Canopy (TSX:WEED) Lost $1.2 Billion: Should You Still Buy?

Description

The much-hyped cannabis industry is probably not looking as good as you thought it was after **Canopy Growth** (TSX:WEED)(NYSE:CGC) released its earnings report on August 14. In the report, WEED recorded a net loss of $1.28 billion in Q1 of the fiscal year 2020 ended June 30, or $3.70 per share.

That is much higher than any loss the company has ever had and among the worst when compared to other cannabis companies in Canada. Now you have to ask yourself whether this major cannabis company is worth investing in or not.

Why is the largest cannabis company underperforming?

Canopy Growth is the largest cannabis company in the world by market capitalization, and as such, it is used as a yardstick for analyzing the entire industry. For an industry expected to be worth about $200 billion by 2030, you may have expected to see better financial reports.

Lower sales than expected

Gross sales in Q1 2020 from the company reached $103.4 million, or net sales of $90.5 million after excise taxes are factored in. This was a decline from net sales of $94.1 million in Q4 2019 ended March 31, 2019. Moreover, gross sales were lower than the market consensus forecast of $109 million.

Market experts were hoping for higher sales figures because the harvest for Q1 2020 was projected at 34,000 kg, more than double the crop from Q2 2019. When a cannabis company does a harvest, that stock is usually sold in the next fiscal quarter. Q2 and Q3 harvests in the fiscal year 2019 were lower because the company was retrofitting its grow houses, but the Q4 2019 fiscal year harvest was much higher. Indeed, the harvest in Q1 2020 was 40,960 kg as expected, but the revenue and gross margin were the problems.

Net revenue in the first quarter of 2020 was $90.5 million, which was 4% lower than revenue in the fourth quarter of 2019. Most market experts were expecting a 17% increase in revenue quarter over quarter.

Underperforming segments

The problem was not in the entire business but rather in specific segments. For example, dried cannabis sales rose by 94% from the fourth quarter of 2019 to $60.8 million in the first quarter of 2020. International sales of cannabis also increased exponentially from $1.8 million to $10.5 million.

However, the company's cannabis oils segment recorded a significant decrease from $36.5 million to only $0.2 million. Now market analysts have attributed this decline in revenue to market stuffing by the company. You may remember how much Canopy Growth's revenues were boosted in the previous quarter. The growth is primarily from sales of cannabis oils and softgels thanks to the acquisition of German company Storz & Bickel.

Gross margins by Canopy Growth were also dismal at 15% in the first quarter of 2020, down from 16% in Q4 2019 and lower than 23% market forecast. The company's CFO Mike Lee said in June that the retrofitting of the facilities would take a toll on gross margins for a few quarters. It turns out he was right, but the CFO expects gross margins to bounce back to 40% by the end of 2020 fiscal year ending on March 31, 2020.

Is Canopy Growth worth investing in now?

When looking for an investment opportunity, you should always look for new industries with a lot of potential. There is a lot of potential about the cannabis industry, but that status also comes with setbacks. The most significant is goodwill, where many cannabis companies are overpaying for acquisitions.

The company's goodwill thus rose from $387 million to $1.93 billion due to these acquisitions, and the $1.18 billion reported as a loss in Q1 2020 was due to the extinguishment of these warrants held by its partnership with **Constellation Brands**. That much goodwill most likely means that the debt will be written down at some point. Even the company's officials in an earnings call stated that it would take between three and five years before a profit is recorded.

Conclusion

All this information means that Canopy Growth would not be an ideal investment for you if you're expecting to turn a profit quickly. But if you are willing to wait a few years, now would be the time to buy and hold.

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