



Should You Buy Aphria Inc (TSX:APHA) Stock Before FY 2019 Earnings?

Description

In April, **Aphria** (TSX:APHA)(NYSE:APHA) became the first cannabis company to report quarterly earnings for 2019. Because the company's fiscal year ends in the summer, the announcement was technically Aphria's third-quarter result of FY 2019.

The stock market was not impressed. According to Fool contributor [Keith Speights](#), several factors were to blame.

First, Aphria was having trouble keeping up with demand. While this ultimately is a great problem to have, difficulties ramping production quickly hurt the bottom line.

Second, the company experienced what it called "temporary packaging and distribution challenges." Again, investors should read this as a difficulty keeping up with exploding market demand.

The final hindrance stemmed from a variety of financial charges. During the quarter, Aphria took a big impairment charge related to an earlier acquisition, struggled with higher distribution costs, and fought rising corporate expenditures.

Despite the lacklustre results, shares fell by only 15%. It seems that the market is willing to forgive current woes in the expectation that Aphria will right the ship over the long term.

The next time Aphria will report earnings is on July 31. I'd expect management to do everything possible to execute over the next couple months to deliver a strong quarter.

Now that shares are on sale, should you be buying ahead of a potentially improved FY 2019 earnings announcement?

Here's what needs to happen

Aphria's weak third-quarter results clearly surprised most of the market. As mentioned earlier, the main issues include

- Slow cannabis production growth;
- Trouble scaling operations; and
- Unexpected expenses.

If Aphria can't overcome these challenges, the stock could struggle. If Aphria shows improvement, however, shares could be underpriced. All the company needs to do is show that these problems won't persist into the 2020 fiscal year.

Can Aphria turn things around before the end of its fiscal year?

It's going to be difficult

Let's handle the first item: slow production growth. While cannabis demand has been growing by leaps and bounds, Aphria can't take advantage, unless it grows enough cannabis to meet that demand.

In contrast to competitors like **Village Farms International**, Aphria as a company has [limited experience](#) growing crops at scale. It's not surprising to see Aphria struggle to assemble commercial-grade facilities essentially overnight.

Management is already guiding for similar sales levels in Q4 compared to Q3, mainly because its Aphria One expansion doesn't come online until Q1 of 2020. That means investors likely won't have any more evidence next quarter that Aphria is on the right track.

The second issue — Aphria's trouble scaling its support operations — also won't go away any time soon.

According to Fool contributor Keith Speights, the problem stemmed from ever-evolving packaging regulations. "Aphria had primarily manual processes in place during the last quarter and couldn't get nearly as much product packaged and shipped as it would have liked," he wrote this month.

As **Tesla** has shown, quickly building fully-automated facilities can be extraordinarily difficult. If Elon Musk is having trouble, Aphria will likely face the same fate.

The final issue, unexpected financial expenses, should be your biggest concern.

Many investors are [shorting Aphria stock](#) on the belief that it "overpaid for acquisitions in Latin America to enrich company insiders, some of which had financial interests in the acquired companies."

Already, Aphria has been forced to take a \$50 million write-down on its recently acquired Latin America assets. If short-sellers are correct, there could be an additional \$150 million in value left to write off.

Stay away

Many cannabis investors will likely jump in at today's discounted price, but if FY 2019 results don't

correct course, the market could continue to dump Aphria stock.

Given the persistent troubles outlined above, it would be quite a feat for Aphria to execute well. I'm sticking to the sidelines.

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