Canopy Growth Corp. (TSX:WEED): Notable Takeaways From the Latest Annual Financial Results

Description

Canopy Growth Corp.**'s** (TSX:WEED)(NYSE:CGC) stock price fell a whopping 10% after the marijuana producer released its full-year financial results for the period ended March 31, 2018. The leading cannabis giant has been one of the most relatively stable marijuana stocks in Canada this year. Is the recent spike in volatility on the ticker warranted?

It may seem so, but maybe not. Canopy's latest earnings release was a mixed bag, and here is why.

Muted overall revenue growth

The company's annual revenue growth, at 95% year over year, was as great as it should be for a marijuana growth stock right now, but a softer sequential quarter-on-quarter revenue performance could have alarmed some investors.

Most noteworthy, Canopy recorded a 5% growth in sales from $21.7 million in the previous quarter to $22.81 million in the latest reported quarter, but this growth was largely driven by higher than expected Germany revenue performance, as the Canadian market delivered little to negative sequential revenue growth — a concerning development.

Surprise Germany sales performance

Canopy's export revenue from Germany grew 124% over three months to make up 10% of total corporate sales during the past quarter — a very encouraging result in this important new growth European market.

The company significantly grew its distribution points during the quarter from over 400 pharmacies by January 2018 to over 1,000. Actually, the Germany subsidiary, Spektrum Cannabis GmbH, now has over 1,200 pharmacies as clients across the country.

Germany shows promising cannabis market growth prospects, and the higher realizable price per gram of cannabis averaging $13.35 per gram for Spektrum last quarter could make competitors envious. The company's channel in Germany may have been more vibrant that that of **Aurora Cannabis Inc.** during the period

Justifiable decline in gross margin

A sudden drop in gross margin from 62% the previous quarter to as low as 31% for the latest quarter could seem alarming, but this was a result of the company's strategic maneuvers while in preparation for enhanced productivity to satisfy recreational marijuana demand.

I wouldn't worry about the temporarily low gross margin, as management explained that the necessary repurposing of several grow rooms over the period decreased the amount of harvested cannabis and, combined with higher overheads in the quarter, led to the low gross margin.

Actually, the gross margin for the quarter was 63% on an adjusted basis.

Massive growth in patient numbers

The company saw a significant 7.25% growth in registered patients to over 74,000 over three months to March 31, and this number has grown a further 10.8% to around 82,000 by end of June. That said, there was no corresponding revenue growth from Canada during the latest reported quarter; one would ask, why?

A possible answer would be that there is no restriction on patients to only buy from one supplier.

Have Canopy's registered patients become choosier and begun shopping more from competitors? That could be a worrying development for a dedicated medical marijuana player.

Controversial non-disclosure of production costs

The company will not release production costs per gram of cannabis anymore!

While there could be several sensible reasons for Canopy to stop reporting the non-standardized average costs of producing a gram of cannabis, the timing for this decision could be very controversial, especially considering the low gross margin. No substitute metric has been given yet.

If production costs had been contained, would the company not disclose the positive performance? Management could be accused of not reporting the cost metric right when it suits them, and more information for investors is always better than a lack of it.

Investor takeaway

Canopy Growth Corp. remains a core holding candidate for a marijuana growth portfolio, and the leading cannabis producer is well prepared to command the largest market share in the recreational market. However, the ballooning operating expenses, which grew 196% for the financial year, way faster than revenue, will need be contained during the next few quarters for an improved visibility towards profitability.

I applaud the management for deciding to limit dilutive financing options, in contrast to its close competitors' actions. The five-continent expansion strategy is executing well, and the company is poised to be a global leader in medical cannabis sales worldwide, while its application for 39 provisional patents in the U.S.A. could create valuable intellectual property in this space.

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