



## Aphria (TSX:APHA): 3 Ways COVID-19 Impacted the Cannabis Stock

### Description

Management at marijuana producer **Aphria Inc.** (TSX:APHA)(NASDAQ:APHA) withdrew its earnings guidance for fiscal 2020 in April due to the COVID-19 pandemic. Aphria's stock is one of my favourite marijuana industry plays for this year. However, I was [skeptical of management's reasons for the withdrawal](#) of seemingly bullish guidance just 46 days before quarter-end.

Understandably, uncertainty was high as to how the pandemic, social distancing measures, and global responses to curb the spread of the disease would impact the business' operations, earnings, and cash flows. However, peers in Canada were massively restructuring operations faced with a potentially oversupplied and a slow-growth market. Wasn't APHA blaming the pandemic instead of just stating the obvious?

Well, management at the top Canadian pot stock was vindicated, but not quite so. Here's how COVID-19 has impacted Aphria's operations and earnings so far.

### Direct COVID-19 related costs

The company incurred additional expenses in Canada of about \$1 million directly related to the pandemic. These included personal protective equipment (PPE) and company-sponsored meals.

Aphria also raised salaries for production staff earlier than initially planned to give them incentives to continue providing services during a public health crisis.

On a positive note, there were no indications of any challenges or delays in its supply chain at the end of last month.

### Aphria lost some margins in Germany

The company faced challenges in procuring pharmaceutical supplies for distribution in Germany. Its supply chain was disrupted due to international governments' regulatory measures to contain the

pandemic.

Encouragingly, the company managed to replace affected inventory suppliers. Unfortunately, this was at higher inventory prices, hence cutting into distribution margins and adjusted EBITDA.

APHA's adjusted distribution margin in Germany declined sequentially from 12.9% during the February ended quarter to 12.1% for the May ended quarter.

Another \$1 million was incurred in additional expenses in Germany relating to COVID-19 initiatives during the fiscal fourth quarter.

## Asset impairment charges

Aphria announced \$64 million in total asset impairment charges in its fiscal fourth-quarter results. Perhaps this was the biggest impact the pandemic has had on the cannabis stock so far.

Assets in Lesotho, Colombia, and Jamaica were written down due to uncertainties and inconveniences brought by the pandemic.

In Lesotho, management and personnel have no access to the premises. The team stays in South Africa and the international border with Lesotho was closed to contain the virus's spread.

In Jamaica, the company's herb houses, which relied on an active tourism market, were shut down. The company ceased funding the business and allowed its local partner there to find alternative financiers. There's potential for equity dilution if a new partner is found. Further, management remains uncertain as to whether tourist activity will return to pre-pandemic levels after travel restrictions are lifted.

Construction delays in Colombia caused management to re-evaluate its growth plans there. Regulatory shutdowns and pending product registrations slowed the company's expected development of the South American market. As a result, a \$40 million impairment charge was levied on Colombian and Argentine subsidiaries.

Now that Lesotho, Colombia, and Jamaican operations were not contributing significant revenue and potentially costing the company in operating costs, I do not expect these development projects to have affected revenue and adjusted EBITDA in a very significant way.

## Foolish takeaways

Aphria's withdrawn earnings guidance was for annual revenue of \$575-625 million and adjusted EBITDA of \$35-45 million. The company managed to report \$543 million in revenue and \$17 million in adjusted EBITDA for the year.

The big question is, did COVID-19 significantly cause the company to miss its previously given but later withdrawn earnings guidance?

It certainly doesn't feel like it. The company had recorded \$391 million in revenue and *just \$8.7 million*

in adjusted EBITDA during the first nine solid months of the fiscal year. About \$26.3 million in adjusted EBITDA was required during the fourth quarter alone just to meet the lower end of the guidance. That was highly unlikely given historical margins and revenue growth rates.

Aphria remains my favourite cannabis stock for this year. Its revenue-producing operations saw minimal impact from the pandemic. Realistically, the company's withdrawn guidance had already been missed by February 2020, well before the COVID-19 crisis. If the pandemic persists into the next year, the marijuana stock could be a defensive play.

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