Why OrganiGram's (TSX:OGI) Q3 Earnings Could Disappoint

Description

The performance of the cannabis sector has been disappointing this year. The lower-than-expected demand, thriving black market sales, pricing pressure, and rising operating costs have been a drag on the sector.

However, the federal governments of both the United States and Canada had declared medical cannabis as essential during the lockdown. Even some of the provincial governments had allowed the sale of recreational marijuana. So, will the performance of the cannabis sector improve this quarter?

We can get a glimpse into the cannabis sector's performance, when **OrganiGram Holdings** (TSX:OGI)(NASDAQ:OGI) reports its third-quarter performance on July 21. Meanwhile, I am not hopeful.

OrganiGram's top-line could disappoint

In a recent update, OrganiGram's management had announced that its third-quarter sales could decline sequentially due to the outbreak of COVID-19 and changing market dynamics. Further, the management expects its wholesale segment's revenue to dip significantly during the quarter.

Meanwhile, OrganiGram's wholesale business had contributed 24% of the total revenue in the previous quarter. So, the dismal wholesale revenue could be a drag on the company's third-quarter revenue.

OrgnaiGram generates a majority of its revenue from its Cannabis 1.0 segment. In the second quarter, it contributed 52% of the total revenue. But the company could see some pressure in this segment due to the increased competition from **Aurora Cannabis** and **HEXO**. Both the companies have introduced their value products amidst the growing demand.

However, OrganiGram introduced a new line of cannabis-derivative or Cannabis 2.0 products, including vapes and chocolates, in the third quarter. These new offerings could drive the company's revenue, offsetting some of the declines.

Despite the sales decline, I expect OrganiGram's EBITDA to improve. The growth in sales of highermargin Cannabis 2.0 products and a decrease in its selling, general, and administrative costs (SG&A) could drive the company's EBITDA. Since April, the company has reduced its headcount by over 620 employees. These layoffs could bring the company's SG&A down.

OrganiGram has also announced to cut down on its cultivation capacity to align its production with the market demand better. So, the management is expecting to report asset impairment on its Moncton facility.

Recent past

In the first two quarters of this fiscal year, OrganiGram has delivered a mixed performance. It had reported an impressive first-quarter performance by posting a sequential revenue growth of over 54%. The strong sales in recreational, medical, and wholesale markets had driven the company's revenue. The company's EBITDA also came in stronger at $4.87 million outperforming analysts' expectations.

However, OrganiGram's second-quarter was disappointing. Its revenue declined by 7.7% on a sequential basis. The weakness in the sales of recreational flower and oil had dragged the company's sales down. Moreover, the company's EBITDA turned negative due to the higher cost of sales and SG&A.

Bottom line

Year-to-date, OrganiGram has lost close to 34% of its stock value. It has underperformed its peers, such as **Canopy Growth** and **Aphria**. Along with its lower-than-expected second-quarter performance, I am worried about its weak cash position, high debt-levels, and dilution due to new equity offerings.

I expect OrganiGram to underperform its peers even in the second half of this year. So, I think investors should avoid this stock and consider other companies in the cannabis space, such as Canopy Growth and Aphria, which have strong balance sheets and also offer better growth prospects.

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