What Bruce Linton's Firing Means for Aurora Cannabis (TSX:ACB)

Description

The surprise firing of **Canopy Growth's** (TSX:WEED)(NYSE:CGC) CEO Bruce Linton has been applauded by many analysts as an opportunity for Canada's largest licensed producer (LP) to finally exercise some fiscal discipline.

Prior to the legalization of recreational marijuana, Canadian cannabis names have been able to serially raise shares and spend the funds *carte blanche* on acquisitions, which may or may not add any value to the core business. Because funding was so cheap, LPs were able to pursue every vertical under the sun without a clear strategy toward profitability.

However, as the sector matures, acquisitions will fall under greater scrutiny and management teams will be under pressure to deliver on profitability metrics and not just share price. Out of all the names who are synonymous with this model, none have pushed the "dilute and buy" more prominently than **Aurora Cannabis Inc** (TSX:ACB)(NYSE:ACB).

Large goodwill balance is troubling

Currently Aurora is carrying $3.18 billion worth of goodwill on the balance sheet. In case you weren't aware, goodwill is essentially the premium that an acquire pays to the acquired, after accounting for their assets and liabilities. Goodwill is generally assigned to intangible things from the acquisition such as customer relations, branding, reputation and patents and is annually tested for "impairment."

That is, if the future cash flow generation of the assets is impaired, then a non-cash charge is booked on the income statement. While it is a "non-cash" charge, bear in mind that hard cash was paid for the asset during the initial acquisition and writing down goodwill is never a positive sign of management's deal-making abilities.

With a current enterprise value as of writing of $10.14 billion, that goodwill represents 31% of the Aurora's value, and it would not surprise me if we see significant impairments in the coming quarters.

For example, during Aurora's Q3 filings, the firm announced a $9 million impairment charge stemming from a decline in value of “certain” permits and licenses, sparking memories of an earlier $68.7 million write-down on its investment of **Alcanna**.

Stock-based comp not aligned with performance

Furthermore, although the goodwill is concerning, I can’t help but question the explosion in share-based compensation, which rose to $79.5 million for the nine-months ending March 31st, from $25.8 million the year prior.

While I believe in fair compensation for management teams, I also believe that compensation should be aligned with shareholders’ interests and only based on key performance milestones being met (such as EBITDA profitability and growth), as opposed to stock price.

Finally, are *all* these acquisitions going to offer synergies? For example, Aurora has opted not to up its stake (while simultaneously offloading shares) in underperforming investments such as **The Green Organic Dutchman,** and questions can be raised around the scalability of boutique organic cultivators such as **Whistler Medical Marijuana**, Aurora’s latest purchase.

Although Aurora’s competitive moat in the medical channel should be applauded, I would have supported more proactive spending by management on higher margin verticals in the recreational space, such as edibles.

In the meantime, I hope that Bruce Linton’s firing weighs heavily on Aurora’s mind and the company manages to exercise some fiscal discipline. Strategic mergers can be synergistic, but should also be assessed carefully against their costs, such as, premiums paid and the dilution to shareholders. Perhaps Aurora will then finally attract some interest from legacy food and beverage and tobacco companies.

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