# Canopy Growth's (TSX:WEED) Latest 62% Revenue Growth Isn't Repeatable

### Description

**Canopy Growth** (TSX:WEED)(NYSE:CGC) stock soared over 15% on Friday after the cannabis firm released a strong earnings report that revealed a 62% sequential net revenue growth to $124 million for its fiscal Q3 2019 ended in December 2019.



Such high double-digit growth rates, especially on a sequential quarter-over-quarter basis, deserve a huge celebration and should naturally drive the stock price wild if they were not already built into analyst and market expectations.

That said, is Canopy Growth's 62% sequential quarterly revenue growth as big as it appears?

## The biggest revenue drivers

Canadian recreational cannabis sales to the provinces and from other business-to-business arrangements surged by 221% over three months, while direct to consumer retail sales grew by 16%.

The "Other revenue" segment pulled a 41% sequential sales surge too. Medical cannabis and international sales were just marginally higher at 4% at best.

Revenue performed very well, albeit not as well. I will discuss this position below.

## Benefits from prior charges

The company made some significant revenue charges during the previous quarter ending September 31, 2019 which management called portfolio restructuring charges.

Significant amounts of cannabis extracts went unsold across the provinces as the recreational marijuana market revealed its strong preference for the traditional, high potency dried flower.

The company had to make a $32.7 million charge on sales for the September quarter as it sought new strategies to move the unsold oils and soft gel volumes at adjusted prices.

Excluding the charges made on prior quarter sales, Q3 2020 total net revenue was only 13.2% higher on a sequential basis!

## Double digit same-store retail sales growth

Cannabis retailers are seeing some respectable growth rates across Canada, and Canopy is benefiting from this wave as well after reporting an 11% same-store-sales growth at its Tweed and Tokyo Smoke-branded retail stores during the past quarter. Overall, direct to market pot sales were 16% stronger on a sequential basis.

## A seasonal thing?

The company's "Other revenue" line saw a 41% surge during the December quarter, but this run rate isn't likely sustainable and a sequential growth analysis may no longer be advisable.



Management revealed that the segment's strong performance was aided by "strong seasonal performance" from its Germany based vaporiser subsidiary Storz & Bickel (acquired in December 2018) and This Works, its British skin-care and well-being subsidiary which joined the group in May last year.

Marijuana hasn't been a seasonally affected business historically, but taking such emerging seasonality into consideration, investors may have start comparing year-on-year performance and abandon sequential growth analysis on this firm's results going forward.

Most noteworthy, another recent acquisition, BioSteel Sports Nutrition, which was added to the fold in October last year, contributed "Other revenue" too. Not all of the reported sales growth was from organic sources, however.

## Foolish takeaway

With meaning to take the recent earnings glory away from this mighty weed grower, the strong sequential performance in the top line was aided by other not-so-repeatable factors. I wouldn't expect the same to happen in the next quarterly results installment.

One sticky issue I still have the world's biggest pot firm is its persistently low gross margins. Even after a change in accounting policies that moved royalties from production costs down the income statement to selling and marketing expenses, gross margins remain severely subdued, at 34% of revenue for the recently reported quarter.

This points to one thing: the company is failing to reduce its production costs per gram of cannabis. Management ceased reporting on per-gram cash costs a long while ago, and I hope the newleadership will give us a better metric, as the former CEO Bruce Linton once suggested.

Otherwise, there's some promising progress here, although bloated operating costs mean that the company is still a long way from cash flow positive operations.

More revenue growth is required, or else a restructuring similar to **Aurora Cannabis**' could be the best route for the new CEO to take to halt the cash burn rate.

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