Hazy With a Chance of Implosion: My 2019 Outlook for Canopy Growth Corp (TSX:WEED)

Description

Canopy Growth (TSX:WEED)(NYSE:CGC), Canada's favourite pot company, recently posted its third-quarter results, and while somewhat impressive on the surface with the 282% pop in sales, there were concerns left, right, and centre, as highlighted by fellow Fool contributor David Jagielski, who did a top-notch job of digging into the finer details in his prior piece.

Gross margins flopped, operating expenses rose, and the company isn't posting the significant cash flows that many pot investors would have expected in a post-legalization era. The most remarkable takeaway from Canopy's quarter, I believe, was not the triple-digit growth figures. Rather, it was the inability of the company to produce a profit and what appears to be a meagre outlook that lies ahead in a commoditized environment that the federal government has set the stage for.

Sure, Canopy remains the "best" pot player in the space because of the safety net that exists with **Constellation Brands**, Canopy's biggest investor, which has deep pockets and will be ready to help lift Canopy off its feet should it and the entire industry decide to implode overnight.

Stop me if you've heard this before, but Canopy (and the rest of the industry) smells like a speculative bubble at these frothy valuations. The company, which undoubtedly has some of the best recreational brands in the industry, continues to trade at a premium in the pot space, but it, like all other marijuana (a commodity) producers, will likely have trouble differentiating itself from the pack with stringent regulations (and potentially strict enforcement) in place.

The case for preferring Canopy over anything else is reliant on the assumption that Canada will give the green light for branding, promotional activities, and other moves that would enable a firm to stand out from the crowd. The federal government's reluctance to allow branding and the like is a definite negative for the "stronger" pot players, as the playing field is leveled for potential up and comers.

Regulations are calling for a commoditized environment, making product differentiation nearly impossible. So, despite Canopy's promising brand scoop-ups (like Tokyo Smoke), it's unlikely that the company will be able to unlock the full potential behind the brands, at least without risking a slap on the wrist from regulators.

With that in mind, I don't think it's safe to assume anything in the crazy world of marijuana. Canopy has been on a huge run, the actual financials don't justify the sky-high multiples, and given it'll take contingent events to get the stock moving up, I don't think Canopy, which is one of the pricier names in the space, will live up to the hype.

What we do know is that Canopy's cash bleed is accelerating, and should Conservative leader Andrew Scheer express the idea of reversing pot legalization, things could get ugly fast.

As for the upside?

I think it's limited, as Canopy already has a big-league investor, and with no evidence of a meaningful improvement to underlying operational efficiencies, I think investors would be wise to exit the Canopy trade (and marijuana as a whole) for 2019.

I think the upside is limited, as positive events don't seem to have as much "oomph" as it used to. Factor in election risk and cash bleed into the equation, and I think the stage is set for some pretty substantial wealth destruction over the medium term.

Investor beware.

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