



## Aphria Inc. (TSX:APHA): Takeaways From the Latest Q2 2019 Earnings Report

### Description

Fast-growing marijuana firm **Aphria Inc.** (TSX:APHA)(NYSE:APHA) released its quarterly earnings results for the three-month period covering September to month end November 2018 on January 11, and there were several misses and some unusual developments in the package.

The company's results included the first six weeks of recreational marijuana sales, and analysts were expecting bumper sales of nearly \$39 million for the quarter and a potential return to positive adjusted operating earnings. None of the two expectations were met, with the company's profitable investments portfolio rising to save the bottom line.

### Weak revenue growth, unusual deferred revenue jump

Gross revenue came in at \$24.52 million before excise taxes and a net revenue figure of \$21.67 million was 44% off analyst estimates. That said, a 63% sequential growth in net revenue from a previous quarter reading is still impressive, but the company could have achieved more. Here's some evidence.

The company saw a highly unusual jump in deferred revenue during the quarter from a \$2.10 million, or 16% of revenue during a previous quarter to a staggering \$35.40 million or 163% of revenue at the end of last quarter. Deferred revenue accumulates when clients prepay for product, but the company doesn't complete delivery during the quarter.

### Serious production constraints

A lower than expected revenue growth combined with a higher than usual growth in deferred revenue can point to limited productive capacity or challenges in the product delivery system. The company's limited productive capacity right now and a slow inventory build during the previous quarters in the run up to adult-use cannabis legalization are likely to blame.

Despite a prior guidance in November for a ramp up in production to 250,000 kilograms annualized by January 2019, the company is still stuck at just over 30,000 kilograms capacity and a new management update is that licence applications were "submitted for facilities expansions" and

“annualized harvest expected to increase to 255,000 kilograms by the end of calendar 2019.”

It appears that Aphria has faced some serious challenges in receiving licensing for its recently extended flagship facility and its new Aphria Diamond facility from Health Canada, and management seems unsure when such licenses could finally be awarded. In contrast, **Aurora Cannabis Inc.** has been receiving licences for a partially completed Aurora Sky facility during the last year.

Shifting the production guidance to the end of the year seems suspicious, however. If the facilities expansion and retrofitting is complete, why would licensing and full crop rotation be expected to take several months if the company was preparing for these things since November 2018?

## **Company could lose low cost producer status**

The cash cost of producing a gram of cannabis continues on the uptrend to \$1.76 from \$1.30 in a previous quarter, as the company continues to suffer from constrained productive capacity. The company could quickly lose its low cost producer status this year, as its elevated cost profile is expected to last a good nine months longer after the receipt of new production licenses.

The average cost of producing cannabis matters now more than ever, as the adult-use market offers lower wholesale margins. That said, I am positive on the company's higher than average wholesale price of \$6.32 per gram of recreational cannabis. Other producers are averaging \$5.50 a gram in this market and [Broken Coast's premium](#) craft grow cannabis could be a factor in the company's favour.

## **Limited update on troublesome LATAM deals**

The company hasn't provided any update on its findings by the special committee of independent directors announced on December 6, 2018 to review the troublesome LATAM acquisitions yet. The review is probably still going on, but I suspect that the prior demotion of its board chairman and his subsequent retirement from the CEO position could somehow be linked to short-seller claims and the internal investigation.

While the company is uncertain what impact the issue could have on its business if the matter becomes any material to the regulators, it has acknowledged the knowledge of six class action lawsuits from losing investors, four domiciled in the United States, and two from Canada and vowed to strongly defend itself.

## **Investor takeaway**

Aphria had a weak quarter and could report weaker revenue growth in the next quarter, as its inventory position barely changed from a previous reading on August 31, 2018. The company's biological assets were of a much lower value at quarter end than in August. There could be surprises if the company manages to move its rapidly growing stock of cannabis oils, but it's important that Health Canada grow licenses be received urgently.

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