



Do Aphria Inc.'s Q4 Results Indicate a Buy?

Description

On July 12, 2017, **Aphria Inc.** (TSX:APH) reported its fourth-quarter results, and the company hit one out of the park. For the seventh consecutive quarter, the company generated a positive EBITDA with an increase of 181% over the previous quarter and a 962% increase over the past year!

Although this is incredible growth, the EBITDA only amounted to \$2.8 million, and the stock is currently trading at a whopping price-to-earnings ratio of 212. Therefore, does it make sense to overpay for a small-cap company that has a valuation built on the anticipated recreational marijuana market?

There's no doubt that the valuations of Aphria and other marijuana producers are too high based on traditional valuation methods. However, the potential recreational market provides an extremely rare opportunity. Lifting the prohibition of the most used illegal substance could result in significant gains for investors.

However, like any investment, it's critical that investors understand the potential risks associated with an investment before putting money into the market. Two of the biggest issues that Aphria and other producers face are

1. The illicit market: Will illegal suppliers be able to undercut legal producers?
2. Provincial regulations: How will it be sold in each province?

Here's how both of these issues will affect Aphria.

Illicit market

Fortunately for Aphria, it's in the best position among producers to outlast the illicit market. The company has established itself as a low-cost producer and is continually improving its margins. In the last quarter alone, the company was able to reduce its all-in costs by 25%, bringing its all-in production costs to \$1.67 per gram.

With the average price of marijuana sitting at \$9.12 per gram in Canada, Aphria has significant room to remain profitable, even if the illicit market tries to undercut legal producers.

Provincial regulation

Unfortunately, there is little transparency over this issue, as there has been backlash from provincial legislation as to how marijuana will be sold, regulated, and policed at the provincial level. However, I believe this isn't as much of an issue for producers as people think.

At the end of day, the supply and demand is there, and there should be enough momentum to eventually push this through. Since Aphria is at the supply end of the chain, it should be able to continue to sell its product as long as the demand continues to be there.

Whether marijuana is sold at convenience stores, liquor stores, or only online, Aphria will be able to find a way to get its product to customers. It just may take some time to determine how it will be eventually sold at the provincial level.

Foolish bottom line

I firmly believe that Aphria has a "good thing growing" and is in the best position among publicly traded producers to succeed in the recreational market. However, this is still a risky venture, and it could take some time for the recreational market to come to fruition.

Therefore, if you do decide to "take a puff" of Aphria, make sure you can handle the short-term volatility and maintain a long-term view.

Fool on!

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