Why I’m Passing on Charlotte’s Web (TSXV:CWEB): The Market Leader in CBD Supplements

Description

If you’re reading this, chances are you’ve heard of **Charlotte’s Web Holdings** (TSX:CWEB) or at least the purported benefits of CBD on treating variety of ailments, ranging from chronic pain to seizures. Personally, I have no opinion on the efficacy of CBD, but I am very much interested in the industry and taking a position in this fast-growing sector. Looking at Charlotte’s Web, however, I cannot say that I could invest in the company at this point.

Market leadership and strong margins

CWEB is currently the market leader in the very fast-growing CBD supplement space. According to the company’s own estimates, CBD supplements will be worth $1.6 billion by 2021, up from $174 million in 2016, or a CAGR of 56%. Of the occupants in this sector, CWEB commands the leading market share north of 10%, while competitors can barely secure 2-3%. Furthermore, this market dominance is poised to continue, as CWEB has inked partnership agreements with several major U.S. retail chains, such as **Walgreens,** to sell its products at their locations.

Overall, CWEB’s products can be found at 6,000 physical locations across 18 U.S. states — a number that is poised to grow with the ramp up in sales in the post-Farm Bill environment. The growth in the retail channel and launch of 12 additional SKUs in its pet CBD line (on top of the existing 23 SKUs) mean that CWEB’s sales trajectory will significantly increase, as notable by the company’s 2019 guidance for the top line of $120-$170 million compared to $69.5 million for fiscal 2018. Furthermore, owing to CWEB’s vertically integrated supply chain, it enjoys stable EBITDA margins of roughly 30-35%.

Based on these qualities, why then am I apprehensive about CWEB? Well, there are few things of concern.

Increasing competition will weigh on margins

While CWEB is the market leader and enjoys significant brand recognition, we can expect competitive pressures to increase as more players enter the CBD space now that the Farm Bill has passed. Bear in mind that although CWEB’s branding has carried the company so far, there are very little switching costs for consumers, as CWEB’s products are not officially considered a medical supplements but marketed as dietary ones. This means that in the coming quarters, we can anticipate CWEB to spend significant amounts of cash to protect its branding, and we will see margin compression going forward.

Although mass retail presence should always to be lauded, we have very little initial sell-through figures on how CWEB’s products are faring. And while mass retailers reach broader audiences, CWEB will also have to fight hard for crowded shelf space among other CBD brands, as it shifts out of the boutique pseudo-“grass roots” vertical.

CWEB has currently filed a base-shelf prospectus to raise an additional $500 million to fund its branding initiatives, nationwide roll-out, and international expansion. Although I understand management’s reasoning for the raise, I am personally not a fan of such heavy dilution, especially as CWEB’s financial statements are currently unaudited and the company is trading at a fair valuation.

So, for now, although I am bullish on the sector, I will have to pass on Charlotte’s Web.

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