The Constellation Investment Is Proving to Be Canopy's (TSX:WEED) Most Significant Competitive Advantage

Description

You may have seen the recent news about **Constellation** (NYSE:STZ) exercising warrants to acquire additional shares in **Canopy** (TSX:WEED)(NYSE:CGC). This announcement was easy to overlook, partly because of its timing (the announcement came out after markets closed on a Friday), partly because Constellation is already Canopy's largest shareholder, and mostly because of everything else happening in the world right now. However, when you dive into the details, you begin to further see how Canopy's balance sheet and aggressive 2017-2018 fundraising is its biggest competitive advantage in this uncertain environment.

Unlike options that average investors buy and sell in the market, warrants are issued by the company, and when the investor exercises them, it's the issuing company that gets the money. This means that Canopy will receive the proceeds of the warrant exercise by Constellation ($245 million, less any applicable fees). While the exercise price was $12.98, this price was negotiated back in 2017 as part of Constellation's initial $245 million investment in Canopy (not the massive $5 billion follow-up investment that occurred in 2018). Therefore, the low exercise price is not a fire sale, but rather, it's consistent with the terms of the 2017 deal — it was always expected that Canopy would have to issue these shares at $12.98.

This is great news for Canopy, as it further entrenches its position as the leading Canadian licensed producer and the one best positioned to ride out the current market uncertainty. While this recent infusion only represents a 10% increase to the company's cash and marketable securities balance, as of Q3 2020, it also represents an entire quarter of operating expenses based on the same quarter. Keep in mind that Q3 2020 includes operating expenses that will no longer be incurred going forward, as the company has significantly pared down production operations since new CEO David Klein arrived — so the $245 million will likely be able to cover more than a quarter's worth of operating expenses, given the company's new and "right-sized" footprint.

Additionally, as part of the 2018 follow-on financing, Constellation was granted about 140 million new warrants that become exercisable through 2021. While most of these are exercisable at over $50 per share, 51.3 million are exercisable at Canopy's average price at the time of exercise. While it is far from certain that these warrants will be exercised, if the share price remains depressed for some time, Constellation may very well exercise these 51.3 million warrants, which could provide Canopy with hundreds of millions in additional funds without the need to negotiate with the capital markets for further funding in such a weak environment.

Ultimately, this recent development reinforces the notion that Canopy's balance sheet is one of its most valuable competitive advantages, primarily because no cannabis company, in the foreseeable future, will be able to raise the kind of money that Canopy did in 2017-2018 at the valuations that it did. This balance sheet will allow it to continue to survive, and even thrive, in the uncertain landscape that we currently find ourselves in.

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Date
2025/08/13
Date Created
2020/05/13
Author
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