Is Canopy Growth Corp (TSX:WEED) a Buy After Its Vape Company Acquisition?

Description

In the past two months, much of the buzz about cannabis we'd seen earlier in the year began to wane. After marijuana stocks tanked, investors started losing interest, and media coverage began to simmer down. But six days ago, news that **Canopy Growth Corp** (TSX:WEED)(NYSE:CGC) had acquired a vaporizer company reignited interest in the cannabis industry. The acquisition was a novel one: usually cannabis companies tend to acquire other cannabis companies in a bid to increase market share. Canopy's foray into vaporizers differs from the normal cannabis M&A pattern, signalling a potential shift in the industry.

In a press release, Canopy's CEO expressed optimism about the acquisition, saying that "with Storz & Bickel's deep IP portfolio and management team, Canopy Growth is poised to lead the high-margin vaporizing category around the world." Indeed, vaporizing does appear to be a high-margin business. But will this acquisition be enough to save Canopy from growing losses? Before we get to that, let's explore why Canopy pursued this acquisition in the first place.

Synergistic businesses

It's natural that Canopy would pursue an acquisition in the vaporizing space, since cannabis and vaporizers are highly synergistic product categories. CBD oil, a product manufactured by companies like Canopy, is commonly smoked in hand-held vaporizers like those made by Storz & Bickel. Unrefined cannabis can also be vaporized in larger volcano or dome-shaped vaping devices.

This provides a number of possible business synergies for Canopy, such as selling vaporizer devices in its Tweed stores, or packaging CBD oil with Storz & Bickel vapes. Either strategy could help increase sales, both for Canopy's core marijuana offerings and for its new subsidiary.

A steep price tag

It's one thing to note that vaporizers could help improve Canopy's bottom line. It's quite another thing to say that the Storz & Bickel acquisition was worth it. And here's where a potential problem comes into play for Canopy: this acquisition was very pricey. Canopy paid €145 million for the company, which works out to around $221 million CAD. Whether the price is worth it or not depends on precisely how much profit Storz & Bickel generates and how much it can be expected to grow in the future.

A profitable industry

Now for some good news: vaporizers are a high-margin product category, and Storz & Bickel is a profitable business. Although exact earnings figures aren’t publicly available, Canopy said in its press release that the company is a profitable and growing enterprise. It might seem naive to take them at their word on that, but I don’t doubt the claim. Vaporizing is a highly niche product category with dedicated customers who will pay extra for a cool device.

Pantelis Ataliotis of Dr. Dabber has gone on the record as saying, “the vaporizer industry is one of the most profitable and fastest growing sectors within the cannabis space,” owing to technological innovation and brand recognition. These factors make vaporizers a much less commodified product category than cannabis, which provides a certain economic moat that the latter can’t match. This means that Storz & Bickel could provide Canopy with the earnings boost it needs to offset growing losses in its core operations.

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Author
andrewbutton