4 Things to Watch as Canopy Growth (TSX:WEED) Reports Earnings Next Week

Description

Cannabis giant **Canopy Growth** (TSX:WEED)(NYSE:CGC) is set to release its financial statements for financial year and fourth-quarter 2019 periods ended March 31, after market on June 20. Here's what I think investors should pay close attention to while looking at the financial results.

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This will be the first set of corporate results issued under the new CFO Mike Lee, whom investors have reason to believe may be the eyes and ears, potential enforcer, and a go-to agent for major investor **Constellation Brands**.

Notably, 12 months seems a very long time in the marijuana industry right now, as many fundamental changes have been taking place at a considerably fast pace, compounded by premium acquisitions. Such changes distort annual earnings results comparisons.

I would therefore dwell much on quarter-over-quarter analysis, with the last two quarters in focus, to get a clearer picture of how things are evolving for the market leader in the hyped industry.

The company's upcoming report will include two quarters of pure medical cannabis sales and two subsequent quarters dominated by recreational wholesale supplies and the introduction of excise taxes. Here are some of the items I would consider of significant importance in the upcoming report.

Adjusted gross margin

The company's adjusted gross margin, which is calculated using the gross profit before any fair-value adjustments to inventory, declined to a mere 18.7% of gross revenue during the December quarter last year.

In other words, after expensing cash costs of production and paying excise taxes, the company was only left with 18.7% of the revenue to meet its growing selling, general, and administration expenses. That is a problem, as shrinking gross margins mean that the company requires even higher revenues from the same operating assets just to break even at the operating level.

A highly competitive industry structure dominated by a few provincial buyers may not allow the company to increase product prices to improve margins. Ideally, the company has to significantly reduce its cash costs of producing a gram of product to improve operating profitability.

However, management stopped reporting per gram costs of production some time ago, so we are left with just the adjusted gross margin as one of the most reliable gauges of how the company is managing its production costs.

Medical cannabis is down. Will sales recover?

Medical product shipments declined sequentially over three consecutive quarters down to 1,814 kilograms in the December 2018 quarter — something the company recently blamed on its reduction of medical-focused brands to only Spectrum and new competition from recreational product offerings.

I have confidence that the company will commit to this revenue segment, and it is building a strong collection of patents, but persistently declining segment sales are a cause for concern. This segment can be a very reliable source of healthy operating margins if product prices continue to be resilient.

Medical sales volumes had better pick up.

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Operating expense management

Investors expect marijuana companies to be profitable someday, although not much emphasis has been placed on this performance metric historically. However, Canopy's closest competitor, **Aurora Cannabis**, has set its sights on achieving positive EBITDA (earnings before interest, tax, depreciation, and amortization) during this current quarter.

Could Canopy Growth see an improvement in its adjusted EBITDA after reporting a sequentially worse loss of $75 million from higher revenue in a December 2018 quarter?

September 2018's quarterly adjusted EBITDA loss stood at $58 million.

It would be nice to see the company narrow down its quarterly adjusted EBITDA loss by growing revenue and containing operating costs, as investor focus increasingly turns revenue growth to improving profitability.

International sales

The company lost to Aurora, **Aphria**, and **Wayland Group** in the Germany local production tender, but that should not frighten investors, as the European country still allows imports. International medical cannabis exports, consisting primarily of sales to Germany, accounted for 16% of net quarterly medical sales by December 2018, and this revenue channel has been registering decent growth recently.

It would be favourable to see the company continuously support this high-margin segment, as management eyes global market domination; otherwise, that position could be threatened by the more aggressive competitors in the long run.

Foolish bottom line

There are many more reported items one would want to monitor with this iconic marijuana giant, including revenue growth, but the above caught my interest today.

Of course, I’m not expecting another small mistake, as what happened in the most recent report. I’ve classified that under non-recurring “items.”

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