Canopy Growth Corp. Shows the Market How Fast a Weed Should Grow

Description

Canopy Growth Corp. (TSX:WEED) reported its third-quarter financial results for the three months ended December 31, 2017, on Wednesday, showing accelerated marijuana revenue growth and a beefed-up bottom line. A move towards sustainable operating profitability in the cannabis business isn't evident yet, but the leading cannabis grower is showing some spectacular execution performance.

While Canopy's revenue figure was below consensus analyst estimates of $24.2 million for the quarter, reported performance is still phenomenal and beat my personal expectations discussed earlier. The company says it is focused on executing a growth strategy; let's see how well it has done towards that agenda.

Spectacular revenue growth

Canopy booked $21.7 million in cannabis revenues last quarter, which were 123% higher than the $9.75 million reported for the same quarter a year ago, and 24% better than the $17.57 million generated during the previous quarter. This was a better execution performance as compared to close competitor **MedReleaf Corp.**, which has just found its feet after a Veteran Affairs Canada policy-change scare.

Revenue per registered patient continued on an upward trend over the last four consecutive quarters from $266.56 in the quarter ended March 31, 2017 to $314.55 in the last quarter, sequentially rising 13% from $278.87 per patient during the previous quarter ended September 30, 2017.

Canopy's client book is performing better with higher-quality client additions, as the company is generating more sales per client now than before. However, revenue per patient was still below the $336.28 generated in the December 2016 quarter, before Canopy made a $430 million acquisition of Mettrum Health Corp. in January last year.

Canopy has increased its client portfolio by 138% to 69,000 registered patients over the past 12 months and has seen improving average price per gram due to introduction of higher-margin oil and capsule sales to the revenue mix.

Impressive growth in Germany … at last

Canopy generated some meaningful revenue in Germany last quarter. Its subsidiary, Spektrum Cannabis GmbH, managed to sell nearly $1 million worth of medical cannabis to more than 400 pharmacies, charging about $12.61 per gram of dried cannabis.

The number of pharmacies in Canopy's Germany client portfolio has not changed from +400 for three consecutive quarters now. However, the high-margin revenue generated in this strategically important market last quarter is impressive.

The company had struggled to book any meaningful sales since entering the nascent market in 2016 and has generated $1.4 million in Germany marijuana export sales during the past nine months to December 31, 2017. **Aurora Cannabis Inc.** (TSX:ACB) generated $2.5 million revenues in this market last quarter.

Gross margin performance

There hasn't been a significant improvement in Canopy's growth margin before fair-value effects yet; it was stuck in the 57% range for several quarters, but there was a slight growth to 57.76% this time. The company blames this on non-producing segments, saying it could have been 71%, excluding the effects from non-cultivating subsidiaries.

Operating expense management

The exponential increase in operating expenses is still a nagging issue clouding the visibility of a profitability trajectory for Canopy. Sales and marketing expenses grew in line with revenue, while general and administration expenses, like those for Aurora, grew faster to constitute 51% of quarterly sales.

The company's operating losses worsened to $26 million during the quarter from $1.1 million in the previous quarter, with share-based compensation expenses increasing by 153% from the previous quarter.

It would have been great to see slowing expense growth for the quarter, as this would boost shareholder confidence in the profitability-generating capacity of the current business model. However, it's too early to demand profits from a young growing firm that is yet to fully execute its expansion strategy.

Foolish bottom line

Canopy is executing well, and the exponential revenue-growth rate attained so far is impressive. However, had it not been for the $8.82 million one-time gain on the disposal of Agripharm Corp. and the recognition of $35.85 million in fair-value changes in financial assets, Canopy could have reported massive net losses for the quarter.

Overall, Canopy reported mixed results which were good enough to justify a hold rating on the stock. The marijuana giant has to continue generating strong revenue growth to sustain the high valuation premium on its stock, while showing profitability potential going forward, especially as the marketenters the legalized recreational to cannabis era in Canada.

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brianparadza