Aurora Cannabis (TSX:ACB) Stock Investors: Buy the Dip or Bail Out After Latest Asset Write-Downs?

Description

Aurora Cannabis (TSX:ACB)(NYSE:ACB) announced a senior management change, a significant corporate restructuring exercise, and asset write-downs that could spark another wave of disappointment among marijuana investors, further weakening the company's stock price before financial results get released on February 13.

The pot producer's founder and CEO has announced his immediate retirement, and the appointment of the company's executive chairman as the interim chief executive could have been a strong sign of a significant strategic shift, had it not been for the fact that the outgoing leader will retain his board seat and become a strategic adviser.

I do like the addition of two independent directors to make a largely independent, 10-member corporate board that could further strengthen corporate governance.

That said, there's a lot more serious fodder to chew in Aurora's big announcements on Thursday.

It's a massive business transformation plan

Given the weak growth outlook in the local marijuana market, management plans to reduce selling, general, and administrative (SG&A) expenses down to $40-45 million quarterly. This will approximately be a 60% reduction in SG&A operating expenses from the provided guidance for the fiscal second quarter (ending December 31, 2019) of $98-107 million.

This plan includes the elimination of about 500 full-time staff positions (including 25% of corporate positions). I feel sorry for those losing their jobs. The company is likely going to have a leaner corporate structure and operations going forward, and if this enables it to preserve desperately needed cash flow, investors will be positive to that.

The company successfully negotiated changes to its debt covenants, and I suspect the former investment banker in the executive team was instrumental on this move. This allows it to avoid a material breach of financial covenants that could have potentially triggered severe negative financial and operational consequences if bankers were to abruptly demand prompt repayments.

The move to cut the company's capital-expenditure budget going forward is only prudent given the slow market growth rate and the company's poor liquidity position.

Beware the massive asset write-downs

As Aurora Cannabis expects to report $190-$225 million in impairment charges and to make a $740-$755 million write-down on the company's goodwill, this move triggers my earlier fears of significant write offs from the balance sheet.

By September 30, 2019, the company's $5.6 billion balance sheet carried $3.2 billion or 57% of its assets in goodwill. Total intangible assets and goodwill accounted for nearly 70% of the cannabis producer's assets.

I expressed my fears in December that "should there be any reason (any reasonable basis at all) for this goodwill to be impaired, the impact to the balance sheet could be catastrophic. And the ongoing production cuts at **HEXO** and construction project suspensions at the company due to lagging demand growth could be the early signs of trouble."

Management says the write-offs are limited to South American and Denmark assets, and the company's core Canadian assets remain unaffected. Over $2 billion was added to goodwill when MedReleaf was acquired in 2018. It could only be a matter of time before the remaining +$2.4 billion in goodwill begins to fail annual impairment tests.

Cash position remains uncomfortable

The company has one of the weakest balance sheets in the industry, with an unrestricted cash position of $156 million by December 31, 2019. This included the $325 million (US$245 million) recently raised under the US$400 million at-the-money equity financing program and there's only $200 million capacity remaining under this dilutive plan.

Management should be more conservative on operating expenses, as there isn't much room for variations until the company becomes cash flow positive. No one knows when this critical milestone could be reached.

Buy the dip or bail out?

With a sigh of defeat, investors may want to look away from Aurora's stock price and give up on the trade over the next few months, but frustratingly selling positions during multi-year valuation lows on a promising ticker in a nascent industry that is still in formative stages may not be that much more comforting either.

The company has admirably decided to swallow the bitter pill that could heal its balance sheet and afford it to survive the industry's tough times, but I wouldn't add any new money until better signs of revenue growth recovery begin to show.

CATEGORY

1. Cannabis Stocks
2. Investing

POST TAG

1. Cannabis

TICKERS GLOBAL

1. NASDAQ:ACB (Aurora Cannabis)
2. TSX:ACB (Aurora Cannabis)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Cannabis Stocks
2. Investing

Tags

1. Cannabis

Date
2025/07/21
Date Created
2020/02/07
Author
brianparadza