Is Canopy Growth Corp.'s Disappointing Q4 a Sign of Bigger Problems Ahead?

Description

Canopy Growth Corp. (TSX:WEED)(NYSE:CGC) released its quarterly results this week and the performance was simply unimpressive. Investors should have some big concerns about the company's long-term future, and should therefore be asking some very important questions.

Will there be enough sales growth to justify current prices?

In its most recent quarter, Canopy Growth's sales were $22.8 million, which is 56% higher than what the company recorded just last year. And while that's impressive year-over-year growth, if we compare it to Q3 results, it's a much more nominal increase from the $21.7 million in revenue that Canopy Growth brought in last quarter.

While it's still early to gauge the growth that the company will achieve given that recreational pot sales aren't legal just yet, investors likely would have expected a bit more growth even in the medicinal marijuana market, which still has a lot of potential.

At more than 100 times its sales, Canopy Growth is trading like a high-growth stock, and so it'll have to produce some significant results for investors to justify that valuation. Simply growing sales won't be enough: it must do it at a high rate of increase.

The challenge will be fighting for market share with **Aurora Cannabis Inc.** (TSX:ACB) and other companies for a market that can at this point only be a guess at this point given the role that the black market will play as well as the difficulty in measuring sales from the underground.

Will Canopy Growth be able to stay out of the red?

For some investors, it's all about sales growth, but sooner or later, profits and generating positive free cash flow will be important as well; otherwise a company will have to take on debt or issue more shares in order to finance its operations. Neither option is great for investors, and the one thing we are seeing is that costs are growing and will likely be much higher once we see legalization take place.

It should raise concerns for investors that even the top pot stock on the TSX has generated a loss in four of its last five quarters, and in its most recent period, its loss more than quadrupled that of last year. A big reason is that there were some big increases in sales and marketing (+259%), general and administration (+185%), and share-based compensation (+274%).

Once legalization hits, the complexity involved in operations will grow, and so too will costs.

Could cash flow become a problem?

In the most recent quarter, Canopy Growth used $36.9 million in cash from its operating activities, which is more than double the $15.7 million it used in the prior year. Combined with its investing activities last quarter, Canopy Growth burned through more than $130 million in cash, which is more than half of the $237.7 million equivalents at the start of the quarter.

Bottom line

Investors should be concerned about these results, as these issues will only get bigger once recreational pot sales commence and operations become even more complex.

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