Canopy Growth Corp. Stock Is Ready for Pot Legalization: Are You?

Description

With the highly anticipated legalization of cannabis set to take place October 17, investors seeking cannabis producers now have a wider range of publicly traded options on the TSX. From newly launched and relatively small operations to juggernauts such as **Canopy Growth Corp.** (TSX:WEED)(NYSE:CGC), investors who are betting that the cannabis industry will explode in Canada and worldwide are driving up prices for cannabis producers, many of which have hit fresh all-time highs within the past two weeks.

The phenomena that has seen valuations increase across the board is a curious one, as not every marijuana grower will be able to attain a spot as one of Canada's handful of companies that make up the eventual oligarchy that will control cannabis production within the country. Betting on the biggest firms, and specifically the ability of such companies to continue to acquire and consolidate this sector, has worked out well for most investors, who have seen their investment in such companies continue to grow.

While Canopy's acquisition strategy has been much more muted than many of its peers such as **Aurora Cannabis Inc.** (TSX:ACB), that company has managed to position itself much more attractively for long-term success than most of its peers. The only company to secure supply deals with all 10 Canadian provinces, Canopy also boasts a balance sheet with more than $320 million in cash on hand, ready to be spent on growth strategies rather than the high-priced acquisitions of many of its peers.

Canopy's recent earnings, which resulted in a net loss more than five times last year's quarterly loss (but less than three times the EPS loss due to dilution over this period) has resulted in some pushback from investors over the cash burn rate of the company currently. While Canopy was able to generate higher revenue per gram for its goods and increase production quantities in lockstep, the amount by which Canopy is going to be able to increase prices is likely to be capped at some level around what it is already selling at, thereby forcing the company to increase organic production growth at a lower cost gradually to make the current valuation multiple make sense.

Bottom line

While sentiment may be at an all-time high, I would steer clear of investing in any company based on a "gut feeling" about how edibles may change the market, or how oils may drive growth, or how cannabis-infused alcoholic beverages may be the "next big thing."

Doing so is equivalent to speculation.

Fundamentals, which are extremely hard to measure in this industry because of convoluted accounting standards imposed on such firms due to their agricultural status, will continue to keep smart money on the sidelines, with retail investors taking all the risk in this sector. Again, I would advise extreme caution with any of these companies at current levels, even companies such as Canopy, with healthier balance sheets than those of their peers.

Stay Foolish, my friends.

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2. TSX:ACB (Aurora Cannabis)
3. TSX:WEED (Canopy Growth)

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