortunate reality about investing in companies that are still in rapid expansion. There are three fundamental ways to finance a business: use cash flow to fund expansion, go to the bank and borrow money, or issue new shares.

Canopy chose the third option, primarily because shares have skyrocketed in value over the past year. When a stock price becomes “expensive,” it’s a great way to maximize new money in the bank without being too dilutive to current investors. And with the stock appreciating 152% over the the past six months (after this 20% drop), it’s clear that a little pullback was necessary.

But is this pullback a buying opportunity?

Admittedly, I have a hard time recommending Canopy as an investment at this time. While I certainly believe marijuana will be legalized, I can’t determine when. Investors are expecting legalization to happen soon, so in the event that regulation doesn’t pass in the company’s favour in an expedient fashion, investors might get tired and move elsewhere.

That doesn’t mean the company isn’t a good business. Thanks to a series of smart acquisitions, including the takeover of Mettrum Health Corp., it has become the leading medical marijuana provider in Canada with half of the country’s patients purchasing its products.

Even better, Canopy recognizes that the key to a successful business in rapid scaling is a strong supply chain. It has entered an agreement with real estate developer Goldman Group. The developer will buy and build facilities to Canopy’s specifications and then lease them to Canopy. In many instances, companies try to be their own real estate developer, but it’s smarter to use an expert on the real estate side and focus on the core business.

Canopy is expanding internationally. It acquired Medcann, a German distributor, which could prove very lucrative for the company. It is illegal to grow cannabis in Germany; however, if it is imported, it is perfectly legal. Therefore, Canopy can grow marijuana in its expanding production facilities and then ship it to the distribution company it owns in Germany.

But there are still a couple of negatives…

First, there’s no end in sight for regulatory changes. Prime Minister Justin Trudeau, in an interview in the beginning of the month, said that new marijuana legislation should be ready by summer, but he said, “until we have a framework to control and regulate marijuana, the current laws apply.” And as is the case with most legislation, they almost always take longer than expected.

And second, Canopy remains very expensive. Last quarter, it only brought in $10 million in revenue. Yet, the company is valued at $1.64 billion. I don’t doubt that marijuana will be legalized in Canada and the United States; however, only time will tell when that will truly become a reality. And with this company significantly overpriced based on revenue, I’m hesitant to buy right now.

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