Beware: Aurora Cannabis' (TSX:ACB) Stock Is the Industry's Most Reckless Company

Description

Through the first couple of months of the year, the TSX Index has enjoyed returns of almost 12%. Not to be outdone, the cannabis industry has also benefited from a significant rebound. Year to date, the **Canadian Marijuana Index** is up by approximately 45%. It is important to note however, that the Index is still trading 27% below its 52-week high it achieved this past fall.

Bulls will point to this being a sign that the market is still undervalued. I'd throw caution to the wind on that statement. At the end of the day, we are still talking about companies trading at more than 100 times future sales. These aren't cheap stocks.

This brings me to **Aurora Cannabis** (TSX:ACB)(NYSE:ACB). Year to date, the company has returned 56.64% outpacing the broader Marijuana Index, but still short of its chief competitor, **Canopy Growth Corp** (TSX:WEED)(NYSE:CGC). Despite earnings outperforming Canopy's in the second quarter, its share price continues to lag.

Share dilution

I've written about this several times before, but Aurora Canopy is one of the least shareholder friendly pot stocks out there.

Why?

Two words: share dilution. Aurora has been on an aggressive buying spree picking up whatever it can. The problem is that these acquisitions are coming at a big cost to existing shareholders.

Every deal that Aurora has made in 2018 as well as those made thus far in 2019 have been financed with new equity, which means that the company has issued new shares to make acquisitions. Purchase price, this has the net effect of diluting existing shareholders ownership in the company.

At the end of fiscal 2014, Aurora had 16.15 shares outstanding. As of writing, it has close to 1 billion!

This is ridiculous by any standards. Research has shown that in such transactions, the acquired company shareholders win out at the expense of existing shareholders. Every time Aurora issues new shares, existing shareholders are left with a smaller piece of the pie.

Analyzing its most recent transaction

Take its most recent transaction as an example. The company recently closed on its acquisition of Whistler Medical Marijuana for $175 million. At its peak, the deal is expected to add 15,000 kilograms of production annually. Assuming the company achieves its annual forecasted production and the milestone share payments are made, the company will have issued an additional 1.8% shares to finance this purchase, which means that existing shareholders have seen their collective share of the new company decrease shrink to 98.2%.

All-cash acquisitions are therefore more lucrative. In such a case, existing shareholders would have reaped 100% of the new capacity generated. Keep in mind, however, that this is but one small transaction and that Aurora has consistently diluted shareholder equity deal after deal.

Foolish takeaway

I understand the need and benefits of ramping up capacity. However, there comes a point where existing shareholders must ask themselves if there are better and more shareholder friendly companies in the sector.

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