



Could Aphria Inc (TSX:APH) Hit \$25 With its New Supply Deals?

Description

These past few months have been great for cannabis stocks, and **Aphria** (TSX:APH) has emerged as one of the biggest winners. Closing at just \$8.72 on August 14, the stock rallied as high as \$21.70 in the month that followed. The Aphria rally has cooled off in recent weeks. But now there's a new development that could reignite it.

I'm talking about Aphria's new [supply contracts](#) with provincial cannabis stores.

As the provinces gear up for legalization on October 17, they're tapping all the top cannabis companies to sell them pot. Many of the world's largest pot companies are based in Canada, so the nation's cannabis stores have plenty of great domestic suppliers to choose from. And it's looking like Aphria is going to be one of the big winners in the supplier sweepstakes, having already signed deals with Ontario, British Columbia, Quebec, and several other provinces.

That Aphria will be supplying significant quantities of cannabis to the provinces is a done deal. The question is whether this will send the stock higher. To answer it, we need to look at Aphria's revenue model.

Aphria's revenue and earnings

Aphria, like most cannabis companies, has a spotty earnings track record. However, unlike its competitors **Canopy** and **Aurora Cannabis**, it has had some profitable quarters and fiscal years. In a recent earnings call, CEO Vic Neufeld said the company had "11 straight quarters" of positive EBITDA, something no other producer had accomplished. **Thomson Reuters** data gives the company a forward P/E ratio of 35.1, which means that the agency expects the company to be profitable in the years ahead.

What does this mean?

Simply, that this company has a strong history of profitability — at least by cannabis industry standards. Granted, much of the company's profits come from its investment portfolio. In terms of operating income, it has missed in three of the past four quarters. Nevertheless, this is a company that

takes earnings and cost-control seriously, which means it has a good chance of turning its supply deals into positive earnings faster than Canopy or Aurora.

Potential downside

There are also two potential downsides to Aphria's supply contracts: downward pressure on prices and cannibalization of its medical products.

Currently, Aphria earns most of its revenue from selling medical cannabis. This is a highly regulated product with a certain amount of price protection. The recreational cannabis market will not be as heavily regulated as the medical market. This could result in downward pressure on prices, as [happened in Colorado](#) shortly after cannabis was legalized there. If that's the case, although Aphria's sales volume will be higher, its margins may suffer.

There's also the possibility of recreational cannabis sales cannibalizing medical ones. Although medical cannabis is more regulated than recreational cannabis, it's essentially the same product. There's no real reason for a patient taking cannabis for nausea or Crohn's disease to spend more on medical cannabis when the same product is available on the recreational market. If recreational sales do cause downward pressure on prices, then they may cannibalize the medical cannabis market, resulting in further profitability issues for companies like Aphria. That may end up sending the stock lower in the end.

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