3 Reasons Cronos Group's (TSX:CRON) Q2 Results Aren't Enough to Make the Stock a Buy

Description

Cronos Group (TSX:CRON)(NASDAQ:CRON) has undoubtedly been one of the most expensive marijuana stocks in the entire industry. Despite not having the sales volumes that some of the bigger players in the industry have, with a market cap of more than $5 billion, investors have been more than willing to buy the stock at its very high valuation.

Last week, the company released its most recent quarterly results. In the second quarter of the year, sales reached $10.2 million after excise taxes, which is more than triple last year's tally of $3.4 million. It was a big improvement on the top line, and Cronos saw its profits soar as well, hitting an enormous $251 million in just one quarter.

Why the results weren't as impressive as they looked

While on paper, it looked like Cronos did a tremendous job during the quarter, the reality is that it still might not be enough to make the stock a buy. There are three reasons why I wouldn't get excited about the company's most recent results.

For one, the company only posted a profit, because it recorded a significant gain on the revaluation of its derivative liabilities of $264 million, relating to the **Altria** investment. Here's to help put into perspective just how big of a difference this made: Cronos had an operating loss of more than $20 million in Q2, which was compared to a profit of $490k a year ago. Without the revaluation gain, Cronos would have posted a significant loss for the quarter. While it's a benefit today, it's important to remember that revaluations can also swing in the opposite direction as well.

Secondly, Cronos needs to get a better handle on its expenses. The reason the company would have posted a (big) loss this quarter is that its gross margin was actually down from the prior year while its operating expenses continued to climb.

With fair-value adjustments not giving the company a big boost as they did in the prior year, Cronos actually had less gross margin to cover its expenses than it did in 2018. And that's a problem, especially with the company's expenses more than quadrupling in just one year. Cronos added more than $8 million in costs for sales and marketing as well as research and development. Last year, these items combined for just $364k.

Lastly, sales are just not strong enough to justify the company's valuation. While the sales growth is impressive, the reality is that Cronos was badly lagging the top pot stocks in the industry. Even at a run rate of more than $40 million per year in sales, it falls well short of how its peers have done. And yet, Cronos still ranks right up there in terms of valuation.

Bottom line

Cronos is definitely a hard sell for me. Pot stocks are still overpriced, and Cronos may be the most expensive one in the industry given what it has achieved thus far. Over the past six months, Cronos has seen its share price drop by more than 30%, and there's little reason to expect things might get any better based on these results.

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