Why You Shouldn't Get Too Excited by Canopy Growth Corp.'s Q3 Results

Description

Canopy Growth Corp. (TSX:WEED) released its third-quarter results on Wednesday, and although sales and profits were up, investors should be careful not to be misled by the results. The headlines will read that the company's top line doubled and that the bottom line nearly quadrupled, but what really tells the story is what happened in between.

Operating costs soared

The company's operating expenses of $45 million were more than triple the $12 million that Canopy recorded a year ago. The biggest increase came by way of share-based compensation, which, at $18 million, was well up from the $1 million the company incurred just a year ago.

The company actually posted a significant operating loss

I like to look at operating results to gauge the health of a company's operations, since it ignores a lot of the noise from non-operating items and gives you a more accurate snapshot of how the company did.

In Q3, Canopy posted a loss from operations of $26 million, which was a big decline from the $5 million operating profit it recorded last year.

What propped up the company's results?

Although Canopy posted an operating loss in Q3, fair-value changes on financial assets added $36 million back to the company's bottom line, and a gain on disposal of a consolidated equity added another $9 million.

These non-operating items, which were zero a year ago, helped pull Canopy out of the negative and into profitability.

The problem with this is that these items are not related to the company's day-to-day operations, and it presents uncertainty, since these results likely won't be present in future quarters. In the worst case, Canopy could see a reversal of fortunes with gains turning into losses and future financials seeing the opposite effect.

Cash burn continues

In the nine months leading up to the end of Q3, Canopy used more than $44 million in cash from operations and another $130 million from investing activities for a total of $175 million cash used before financing activities. By comparison, a year ago the company used just $11 million in cash from operations and $17 million from investing activities.

The end result is that Canopy is left having to raise cash, and it typically does so in the form of issuing shares. In the last nine months, the company raised $270 million from shares issued compared to just

$106 million in the prior year.

The downside for investors is that the more shares that are issued, the more diluted existing investors are. While it may help the company avoid debt, it's not a perfect solution for shareholders.

Stock price up less than 2%

Despite the strong sales and profit numbers, investors were lukewarm about the results, as the stock price was up just 1.6% in trading on Wednesday. Not only did non-operating items give the company's performance a boost, but as strong as the sales growth was, it still fell short of expectations.

Bottom line

Canopy has secured some key supply deals that will help the company grow its business once marijuana legalization takes off, and that should result in even stronger sales.

The stock has a lot of potential, and I believe it could hit $50 this year, as we'll likely see optimism in the industry reach a peak once pot is finally legalized.

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