Canopy Growth (TSX:WEED) Earnings Drag Cannabis Stocks Lower

Description

Shares of Canada's leading cannabis company **Canopy Growth** (TSX:WEED)(NYSE:CGC) fell 14.5% yesterday after it announced fiscal second quarter of 2020 (year ending in March) results.

In the September quarter, Canopy Growth reported sales of $76.6 million, a year-over-year growth of 228% compared to sales of $23.33 million in the prior-year period. The company's earnings per share improved from -$1.52 to -$1.08 in the same period.

Canopy reported earnings and revenue significantly below consensus estimates. Analysts estimated Canopy Growth to post sales of $108.48 million and EPS of -$0.39 in the fiscal second quarter. Net revenue also fell 15% compared to sales of $90.5 million in the first quarter of fiscal 2020.

The company's less-than-impressive results dragged the entire cannabis sector lower. Shares of **Aurora Cannabis**, **Hexo**, and **Cronos** were down by 8.7%, 7.6%, and 4.2%, respectively, on November 14, 2019. **Horizons Marijuana Life Sciences ETF** was also down 5.3% yesterday.

What drove Canopy Growth sales in Q2?

In the September quarter, Canopy Growth established a market share of 35% in Alberta, which is considered to be the country's most developed provincial recreational market. The company continued to benefit from the growing demand for cannabis.

Its same-store sales in recreational cannabis rose 17%, while global medical organic growth was 23% on a sequential basis. However, the lower-than-expected sales were attributed to a challenging market environment.

Several provinces have reduced demand to lower inventory levels. Further, as cannabis is a highly regulated market, the retail store openings have not been on expected levels. Though several companies have invested heavily in cannabis-infused vapes, edibles, and concentrates, these products will not hit retail shelves till mid-December.

Canopy Growth CEO Mark Zekulin stated, “The last two quarters have been challenging for the Canadian cannabis sector as provinces have reduced purchases to lower inventory levels, retail store openings have fallen short of expectations, and Cannabis 2.0 products are yet to come to market … However, we believe these conditions are a short-term headwind in what is a brand-new industry, and Canopy continues to be best positioned with cash-on-hand, a world-class infrastructure, and a portfolio of intellectual property to deliver sustained, long-term market leadership.”

What’s next for Canopy Growth and investors?

Shares of Canopy Growth are currently trading at $20.7, which is 72% below its 52-week high of $71. Investors have lost significant wealth in the last year after the euphoria about the legalization of recreational cannabis had run its course.

So, how is Canopy Growth looking to solve lower demand and rising inventory levels? At the end of the September quarter, Canopy had inventory worth $461.8 million, which is massive given the tepid demand.

The company’s management has initiated a portfolio review, which resulted in restructuring charges of $32.7 million for returns, returns provisions, and pricing allowances. This strategy includes a new retail pricing architecture, a rationalized package assortment and a focus on a marketing strategy to increase consumer awareness.

Canopy Growth has submitted over 30 SKUs (stock-keeping units) to Health Canada for approval of Cannabis 2.0 products, including chocolates, vapes, and beverage formats. The cannabis-infused edibles will be a critical driver of sales. But as we know, it is too early to estimate demand in a market that is facing teething and regulatory issues.

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