2 Reasons to Dump Aurora Cannabis (TSX:ACB) Stock Today

Description

Aurora Cannabis (TSX:ACB)(NYSE:ACB) stock is finally rebounding from its lowest point this year. At the time of writing, the stock is up 6.6% at market open. This relief rally comes after the company shed 36% of its value over the past six days.

Part of the reason for the turnaround is the fact that legislators in the United States seem to be moving closer towards legalizing marijuana on a federal level. The U.S. House Judiciary Committee is expected to pass the Marijuana Opportunity Reinvestment and Expungement Act (More Act).

If the bill gets passed by the Senate, marijuana could finally be legal in the world's largest market for the substance. Optimism and contrarian bets seem to be pushing Aurora's valuation higher today.

However, there are two reasons investors should still be concerned about the company's prospects.

The supply glut

It's no secret that cannabis producers have been ramping up production while the distribution channels were holding their product back from end consumers. Now the industry faces an oversupply challenge that could create competition among the top players and consequently reduce prices for customers.

According to data from Health Canada, there was 48,918 kilograms of finished inventory and 5,379,725 of plant inventory in the system at the end of June this year. Meanwhile, quarterly sales have been close to 28,374 kilograms over the same period. In other words, supply is outstripping sales by a wide margin.

The supply glut and competition are steadily being reflected on Aurora's books. This quarter, the company reported that the average selling price per gram for medical cannabis dropped from $8.51 to $8. Wholesale prices also dropped from $3.61 per gram to $3.46 per gram over the same period.

Cash crunch

Unlike its rivals, **Canopy Growth** and **Cronos**, Aurora doesn't have a large stockpile of cash it can use to sustain the business while the market collapses. At the end of the latest quarter, Canopy reported cash and cash equivalents at $2.7 billion, while Cronos reported $1.9 billion. Aurora has only $192 million in cash on hand.

That's not enough to sustain the company's current pace of operating cash flow for more than a year, which is why the company decided to halt construction of two production facilities earlier this month.

To ease the crunch, the company may have to borrow more capital or issue more shares. It seems to be doing both. Earlier this month, the team announced a $230 million issue of 5% convertible notes that mature in March of 2020 at a discount to the stock's five-day average trading price. In other words, the team has added debt today and will dilute shareholders next year.

In my opinion, that additional $230 million won't be enough to hold off competition as the market gets tougher next year. I expect Aurora to raise more external capital later.

Foolish takeaway

Aurora faces a lack of resources, just as the market faces oversupply and intense competition. Investors should expect more dilution and debt over the next year, which is why I think they should avoid the stock in favour of its larger rivals.

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