



My Top Cannabis Pick

Description

This recent market turmoil has resulted in what I can only describe as a tectonic shift in the Canadian cannabis sector. Investors have moved from a growth-at-any-cost, risk-seeking base of retail investors to a much more conservative, long-term group of investors.

Stock prices tell this story. In this article, I'm going to discuss why, despite more downside likely on the horizon, **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) is now my top pick in this sector.

Economies of scale and cost advantage are important

As we've seen recently with the ports of massive supply glut of cannabis in the Canadian market, economies of scale have turned out to be quite the double-edged sword. Investors are now concerned about too much cannabis being produced on an ongoing basis. This structurally hurts the margins of producers such as Canopy.

The good news is that [Canopy has done a much better job than its peers](#), in my view, of reducing production. Therefore, Canopy acted as the market leader, in this regard. Massive production capacity has provided Canopy with excellent unit economics at competitive costs advantage over its peers. However, this has also contributed to the supply glut we now have in the market.

As of the first fiscal quarter of this year, Canopy had approximately 2.5 years' worth of cannabis inventory. To combat a growing inventory and demand implosion for all intents and purposes relative to previous predictions, Canopy wisely decided to trim its production capacity in a rapid way. The company was able to trim millions of square feet of production space and hundreds of jobs. The goal of Canopy was to become leaner and meaner in these uncertain times.

Long-term outlook is a big plus

In addition to these production moves, I also appreciate the focus Canopy's board has had on moving the company toward profitability sooner than its peers. Canopy announced that David Klein, the former

CFO of **Constellation Brands**, would become the company's new CEO. Constellation Brands is a majority stakeholder in Canopy.

This move signaled a corporate focus on profitability and cost containment, away from a growth-at-any-cost model. This move was also applauded by some analysts who viewed the move as a "growing up" of an adolescent industry. I wholeheartedly agree with this sentiment.

These short-term changes carry long-term importance, in my view. Canopy has made moves that will ensure it retains a top spot in terms of quality in a sector which was previously valued on volume metrics. Profitability is becoming the priority (finally), and Canopy is in it to win it.

Canopy's balance sheet is stocked with cash. The company's path forward to a real positive cash flow is much cleaner and easier to see than most of the company's peers. In a word, Canopy is the only real player in this space in Canada, in my view.

For investors with a long-term outlook, I definitely recommend Canopy as the only option to consider in the cannabis space right now. With uncertainty likely to continue, headwinds are likely to remain. Volatility could also remain amplified in this sector. Trade accordingly.

Stay Foolish, my friends.

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