Aphria (TSX:APHA) Is Fast Shaping Up to Be the Top Pot Stock to Own

Description

Marijuana stocks have been roughly handled by the market since the start of 2019 with many pundits fearing that sales would not support their nose-bleed valuations. A spate of regulatory investigations and claims that the global legal cannabis market is not as big as initially claimed have only magnified those fears.

Leading cultivator **Aphria** (TSX:APHA)(NYSE:APHA), which was derided in a research report in late 2018, continues to demonstrate why it is one of the very few marijuana stocks to own.

Profitable grower

Unlike industry leader **Canopy Growth**, it has proven that it can be profitable in the difficult operating environment afflicting the industry. It was Canopy's massive fiscal 2019 loss of $685 million which rattled markets and saw cannabis stocks heavily marked down.

The fears that triggered regarding cannabis stocks were further magnified by Canopy's first-quarter fiscal 2020 $1.3 billion loss, which saw the company shed a whopping 41% over the last three months.

In comparison, Aphria reported a fiscal first-quarter profit of $16 million, and that came on the back of a full-year 2019 loss of $16.6 million, indicating that the cultivator is building sales momentum and starting to deliver value for shareholders.

A key reason for Aphria's impressive performance compared to its peers is that it is among Canada's lower-cost producers reporting first-quarter 2020 cash costs of $1.43 per gram of cannabis produced and $2.52 a gram for its all-in sustaining costs (AISCs). Those costs were higher than they had been a year earlier and that can be attributed to higher packaging, conversion, and distribution costs because of a significant 39% year-over-year increase in production.

Aphria was beset by a range of issues, which impacted its performance during the quarter, including a fire at Aphria's Broken Coast facility, which prevented it from making shipments during the last 11 days of the quarter. As they are resolved by Aphria, its earnings and profitability should expand.

A key strength is that the company has developed a global cultivating footprint, which is expected to reach 2.4 million square feet in Canada alone once the Aphria Diamond facility is approved This will allow it to produce up to 255,000 kilograms in Canada annually.

In a positive development, the industry regulator Health Canada has indicated that it is expediting the licensing process for Aphria Diamond. That will allow the cultivator to boost its dried flower output and meet supply contracts, thereby further boosting earnings.

Another compelling reason to invest in Aphria is that it has established a large global distribution network, encompassing Canada, Western Europe, and Australia. This includes a significant presence in Germany, which is viewed as one of the most lucrative medical marijuana markets globally, although Aphria is experiencing issues in that market which forced it to adjust its strategy.

While some pundits point to the fact that Aphria receives most of its earnings from distribution operations rather than the sale of dried flower as being an issue, it is not as significant as some pundits believe. This points to the effectiveness of Aphria's distribution network and the considerable value add that it adds to its cultivating operations.

Ultimately, it will be the strength of a legal marijuana company's distribution network which will form a key part of its economic moat, because cannabis cultivation is a relatively easy business to enter.

As the U.S. increasingly legislates in favour of legal marijuana cropping and reduces industry barriers, more capital will become available, leading to a flood of new cultivators all fighting for a slice of the same limited market. That — along with Latin America's rapidly expanding legal cannabis industry, where dried flower can be produced for less than a 10th of what it costs in Canada — means that the market will be flooded with growers.

Foolish takeaway

Aphria has been one of the few major Canadian legal cannabis cultivators to prove that it is profitable in what is essentially an untested global marijuana market. This, coupled with its steadily progressing plans to expand production capacity and large global distribution network, makes it a top play in the burgeoning global legal marijuana market.

Those characteristics also point to it being one of the very few cannabis cultivators to survive the looming rationalization of the industry.

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