Canopy Growth (TSX:WEED) Stock: Should You Buy the Dip?

Description

Cannabis stocks were riding high, as we moved into the spring of 2019. The glow had returned after a rough post-legalization dip for the sector. Broader market turbulence has historically had a strong impact on cannabis stocks, and the late 2018 correction was no different. Unfortunately, this momentum has not lasted.

In the middle of spring, I'd warned investors that cannabis stocks were likely headed for a bout with the bear. The catalyst for this poor outlook was the revelation that cannabis sales had broadly disappointed to start 2019.

Scotiabank released a forecast that projected disappointing earnings for many of the top producers. The warnings have turned out to be accurate, as earnings have poured out in the spring and summer.

Canopy Growth (TSX:WEED)(NYSE:CGC) stock is the largest cannabis company by market cap on the TSX. Shares gained a second wind from mid-April into May. In late May, I'd discussed Canopy Growth's impending Q4 and full-year earnings release and said that Canopy Growth was too pricey to pick up at the time.

The company released its first-quarter fiscal 2020 results on August 14. Shares fell after the release as Canopy Growth's earnings disappointed analysts. The company posted a $1.28 billion loss, or $3.70 per share, in the first quarter, down significantly from a $91 million loss, or $0.40 per share, in Q1 fiscal 2019.

Canopy conceded that it was still likely three to five years away from profitability. This comes a month after former CEO Bruce Linton was pushed out, reportedly due to dissatisfaction in the company's performance from **Constellation Brands** and other stakeholders.

It was not all bad news for Canopy Growth in the quarter. The company reported that it had increased dried cannabis sales 94% compared to Q4 fiscal 2019. Its international cannabis revenue rose 209% from the prior year.

Still, Canopy's inability to turn improved sales in the wake of legalization into more significant revenue growth is concerning. The company is facing an uphill battle, as deteriorating margins and cash flow come into focus.

Canopy built massive inventory in preparation for legalization, which helped it get off to a fast start in late 2018. This led to positive sales initially, but the company has struggled to convert its greenhouse assets into grow operations as quickly as investors would have liked to see. The running of these facilities, which were going off zero production, led to an industry-low gross margin of 15%.

Is there any reason to jump on Canopy stock right now?

Shares of Canopy have plunged 23% over the past month as of close on August 19. The company is years away from profitability, and the more analysts focus on financial metrics, the more shareholders will find themselves frustrated.

Even more alarming are some of the broader indicators in the sector. Canada has failed to weed out the black market, and now that legal prices are rising, many buyers have simply moved back to underground channels. Demand has fallen below estimates on the domestic front. Disappointment is the word that comes to mind as we approach the one-year anniversary of recreational legalization.

Canopy stock had an RSI of 25 as of close on August 19. This puts the stock in technically oversold territory, but there are too many hurdles for me to consider jumping on the stock in the late summer.

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