Why Canopy Growth (TSX:WEED) Just Got a Whole Lot Closer to Posting a Profit

Description

Canopy Growth (TSX:WEED)(NYSE:CGC) knows that it needs to find a way to cut down its costs. With a big loss in its most recent quarterly earnings, investors have started to distance themselves from the stock with the share price falling again. And with Canopy Growth recently saying that it planned to be EBITDA positive, the pressure is on for the company to produce much stronger results.

One way it can do that is by bringing its costs down. Earlier this week, the company announced that it had received a new licence from Health Canada to produce cannabis at an outdoor site in Saskatchewan. With an outdoor operation, Canopy Growth can produce cannabis at a much lower cost than at its indoor facilities. The problem is that there's less control when it comes to growing cannabis outside, and that can create more variability in the end product.

However, it's an important step for the company to take, as it needs to find ways to improve its margins, and growing outside could be a way to help bring its cost of sales down. At 160 acres, the site is a significant one, and it will help Canopy Growth benefit from economies of scale. Producing at such a large volume will definitely improve its overall cost structure.

Will higher margins be enough to land the company in the black?

The problem is that even with a higher margin, the rate at which operating expenses have been rising may still negate any improvement in gross profit. Since the industry is experiencing high growth, costs are inevitably going to rise, as companies open more locations and expand their facilities.

It isn't that the costs aren't warranted; it's that they're getting out of control. With significant sales growth, we would normally expect to see some improvement in the bottom line, as margins from the incremental sales flow through to the bottom line, but that just hasn't been happening.

The good news, however, is that with the launch of edibles, Canopy Growth will be able to diversify its product offerings a bit and could improve its margins by doing so. And once things calm down in the

Canadian market, we shouldn’t continue to see the big increases in operating expenses either.

Now that things are finally starting to normalize in the industry, the pressure will be on Canopy Growth to prove that it can run a tighter ship. The company can shift its focus from acquisitions and work on cleaning up its house to try and cut out any redundancies and inefficiencies that have resulted from its aggressive growth strategy.

It’s going to be a big test for Canopy Growth to be able to show that it can make significant progress in trimming its expenses and getting closer to breakeven. Now with cannabis investors having so many different pot stocks to choose from, the company is going to have to provide investors with more than just promises of future growth.

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djagielski