



Why Canopy Growth Corp (TSX:WEED) Still Has Room to Run

Description

It would be hard to make a bullish case for Canadian marijuana stocks if we were to evaluate them based on current or trailing sales. After all, there is no scenario, no matter how optimistic, that justifies a market cap of \$15 billion for **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) based on its fiscal year 2018 sales of \$77.9 million.

However, if an investor were to evaluate Canopy based on [post-legalization fundamentals](#), an entirely different picture emerges for a stock that is not only trading at a justifiable valuation, but which also presents further upside, given its tremendous growth prospects.

Is Canopy a \$75 stock?

So, how does one justify the current \$14.9 billion market cap for a company with a net loss of \$54 million in the last fiscal year? As mentioned earlier, we must look at Canopy's future from a post-legalization standpoint, as the Canopy we know today is going to be drastically different than the Canopy in 2020.

To start with our back-of-the-envelope analysis, we use **CIBC's** recently released estimates of recreational cannabis sales hitting \$6.5 billion in two years (though, to be more conservative, we will use a \$6 billion figure).

Now, based on its clear market leadership position, we can assume that roughly 30% of the \$6 billion in sales will come from Canopy (note, this is not farfetched, as Canopy currently has supply agreements with the provinces for 67,500 kgs of pot, representing roughly 36% of all announced supply agreements in place).

Applying the average consensus earnings before interest, taxes, depreciation, and amortization (EBITDA) margin of 30% to the forward revenue estimate and using a justifiable 28 times multiple to this figure, we can reach the conclusion that Canopy should be worth roughly \$15.12 billion, and after accounting for debt, cash, and minority interest, we are left with an implied value for Canopy's shares of approximately \$75.

Canopy commands a warranted premium

Even Canopy's most vocal critics must admit that the company is the clear market leader in the cannabis sector, and so it follows that the company warrants a premium valuation above its peer group. As you might recall, I applied a multiple of 28 times its forward EBITDA (for reference, fast-moving tech stocks like **Amazon** and **Netflix** are currently trading at 47 and 108 times their respective forward EBITDAs), which, in my view, is justifiable for the following reasons.

Firstly, Canopy has won the most provincial supply agreements out of any of the licensed producers.

Secondly, Canopy has built up its brand name through key celebrity endorsements and a diverse portfolio of products, while establishing a physical retail presence across five Canadian provinces, as well as e-commerce channels.

Thirdly, **Constellation Brands's** recent [upsized stake](#) in Canopy has not only reinforced the legitimacy of the company as a viable investment opportunity but will also bring close to \$5 billion into Canopy's coffers once the deal closes in October.

Fourthly, though its retail operations get the bulk of the attention, Canopy has also been busy deploying its capital towards the medicinal sector, with 15 clinical trials in progress, while having applied for 39 U.S. patents.

Finally, no other Canadian brand has a fraction of Canopy's international footprint. For example, through partnerships and subsidiaries, Canopy has a presence in 10 countries outside North America, but, more importantly, the company's management has hinted at initiatives and options currently in the works for Canopy to quickly expand to the +\$50 billion American market once cannabis is federally legal.

With all these growth drivers, it's easy to see why Canopy would command a premium valuation to the sector. Although the stock has moved up tremendously in the past few weeks thanks to a constant stream of news flow, any pullbacks should be considered buying opportunities for this market leader.

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