A Look Behind Canopy Growth Corp.'s Poor Quarterly Results

Description

With marijuana legalization either complete or in the works in many parts of the world, the opportunities for this industry are growing by the day. A big player on the TSX is **Canopy Growth Corp.** (TSX:WEED), the first publicly traded Canadian company in the industry. The results for Canopy Growth's stock have been terrific so far, yielding a return of over 152% since inception. The stock has been performing well despite lacklustre results and frequent losses.

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The outlook for the stock and its growth prospects remain strong and are likely why the stock is still hanging on to its valuation. While Canopy Growth may still be in the honeymoon phase, in order for it to continue to progress, the stock will need to show not only sales growth, but profits as well.

Canopy Growth recently released its year-end financials and showed a remarkable year-over-year revenue growth of over 200%. However, despite the company's significant increase in sales, its losses from operations grew at an even higher rate. One of the reasons for the increase in costs has been the company's focus on acquisitions.

The company issued over 60 million shares to help acquire as many as seven different companies. The acquisitions allow Canopy Growth to reach more people, more markets, and sell more products. However, with acquisitions also come challenges and redundancies that can be costly if not addressed.

As a result of Canopy Growth's acquisitions, there was an increase in acquisition-related costs of over $6 million from the prior year. However, the largest increases in the company's overhead came from non-acquisition costs, such as general and administration, which grew by over $8 million. In addition, sales and marketing expenses also grew by $7 million. These increases in cost amounted to over $21 million dollars, which was the total overhead in the prior fiscal year alone.

A percentage of revenue, sales, and marketing, combined with general and administration costs, represented three quarters of total sales. These rising overhead expenses being incurred by Canopy Growth are eroding any profitability the company is able to achieve.

In order to turn a profit, Canopy Growth will need to find a way to create efficiencies and cut costs. Adding sales can solve many problems a company is having, but those solutions will be negated if costs rise at a quicker rate.

MedReleaf Corp. (TSX:LEAF) is a fairly new stock and completed its initial public offering in early June of this year. Although it initially had a poor showing on day one, the stock has since produced a return of over 10% and trades at a miniscule price-to-earnings ratio of 0.5. It presents a great opportunity for value investors.

Unlike Canopy Growth, MedReleaf has relied on organic growth and has not been burdened with acquisition-related costs. The company has been able to maintain a low, manageable overhead which has allowed it to turn a profit while enjoying rapid sales growth. It wouldn't be a surprise to see this stock outperform Canopy Growth if these trends continue.

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