5 Takeaways From Cronos Group's (TSX:CRON) Latest Quarterly Results

Description

Canadian marijuana firm **Cronos Group** (TSX:CRON)(NASDAQ:CRON) released seemingly weak and unimpressive fourth-quarter and full-year 2018 financial results on Tuesday that exhibited non-disclosure of some information of interest and poor operating performance.

A quarterly net revenue of $5.6 million represented a sequential revenue growth of just 49% from prior-quarter reading, while the competition did much better, even as average prices fell and excise taxes chewed on margins.

There were many more issues in the company's results, as highlighted below.

An irritating secrecy on recreational cannabis

Quarterly sales volumes grew 102% from 514 kilograms of cannabis sold during the third quarter, thanks to a new recreational market that opened in October, but management wouldn't disclose exactly how much they sold into the adult-use market.

The new market is an important growth driver for all firms in the Canadian space and investors need all the information they can get on recreational sales. The non-disclosure is a potential red flag of concerning poor performance, as volumes grew but revenues only ticked a little.

Alarmingly low gross margins

The fourth-quarter gross margin before fair-value adjustments was 44%, down from 55% in the previous quarter. This was much better than **CannTrust Holdings's** 34% during the same quarter. The trend was common, as most other cannabis stocks saw this margin measure decline, as new excise taxes have chewed into net revenues since October 17.

The quarterly gross margin came at an alarming 16%, down from 56% for a previous quarter!

Investors should note that the company voluntarily changed its accounting policy mid-2018 to capitalize direct and indirect costs attributable to biological assets, instead of expensing them during the accounting period they were incurred.

The change reduced cost of sales before fair-value adjustments and had the effect of smoothing the immediate gross margin measure, making it higher than it could have been as costs were brought down below to fair-value adjustments.

Worsening losses

The company declared a quarterly net loss of $11.6 million from $5.6 million revenues.

Not only did a low gross margin of 16% set the company up for dismal operating performance, but there was a 328% sequential increase in operating expenses during the quarter, led by a 329% increase in selling and marketing expenses and the recognition of a new research and development expense line associated with the company's potentially disruptive innovation attempts, while professional and consulting fees associated with the recent $2.4 billion **Altria** investment also pushed operating expenses higher.

Poor export performance

The company may have exported a mere $16,000 worth of dried cannabis in Q4 and not a single bottle of cannabis oil during the last quarter.

Management didn't explicitly report on quarterly export sales, but full-year export sales increased to $1,199,000, up from $1,183,000 for the first nine months of 2018, while cannabis oil export sales never changed from $44,000 recorded during the nine months to September.

The company could have prioritized recreational sales over exports, but I think exports could have generated higher revenue per gram and better gross margins, as Germany prices are higher, or else there were some constraint issues with the Germany market.

Capacity constraints hampering growth

The company had a distressingly low finished cannabis inventory of 187 kilograms in dried marijuana and 115 kilograms of cannabis oils ready for sale by January 1.

Although work in progress was 1,789 kilograms of dried marijuana and 220 kilogram equivalents in cannabis oils, and this inventory could have fed into shipments during this quarter, I'm not expecting a phenomenal revenue growth increase in the next quarterly financial results either.

There was a very young crop with an average age of just six weeks by December 31, 2018, yet the growing cycle is a long 16 weeks! Although the expected yield was 6,303 kilograms from the liveplants, first-half 2019 sales could remain weaker that competitor results as annualized productivecapacity remains below 40,000 kilograms per annum.

That said, additional facilities may boost the company’s capacity to 117,150 kilograms per annum in 2020, and cannabis revenues could improve then, but the competition may be on to a new level by that time.

Investor takeaway

I’m concerned that Cronos Group may underperform peers going forward if management doesn’t take a new growth path that may include an acquisition. The stock could trend lower as the hype created by the $2.4 billion investment by Altria fades.

That said, the company is now sitting on a huge cash pile that could allow it to fund ambitious expansion projects. I wouldn’t recommend shorting its shares, as management may announce acquisitions or some new strategy that could find favour among investors.

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