Canopy (TSX:WEED) Is Being Sued for $500 Million: Sell the Stock?

Description

Cannabis has been a difficult sector for investors to navigate. There was so much hype when the marijuana was about to be legalized that many big players got propped up high on investor sentiment. It all changed when the reality hit, and cannabis producers realized that they still had many battles to fight. Legal status alone couldn't help them compete with black market products.

The black market and its low prices aren't the only woes of the marijuana industry. The complicated system, backlogs at getting certifications, very few and scattered pot stores all contribute to making the sector weak. These problems plague most marijuana companies, but they also have their specific issues to deal with.

One of these problems is **Canopy Growth's** (TSX:WEED)(NYSE:CGC) $500 million lawsuit.

The $500 million supply dispute

Canopy Growth, along with some other cannabis producers, is being sued for half-a-billion dollars by a group of shareholders behind an Ontario-based greenhouse facility. The company is being sued for trading in bad faith, fraud, civil conspiracy, and a few other things. Most allegations are regarding some supply contracts that the plaintiff had with Canopy Growth and other companies in the lawsuit.

It built a $114 million pot facility and began production on behalf of Canopy Growth and the rest. The supply contracts decided on a fair price. But according to the plaintiff, Canopy Growth refused to buy the produced cannabis on the agreed-upon price, claiming that it's no longer commercially reasonable. It's now sitting on 7,500 kilograms of unsold cannabis flower.

Canopy Growth's subsidiary Canopy Rivers, which is also named in the lawsuit, claims that the allegations are baseless, and it intends to "vigorously" defend its position.

What should investors do?

That's the $21.5 question (the current share price of Canopy Growth). The answer cannot be very straight forward because, like most other weed companies, the stock is already weak and undervalued. It's hard to say how much this lawsuit's pressure and negative reputation would push the stock down further.

But if your concern is whether or not the company can survive to pay that fine, you don't need to worry. It's sitting on $2 billion cash and has a very strong balance sheet. So, even if it does end up paying part of the $500 million penalty, its finances won't suffer beyond repair. The timing couldn't be worse, because Canopy is one of the very few weed stocks that sustained the upward momentum the sector gained after the market crash.

So, if you already have Canopy Growth in your portfolio, holding on to it might be better.

Foolish takeaway

One thing that can complicate this situation further is that if Canopy gets slapped with more than just a financial penalty. If it gets its licences revoked, or its production facilities come under review and have to stop operation, then the stock might genuinely suffer. If you believe that is a strong possibility, selling now instead of holding on to it for years and waiting for it to recover might be a good option.

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