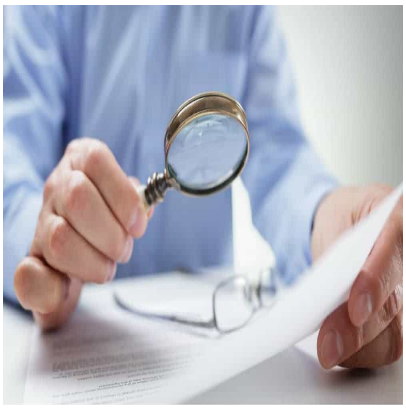

Aphria Inc (TSX:APH): 7 Important Takeaways From the Latest Earnings Report

Description

Aphria (TSX:APH) released its very last pure medical cannabis quarterly financial results for the period ended August 31 on Friday, and a quick look into the latest earnings installment reveals some significant takeaways that warrant a discussion today.

The company sequentially grew revenues by 10%, and that is a good thing, as investors want nothing but growth from a marijuana player today. But this is not my focus today, as medical marijuana sales may quickly be overshadowed by adult-use revenue going forward.

1. The positive EBITDA running streak is no more

Aphria management was always proud to report on the company's running record of positive adjusted EBITDA from the Canada marijuana business segment, but investors will not find this line of talk in the company's latest quarterly earnings report.

For the first time, after 11 consecutive quarters of generating positive operating earnings from Canada operations, the company reported a loss of $828,000 for the quarter as expansion costs weighed in.

No other cannabis player had achieved such a long streak of positive operating earnings, and I give a thumps-up to management for pulling out such a great job. The record-breaking performance has ended, but for good reasons, as the company has incurred significant expenses in preparing the business for success in the recreational marijuana market set to debut sales next week

2. Adjusted gross margin declines

The company's adjusted gross margin declined to 63.6% from 78.7% during a previous quarter and 78% in a comparable quarter last year, mostly as a result of the disposal of 13,642 cannabis plants prior to harvest during the quarter; it was also a result of a concerning development highlighted next.

Even after adjusting for this plant loss, the gross margin could have been 71% for the quarter, which is still lower. This decline could be driven by increased wholesale sales during the quarter. Now that most provincial supply deals may be on wholesale terms, how low could margins look like in the adult-use market?

Let’s wait and see.

3. Labour shortages

Aphria suffered production losses, as it had to throw away overgrown plants as highlighted above, all because the company could not find qualified labour to harvest the plants in a timely manner; they outgrew their optimal harvest period by a week.

So, the cannabis industry is prone to labour shortages, too? If persistent, this phenomenon could continue to drive employment costs higher, hurting profit margins.

That said, I am happy that the company is adequately staffed now.

4. Cash costs to produce no longer under $1

The low-cost producer saw its cash cost to produce cannabis increase sequentially by nearly 37% from $0.95 a gram during a previous quarter. At $1.30, Aphria’s cash costs per gram are no longer under $1, as previously boasted.

However, this is likely a temporary development, as production line automation is expected to significantly lower costs next year.

5. Company now has supply agreements with every province

Aphria has entered marijuana supply agreements with all Canadian provinces and the Yukon. With almost the same country coverage as **Aurora Cannabis**, the company is now capable of competing head to head, even against market leader **Canopy Growth**, across the whole country in the adult-use market. This makes it a strong outperform candidate in the budding sector.

6. Revenue composition

Higher-margin cannabis oils revenue grew to compose 39.1% of corporate sales, up from 23.2% during a prior quarter. I was about to applaud management for this achievement before noticing that this improvement was primarily driven by management’s formula change for an equivalency factor.

7. Impressive inventory growth

The company grew its harvested cannabis inventory by nearly 52% over three months, increased cannabis oils inventory by 20% to 9,295.6 litres, while significantly growing distillate and soft-gel capsules inventory from zero. The company had 8,402 kilograms and kilogram equivalents of marijuana product exit August, and this gives it a good starting point in the recreational market.

Investor takeaway

Even if operating activities generated losses, the company’s long-term investments portfolio produced significant profits that rescued the bottom line. This portfolio could be problematic should marijuana stocks plunge in the future.

Overall, Aphria reported a fair quarter. The company looks ready to give the leaders some serious competition and its operating loss was small compared to the big guys. This company could potentially be the most profitable marijuana industry player.

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brianparadza