Why Aphria Inc.’s Q2 Results Should Have Investors Worried

Description

Aphria Inc. (TSX:APH) released its second-quarter results on Wednesday, which continued to show significant growth. Sales of $8.5 million were up 63% from last year, and its net income of $6.5 million was also a big improvement from the $945,000 that made it to the company’s bottom line a year ago.

When it comes to pot stocks, profits are rare, but Aphria’s focus on low costs has helped the company post a profit in four of the past five quarters.

However, a closer look at the results reveals that the quarter was not as impressive as it appeared.

Cost of sales up

The company’s “all-in” costs of dried cannabis per gram were $2.13, which is a 32% increase over the $1.61 per gram that Aphria averaged in Q1. However, Aphria says the increase here was “temporary,” a result of an effort to rush orders after the company received approval of the second part of its expansion from Health Canada.

Aphria claims that one of the main reasons behind the increase in costs was related to transferring plants that are older than normal, which results in a lower yield.

We’ll have to wait for Q3 to see whether or not these “temporary” increases stick around.

Operating income down from a year ago

While the company boasted improved net income this quarter, it was largely due to non-operating line items. After operating expenses, Aphria had a loss of $1.1 million compared to a profit of $486,000 a year ago. While gross profits are up 50% from last year, operating expenses have doubled, with share-based compensation rising from just $251,000 to $2.2 million.

Gains and other income helped the company achieve its impressive bottom line. Long-term investment gains contributed over $6 million to the company’s bottom line, and financing income added another $1.4 million. Last year, Aphria had just $459,000 generated from its non-operating items compared to

$7.9 million this year.

However, this is not related to the company's operations, so it's not something that investors should rely on in future results. The real danger is that if these investment gains turn into losses, it could potentially wipe out a good quarter.

In Q1, the company had even stronger gains, which resulted in an extra $16 million that was added to Aphria's bottom line.

Is the stock worth its high value?

In the last four quarters, Aphria's sales have totaled more than $25 million. With a market cap of over $3 billion, the stock is trading at a price-to-sales ratio of well over 120. The company's price-to-earnings ratio is also in triple digits as investors are paying a big premium for Aphria's stock.

Although the share price has tripled in the past year, it's hard to see that happening again in 2018, especially amid investors' potential concerns about the stock not being in compliance with TSX regulations.

Pot stocks in general are trading at very high values and it's hard to find a good buy in the industry. Investors might therefore be better off waiting out a dip in price before buying in at these high valuations.

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