A Look at Rising Inventory Levels for Top Cannabis Players

Description

In the last week, we saw several cannabis players announce their quarterly results that disappointed investors. Cannabis manufacturers have been impacted by competition and rampant cannibalization of product sales from the illegal market.

While Canada legalized marijuana for recreational use last October, the country's illegal market still accounts for 40% of total adult-use sales due to lower prices.

The slow rollout of retail stores has also hampered sales, resulting in lower than expected revenue growth for cannabis companies.

Companies were banking on the Ontario province to drive sales, but according to one Cannabis benchmark report, the province has about 24 operating stores to date. The increasing demand-supply gap has resulted in high inventory levels for cannabis manufacturers.

Aurora, Canopy, and Cronos witness considerable growth in inventory value

Aurora Cannabis (TSX:ACB)(NYSE:ACB) announced its fiscal first quarter of 2020 (year ending in June) results last week, reporting net revenue of $75.24 million, a fall of 19% sequentially.

Comparatively, the company's inventory value rose 33.5% from $113.6 million in the first quarter of fiscal 2019 to $151.76 million in the first quarter of 2020.

ACB's inventory levels account for 34% of the estimated 2020 sales.

Canopy Growth (TSX:WEED)(NYSE:CGC) also announced its fiscal second quarter of 2020 (year ending in March) results and reported net revenue of $76.61 million, a fall of 15.3% sequentially.

Comparatively, the company's inventory value rose 17.3% from $393 million in the second quarter of fiscal 2019 to $462 million in the second quarter of 2020. Canopy's inventory levels account for 77% of the estimated 2020 sales.

Cronos Group (TSX:CRON)(NASDAQ:CRON) announced its third quarter 2019 results and reported a net revenue of $12.7 million, a rise of 24% sequentially. Comparatively, the company's inventory value rose 27% from $41.66 million in the third quarter of fiscal 2018 to $52.86 million in the third quarter of 2019. Cronos' inventory levels account for 137% of estimated 2019 sales.

These high inventory levels strongly put the focus on tepid demand for marijuana producers. Cannabis Benchmarks estimated top players such as Aurora and Canopy Growth to sell just 30% of the total harvest in the September quarter.

Although most manufacturers are heavily spending on increasing production capacity, they're finding it difficult to generate demand in a highly regulated market. Should high inventory levels persist, investors can expect million-dollar write-downs due to degradation of the inventory.

In fact, Canopy Growth had to write-down $15.9 million of inventory in the September quarter — almost 20% of its quarterly sales. Although the capital expenditure investments are helping manufacturers reduce production costs and increase gross margins, it is offset by lower product demand, which in turn hits the bottom line hard.

Aurora, Canopy, and Cronos are have burnt significant investor wealth

The structural issues impacting cannabis companies has resulted in severe wealth erosion for investors. Shares of Aurora Cannabis are trading at $3.24 at writing, which is 76% below record highs.

Similarly, Canopy Growth stock is trading at $19.45 which is 75% below record highs while Cronos stock is trading at $8.2, which is 75% below record highs.

The near-term concerns are expected to weigh on pot producers over the next few months, which means increased volatility for investors as we head into 2020.

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2. NASDAQ:CGC (Canopy Growth)
3. NASDAQ:CRON (Cronos Group)
4. TSX:ACB (Aurora Cannabis)
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