This Micro-Cap Canadian Cannabis Stock Gained Momentum Last Week

Description

Shares of **Zenabis Global** (TSX:ZENA) are trading at $0.2150. The stock has gained 16% in the last week of November, even after accounting for a 12.2% decline on November 29. Despite the recent upward spiral, Zenabis is trading a staggering 97% below its 52-week high.

Zenabis investors have been impacted by the overall weakness in the cannabis space. Investors are worried about lower-than-estimated growth, rising inventory levels, regulatory concerns, and more.

In addition to this, Zenabis was also struggling with cash flow issues and revised construction timelines for its Langley facility, which dragged the stock to its 52-week low.

Zenabis completes rights offering

On November 28, Zenabis Global announced that it has closed rights offerings, which will result in the issuance of 139,086,624 common shares at $0.15 per share for gross proceeds of $20.8 million. The rights offer was oversubscribed, which resulted in a 20% gain for investors on Thursday.

To date, Zenabis has raised close to $260 million in debt and equity capital. This has helped the firm increase production capacity at a significant rate. According to Zenabis Global's presentation, the company has managed to increase production capacity from 5,700 kg in the fourth quarter of 2018 to 57,000 kg at the end of September 2019.

The company is now looking to increase its production capacity to 96,000 kg by the end of 2019 and to 143,200 kg in 2020. But given the tepid demand due to the slow rollout of retail stores across major Canadian provinces, is it a good time to invest heavily in increasing production facilities?

The inventory levels of most cannabis companies stand at record levels and might lead to write-offs, lowering profit margins.

Zenabis reports Q3 results

Earlier this month, Zenabis global announced its third-quarter results as well. In the September quarter, it reported a net revenue of $12 million — a decline of 52% compared to net revenue of $25.04 million in the June quarter.

Though gross profit fell 40% to $5.06 million in Q3, the gross margin stood at 42% compared to a margin of 33.6% in Q2. Analysts expected Zenabis Global to post sales of $15.4 million in the third quarter of 2019.

While Zenabis sales were down over 50%, its inventory rose 58% sequentially to $28.34 million and accounted for 42.7% of the estimated 2019 revenue. Similarly, while sales were up 235% year over year in the September quarter, inventory rose by 541% year over year in the third quarter.

Zenabis cultivated 5,239 kg of cannabis in the September quarter and increased kg yield by 112% sequentially. It increased licensed annual production capacity by 147% as well. However, these increases need to be supported by strong demand, and this has not been the case for most cannabis companies.

Over the last few months, analysts have revised sales estimates significantly lower. These estimates have fallen lower for Zenabis as well. Analysts expect the company to report revenue of $64 million in 2019 and $318 million in 2021.

Just last month, Zenabis was estimated to report revenue of $86.2 million in 2019 and $396 million in 2021. The sales estimates for 2021 stood at $478 million in September this year.

The oversupply issues will impact cannabis companies as we inch closer to 2020. Cannabis is a highly regularized market, and the retail rollout will be slow rather than steady. However, will investors be buoyed with the latest capital financing for Zenabis, and are they willing to bet on a stock that is trading at a cheap valuation after losing 96% in market value?

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