Why Aurora Cannabis (TSX:ACB) Is Still Overvalued

Description

Aurora Cannabis Inc (TSX:ACB)(NYSE:ACB) is a stock that has seen better years. After starting the year at $7.09, it has since fallen to $5.82–a 13.6% decline.

On Aurora's bumpy ride, there have been opportunities for short term traders to make money. However, the stock has overall been a losing proposition–particularly since March.

When you've got a stock that's falling while growing revenue like wildfire, you may be tempted to think it's undervalued. Aurora's growth is absolutely off the charts, so a stratospheric price-to-sales ratio could seem justified.

However, when you look more closely at Aurora's recent financial performance, it becomes clear that the stock is still very expensive. To understand why that is, let's first look at those valuation metrics.

Steep valuation

From a value perspective, the worst strike Aurora has against it is an extraordinarily high price relative to sales. Its price-to-sales ratio is about 23–less than 2 is considered cheap.

Of course, we have to take growth into account. Aurora's 416% year-over-year revenue growth could justify a higher asking price than most companies go for.

However, keep in mind that we're only talking about revenue here: the company doesn't have positive earnings in the trailing 12-month period, so "growth" in this sense doesn't refer to profits. When we look at that metric, the picture becomes a little less clear.

A return to losses

In Q1 of fiscal 2019, Aurora surprised everyone by posting $104 million in net income. Although this figure was heavily influenced by non-operating items, it was still the first time a cannabis company ever produced such big-time profits.

It was a pretty big deal back then, but the company has since swung back to losses, with a $11.7 million loss in its most recent quarter. This loss was fairly small as a percentage of revenue, a 68% improvement over the same quarter a year before. However, it illustrates that revenue growth and earnings growth are two different things.

Growth will soon slow

While a 416% revenue growth rate might justify steep valuation, that growth rate will soon decelerate.

The reason is simple:

In fiscal 2019, Aurora–like all cannabis stocks–is benefiting from the legalization boost.

The legalization of marijuana hit in October of 2018. Before that, marijuana companies were earning no revenue from legal adult-use sales. Today, they are, which means that a portion of their sales this year comes from a totally new business. When they compare this year's revenue to last year's, they're obviously going to experience a big boost.

In its most recent quarter, Aurora had $44 million in adult use sales. That's about *half* of total revenue, and it contrasts with $0 in the same quarter last year. Of course, a huge new revenue stream like that will result in obscene growth.

But as legalization fades into the rearview mirror, Aurora will be comparing one quarter of legal sales to another–and $44 million will be a lot harder to beat than $0. Consequently, year-over-year revenue growth will slow down to a rate similar to the most recent sequential growth. And while 60% ain't bad, it doesn't support a price-to-sales ratio of 23.

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