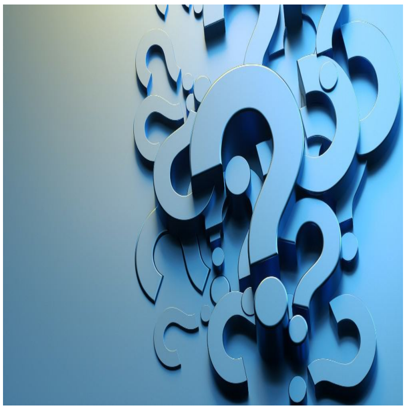

Cannabis Stock Bankruptcies Are Rising: Is Aurora Cannabis (TSX:ACB) Vulnerable?

Description

Canadian cannabis stocks have suffered sharp losses because of the coronavirus pandemic. The largest cannabis ETF, the **ETFMG Alternative Harvest ETF,** has lost 33% since the start of 2020. The ETF was led lower by its sixth-largest stock holding **Aurora Cannabis** (TSX:ACB)(NYSE:ACB), which has lost a whopping 64%.

After the latest developments, the market has priced Aurora for bankruptcy. Canada's third-largest cultivator by revenue is trading at less than a twelfth of its 52-week high.

Poor outlook for cannabis stocks

The outlook for cannabis stocks is poor, especially after the marijuana bubble burst in late April 2019. After almost two years of delivering super-sized returns, many cannabis companies are struggling to grow as anticipated. A combination of non-existent profitability, large capital spending, smaller-than-anticipated market, and dwindling liquidity is weighing on their outlook.

These issues are being magnified by the coronavirus pandemic. Governments across the world have shuttered non-essential services, including marijuana dispensaries in many jurisdictions. They have also implemented restrictions on movement and travel bans, which are further weighing on the consumption of legal cannabis products.

It has also seen governments focus on issues more urgent than legalizing the medical and recreational use of marijuana.

These factors represent a poor development for companies which have been struggling with profitability, triggering bankruptcies among cannabis stocks.

Weak sales growth

A distinct lack of profitability is a long-term issue for many cannabis stocks. This is being impacted by the global legal marijuana market being far smaller than originally anticipated by the industry. Aurora reported a massive $1.3 billion fiscal second quarter 2020 loss, which was more than five-times greater than the $239 million loss reported for the same period in 2019.

The cultivator is struggling with liquidity. Aurora finished March 2020 with $205 million in cash compared to $544 million of long-term debt. Earlier this year, investors were warned that Aurora, because of its liquidity issues, could fail to meet its debt covenants.

In response, Aurora renegotiated its credit facilities seeing the EBITDA covenant removed but the size of the facility was reduced by $141.5 million, further impacting its liquidity.

Aurora's lack of capital and liquidity saw it announce almost two weeks ago that it intends to raise up to US$350 million in equity capital to bolster its coffers, which will likely have a dilutive event for existing shareholders. It's difficult to see how Aurora can successfully complete such an action without offering the stock at a deep discount to potential subscribers.

The company believes this will address the risks surrounding its debt covenants and need for capital to continue developing its operations.

Risks ahead for cannabis stocks

While Aurora's short-term position is improving, there are still considerable risks associated with its operations and there are signs of more to come. Declining margins weighed on Aurora's second quarter performance.

The cultivator also recorded just over $1 billion of impairment charges for the second quarter. The value of many assets, notably goodwill and cultivating operations, in the industry appear overcooked.

There could well be further write-downs and impairment charges ahead for Aurora. The cannabis cultivator is still working out how to unlock value from its business and complete the transformation of its business.

Foolish takeaway

Cannabis stocks are under considerable pressure. The current adverse circumstances sparked by the coronavirus pandemic could spark bankruptcies in an already stressed legal cannabis industry.

Along with overall poor outlook for Canada's legal marijuana stocks Aurora is one of the most vulnerable. A likely outcome from economic downturn triggered by the coronavirus is a reduction in sales and hence cash flow.

This will apply further pressure to cultivators like Aurora, which are already experiencing liquidity issues. When coupled with Aurora's plans to raise equity capital, through what will likely be a dilutive offering, it's difficult to see its stock rallying.

Many of these short-term issues will morph into long-term headwinds that could challenge Aurora's ability to remain a going concern.

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mattdsmith