



Why Did Cronos Group (TSX:CRON) Stock Trade 9% Lower After Q1 Earnings on Thursday?

Description

Cannabis producer **Cronos Group** ([TSX:CRON](#))([NASDAQ:CRON](#)) shares traded as low as 9.6% on Thursday after the cash-rich company released a mixed bag of Q1 2019 results before market open.

The company actually showed some improvements in its financial performance as compared to a previous quarter, but revenue growth, the market's main focus today, was much weaker than desirable.

Not-so-impressive revenue growth

Marijuana investors are looking out for massive revenue-growth rates on this industry's stocks, and Cronos Group delivered a modest 15% quarter-over-quarter increase in the top line to \$6.5 million for the first quarter of this year. This was supported mainly by increased productivity that saw the company sell 7% more product volumes at 1,111 kilograms of cannabis equivalents during the quarter as compared to a most recent quarter.

As [previously discussed](#), sales growth may remain subdued during the first half of this year due to productive capacity constraints.

Gross margin improvements

Even better, the gross margin before fair-value adjustments has rebounded this time from 44% in Q4 2018 back to 54%, just as the overall gross margin ballooned from 16% a quarter ago to a staggering 191% for the quarter. To the extent that overall gross margins are heavily influenced by biological assets valuations, I wouldn't bank on the gross margin measure much, as it will continuously fluctuate with agricultural production.

Still no details on recreational cannabis

Cronos management hasn't yet decided to break down cannabis sales into medical and consumer sales buckets, so the investment community can easily judge the company's performance in each of these critical segments. This can be very frustrating, as market dynamics are likely to be divergent for the two distinct revenue categories.

That said, the company is gaining more traction in the recreational use market with provincial wins, as it increased the number of provincial agreements to five during the quarter to cover over 58% of the Canadian population. Management anticipates covering more geographical markets as the company's production footprint expands further.

Marginally improved production cost profile

The company managed to report an 11% reduction in cost of sales per gram before fair-value adjustments to \$2.69, down from \$3.02 in the previous quarter.

Thanks to improvements in productivity, the company can now manage to spread overheads over more output, but the cost per gram readings are still far away from an ideal \$1 a gram or less to cushion the firm from further product price weaknesses as a massive production ramp up across the industry threatens market oversupply.

Investor takeaway

Investors are already looking past the \$2.4 billion **Altria** investment the company closed during the quarter, and they are not impressed by the slower-than-desirable revenue-growth rate. A \$6.5 million quarterly revenue run rate is just hard to justify on a \$6.4 billion stock that still seems far from ramping up production to its 117,000-kilogram capacity target by the end of next year.

There's some great growth potential in export revenues as Israel production is now permissible to be exported, but the company hasn't been able to use its massive Germany distribution deal to its advantage yet.

I wait to see how the company's innovative ambitions to create cannabinoids from fermentation processes will disrupt the young cannabis industry, but its escapades with majority investor Altria will likely steer it to become a major player in the emerging cannabinoids market.

One more thing: Altria's outstanding warrants to increase its stake to 55% in the marijuana firm has been recorded as a \$1.6 billion derivative liability on Cronos's books. There will be severe volatility in the company's future earnings, as this liability is revalued in line with the company's share price, and the valuation gains and losses will wreak havoc on the income statement.

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