Canopy Growth (TSX:WEED) Smoked on Earnings: Should You Buy on Weakness?

Description

Don't say you weren't warned!

Canopy Growth (TSX:WEED)(NYSE:CGC) got clobbered 7.6% on Friday following the reveal of a weaker-than-expected quarterly report that showed a big loss together with swelling operating expenses. Fellow Fool contributor Karen Thomas did a top-notch job of reviewing the results. In this piece, we'll try to determine whether it still makes sense for the average Canadian investor to hold shares of the marijuana giant as it loses steam.

You need to spend money to make money, right?

Canopy CEO Bruce Linton's tone shouldn't have come as a surprise to investors. Every time Canopy reports a number that's deep in the red, Linton shrugs it off and provides commentary on his views of the longer-term picture and why near-term losses aren't a big deal in the grander scheme of things.

"You need to use that capital to build scale. And we did," said Linton in Canopy's conference call.

To Linton, it's all about short-term pain for long-term gain, and with his foot on the gas, he'll likely have no problem telling prospective marijuana investors to "go buy a bank" if a dividend or lower capital spending is what they seek from his hyper-growth firm.

In terms of profitability, Linton also told analysts that Canopy "would have been a nice, tidy little company, probably quite profitable" if the firm "had stayed" in its high-margin state.

Linton sees margins racing higher at year-end as investments begin paying off, while higher-margin edibles sales start coming into the equation. With Canopy readying to jump on the edibles bandwagon later this year, many investors are wondering if big-name cannabis kings like Canopy could stand to experience another exponential rally.

Should you take Linton's word for it?

While I am a fan of Linton's aggressive spending, I also think Canopy has the least upside relative to its peers for many reasons that I outlined in past pieces. Moreover, legal edibles sales will be an industry-wide boon to margins, and although Canopy is getting locked and loaded, so too are other pot players that've posted better margins of late.

Sure, Canopy has a deep-pocketed dance partner in its corner and may be perceived as one of the "safer" bets in the space, but investors have to remember that Canopy trades at nearly 80 times sales, making it one of the most expensive stocks on the planet. Canopy could halve several times over and still be considered "expensive" through the eyes of fundamental analysts. By comparison, Canopy makes **Shopify**, one of Canada's highest-flying stocks, look like a cheap stock with its hefty 30 times sales multiple.

I can't say I'm an advocate of buying shares of Canopy after its latest dip. We're almost a year into legalization, and the "edibles tailwind" that some investors are growing excited about may not be enough to reverse the negative momentum faced by the industry, especially should Canada face an unexpected cannabis oversupply problem going into year-end.

Canopy is a premier cannabis player, but it's also priced like one. The recent 7.6% drop in Canopy shares would have me worried sick to be an investor.

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Author
joefrenette