Why Canopy Growth (TSX:WEED) Stock Gained 10.8% Yesterday

Description

Shares of Canada's cannabis giant **Canopy Growth** (TSX:WEED)(NYSE:CGC) gained close to 11% on January 28, 2020. The stock closed trading at $31.45 yesterday. Canopy shares rose after investment bank BMO Capital upgraded the stock to outperform from market perform.

According to one report from *The Fly*, BMO Capital analyst Tamy Chen increased the stock's 12-month price target from $25 to $40. Chen stated the sell-off that drove Canopy stock lower in the last year was driven by a sub-optimal product mix coupled with industry-wide challenges.

The analyst expects Canopy Growth to post solid fiscal third-quarter 2020 results, as the new product mix will be aligned with consumer demand, and even a small beat in earnings or revenue can shift investor sentiment.

We know that the cannabis space has been impacted by several structural issues, including oversupply, competition from illegal sales, and falling profit margins. This has led to a severe sell-off in pot stocks over the last 12 months.

Despite the 10.8% gain for Canopy Growth, the stock is still trading 56% below its 52-week high. The upcoming company earnings will be a key driver of stock price not just for Canopy, but for other publicly traded pot stocks as well.

Analysts expect revenue of $103.8 million

In the fiscal third quarter of 2020 (ended in December), analysts have forecast company sales to reach $103.8 million — growth of 25% year over year. Earnings are expected to fall 26.3% to -$0.48.

In the September quarter, Canopy Growth reported sales of $76.6 million, 15% lower compared to the sequential quarter. It had to book a loss of $32.7 million in Q2 due to lower demand that resulted in product returns for its high-margin soft gel and oil products.

The other major issues that resulted in an operating loss of $265.8 million in the September quarter for

Canopy was its share-based compensation, which was higher than its quarterly sales.

Canopy Growth ended the first quarter with a cash balance of $2.75 billion and a debt of $720.5 million. Though the company has huge cash reserves, it will need to focus on increasing profit margins, as it is ended Q2 with an operating cash flow of -$681.71 million.

Canopy Growth continues to invest heavily in capital expenditures (capex). Analysts expect the company's capex to increase from $644 million in fiscal 2019 to $727 million in fiscal 2020, which will result in a lower cash balance by the end of this fiscal year.

These investments will mean Canopy Growth will post a negative EBITDA over the next few years. According to analyst estimates, Canopy's EBITDA might fall from -$257 million in 2019 to -$452 million in 2020 and improve to -$66.8 million by 2022.

What next for investors?

Canopy Growth stock has made a strong comeback in CY 2020. Shares have gained 20.4% year to date compared to the returns of 7.7% for the **Horizons Marijuana Life Sciences ETF**.

While there are structural issues that will continue to impact Canopy Growth in the short term, the rollout of retail stores in major Canadian provinces, the investment of **Constellation Brands**, and the company's massive reach will hold investors in good stead.

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Date
2025/08/26
Date Created
2020/01/29

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