3 Ways Canopy Growth Corp (TSX:WEED) Is Overvalued

Description

Recently, I wrote about weed company **Aphria's** ambitious $1 billion sales target and the difficulty of hitting that goal. This time, I heard a similar tune from **Canopy Growth** (TSX:WEED)(NYSE:CGC). Being the largest publicly traded weed stock in the world, the goal of $1 billion net revenue is not ill-conceived.

However, despite the $18.9 billion market cap and industry leader status, the chances of Canopy Growth missing the target are high. Enthusiastic investors might be in for another disappointing episode. But don't tell that to Bill Newlands, CEO of **Constellation Brands**. The Corona beer maker CEO is exceedingly hopeful.

Tough call

You can't tell if Mr. Newlands is serious or merely grandstanding about his optimistic view. Constellation Brands has $4 billion investment in Canopy Growth, which is equivalent to 38% ownership. But then again, it might be a sign of restiveness. The massive investment needs to start paying back soon.

The $1 billion net revenue target is a tough call. Cannabis sales in Canada are projected to be in the vicinity of $5-6 billion in 2019. The current sales seem to be along those figures. If Canopy Growth is bent on hitting Newland's desired revenue, the company should deliver three times more than the latest net revenue.

Constellation Brands is also hoping to introduce cannabis-infused beverages and edibles by year-end. The new market might add a significant amount of revenue. But a major roadblock stands in the way. Health Canada is poised to implement licensing regulations.

Hence, Canopy Growth will be hard pressed to meet annualized revenue that is over and above $1 billion. The reality is that sales aren't growing exponentially. Also, because of disenchantment and unpleasant experience with the Tweed brands, medical clients are shifting to less-costly unlicensed options.

By the end of the current fiscal year, annualized net revenue might double from the $332 million run rate Canopy achieved during the fourth quarter of 2018. For that to happen, though, the company needs to get awfully lucky.

The problem of oversupply

The cultivation potential of Canopy Growth is enormous. A peak annual production of 500,000 kilos is not far-fetched. The five largest farms will get the job done. Unfortunately, industry peers are also working double time to increase production capacities. The danger of oversupply looms large.

If the market is overflowing with cannabis, pricing pressure will be tremendous. The sharp drop in prices and reduced gross margins will weigh heavily on Canopy Growth and the rest of the cannabis-producing companies. You can throw away the dream of $1 billion annual sales out the window.

Mixed signals

The signals are mixed. You begin to wonder why some analysts still maintain a price target of $73.33 and an absurdly high estimate of $100. I'm not bursting anyone's bubble. But the way things are going, Canopy Growth and other cannabis companies should come clean. It's better to stick to realistic numbers than pluck them out of the air.

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