Aurora Cannabis (TSX:ACB) Is Soaring High: This Is Why You Should Avoid it

Description

Aurora Cannabis (TSX:ACB)(NYSE:ACB) is surprisingly trending upward this week. However, if there's a marijuana stock I'd avoid in 2019, Aurora Cannabis is the one. Investors in the cannabis space expect impressive returns. On paper, Aurora seems mighty enough to deliver the goods. But underneath the surface lurk a lot of problems.

Stock performance versus industry peers

Many see this year as the breakout year for the cannabis industry. The enactment of the Cannabis Act in mid-October 2018 was supposed to lift all stocks associated with marijuana to greater heights. Excitement turned to dismay as most weed stocks tanked sharply. The race to the bottom was on.

That's all water under the bridge now. The start of 2019 presented a fresh perspective. The race to the top has begun. At present, **Canopy Growth** (TSX:WEED)(NYSE:CGC) is doing pretty well and has risen by 74.24% from the year-end closing. **Cronos Group** (TSX:CRON)(NYSE:CRON) zoomed 102.36%, while underdog **Aphria** improved by 64.58%.

Aurora Cannabis appears to have the inside track given the estimated 570,000 kilograms annual production. Production capacity is a definitive advantage. But, lo and behold, Aurora Cannabis's recovery went about in a snail pace compared to industry rivals. Aurora Cannabis is at the tail end, rising by 60.76%.

Stockpiling losses and shrinking margins

Aurora Cannabis reported $237.8 million losses on net revenue of $54.2 million. Analysts anticipated Aurora Cannabis to declare losses as a result of the buying binge and investments in other weed companies.

Aurora Cannabis needs to contend with shrinking margins. The gross margin on cannabis sales dwindled from 70% to 54% in the prior quarter and 63% in the year-ago quarter. Management had ready answers to justify the shrinking gross margin.

Glen Ibbott, CFO, said the company expensed out $3 million in excise taxes for medical-marijuana patients in the quarter. He said, “The decrease [in gross margin] was primarily due to a lower average selling price per gram of dried cannabis, the impact of excise taxes on medical cannabis net revenues, and a temporarily lower proportion of cannabis oil sales in the company’s sales mix ratio.”

A mountain of debt

Even if margins improve tremendously, there is a more frightening issue for Aurora Cannabis. It boggles the mind when you look at its mountain of debt. Other industry players are sourcing funds but not as aggressive as Aurora Cannabis’s debt financing activities.

The risks are multiplying. In case Aurora Cannabis fails to optimize the use of borrowed funds to grow returns, equity investors are facing substantial losses. My deepest concern is if Aurora Cannabis’s operating cash flow can cover debt commitments, both short term and long term.

Some of the purchases might have been overpriced. The company has to make certain of cost synergies and maximize growth avenues. But that would amount to billions of dollars. It’s too high a price to justify the investments and acquisitions.

I wouldn’t risk my money on Aurora Cannabis or lose quality sleep over the surging debt levels and declining gross margins.

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