5 Takeaways From CannTrust Holdings's (TSX:TRST) Redeeming Q1 Earnings

Description

Canadian marijuana producer **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) stock rallied as high as 11% during morning trade on Tuesday, as the market reacted to the company's latest quarterly earnings installment. Investors had some justifiable reasons to celebrate the company's redeeming set of financials after a poor show in a previous quarter. I'll discuss some notable takeaways from the quarterly installment.

A strong medical sales performance

The company added 10,000 more medical marijuana patients to reach 68,000 active customers to record a marvelous 17% sequential growth in registered patient numbers within just three months.

In turn, medical product sales increased 18% sequentially, and this was a significant contributor to revenue growth for the quarter, just as wholesale or recreational sales declined 16% quarter on quarter.

Total revenue grew 4.2% sequentially, and this was a softer performance which was significantly made up for by celebrated margin and productivity improvements, even as sales volumes declined.

Total sales volumes decline

A slightly concerning development — total sales volumes on a cannabis kilograms equivalent basis declined by 11.5% sequentially to 3,014 kilograms during the last quarter. Wholesale sales led the declines, and this could be explained by a weaker marijuana retail sales reading for February at country level.

Hopefully, there could be some seasonality to customer traits in winter to justify weaker sales, and a sustained demand growth will be witnessed going forward, or else, there could be a bigger problem for industry stocks if anticipated high recreational market growth rates do not materialize.

An unsustainable source of growth?

CannTrust managed to realize marginal sales price increases across all product categories to report a 15% sequential growth in average price per gram of $5.47 a gram for the quarter. The revenue mix, identified as another culprit for margin contractions in the previous quarter, was more favourable this time, as medical cannabis prices and volumes both increased while lower-margin wholesale sales volumes declined.

The company won't sustain the trend of increasing prices going forward as market structure, dominated by few provincial buyers and heavy medical market competition, won't allow that to be a consistent source of profitability and revenue growth.

I do like the improved margins, though.

Gross margin improvements

The company's gross margin before biological assets fair-value adjustments rebounded significantly from a low of 35% in a previous quarter to a respectable 43%. Though still lower than the 63% margin achieved for the same quarter in 2018, the margin expansion was an impressive achievement considering the new excise taxes levied in October 2018, and the fact that management decided to absorb all excise taxes on medical sales.

Margin growth was aided by better productivity that lowered average production costs per gram, the average price increases noted above, and the lower contributions of wholesale dried cannabis to total sales.

Quarterly production nearly doubled quarter over quarter to 9,424 kilograms of marijuana as new productive space came online, leading to lower cash costs per gram, but there's more room for improvement if the company is to rank among the industry's low-cost producers.

A marked improvement in profitability

The company emphatically swung back to accounting profitability during the quarter to report a $12.8 million net profit after a $25.5 million bottom-line loss in a previous quarter, but I am more impressed by adjusted EBITDA, a more trusted measure of operating profitability, which showed an encouraging improvement from a quarterly loss of $8.5 million in a previous quarter to a smaller $3.8 million loss during the first three months of this year.

Further operating earnings improvements could favourably support the share price going forward.

Foolish bottom line

The company’s latest earnings installment looks much better than the previous one, and any continued operating results improvement may be celebrated by the market.

Top-line growth could be sustained, as the company distributes adult-use cannabis to all 10 provinces in Canada now, but I like the impressive show in the more resilient medical sales segment, as this could bring more stability to future operating cash flows.

That said, it’s too early to read into any long-term trends, though there were some good reasons to celebrate the improved performance, but there is a worrying weakness in retail sales that needs to go away as soon as possible.

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