Is Now the Time to Buy Canopy Growth Corp. (TSX:WEED)?

Description

The significant pullback in the cannabis sector should not have come as a surprise to anyone. What is surprising is that there are so many people who believe that stocks without earnings can go up indefinitely without any sort of downturn. But now that there has been some moderation in the stock prices of these companies, investors need to ask themselves whether they should stay away or if it is time to get in.

Even with the downturn in the cannabis market, it is hard to make the argument that these stocks are cheap. The large, more established companies like **Canopy Growth** (TSX:WEED)(NYSE:CGC) still have sky-high valuations. But while these are not inexpensive stocks by any stretch of the imagination, they are at least good growth candidates now that some of the froth has finally come off these stocks.

To make a reasonable guess as to the value of these stocks, it would make sense to determine what the growth prospects there might be for the company. At the moment, Canopy is making good use of its high-priced shares as currency to build cash and spend on acquisitions, like its acquisition of shares in ManitobaCo in late 2018 in order to build the scope of its business.

Canopy's balance sheet is still strong, with plenty of cash on the books and very little debt. One problem with the balance sheet, though, that was quite noticeable was a large number of its assets were attributed to goodwill. The value of its goodwill was almost double the assessed value of tangible assets, such as its property and equipment.

There are a few aspects of the marijuana industry that are a little disconcerting. There is a lot of competition at the moment for products, especially recreational varieties, which may cause the commodity's price to collapse. Geopolitical risks are also a danger due to the fact that several major countries are still very much opposed to legalized cannabis.

That being said, there are a number of areas that might turn out to be cash generators for the industry. One of the more important may turn out to be the medical side of the business. The reason is fairly simple: marijuana as a recreational drug is extremely easy to grow. But the process of withdrawing the active agents and infusing them into medicine is a more defensible business that is not easily copied. Canopy Growth showed that there is medical demand for its products, with registered medical patients increasing 34% year over year last quarter.

The companies are also still demonstrating that they are able to grow revenues. Canopy Growth, for instance, grew its total revenues by 33% year over year as of its November 2018 report. In part, this was through its ability to increase its average selling price per gram of cannabis by 24% over the same quarter of the previous year. While these returns have not yet translated into solid earnings, it does indicate the possibility of growth in the future.

Even though stock prices in the cannabis sector have fallen off somewhat, they are still elevated and priced for growth. This is not a cheap time to invest. The downside risks are still high, although there are some promising aspects of the sector. To mitigate the downside risks, investors should choose a market leader like Canopy Growth, which has developed brands, is diversified into the medical sector, and has greater supply chain development.

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