Ignore Canopy Growth's (TSX:WEED) Shock Earnings and Buy Today

Description

Canada's leading cannabis cultivator **Canopy Growth** (TSX:WEED)(NYSE:CGC) disappointed the market, recently reporting worse-than-expected results for the fiscal fourth quarter. Its stock has fallen sharply in recent days to be down by 13% over the last three months. It is worth noting that even after this sharp decline, Canopy is still up by 41% since the start of 2019. While there is growing pessimism surrounding cannabis stocks, which has seen many dragged down in the wake of Canopy's poor results, investors should not be deterred from investing in Canada's largest legal cannabis cultivator.

Latest results are not as bad as they appear

Let's take a closer look at Canopy's latest results and identify what went wrong for the cannabis cultivator. Full-year fiscal 2019 revenue surged to $226 million, or was almost three times greater than for 2018. That can be attributed to the additional sales of marijuana for recreational consumption and a marked increase in the volume sold internationally for medical use. In fact, revenue from international medical marijuana sales almost tripled year over year to over $10 million.

What really upset investors over Canopy's latest numbers, is its massive net loss, which ballooned from $54 million in 2018 to $670 million for fiscal 2019, despite the almost threefold increase in net revenue.

What has emerged from those numbers is that Canopy experienced a sharp surge in expenses. Sales and marketing as well as general and administrative expenses rose roughly fourfold year over year, while research costs were 15 times greater. This can be attributed to Canopy investing heavily in scale up its operations to meet growing demand the anticipated growth of the global legal marijuana industry; it is expected that world legal cannabis sales will hit US$15 billion this year alone.

Analysts believe that the market could eclipse US$30 billion by 2020, and sales are expected to grow at a compound annual growth rate of around 27% over coming years.

As legal cannabis cultivators rush to meet the anticipated surge in demand, there will be a race to the bottom, as they invest heavily in expanding their production and processing facilities. This makes it imperative for Canopy to invest heavily in its operations if it is to retain its first-mover advantage and construct some form of economic moat to protect its business.

The pending legalization of marijuana edibles, extracts and topicals in Canada has only increased the urgency to expand production facilities. That market segment alone is expected to be worth around $2.7 billion annually, according to a report from Deloitte. The edibles market could very well be worth far more with it set to remove much of the stigma associated with recreational marijuana consumption, which led to an explosion in the consumption of marijuana-infused products after being legalized.

Such disappointing results are to be expected from a company that is rapidly ramping up its operations in a growing industry. While the market hasn't taken them particularly well, investors shouldn't be deterred from investing in Canopy. The cultivator almost tripled the amount of marijuana sold during fiscal 2019 to 24,320 kilograms, and the average selling price for domestic and international medical cannabis was 7% and 3% greater, respectively.

Canopy expects the cannabis harvested for the fiscal first quarter 2020 to reach 34,000 kilograms, allowing it to replenish inventories and keep boosting sales volumes. It also recently received a licence from Health Canada to expand its cultivation facility in Saskatchewan, where it has planted seven million square feet of cannabis cuttings.

The cultivator finished fiscal 2019 with $4.5 billion of liquidity made up of cash, cash equivalents, and marketable securities, giving it enough capital to continue expanding its operations and distribution channels.

Foolish takeaway

The cultivator's alliance with packaged liquor giant Constellation Brands, which invested $5 billion in Canopy, uniquely positions it to take full advantage of the legalization of marijuana edibles and extracts. While cannabis cultivation is still a speculative emerging industry, it is becoming increasingly clear that it is here to stay, and the legal use of marijuana will expand at a rapid clip across the globe in coming years. That means Canopy's recent pullback has provided a handy entry point for risk-tolerant investors seeking a speculative play on marijuana.

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