How the World’s Top Marijuana Stock Fell From Grace

Description

Canopy Growth (TSX:WEED)(NYSE:CGC) was once the world’s most beloved marijuana stock. After its $5 billion **Constellation Brands** deal, it went on a tear in the markets so pronounced, it lifted the rest of its sector with it. It’s hard to imagine now, but there was a time when many commentators believed Canopy was destined to soar to $100 and reach a market cap of $33 billion. In fact, it was at one point not far from hitting that milestone: its peak 2018 closing price was $73 and it had a market cap over $20 billion at that time.

That was then, this is now.

After the firing of its CEO and a $1.23 billion net loss, Canopy’s shares have been tanking hard. Down 14% for the full year and 51.9% from its peak price, WEED is about as bearish as they come. Although most marijuana stocks have been doing poorly this year, Canopy has been one of the worst. The following are three reasons why.

Ballooning expenses

It’s no secret that Canopy wasn’t profitable in its most recent quarter. In fact, with a $1.23 *billion* net loss, it was far from it. The lion’s share of Canopy’s enormous Q1 loss was warrant extinguishment, a one-time event that won’t recur. However, even the operating loss (which doesn’t include financing factors) was fairly large, coming in at $109 million.

A big reason for these losses is rising expenses. From Q2 to Q4, Canopy’s expenses grew from $234 million to $254 million, a sizable jump. However, those expenses fell to $200 million in Q1, so it’s possible that this long-term trend is starting to reverse.

Growth not matching competitors

The case for bullishness on marijuana stocks is based on one thing: growth. Almost none of these stocks are profitable, but most of them have revenue growth in spades. Canopy is no exception to this rule, having grown sales by 331% year over year in its most recent quarter. However, compared to ultra-high growers like **Aphria**, that's not particularly great, especially when you consider that the company's revenue growth will likely slow down as the one-time boost from legalization fades into the rear-view mirror.

Massive amounts of goodwill

A final factor that could be negatively affecting Canopy's stock price is the goodwill on its books. Goodwill is generally defined as the premium a company pays for an acquisition above the target company's book value. This "premium" can be kept on a company's balance sheet as an asset, provided the asset is generating value for shareholders. However, accounting rules require that companies periodically "test" their goodwill to make sure it's actually generating value for shareholders. If it's not, then it may have to be written down.

As of its most recent quarter, Canopy had about $1.9 billion in goodwill on it books — the largest single category of assets it possessed. Should some of the company's acquisitions prove to have been worthless, then much of that will have to be written down, drastically diminishing Canopy's book value. If this comes to pass, then Canopy's fall will likely continue.

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Date
2025/08/25
Date Created
2019/09/23
Author
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