Could Aurora Cannabis Stock Give Up Recent Price Gains Soon?

Description

Most investors who bought **Aurora Cannabis** (TSX:ACB)(NYSE:ACB) common shares during the past year are still in the red, even after the recent 117% rally in Aurora Cannabis stock price over the past few trading sessions. The marijuana firm's latest quarterly results have shown desired progress.

Can we expect the positive momentum to hold for much longer, or the company is setting investors up for another disappointment?

As we have just witnessed over the past few days, the bullish case holds more weight now. The facts in Aurora's case have significantly changed and investors may never see the early May 2020 lows again.

However, the company still faces internal challenges, and industry headwinds that could still suppress recovery gains in the foreseeable future.

Aurora Cannabis could retain most of its May stock price gains

I had been bearish on ACB for several months now. Noting its cash flow challenges and bloated operating expenses after an overly ambitious acquisition spree while operating in a disappointingly slower than expected growth in the Canadian marijuana market.

The facts have changed now, and the company is writing a new and interesting chapter in its storybook. The new story includes the following bullish developments:

Lower operating expenses

The company has undergone a painful restructuring exercise. Massive layoffs, asset sales, and the disposal of entire subsidiaries helped management cut selling, general and administration (SG&A) expenses over the past quarter.

Adjusted gross margins have been maintained at 54%. Lower production costs have worked well to dilute the impact of lower prices and increasing marginal excise taxes.

Operational breakeven

Aurora Cannabis looks well positioned to breakeven operationally as quarterly operating expenses (SG&A plus research and development costs) decline towards a target of $40-45 million by September this year.

Potentially sustainable revenue growth drivers

A surprise 35% sequential revenue growth to $75.5 million during the first calendar quarter of this year lifted investor spirits. It's true that the recent growth rate is elevated due to massive provisions for returns and inventory write-downs during the December 2019 quarter.

That said, the introduction of a value brand (Daily Special), a full quarter of edibles sales, and the resumption of sales in Germany were significant growth drivers — and they are sustainable sources of growth too.

Lower cash burn rates

One more thing: lower operating expenses, growing revenues, and substantially reduced capital expenditures should result in much lower cash burn rates. This should not only reduce the chances for bankruptcy, but could also mean reduced dilution rates for existing shareholders.

All these new developments mean lower investment risks on the company's stock. The elevated negativity on the company's shares post the May reverse stock split is no longer warranted. I wouldn't expect the stock price to drift back to early May levels again unless something goes wrong somewhere.

What could go wrong at ACB?

Perhaps this could be a subject for another article, but it's important to note that the company isn't out of the woods yet.

The company still has massive debt on its balance sheet. A $593 million total debt balance, including a $54 million current portion by March 31 seems too high leverage for a cash strapped company with negative operating cash flows, operating losses, and exhausted borrowing capacity. Interest costs will also continue to gobble cash flows.

Equity investor dilution is still a real risk to consider as management works to retire or refinance the outstanding amounts. New equity raises appear necessary in my view.

Massive write-downs are still possible on the company's $2.4 billion goodwill balance from overly-ambitious acquisitions. I clearly wasn't a big fan. Huge losses from write-downs could dampen market spirits.

Another big concern is that pantry loading could have driven marijuana sales growth going into COVID-19 lockdowns last quarter. If true, then revenue growth rates could potentially be softer going forward.

Moreover, marijuana prices are still trending lower yet volume sensitive excise taxes remain sticky, this is a threat to earnings margins and could worsen operating cash burn rates in the near future.

Foolish bottom line

Let's continue to watch how the new Aurora Cannabis story evolves. While things could still go wrong, it seems as if the worst episode is over. The company's recent stock price gains could linger for longer after consolidations.

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