Canopy Growth: What Went Wrong?

Description

It might sound strange now, but **Canopy Growth** (TSX:WEED) was once the hottest stock in Canada. Back in 2018, before legalization hit, the stock was soaring, as was its public profile. It seemed like every other day, you were hearing one story or another about the company's meteoric rise. The $5 billion Constellation Brands deal, the expansion into Europe, the launch of Canada's first Cannabis retail store. No matter where you looked, Canopy was always rising–in the stock market and in the public's imagination.

Then, something changed.

In November 2018, cannabis was legalized in Canada. Almost immediately, cannabis stocks — including Canopy — started falling. Investors began to complain about these firms' lack of profits despite their rapidly growing sales. Eventually, Canopy CEO Bruce Linton was fired after his biggest investor complained about rising losses.

Mounting losses

One of the biggest factors contributing to Canopy's decline was its persistent losses. Because of a combination of asset impairment and poor operating performance, Canopy ran several quarterly net losses — ranging from a few hundred million dollars to over a billion. Canopy was already unprofitable before legalization, but the legalization-fueled sales boost took things to a whole other level. Suddenly you had Canopy growing revenue by more than 100% … and growing its expenses even more than that. Predictably, losses swelled.

Huge writedowns

A big part of Canopy's poor performance was impairment, something that happens when a company decides that its assets have lost a ton of value. In the lead up to legalization, Canopy spent billions of dollars on buying up competitors, hoping to acquire a massive share of the market. Unfortunately, many of the assets Canopy bought proved worthless. As a result, Canopy ran several massive net losses that greatly exceeded losses from operations.

Even revenue is declining now!

It would be bad if a company lost billions of dollars because of a series of acquisitions that proved worthless, but if the company made it up to investors later with profits, perhaps those earlier losses could be forgiven. Unfortunately, that isn't what happened with Canopy. In its most recent quarter, the company not only ran a $108 million net loss, but it also saw its revenue decline 8% on a sequential basis! So here we've got Canopy continuing its post-legalization money-losing streak, but now with less revenue. It's not a good look.

Foolish takeaway

It's been almost three years since cannabis was legalized in Canada, and the weed sector overwhelmingly hasn't lived up to the hype. Today Canadians can legally light up whenever they want to without fear of prosecution, yet the cannabis producers haven't managed to turn a scrap of profit from all of this. Canopy Growth, once the star of the industry, is now in just as bad a place as its smaller peers.

Where do we go from here?

It's hard to say. Cannabis is a commodity, meaning that consumers mostly treat different strains as equivalent. A few aficionados may have brands they prefer, but most Canadians just buy whichever product is available. There is no obvious path to profits here, so investors may want to treat Canopy Growth with skepticism. The company isn't in a great place.

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