Sell Warning: This One Stock Will Kill Your Portfolio

Description

Growth investors may be enticed to consider various cannabis stocks today on stock price alone. One must think that if a group of stocks loses the vast majority of their value in a short period, value is beneath the surface. I'm going to explain why I believe this is a dangerous perspective.

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Even the best cannabis stocks are in trouble

I commented in the past on why **Canopy Growth Corp.** (TSX:WEED)(NYSE:CGC) remains an outperforming candidate in this space. I still think this holds true. Further, I believe Canopy is likely to maintain this performance gap in the future. That said, even the best option in this sector is, I believe, likely to underperform the broader market long term (over the next 10 years).

This take is predicated on a number of important headwinds. These were highlighted in the company's recent earnings report. Canopy missed Q4 revenue expectations. This alone is worrisome, since cannabis stocks are still valued as a multiple of top line performance.

Revenue shortfalls

Despite year over year revenue growth of approximately 70%, this revenue miss resulted in a 20% decline in WEED on the day of the earnings announcement. This is indicative of market sentiment.

Far more serious to Canopy's outlook is the company's reported net loss of $1.3 billion in the quarter. This loss was also indicated to potentially not be a one-time event.

In addition, the company's management team has withdrawn profitability targets. This was previously one of the key reasons I've touted Canopy in the past when comparing the company to its peers. Management decided to do so in part to the COVID-19-related retail closures which the company blames for its top- and bottom-line woes.

Those bullish on Canopy's stock have noted the $2 billion of cash on the company's balance sheet.

Majority stakeholder **Constellation Brands** also exercised warrants, providing Canopy with another $230 million this past quarter.

That said, with a net loss of more than $1 billion a quarter and a significant negative cash flow, Canopy is likely to need capital injection within the next 12 months. This is a very serious headwind — one I don't think is being fully priced in right now.

The focus on cutting costs and streamlining operations is good. But the question now is: was this action taken too late? A reduction of production capacity of 40% and announcements of large layoffs does lower the company's financial burden moving forward.

Additionally, the company's announcement that it has shifted its strategic focus away from being a global player covering five continents to a three market player (Canada, U.S., and Germany) is encouraging. That said, this will indeed continue to be a long journey of write downs and losses. Investors in Canopy need to expect this before jumping in.

Bottom line

There simply aren't enough bullish headlines to cover up the financial mess cannabis producers have made. Investors are now focused on profitability and cash flow. Cannabis producers don't meet investment grade on these metrics.

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My advice is to avoid the hype around "cannabis 2.0" products, margin expansion, and revenue growth. Instead look at these companies' balance sheets. One will then discover the cannabis sector overall is one to be avoided long term.

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