

## This Aurora Cannabis Investee's Stock Is Facing Turbulence: Time to Buy?

### Description

**Aurora Cannabis Inc.** ([TSX:ACB](#))(NYSE:ACB) picked up a 25% stake in liquor retail giant **Alcanna Inc.**(TSX:CLIQ) (formerly Liquor Stores N.A.) in February this year and the cannabis firm has some warrants that allow it to increase its equity position to 40%. However, the investment is suffering heavy losses as Alcanna's stock has underperformed one of the [worst Canadian retail stocks so far](#) this year.

The Liquor Depot stores operator has begun showing some recovery signs recently: could this be the right time to make a contrarian investment in Alcanna, alongside Aurora Cannabis?

Alcanna is working industriously to regain lost market share from the competition, and the 10 new Deep Discount Liquor stores model that generated 110% year-on-year revenue growth from same store locations last quarter could sustain a rebound in revenue growth going forward.

New investments in store renovations, product promotions together with a deliberate low price strategy have seen the company report a positive same store sales growth figure during the third quarter for the first time in five consecutive quarters.

Somewhat impressive has been the cannabis stores revenue run rate, which the retailer's five NOVA Cannabis branded stores in Alberta generated \$3.7 million in revenue during the first 19 days of recreational marijuana sales. There is some light in this new division, and the company targets opening up to 37 such stores in the province and more in Ontario and British Columbia as soon as regulations permit.

Worth some investor attention is a recently announced intent to partner with Ace Liquor Corporation to form the Canadian Liquor Retailers Alliance could generate better performance prospects.

That said, Alcanna still faces some turbulence.

### The big risks

New investments are impacting operating earnings significantly, and the low margin sales strategy will require significantly higher sales volumes to achieve significant profitability and generate adequate free cash flow, yet the alcohol sector is seemingly bracing weaker demand in Western Canada where the predominantly company operates.

The company has been intentionally lowering gross margins to regain lost market share in its core business. This is an unsustainable way of gaining competitive advantage, yet sales, distribution and administration costs are increasing as the company restructures operations.

The strategy may fail to deliver growth and a return to healthy profits if Albertans continue to consume less alcohol.

Most threatening is the potential dividend cut in 2019.

Alcanna is currently in breach of one of its debt covenants, namely, the fixed charge coverage ratio as outlined in its syndicated credit facility with bankers. As the company is currently not drawn on the credit line, a waiver has been granted, but if conditions don't improve during 2019, a dividend cut may be a good idea to secure necessary funding.

Dividend cuts aren't an investor's favourite thing.

With a cash balance of about \$45 million as of November 8, the company is still well financed, but plans to negotiate with the bankers by end of the first quarter of 2019.

New financing may be required to pull off the cannabis division expansion plans, but Aurora may not exercise its warrants at \$15.75 a share if Alcanna shares continue trading around \$9 a share over the next few months.

It's currently not yet clear just how profitable the cannabis business line can be, as margins information is not yet available. Full quarterly earnings results from recreational cannabis players will start trickling in during the first quarter of 2019.

My take is that even if cannabis can be expected to boost Alcanna's earnings prospects usher new growth opportunities into the business, the company is currently operating too few marijuana retail stores to generate significant corporate revenue growth and stir the bottom line in the near term.

There's currently financial trouble in the core business line that warrants a significant valuation discount on the stock.

### **Foolish bottom line**

With a new investment by Aurora and a venture into pot retailing, Alcanna's stock is susceptible to the high volatility bedeviling cannabis stocks today; a 10% plunge in a single day should therefore not be that alarming.

That said, as the liquor retailing core business struggles, the share price will continue to suffer until there is some visibility to the return to operating profitability while the new cannabis sales business line grows big enough to command a significant share of corporate revenue – with acceptable margins too.

The stock is of strategic importance to Aurora, but foolish investors will consider the investment risks more seriously.

### **CATEGORY**

1. Investing

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### **Author**

brianparadza

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