Canopy Growth (TSX:WEED) Stock: Investing on Hope and a Prayer

Description

The cannabis industry had a disastrous performance this past fall. After the legalization of recreational marijuana, the industry tanked. In 2019, the industry made a comeback before peaking in March. It has been in a downtrend ever since.

Since reaching a 2019 high on March 19, the Canadian Marijuana Index has fallen by 30% as of Friday's close. It is also worth noting that the index is down 50% from its all-time high achieved in January of 2018 and down 42% from its 52-week high. This means that there are plenty of investors who are in the red if they'd bought into the hype at those times.

Last week, **Canopy Growth** (TSX:WEED)(NYSE:CGC) released fourth-quarter earnings. As the industry leader, it sets the tone for the industry. Unfortunately, it did little to kick-start a new uptrend. In fact, it did the opposite and its stock tanked on Friday.

WEED's first-quarter results

Let's start with the good news. Revenue was strong, jumping 312% to $94.1 million, beating estimates by $0.41 million. The company also exited the quarter with $4.5 billion in cash and marketable securities. This is a nice buffer to have as it expands operations.

Now, the bad news: the company posted a net loss of $323 million, or $0.98 per share. This was four times higher than estimates, as it missed by $0.66 per share. Gross margins shrank as the average selling price per gram dropped by 11% year over year.

The company also appears to be foregoing the medical marijuana space. Revenue in the Canadian medical marijuana segment dropped by 41%, and international medical marijuana revenue dropped by 25%. This is concerning, as medical marijuana is a higher-margin product.

Management, however, believes current margins are at the lowest point in its history. It believes it will be back at 40% margins within the next 12 months.

Opportunities abound

The Canadian recreational marijuana market hasn't taken off as much as expected. The launch was hindered by several operational issues, and price per gram has been on a decline. Canopy Growth has also stated that it intends to focus less on medical marijuana and more on adult use. This was evident in fourth-quarter results.

That doesn't mean it's all doom and gloom. But savvy investors should question the company's $18 billion valuation. Canopy was on record saying that it would achieve profitability once adult recreational use launched. Now, management is pointing to edibles as the key to profitability.

In an interview, co-CEO Bruce Linton said "[Edibles] is what we've been built for. It is the whole point of this exercise, to create things that are a bit more complicated and have a much more desirable consumption pattern." Ever since the **Constellation Brands** investment, the company has been positioning itself to dominate the space.

Edibles are higher margin and, as per the company, should propel the company to profitability. This may be true; however, we are starting to see cracks in the industry. Many of these companies are still trading at sky-high valuations on a promise — a promise of big things to come.

First, it was Canadian adult use. Now it is edibles and the U.S. market. In the meantime, the industry remains speculative. Big losses and lower margins dominate the headlines. Although investing on a hope and a prayer can provide outsized returns, it can also lead to significant losses. Just ask those who bought in January of 2018 or September of last year. Invest with caution.

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