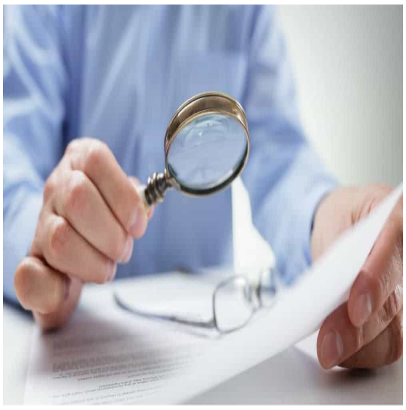

4 Must-Know Developments in Aphria's (TSX:APHA) Q2 2020 Earnings Report

Description

Canadian marijuana producer **Aphria** (TSX:APHA)(NYSE:APHA) released its fiscal second-quarter 2020 results for the period ended November 30, 2019, on Tuesday in a report in which management stressed strong consumer cannabis revenue growth and three quarters of positive EBITDA, but there is a lot more to chew when one closely examines the numbers.

Here are some takeaways from the company's latest quarterly financial report.

Persistent sequential revenue declines

Total revenue has declined for three consecutive quarters now, but not for the reasons you might think.

The pot firm reported $120.6 million in total net revenue for the quarter, which was 4.4% lower than the $126.1 million report for the recent past quarter, which ended in August 2019, but the source of weakness is a totally different one from that affecting local peers.

Canadian cannabis operations are still growing strong after registering a 9.4% sequential growth to $33.7 million, powered by a strong 46% increase in adult-use cannabis sales during the three months to November.

Unlike some local peers who saw Canadian cannabis revenues shrink recently, Aphria's source of problems are from Germany, where its distribution operations have taken a hit after government changed its previously too generous insurance reimbursement policy on medical marijuana purchases.

Quarterly distribution revenues fell more than 9% sequentially to $86.4 million, and they were 12% lower than their peak at $99.2 million by May last year.

Strong product demand in Canada?

This might surprise you, but management claims that the company failed to fully supply a hungry market for its products in Canada during the quarter and had to buy some inventory from peers in the wholesale market to meet its supply obligations.

That said, challenges of a stalling overall market demand growth are so near, and management was forced to make significant adjustments to its forecasts in the press release. More on this later.

Some margin expansion

Adjusted gross margins from cannabis sales expanded to 56.6% during the quarter, up from 49.8% during this first quarter and 49.3% a year ago, while distribution segment gross margins slightly weakened by 0.1% sequentially to 12.7%.

The company has enjoyed declining costs of production, as more production spaces were licensed during the past calendar year.

Surprisingly though, the company reported a strong 8% increase in the average selling price of medicinal pot per gram (excluding wholesale sales) due to higher contribution of premium priced product from organic grower and subsidiary Broken Coast, but prices were significantly weaker in the adult-use segment (think 13% lower sequentially), and this was before excise taxes.

A net loss of $7.9 million was recorded mainly due to investment losses, but this wasn't the bad news.

A significant cut to the earnings guidance

As previously feared, and with just four months to go before the company's financial year end in May, management had to get real and revise its earlier ambitious guidance for the year.

The company had previously anticipated generating $650-700 million in revenue and $88-95 million in adjusted EBITDA for the fiscal year, but operations have already underperformed during the first two reported quarters thus far.

Management now expects to report $575-625 million in revenue and $35-42 million in adjusted EBITDA for the full year. This is a huge climb down, especially on the EBITDA side.

Executives blame a "slower-than-expected retail location rollout in Ontario with more than 40 store openings still pending, the temporary banning of vape products in the province of Alberta while it studies the impact of vape products, the higher costs of third-party supply as a result of the timing of the receipt of Aphria Diamond's licence, and a slowing in CC Pharma's growth arising from recent changes in the German government's medical reimbursement model" as the reasons for the adjustment.

CC Pharma is the Germany subsidiary that has seen market challenges after a government policy change, and this should impact adjusted EBITDA significantly, since distribution revenue is expected to contribute more than half of corporate sales.

Adjusted EBITDA from distribution operations declined sequentially by nearly 48% during the quarter.

Foolish bottom line

The company is trying its best to please investors, but the operating headwinds are just too strong, and the business is taking a hit in an unlikely territory. The stock may take a beating in the short term but a strong recovery is possible if the revised guidance, which still seems bullish, can be achieved this year.

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