Should You Consider Buying Canopy Growth (TSX:WEED) at These Levels?

Description

The last 18 months have been tough for the cannabis sector. The structural issues, such as weak demand, higher production, robust black market, and slow rollout of retail stores in Canada, have lowered the cannabis sales, causing higher operating losses and cash burn.

Meanwhile, **Canopy Growth** (TSX:WEED)(NYSE:CGC), with a strong balance sheet and a viable business model, is well equipped to ride out this crisis. Let's look at its performance in the recently completed first quarter.

Strong first-quarter performance

Canopy Growth outperformed analysts' expectations in its first quarter. Its revenue came in at $110.4 million, representing 22% growth on a year-over-year basis. Higher medical cannabis sales in both Canada and international markets drove the company's revenue. However, the decline in recreational cannabis sales amid the temporary closure of retail outlets due to the pandemic offset some of the sales growth.

Its adjusted EBITDA losses declined marginally from $93 million to $92 million. Lower SG&A (selling, general, and administrative) expenses and decline in share-based compensation led to an improvement in its adjusted EBITDA. More importantly, the company's cash burn declined by over 50% to $181 million. Meanwhile, the company had cash and cash equivalents of $2 billion at the end of the quarter. So, the company's liquidity position looks healthy.

Outlook

Although the cannabis sector is going through a challenging period, the outlook looks brighter. Last month, BDSA projected global cannabis sales to grow by 38% in 2020 to reach $19.7 billion, despite the pandemic's impact. Further, the market research firm estimates the cannabis sales to reach $47.2 billion by 2025 at a CAGR of 22%.

Meanwhile, Canopy Growth is well positioned to capture a higher market share in the growing cannabis market. It has recently re-positioned its value products with higher and more consistent THC ranges to meet the customers' needs. It is also working on enhancing its quality and has launched several research initiatives.

Further, the company looks to expand its Cannabis 2.0 offerings, including cannabis-infused beverages, chocolates, and vapes. It has currently introduced four beverages and has plans to introduce two more later this year.

In the United States, Canopy Growth has increased its digital presence by launching an e-commerce site, where you can buy any of its 25 SKUs. Further, it has expanded the distribution of its vaporizer and non-CBD beverage products to key markets. Recently, the company announced it will introduce THC-infused beverages by summer 2021 in association with Acreage Holdings. So, the company's sales outlook looks healthy.

Improving margins

Although the company's EBITDA improved during the first quarter, it is still in negative territory, which is a cause of concern. Meanwhile, the company has been focusing on reducing its expenses.

It has slashed 18% of its workforce since the beginning of this year. Further, it has closed several production facilities to align its production with the existing demand. So, along with these cost-cutting initiatives, the growth in higher-margin Cannabis 2.0 products could help the company become profitable.

Bottom line

Canopy Growth has lost over 30% of its stock value this year. The weakness in the cannabis sector has dragged the company's stock down. However, its long-term growth potential remains intact. So, if you have a time frame of three to five years, I believe Canopy Growth would be an excellent buy.

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