



Aphria (TSX:APHA) Stock Gives Up All Pre-Earnings Gains: What's Next?

Description

Cannabis producer **Aphria** (TSX:APHA)(NYSE:APHA) saw its stock soar as high as 24% after a quarterly earnings release on October 15, only to lose back all the quick gains within a week as investors dug deeper into the company's most recent financial results. Could there be any new reasons to maintain bullish on this marijuana play?

APHA stock was indeed a great buy-the-dip earnings trade as I [explained earlier](#). Investors who bought shares on the dip just before the Thanksgiving market holiday could have pocketed some nice (and quick) double-digit gains on the 15th, but shares have traded lower after the profitability induced hype.

Was there anything wrong deep in the numbers?

A critical target was missed...

The company missed on revenue, despite conservative market expectations that required just a 4% sequential sales growth.

Although recreational cannabis sales grew by 8% sequentially during the quarter, total revenue declined by 2% quarter-over-quarter, and the biggest weakness was seen in the company's biggest operating segment.

The European subsidiary, CC Pharma, which is expected to lead the company in achieving its \$650-700 million sales guidance for the 2020 fiscal year saw its distribution revenue decline by over 3.5% sequentially.

Germany sales were reportedly negatively impacted by a seasonal weakness and a change in government policy on insurance reimbursements on medical cannabis purchases. The company had to tweak its business strategy there. I'm not concerned yet, but what if sales growth slows further in this critical revenue segment?

We are told of a fire mishap at the company's organic cannabis subsidiary, Brocken Coast, in August,

which is estimated to have cost the company about \$1.5 million in lost revenue.

It's therefore reasonable to expect some sales recoveries going forward, but a [critical supply deal is gone](#) already due to failure to satisfy a big customer, prices are weakening market wide and overall local demand isn't growing as fast as desired. This could be a big threat to the growth profile.

Production costs are rising

There was an increase in the cost to produce cannabis, which the company describes as temporary, but these elevated costs are expected to sustain until the yet to be licensed Aphria Diamond facility is fully planted. That could take a long time, and adjusted gross margins could shrink further.

And reported profitability isn't encouraging yet...

We saw the company report its second consecutive positive adjusted EBITDA quarter and another sizeable net profit figure. This should be great news, but profits came from non-operating sources and the adjusted EBITDA from cannabis operations, a critical growth driver, was down 28% sequentially.

The increase in adjusted EBITDA was mainly from cost savings in businesses under development. This could be a good thing, but cost cuts on critical development projects could sometimes imply slower future growth rates as some necessary expenses get eliminated.

The best news piece

The company could finally get new production licenses on its biggest facility, Aphria Diamond, and its associated Extraction Center of Excellence. Management received a letter from Health Canada advising that the regulator is in the process of expediting the issuance of this much awaited license after applications were submitted back in March 2018.

This should be a bullish development that could allow the company to meet its contracted product supplies as well as to grow its exports when it receives the correct EU-GMP licenses probably during the next six months.

Could the stock price recover soon?

Investor confidence in the cannabis space is currently under trial, and companies are hard-pressed to deliver the demanded growth and to show the profits *right now*.

It's good that the balance sheet remains strong and management has reiterated its earlier revenue and adjusted EBITDA guidance for the fiscal year, but for good reasons, I wouldn't bank on anyone's projections yet.

While it could take a while before a significant bullish sentiment returns to the industry again, the coming edibles market could help bring back some lost hope and a slow recovery could be witnessed over the coming months.

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