Why Profitability Matters: Canopy Growth Corp.

Description

Here's an exercise for investors ready to do some philosophical thinking: tell me about a company or an industry in which profitability simply doesn't matter.

Canopy Growth Corp. (TSX:WEED) is an up-and-coming cannabis producer trying to convince its investor base that right now, profitability doesn't matter. After all, iconic companies such as **Amazon.com, Inc.** and other high-flying technology, mining, pharmaceutical, or biotechnology stocks have told a similar story. Some have gotten away with the message, and some haven't. What's interesting about all of these companies, however, is that at some point, the laws of finance come into play and investors being demanding profits.

After posting dismal quarterly and fiscal year-end results, Canopy's chairman and CEO Bruce Linton suggested that investors ignore the company's current state of profitability and focus on the business's expanding production ahead of legalization, which stands to come into effect in 2018. The appeal being made by Canopy's management teams is for investors' long-term patience — something which appears to be in low supply of late.

After the announcement by the Canadian government on April 12 that legalization would happen later than initially anticipated, many marijuana concerns, including Canopy, took a large hit — a hit which has not been recouped in large part due to a widespread lack of continued hype and excitement. These factors make the momentum trade less attractive for profit-seeking investors looking to take advantage of the latest hot commodity in the Canadian stock market.

This past year, Canopy's loss widened to $16.7 million from a loss of $3.5 million, disappointing investors hoping for positive news on the profitability front. Revenue also underperformed expectations; quarterly revenue came in at $14.7 million, more than 10% lower than analyst estimates of $16.4 million for the period.

Herein lies one of the long-standing issues I have with Canopy and the whole marijuana industry in general since late 2016: growth expectations for these firms are simply out of whack. While Canopy was able to produce a 191% quarterly increase year over year, the company still came in more than

10% under the growth expectations of analysts. Canopy and other marijuana firms in the industry are under intense pressure to produce year-over-year growth of +200%. They will be forced to engage in sloppy acquisitions (Mettrum), massive production ramp up, and costly capital expenditures (plant upgrades and expansions into New Brunswick and Alberta), with less and less focus on long-term profitability and returning value to shareholders.

Investors hoping to cash in on a $1.3 billion company turning a loss of $17 million per year on quarterly revenues of $15 million may have to wait *just a little bit longer.*

Stay Foolish, my friends.

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