Should You Buy Canopy Growth (TSX:WEED)?

Description

In case you haven't noticed, Canada's enviable cannabis sector has been busting more than booming lately. In the months and weeks counting down to legalization, cannabis stocks such as **Canopy Growth** (TSX:WEED)(NYSE:CGC) shot well into the stratosphere. Unfortunately, after a rally in the early part of the year, pot stocks have taken a turn and dropped sharply. In the case of Canopy, the stock is down 44% in the past six-month period, trading right near its 52-week low.

Let's take at why the cannabis sector is lagging, and if Canopy is still the incredible investment that it was once was.

Are expectations too high?

When legalization was first announced, investors and analysts alike viewed it as the incredible opportunity that it was. For Canopy, that hype amounted to an incredible amount of investment capital, which was used to boost production and distribution capabilities. The company also completed several acquisitions to bolster its standing at home and abroad.

Each of those actions drove expectations higher and attracted even more investments. This was a new segment of the market, and Canopy was the market leader.

The only problem was (and continues to be) profitability.

Earlier this month, Canopy reported earnings for the first fiscal quarter of 2020. During the quarter, Canopy reported a loss of $1.28 billion, or $3.70 per share, which was a stark difference from the loss sustained in the same quarter last year, which amount to $91 million, or $0.40 per share.

A non-cash loss of $1.18 billion was the primary driver for the loss, which was attributed to the extinguishing of warrants held by one of Canopy's larger investors, **Constellation Brands**. A restatement of investor rights between the companies was made at the end of June, which resulted in the non-cash loss.

Adjusted EBITDA for the quarter came in at a loss of $92 million, which reflected a small improvement over the $97.7 million loss reported in the prior quarter. Canopy noted that some of that loss was also attributed to expansion costs, particularly a hemp facility in New York.

When can we expect a profit?

That's the question on every investor's mind; it is difficult to answer. This is still a segment of the market that is very much in its infancy that is continuing to evolve.

Adding to that complexity is what many are referring to as legalization 2.0 — the introduction of edibles into the market is set to begin later this year. That expansion will bring a flurry of new products such as beverages, edibles, and vapes to the market, with Canopy and its peers ramping up production and making investments into those new product verticals.

What this means is that investors should view the sector as one that is still in its infancy and, by extension, view Canopy as a company that is still in a start-up mentality, where investments and ramping up production is key and posting a huge profit comes secondary.

Final thoughts

Canopy is an intriguing investment that is operating in uncharted territory, but it's not all bad news. While the stock may be down considerably year to date, Canopy is still up over 260% in the past two years.

Investors that have long-term timelines and an appetite for short-term risk may want to include the company as part of a larger, well-diversified portfolio.

However, if your investing timeline is shorter and you haven't already invested in Canopy, you may want to consider any number of other, more defensive options, many of which come with handsome dividends.

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