Canopy (TSX:WEED) Still Appears Overvalued Even After Losing 53%

Description

The last two years have been a particularly turbulent time for cannabis stocks. The cannabis bubble appeared to burst in late 2018, which saw many industry players plunge in value as investors quickly moved to take profits.

The largest industry exchange-traded fund (ETF), the **ETFMG Alternative Harvest ETF**, which has around US$747 million in assets, has lost a whopping 54% over the last year.

Many of the major legal marijuana cultivators have suffered similar declines. **Canopy Growth** (TSX:WEED)(NYSE:CGC), which is the largest single holding in Alternative Harvest, has also lost 54%.

While pot stocks have rallied since the start of 2020, notably after **Organigram** reported strong fiscal first quarter 2020 results, the outlook for the legal cannabis industry may not be as positive as pundits would have investors to believe.

Weak outlook

For its fiscal second quarter 2020, Canopy reported a whopping $375 million loss on the back of a full-year 2019 loss of $671 million.

That significantly undermined confidence in the company once hailed as a revolutionary market leader. Even after allowing for that loss of confidence and sharp decline in market value, Canopy has gained an impressive 196% over the last three years, seeing it trade with a market cap of over $10 billion.

This sees the loss-making cultivator worth more than well-known Canadian growth stock **Parkland Fuel**.

Canada's largest legal cannabis cultivator brought in revenue of just $253 million for its fiscal full-year 2019 compared to Parkland reporting sales revenue of almost $14 billion for the first nine months of last year.

This sees Canopy trading with a nosebleed valuation of 30 times sales compared to Parkland, which is sporting a price-to-sales ratio of 0.4.

It's difficult to see how Canopy can expand its sales so at to be earning revenue that's analogous to its market value. Companies operating in similar industries, such as packaged liquor giant **Constellation Brands**, Canopy's cornerstone shareholder, trades at just over four times sales.

Tobacco giant **Altria**, which made a US$1.8 billion investment to acquire a 45% interest in cannabis grower **Cronos Group**, also has a market value of around four times sales.

If Canopy is to trade with comparable metrics, its revenue would need to grow roughly 10-fold or see its market value fall to around a tenth of its current value.

It's unlikely that cannabis cultivators will experience the massive sales growth that many industry insiders and investors were predicting less than two years ago. Canada and Uruguay are the only countries to have full legalized the recreational consumption of marijuana.

While it appears increasingly likely that marijuana will be removed as a U.S. federal schedule one substance, there's increasing resistance to legalizing its social consumption.

In many countries, there's still a considerable stigma attached to the use of cannabis, while higher rates of hospital admissions and motor vehicle accidents in jurisdictions where it is legalized serve as a deterrent to lawmakers in other locations.

It's estimated that the global legal marijuana industry may be worth only US$97 billion by 2026 compared to 2018 claims by Canopy's former CEO Bruce Linton that it was potentially a global US$500 billion industry.

The removal of cannabis as a U.S. federal schedule one controlled substance will trigger a veritable green rush as new cultivators enter an industry with few barriers to entry to profit from the predicted massive growth in consumption.

That will occur because it will allow financial institutions and other providers of investment capital including venture capital firms to start funding to cannabis companies and related start-ups.

Such an explosion in competition will only reduce the potential for existing cultivators such as Canopy to grow sales and revenue as initially anticipated.

Looking ahead

There are considerable headwinds for the global legal cannabis industry. While consumption of marijuana products is expected to grow at a rapid clip, so too will global supplies of dried flower and derivative products.

And that, along with regulatory pressures and increasing uncertainty over the true size of the global legal marijuana market renders it unlikely that Canopy will live up to the hype that initially surrounded its stock. Clearly, Canopy still has a ways to fall.

CATEGORY

1. Cannabis Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:CGC (Canopy Growth)
2. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Cannabis Stocks
2. Investing

Date
2025/06/29
Date Created
2020/02/05
Author
mattdsmith