



## Cronos Group Stock Price to Suffer an Earnings Restatement Penalty

### Description

**Cronos Group** ([TSX:CRON](#))([NASDAQ:CRON](#)) stock price fell by 12% early on Wednesday to give up some of its near 13% gains on Tuesday after the marijuana firm said it will effect a 40% charge on its third quarter 2019 revenue and will make a similar adjustment in its restated Q1 2019 earnings results.

Cronos will reduce its first-quarter and third-quarter revenues by C\$2.5 million and C\$5.1 million, respectively. Q1 2019 revenues were C\$6.47 million, while Q3 2019 sales were reported at C\$12.70 million.

### A significant write-off

The restatements will wipe off nearly 26% of the company's reported revenue for the first nine months of last year. A similar charge could be made in the outstanding fourth-quarter earnings.

Management had stated earlier, after a delay in the release of the company's annual financial results, that it had yet to determine a final position vis a vis revenues from bulk sales of cannabis and extracts.

A review of "several bulk resin purchases and sales of products through the wholesale channel and the appropriateness of the recognition of revenue from those transactions" was ongoing by the first week of March.

### Why is Cronos Group restating earnings results?

As the investing public, we still don't know what triggered a review of the firm's revenue recognition policy concerning wholesale market deals — and why this is happening at this hour.

Perhaps there was a surge in product return notifications, which has already happened at many other industry firms. **Aurora Cannabis** and more recently at **Canopy Growth** are among the affected large pot growers.

I [speculated earlier](#) that the company's reporting delays could have something to do with the firm's accounting standards migration.

The company is moving from a principles based International Financial Reporting Standards (IFRS) to a generally prescriptive and rules-based U.S. Generally Accepted Accounting Principles (U.S. GAAP) financial reporting framework.

That said, I wouldn't expect revenue recognition policies to differ much between IFRS and U.S. GAAP, even for agricultural and pharmaceutical business operators.

We have seen extensive efforts toward the convergence of these two frameworks for some years, with the former largely consuming the later.

## A disappearing market segment?

The wholesale bulk cannabis market has proven to be a significant source of challenges for the nascent industry, yet it was a significant source of growth for Aurora in the early legalization days in 2019.

CRON "...has been conducting a review of certain bulk resin purchases and sales of products through the wholesale channel, and the restatement is being made to eliminate certain of these transactions through the wholesale channel," the company's latest statement reveals.

The company is going to treat some wholesale market deals by eliminating them, as if they never existed.

While this is good in the sense that the remaining sales are likely to be the more recurring ones as we project revenues into the future in our financial models, this also means that a whole revenue segment has become increasingly unreliable and must be treated with extreme caution.

The wholesale segment should naturally die as everyone has already ramped up production.

## Foolish bottom line

Revenue growth at CRON hasn't been spectacular since recreational market legalization in Canada, and a significant portion of the little that the company posted in sales is now being written off in earnings restatements. Investors should be disappointed.

That said, this company is promising to disrupt the nascent cannabis industry through innovative cannabinoid manufacturing. Its recently acquired subsidiary in the United States could improve its growth prospects.

Moreover, it has one of the strongest industry balance sheets, thanks to a C\$2.4 billion **Altria** investment. This feature makes it one of the numbered pot firms to survive the ongoing market turmoil.

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