Should You Buy Canopy Growth (TSX:WEED) Ahead of Its Q1 Earnings?

Description

So far this year, **Canopy Growth** (TSX:WEED)(NYSE:CGC) has lost close to 15% of its stock value. The weak performance in its fourth-quarter had dragged the company's stock down. It had reported net losses of $1.3 billion and had burnt $300 million of cash during the quarter. More importantly, its market share declined amid a shift in customers' preferences towards value products.

However, since then, Canopy Growth's management has taken several initiatives, such as optimizing its product portfolio, the introduction of new Cannabis 2.0 products, and the expansion of its CBD portfolio in the United States to improve its sales.

We would be able to see the impact of these initiatives on the company's performance when it reports its first-quarter earnings on August 10. So, let's look at what to expect.

Canopy Growth's top-line could fall

In the previous quarter, Canopy Growth's revenue fell close to 13% on a sequential basis. Due to the increased competition in the value segment, Canopy Growth had lost its market share, leading to a decline in its revenue. I believe the same trend to continue in the first quarter as well.

Amid the outbreak of COVID-19, many retail cannabis stores in Canada were closed. Canopy Growth had also temporarily closed its 22 company-owned retail stores, which could impact its first-quarter sales.

Meanwhile, the company had expanded its Cannabis 2.0 portfolio by introducing new cannabis-infused beverages and vapes. It had also added a new line of CBD creams under its First & Free brand. Further, to improve the convenience and safety of its customers, the company had rolled-out click-and-collect and home delivery services in its company-owned and partners' stores located in Ontario. All of these initiatives could offset some of the sales declines.

EBITDA losses could rise

Thus far this year, Canopy Growth has taken many initiatives to cut its expenses. It closed two of its facilities in British Columbia, and one indoor facility in Saskatchewan, thus reducing its headcount by over 500. Also, it exited its operations in Africa and has moved to an asset light-model in Latin America.

Despite these cost-cutting initiatives, I believe the company's EBITDA losses could rise on a sequential basis. Unfavorable cannabis prices and sales deleverage could put pressure on the company's margins.

Bottom line

Yesterday, **Cronos Group** had reported a mixed second-quarter performance. Although it outperformed analysts' top-line expectations, its EBITDA losses came in higher than expected, leading to a decline of over 15% in its stock price. Meanwhile, last month, **OrganiGram Holdings and Aphria** had also delivered lower-than-expected performances.

So, amid the unfavourable environment, I am not much hopeful about Canopy Growth's first-quarter performance. However, I believe its long-term growth story to be still intact. When the liquidity position of many cannabis companies looks fragile, Canopy Growth had $2 billion of gross cash at the end of the fourth quarter. So, it is well-capitalized to fund its growth initiatives.

Despite the decline in its stock price, Canopy Growth trades at a premium. Its forward EV-to-sales multiple stands at 12.2. Meanwhile, its peers, Aphria, OrganiGram Holdings, and Cronos Group trade at 2.4, 3.9, and 8.7, respectively.

So, given the weakness in the cannabis sector and Canopy Growth's high valuation multiple, investors should avoid the stock ahead of its first-quarter earnings.

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Author
rnanjapla