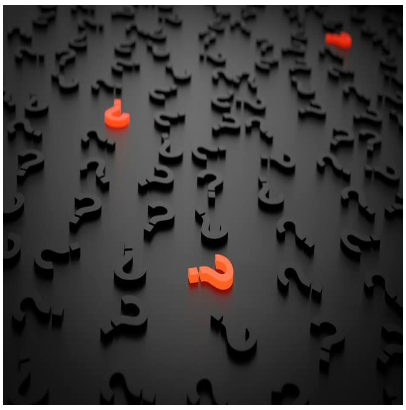

Why Investors Should Be Concerned About Canopy Growth Corp.'s Q2 Results

Description

Canopy Growth Corp. (TSX:WEED), one of the early leaders in the cannabis industry, released its Q2 results on Tuesday. The company continued to see strong revenue growth in the quarter with sales of $17.6 million doubling last year's total of $8.5 million. However, Canopy still posted a loss of $1.6 million, down from a profit of $5.4 million a year ago.

Unfortunately for investors, this is not new, and we saw, in Q1, that the company showed strong top-line growth but still posted a loss overall. Let's take a closer look at Q2 to see if anything has improved since then.

Operating expenses continue to outpace revenue

We again saw operating expenses tripling last year's totals. Shared-based compensation was up over $6 million, and the company also incurred $4.3 million more in depreciation costs. General and administrative expenses doubled and were up $4.4 million, while sales and marketing expenses nearly tripled and saw an extra $4.8 million in costs this quarter.

As a result of the increases, Canopy saw $20 million added to to its cost structure, which wiped out the extra $13 million the company added to its gross profit. Canopy posted an operating loss of $1.1 million compared to a profit of $6.1 million in the prior year.

Company continues to bleed cash

Cash used from operations totaled $22.9 million in the past six months, which is up from $8.9 million in the prior year. In addition, investing activities saw the company take another $33.8 million out of cash from the business compared to $8.7 million a year ago, and we can expect more cash used for investing purposes as Canopy continues to try to acquire businesses and grow its brand.

The company has avoided issuing debt and has raised funds by issuing more shares, and the problem this presents for investors is that this will dilute their ownership and drive down the value of the shares, reducing overall returns.

Canopy focusing on “global leadership position”

With partnerships in Denmark and Jamaica announced in the past couple of months, Canopy is working on expanding its reach across the globe.

The concern I have about this is that it might be a bit too aggressive, given there is still plenty of opportunity just in Canada that should be focused on before the company looks beyond its own borders. Too much expansion too quickly could only continue to accelerate costs, which will negate any improvements in the company’s top line.

Should you buy Canopy?

There is a lot of potential in the cannabis industry — that is undeniable. However, Canopy’s costs have significantly outpaced revenue, and the rate at which the company is trying to grow is not going to see that change anytime soon.

It may be exciting to buy into the early growth stages of the industry, but investors should be reminded there are other growth options out there that might be less risky.

There’s still a lot of uncertainty in the industry that could impact sales and profits, and that could catch investors by surprise. Canopy is a stock I would wait to buy, as its valuation is simply too high for the level of risk it presents.

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