Canopy Growth Corp. (TSX:WEED): The $5 Billion Question

Description

It's official: the summer of **Canopy Growth** (TSX:WEED)(NYSE:CGC) is here. Between red-hot earnings growth, impending pot legalization, and a hurricane of positive coverage, things seem to be going great for Canopy. The latest news is that the stock saw a 40% jump in its price in a matter of days–a heady gain to say the least–although it remains down from its June 20 high of $47.

The massive rally in Canopy shares was most likely driven by news that **Constellation Brands Inc.** (NYSE:STZ) had invested $5 billion in the company. Constellation, a company best known for making Corona beer, announced the acquisition in August. It will bring Constellation's ownership in Canopy to a whopping 38%–just 12% shy of a controlling interest.

What does Constellation's investment mean for Canopy shareholders?

I'll start by looking at the balance sheet.

Financial implications

Canopy's overall financial health can be described as mixed. While the company has over $300 million in cash on hand (against just $8.4 million in debt), the company's income statements have generally held less-positive news. Although revenue continues to grow, negative earnings have been a persistent blight on the company, with a $90 million loss in the most recent quarter.

Could the Constellation investment turn this around?

In the long term, possibly.

Canopy's negative earnings have mainly been attributed to rising operating costs. The $90 million Q2 loss, for example, was in spite of 63% revenue growth; although revenue was up, costs were up more. The Constellation investment could potentially remedy this situation. Constellation bought its shares directly from Canopy, rather than on the open market, which means Canopy will see a $4.5 billion cash injection as a result of the purchase.

The company plans to use this cash to increase overseas operations. In a recent announcement, the company said: "This investment, the largest to date in the cannabis space, will provide funds that Canopy Growth will deploy to strategically build and/or acquire key assets needed to establish global scale in the nearly 30 countries." Increased global infrastructure could help bring Canopy's operating costs down. The company could, for example, build production facilities onsite in countries it serves. This would lower costs related to shipping and storage. $4.5 billion is an enormous sum–more than 10 times Canopy's current cash holdings–and the infrastructure/R&D possibilities are unlimited.

Partnership potential

When Constellation's investment in Canopy was announced, it was positioned as a partnership. This is significant because it implies that the two companies will be cooperating with each other; specifically, working to build international infrastructure. The exact nature of the cooperation has yet to be announced, but it includes increasing Canopy's foothold in the United States, where Constellation has a huge presence. Constellation's U.S. infrastructure and legal assets could be a massive boon to Canopy, helping it move product in that country with greater ease.

Buyout possibilities

A final possibility is that Constellation could buy Canopy outright. The purchase agreement between the two companies includes warrants that stipulate that the former can increase its stake in the latter to 50% or more. In other words, Constellation has a green light to buy more Canopy shares–a complete acquisition is not out of the question. If that happened, anybody holding Canopy shares today would likely profit, as acquisition agreements tend to be at prices that benefit existing shareholders.

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