Canopy Growth Corp.: What to Look Forward to as the Marijuana Giant Reports Quarterly Results on Wednesday

Description

Canopy Growth Corp. (TSX:WEED) is set to report its third-quarter financial results for the three months ended December 31, 2017, on February 14, probably before market opening, and it will conduct a conference call to discuss the results at 8:30 AM EST amid a jittery cannabis sector performance, which further punished the marijuana stock in a generally recovering stock market on Monday.

Canopy's stock traded 4.51% lower on Monday and is down 36.86% from its peak on January 9 this year. Investors are looking forward to judging the stock's valuation once the company releases a quarterly performance update.

Here is my take on Canopy's probable performance during the December 2017 quarter.

Improving revenue growth rate: target $19.5 million

Canopy has been registering impressive top-line growth rates throughout 2017, and I expect its revenue performance to be no different during the quarter ended December 31, 2017.

The company grew its registered patient base by 9.52% from 63,000 patients by end of September to about 69,000 by December 31, 2017. Average revenue per patient has been on a steady increase over the previous three quarters, rising from $266.56 per client by March 2017 to $278.87 per patient during the September 2017 quarter.

I am expecting a further increase in Canopy's top line of about 11% and more than 100% from the $9.75 million reported for the comparable quarter the previous year to about $19.5 million, and I am more than willing to be surprised by an upside.

Most noteworthy, average revenue per gram has been steadily trending up to $7.99 a gram for the previous quarter and could continue on the upside should Canopy increase the proportion of high-priced cannabis oil and capsule sales in its revenue mix.

Gross margins

Canopy's gross margin before fair-value adjustments has been stuck at 57% of sales in two previous consecutive quarters, but the firm advised that the margin could have been as high as 63% had there been no write-down of $703,000 in hemp product inventory due to discontinued product lines and a $391,000 charge due to facility improvements at Mettrum Creemore grow operations.

Unless there was another unexpected charge during last quarter, Canopy's gross margin could improve considerably in the coming quarterly report.

Operating expense

This has been the most nagging portion on Canopy's income statement for a long time. I do not expect a decline in operating expenses for the growing firm, as it is yet to strike a balance while rolling out strategic expansion plans, but a slower rate of growth in expenses could be a huge plus towards a move to profitability.

Export revenue performance

Canopy has reported some export sales since its entry into the Germany market a few quarters ago, but revenue from this segment has been very minute, yet competitor **Aurora Cannabis Inc.** (TSX:ACB) has been registering exponentially growing revenue there, reaching $2.5 million last quarter. However, Aurora has five times more distribution points than Canopy in this market.

Exports may improve, as Canopy has established inroads into more jurisdictions and strategic agreements in Brazil, Chile, as well as Australia. Canopy will reap more benefits through Germany cultivation operations; final tender results are expected in March.

Investor takeaway

Canopy has not been as active as Aurora and **Aphria Inc.** in the acquisition space during the last quarter, and it may have lower acquisition- and integration-related expenses in the coming report. While I don't expect operating expenses to come down, top-line growth could be impressive, and this is a critical performance factor required for Canopy and all of its marijuana competitors to justify the high market valuation premiums on their equity.

Valuations remain stretched for the sector. Let's see if Canopy can measure up to the growth challenge in the coming report, but I would be disappointed if it reports anything less than $19 million in revenue.

Canopy has to continue reporting strong sequential and year-on-year revenue-growth rates to justify the high stock price, price-to-sales, and price-to-book value multiples on the stock.

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