Is This Pot Stock in Trouble?

Description

Amid all the excitement surrounding pot stocks, oftentimes the fundamentals get lost in the noise. And that can be dangerous because while companies like **Canopy Growth** (TSX:WEED)(NYSE:CGC) are generating strong results and expanding into various parts of the world, the growth prospects become very exciting for investors.

However, it's important to have some skepticism and not get caught up in the promises of what future growth might bring. After all, there's no guarantee that actuals will meet expectations. For Canopy Growth, we've already seen the company miss the mark — by a lot. And although the company has recovered from that and revenues are growing at an incredible rate, it has still continued to produce operating losses and negative cash flow.

Cash is a big problem in the industry, as companies like Canopy Growth are bleeding through a lot of it and that creates a need to either take on debt or issue shares. The former adds interest expenses and obligations while the latter dilutes existing shareholders, leaving neither option desirable. That's why many of these acquisitions in the industry are all-stock deals since it's easier than dipping into the limited supply of cash that a company may have.

In Canopy Growth's case, it has Constellation Brands as a big investor in the company to help its growth in various ways. Other companies are in a bit more difficult situations and can be risky for investors. For instance, **MedMen Enterprises** (CNSX:MMEN) is one company that has also been burning through a lot of money, as it continues to expand its business. In just the past four quarters, the company has used up $175 million in operations and over that time has had negative free cash flow of $277 million.

The pressure has been evident on the MedMen's balance sheet as well. As of the close of 2018, the company had non-current liabilities totalling $87 million on its books compared to $3.6 million only six months earlier.

MedMen's ex-CFO has been accused of being wasteful with money; certainly, the financials don't resemble a company that's being careful with its funds — operating expenses in MedMen's most recent results were up 633%, with general and administrative costs leading the way and up over $56 million in just one year. While the company's growth will certainly be a big factor in the rapidly increasing expenses, investors should expect more and shouldn't be ready to excuse everything in the name of growth.

Bottom line

MedMen's stores have proven to be very popular with customers, but if investors are buying part of a business, they should be comfortable with all parts of it, and that includes its cash flow and expenditures. From what I've seen on its financials, there are too many red flags and question marks that prevent me from investing in MedMen, regardless of how much potential there might be in the U.S. market.

This is a stock I'd keep a close eye on going forward because if MedMen's share price struggles, it'll only be more difficult for the company to raise the capital it needs to fund its growth and operations, which will only compound its existing problems.

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