Aurora Stock: Will it Make a Comeback After Impressive Q3 Results?

Description

The cannabis sector has experienced an extended sell-off over the last 12 months. Most pot stocks were trading close to record highs when Canada legalized the recreational use of marijuana. While valuations were sky high and warranted a pullback, the expanding addressable cannabis market got investors excited.

Now, pot companies have been impacted by a slew of structural issues including regulatory concerns, the slow rollout of retail stores in Canada's major provinces and health concerns related to vaping. The ongoing COVID-19 pandemic has added fuel to fire and exacerbated this decline.

Shares of cannabis giant **Aurora Cannabis** (TSX:ACB)(NYSE:ACB) are trading at $9.2 at the time of writing, which is 94% below its record high. Despite this massive decline, Aurora stock is not quite out of the woods. The highly diversified pot producer has a lot going against it. Let's see if Aurora's stock price will gain momentum in the second half of CY 2020.

Cash balance is precarious

One of the major concerns for Aurora Cannabis investors is its low cash balance. In February this year, investment bank Ello Capital claimed that Aurora Cannabis had fewer than three months of runway left.

According to Aurora's latest filings, it ended the March quarter with a cash balance of just above $230 million. Comparatively, its current liabilities stood at $206.4 million. Aurora reported an operating loss of $83.56 million in the March quarter, indicating a perilous liquidity problem.

Last month, Aurora Cannabis announced it might raise US$350 million in equity capital in ATM (at-the-market) offerings. Aurora Cannabis has increased its share count from 16 million in June 2014 to 1.31 billion in April 2020. In order to continue being listed on the New York Stock Exchange, the company has undergone a reverse split at a ratio of 12:1.

This has resulted in a lower share count and a higher stock price. However, Aurora Cannabis has diluted shareholder wealth significantly over the years by raising equity capital in order to stay afloat.

Aurora stock has been decimated due to overvalued acquisitions

Aurora Cannabis went on an acquisition spree in the last few years. It acquired companies at high valuations and paid a premium. This premium is also known as goodwill. In short, the difference between the book value of a company, and its acquisition price is reported as goodwill on the balance sheet of the acquiring firm.

In the December quarter, Aurora reported a goodwill impairment writedown of $762.2 million. This is an accounting charge and is recorded if the particular assets no longer generate expected returns. Aurora Cannabis still has $2.41 billion as goodwill on its balance sheet. Goodwill accounts for 51.1% of total assets, which means that significant writedowns are on the cards.

Aurora Cannabis paid a premium for these acquisitions due to the underlying positive market sentiment prevalent at that time. It burnt considerable cash to acquire these assets. In hindsight, Aurora could have used it to buy similar assets at discounted prices in the current bearish environment. Instead, the company is struggling to maintain operations and has to raise additional capital.

Aurora stock has grossly underperformed the broader markets in the last year due to the above-mentioned reasons.

Aurora Cannabis tackles widening losses and high inventory levels

In the March quarter, Aurora Cannabis reported net revenue of $75.5 million compared to net revenue of $65.15 million in the prior-year quarter, indicating a year-over-year rise of 16%. However, the company's operating loss also widened to $83.6 million from $77.6 million in this period.

Aurora's performance in its most recent reported quarter can be attributed to a 68% sequential increase in consumer cannabis sales. Medical cannabis revenue was up 14%. Aurora increased its production sequentially by 18% to 36,207 kg in Q3, which reduced its cost to produce per gram by 3.4% to $0.85.

Despite a rise in sales, Aurora's inventory to $251.2 million, up from $113.6 million at the end of fiscal 2019. This exposes the company to inventory writedowns as well.

We can see that the company still has a lot of fundamental issues that it needs to address. Investors expecting Aurora stock to rebound in 2020 might be disappointed.

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