Can This Cannabis Stock Sustain its Strong Start to 2020?

Description

Shares of Canada-based cannabis company **Charlotte's Web Holdings** (TSX:CWEB) have gained close to 18% since the start of 2020. Several cannabis stocks got a boost after **Organigram** reported its stellar quarterly report on January 14.

Pot stocks have also gained momentum after the Ontario government announced plans to increase the number of cannabis stores in the next two years. However, this accelerated rollout will not positively impact the top line for CWEB, as it primarily focuses on the production and distribution of hemp-based cannabidiol (CBD).

CWEB is engaged in the alternative medicine sector, and products are made from strains of hemp extracts that do not possess any psychoactive effects. It does not produce or sell medicinal or recreational marijuana products.

While the stock has recently gained momentum, it is still trading 14% below its IPO price of $13.25.

Strong financial metrics

CWEB claims to be the top brand in the hemp-derived CBD market. It has managed to grow sales from $14.7 million in 2016 to $40 million in 2017 and $69.5 million in 2018. The company is vertically integrated, giving it opportunities to optimize the supply chain. CWEB gross margins have risen from 65% to 75% between 2016 and 2018, while adjusted EBITDA margin rose from 14% to 30% in the same period.

In the last reported quarter, Charlotte's Web Holdings reported sales of $25.1 million — a growth of 42% year over year with a gross margin of 71%. Over 50% of sales in the third quarter were from the e-commerce channel, while B2B sales were up 66.4%.

CWEB has increased its total production area from 70 acres in 2017 to 862 acres in 2019. This will result in a significant jump in total hemp production for the firm.

Increase in distribution network

CWEB has expanded its distribution in 2019, which has driven sales higher. At the end of the third quarter, CWEB products have been available in 9,000 locations and are estimated to touch 10,000 by the end of the December quarter.

The company is eyeing growth in the FDM (food/drug/mass) channel. During the earnings call, CWEB CEO Deanie Elsner stated, “Over the past several months, we’ve put substantial infrastructure in place to accommodate anticipated future growth driven by the FDM channel. This includes management team processes in addition to investment in expanded production, distribution, R&D and extraction capacity.”

Elsner added, “We continue to progress our expansion plan so that when the FDA regulations are set for the CBD category, we are ready with the infrastructure and capacity to disproportionally capture that growth. The FDM channel introduces new patterns to our sales growth as large pipeline orders get filled creating an initial revenue spike in any given period.”

What’s next for investors?

CWEB is one of the few pot companies to report a positive EBITDA. Analysts expect sales to touch $99 million in 2019, $147 million in 2020, and $264 million in 2021. Its EBITDA margin is expected to improve from 9% in 2019 to 26% in 2021.

CWEB is not dependent on retail stores to push inventory and drive the top line higher. It is also immune to the impact of illegal sales that hinder traditional pot stocks in the recreational cannabis sector. CWEB is targeting a niche segment and is set to benefit from the growth in this space.

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