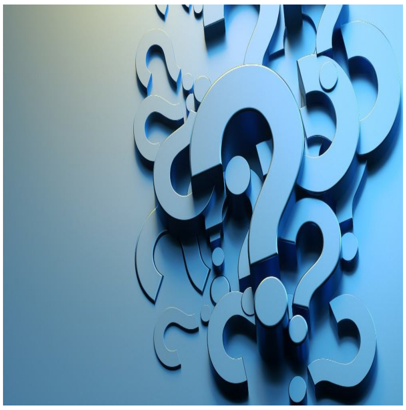

Is Aurora Cannabis (TSX:ACB) Stock a Buy Right Now?

Description

Big changes keep happening at **Aurora Cannabis** (TSX:ACB)(NYSE:ACB) this year. The marijuana producer has significantly restructured its operations and balance sheet as industry focus turns from growth to profitability. The big question for investors is whether Aurora Cannabis stock is a buy or sell after the latest restructuring update announced on Tuesday.

What's happening at Aurora Cannabis?

Aurora is suspending production at five small sites across Canada. This will take off approximately 39,300 kilograms in the company's production capacity going into 2021. This is huge. Since announcing its restructuring plans, ACB had cut back its planned production capacity from over 625,000 kilograms per annum to just 150,000 kilograms by May this year. Given Tuesday's announcement, the company should exit 2020 at a production run-rate of about 110,000 kilograms per year.

The company will consolidate its production at its four most efficient Canadian facilities by the end of this year. This is a new tact the company has employed to further reduce its quarterly selling, general and administration (SG&A) expenses to levels below the initial $40-45 million target run-rate.

Aphria, the company's closest competitor, is currently operating-earnings positive at a productive capacity of over 255,000 kilos per annum. It's sad to see a former giant like Aurora shrink so much — and so fast.

Further to earlier restructuring exercises, Aurora is axing about a quarter of its operating staff, most of them immediately. The company is also laying off about 30% of its production staff complement over the next two quarters.

These painful moves aim to reduce the company's SG&A run-rate to $42 million per quarter. An earlier retirement of the company's president and co-founder this month was linked to this maneuver.

Most noteworthy, the company expects to record an asset impairment charge of about $60 million for the quarter ending this month-end. Management also expects to make a $140 million inventory charge "to align inventory on hand with near-term expectations for demand."

What do Aurora's latest actions mean for investors?

The inventory write-down mostly affects cannabis trim and is 40% composed of non-cash fair value adjustments. This implies that 60% of the write-off is potentially related to cash production costs. We should expect higher but unsustainable future gross margins.

Staff rationalizations and facility consolidations are welcome cost-reducing actions. They lead to cost efficiencies and better operating margins. All would be well if productivity is maintained.

That said, inventory write-downs are a big (and yet recurring) problem. They are a significant red flag to any growth-oriented investor. Companies usually make inventory charges when they no longer expect to realize the carrying values through normal sales activities. Declining market prices usually trigger such painful accounting events.

Inventory write-downs are usually a feature of a saturated market with lagging demand, minimal product differentiation, and growing price competition. Entrepreneurs usually avoid investing in such industries because margins could keep falling.

Should you buy Aurora Cannabis stock?

Aurora's management is turning around the fortunes of the cash strapped marijuana firm. The company remains focused on becoming operating-earnings-positive during the second half of 2020. However, the latest moves as mere survival tactics for a financially challenged company faced with a smaller-than-anticipated market.

Buying new shares in Aurora Cannabis is a speculative bet on the future of cannabis. The company's cash situation seems improved, but its growth story is distorted. Many questions need be answered after recent restructuring efforts.

Who wants to hold shares in a company that's writing off its inventory because market prices are consistently declining? Should we buy a stake in a company that is significantly downsizing because its target market is unsustainably smaller than previously thought?

Perhaps a contrarian investor would buy the cannabis stock. However, contrarian investors make huge profits because they take huge but well-calculated risks. The Canadian marijuana market isn't a fast-growing market anymore.

Revelations of slow uptake of high margin cannabis extracts (including oils and capsules) and consumers' proven preference for traditional dried marijuana flower products make me worry about the company's potential for healthy margins and the success of any price differentiation strategies.

The company's fundamentals remain questionable going forward. There are better options for long-term wealth creation on the **TSX.**

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