Is Canopy Growth (TSX:WEED) a Bargain Stock?

Description

High insider ownership is usually considered a good sign for a stock's future prospects. When people who know everything about a company's operations buy it, it indicates that the stock has a good future — or so the theory goes.

Enter **Canopy Growth** (TSX:WEED)(NYSE:CGC).

Recently, it was revealed that the company's ex-CEO Bruce Linton had been buying up shares, calling its August beatdown a "sale," and re-affirming his belief in the company's long-term soundness. Prior to this, investors had sent WEED shares tanking after a surprise earnings release that showed an unprecedented $1.3 billion net loss.

Although he's technically no longer a Canopy insider, Linton *was* on the inside as recently as last quarter. This means that his opinion on Canopy may be worth listening to. Before assessing whether Bruce Linton is correct about this "sale," let's look at some of the criteria investors use to decide whether a stock is a bargain.

What makes a stock a bargain?

For value investors, stocks are generally considered cheap when their share price is low compared to their discounted future cash flows. The word *future* is key here, because it means that there's no accurate way to measure the most important metric. Past cash flows don't necessarily indicate future cash flows, and earnings projections can falter just as much as stock price forecasts.

To compensate for the lack of data on discounted future cash flows, value investors use a number of metrics to value shares. The price-to-earnings (P/E) ratio measures a stock's price against its trailing 12-month earnings. The price-to-sales (P/S) ratio measures price against sales, which don't necessarily indicate profitability but may be the only metric available for young companies that are still losing money. Finally, the P/E-to-growth ratio measures a company's price and earnings against its earnings-growth rate.

Is Bruce Linton right?

With a basic understanding of metrics that value investors use to decide whether a stock is “on sale,” we can now tackle the main question: *Is Canopy “on sale?”*

Unfortunately, it’s not going to be an easy one to answer.

For one thing, the company is not profitable, so the trailing P/E ratio isn’t applicable.

For another, while the P/S ratio (41) is still *extremely* high, the price-to-book ratio (2.1) is actually fairly reasonable, so what metrics we do have give us conflicting signals.

The company’s quarterly revenue growth rate (249% year over year) is *unbelievably* high, and if it can be maintained for several years, it may even justify a P/S ratio in the 40s.

Put simply, the valuation metrics available for Canopy are extremely hard to read, which may be why investors in this and other emerging growth stocks prefer to use technical analysis.

Foolish takeaway

Ultimately, I think Canopy is still overvalued, even after the August “sale” — the reason being that I don’t think its current revenue growth rate will be maintained into 2020. Whenever Canopy releases earnings this year, it compares post-legalization revenue to pre-legalization revenue, because all the comparable “last year” periods were from before legalization. Legalization was an enormous catalyst that gave weed companies a huge one-time revenue boost, and there are no other catalysts like this on the horizon. So, revenue growth rates will most likely slow in 2020, and these extraordinarily high P/S ratios will be harder to justify.

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