Aphria (TSX:APHA): 4 Takeaways From Latest Q3 2020 Earnings

Description

Marijuana firm **Aphria**'s (TSX:APHA)(NYSE:APHA) stock price surged in early trading on Wednesday. The cause was the release of its latest earnings results for its fiscal third-quarter 2020, which ended in February. Aphria was one of the most closely watched cannabis stocks in April for its potential to deliver strong financial results, and it did just that.

Quarterly revenue at $144.4 million was 96% higher than the year before and 65% better than the prior quarter, beating market expectations. Moreover, a net income reading at $0.02 per share widely beats consensus analyst estimates. However, gross margins declined, and not everything was as rosy in the earnings release.

Strong revenue growth, double sales volumes

Compassionate pricing on medical cannabis and significant low-priced wholesale sales during the quarter weakened average prices. However, higher sales volumes and a favourable sales mix in recreational sales powered a 65% growth in quarter-over-quarter revenues.

Sales volumes in Aphria's latest earnings nearly doubled to 14,014 kilograms, up from 7,062 kgs in a prior quarter. Actually, the company had to purchase inventory from the wholesale market (again) to meet strong demand from its customers.

This is amazing. Most Canadian marijuana firms increasingly made provisions for product returns recently, but here's a fired-up pot firm that is struggling to meet surging demand. An ongoing production ramp-up to 255,000 kgs per annum after key facility licensing will help cover inventory shortfalls in the near term.

Declining cash costs per gram

For a third consecutive quarter, Aphria's cash costs to produce cannabis are declining, and they are doing so very fast. Cash costs per gram have fallen from $1.43 in August 2019 to $0.93 a gram. That was a strong 35% improvement in production cost efficiencies over nine months.

Lower costs per gram help improve margins. Further, being a low-cost producer could be a critical competitive advantage in the long term as pot prices continue to soften with increased industry oversupply and slower than expected growth in demand.

Strong adjusted EBITDA growth

Very few cannabis firms reported positive adjusted operating earnings over the past 12 months, but Aphria has done so for a fourth consecutive quarter. Revenue growth and contained operating costs resulted in a 78% sequential growth in adjusted EBITDA.

Increasingly positive adjusted EBITDA gives hope for the attainment of operations that are operating cash flow positive. Investors love cash flow positive companies and they will like the company's stock for that potential attribute.

COVID-19 and Aphria's earnings guidance withdrawal

With just 46 days remaining before the close of the company's fiscal year, management has pulled down its overly bullish earnings guidance for the year. The COVID-19 pandemic's associated uncertainties have been blamed for the withdrawal.

The question is, with so few days remaining until May 31, is management justified in withdrawing full-year guidance now? Would the guidance have been attainable if wasn't a coronavirus pandemic? I have my doubts.

Was Aphria's earnings guidance attainable anyway?

Revenue and earnings were already falling behind the company's $575-$625 million annual sales target. Management's $35-$45 million adjusted EBITDA guidance was probably too high a target too. The company booked $391 million in revenue and under $8.7 million in adjusted EBITDA in nine months. To achieve its ambitious targets, it needed to book *$184 million* in revenue and *over $26 million in adjusted EBITDA.* Such achievements were required to barely meet the low end of the guidance.

APHA needed to grow its quarterly adjusted EBITDA by 358% sequentially just to meet the low-end of its withdrawn guidance. Even if we adjust for the $7.6 million in lost EBITDA due to wholesale purchases during the third quarter, the target was still a dream too high to be attainable by May 31 this year.

I bet the company was already missing its adjusted EBITDA guidance. Management was wise to use the COVID-19 pandemic as a valid excuse for withdrawing prior guidance. But the firm acknowledged a surge in cannabis sales in some Canadian provinces and a 10%-15% rise in weekly sales run-rate in Germany due to pantry loading. Most noteworthy, the latest MD&A claims that no order delivery disruptions have taken place so far, and we are already midpoint into the fiscal fourth quarter.

The COVID-19 pandemic and the current economic lockdown are indeed unprecedented disruptive events. No one can predict government policy changes around pandemic management with absolute certainty, but someone could just have saved face here.

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