



5 Important Takeaways From Cronos Group's (TSX:CRON) Latest Quarterly Earnings

Description

A sequential quarterly net revenue growth of 24% and a 214% jump in quarterly net earnings to \$788 million could top the highlights for **Cronos Group's** ([TSX:CRON](#)) ([NASDAQ:CRON](#)) latest financial report delivered early on Tuesday, but there was a lot to chew in the company's latest quarterly results.

Let's just quickly get down to it.

Revenue growth was aided

Cronos reported a sequential revenue growth of 24% over the third quarter to \$12.7 million, which was a 238% year-over-year increase in the top line, but this growth included newly acquired Redwood's revenue from U.S. hemp operations.

Adjusting for this recent acquisition, cannabis gross revenues increased only by 15% sequentially, as cannabis oil sales significantly shrank in half, and there was a negative revenue recognition in international dry cannabis sales, which may need further investigation, as this charge represented about half of international dried product sales recognized during the second quarter.

The big question is, what could have driven this export revenue charge when the company is supposed to be one of the [best-placed](#) pot growers to capture a growing Germany medical marijuana market?

Shrinking gross margins

The company's adjusted gross margins were significantly compressed to 41%, down from 53% of revenue, as realized product prizes declined and high-margin extracts sales declined.

Management mentioned that the majority of sales happened in the wholesale market, and this should explain why margins suffered. Another licensed producer, **HEXO**, [had a nasty experience](#) with the wholesale market recently.

A strong 98% growth in kilograms sold

The company grew its sales volumes by about 98% to 3,142 kilograms of cannabis over three months to September, as compared to the June-ended quarter. This was supposed to be an impressive achievement, but, disappointingly, the product was sold at an average price of \$3.75 per gram, down 42% from \$6.44 a gram in the previous quarter.

Volumes have grown, but there wasn't a meaningful corresponding increase in booked revenue due to a severe weakness in selling prices.

Pricing pressures are indeed showing up in the nascent marijuana industry, and that's discouraging for growth investors.

Slightly improved cash burn

The company used "only" \$26.4 million in operating activities during the third quarter, down from \$57.4 million during the second quarter.

A lower cash spend rate could help maintain a healthy balance sheet in the near term, even as the strategic acquisition of hemp operations from Redwood during the quarter drained \$301 million from the cash book.

Company to re-purpose parts of its largest grow facility

One of the biggest surprises from Cronos management was the announcement that the company intends to re-purpose some facilities at its Peace Naturals Campus (the company's biggest functional production facility) from cultivation activities to research and development activities and storage and warehousing functions.

This move is likely to result in a one-time charge of about \$15 million to the income statement mostly for the current fourth quarter.

The company ranks very low on productive capacity in the industry with a proforma capacity of just over 115,000 kilograms per annum once the other facilities under construction are brought online. Productive capacity could therefore decline soon.

Investor takeaway

The company's balance sheet remains intact with nearly \$2 billion in cash, cash equivalents, and short-term investments on the balance sheet, but I wish there could be more revenue growth and

improvements in operating earnings.

Pricing pressures may have come too early to this young industry, and the company should reduce its costs per gram further and grow extracts sales to protect threatened margins while progress is required on the export front.

Overall, this was a mixed quarter, but the stock price responded positively, as investors liked the massive bottom-line profit, which was largely a gain on derivative contracts.

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