



Aurora Cannabis Q4 Earnings: Where Did Things Go Wrong?

Description

Aurora Cannabis's ([TSX:ACB](#))(NYSE:ACB) stock price dropped 23% on Wednesday morning after a 15% surge during Tuesday's trading session. Investors [looked forward to some encouraging news](#) in the company's fiscal fourth-quarter earnings released after market on Tuesday, but they were disappointed instead.

ACB's quarterly earnings results were slightly better than the previous guidance, but some critical operating areas look wrong in a big way — more so given management's guidance for the next quarter.

ACB earnings were better than prior guidance, but not great

Net revenue at \$72.1 million beat analyst expectations and was higher than the upper end of the \$70-72 million guidance. The number was 5% lower than the previous quarter's sales.

Cannabis net revenue at \$67.5 million was 3% weaker sequentially, but the number was well within the \$66-68 million guided for earlier this month.

The company's 50% adjusted gross margin was significantly better than the 43% reported during the third quarter.

The market has seen Aurora's operating costs decline significantly after a business model reset. Selling, general and administration (SG&A) costs decreased to \$63.8 million for the quarter, and management says the run rate is now in the low \$40 million range quarterly.

Operating costs look more sustainable now, and a lower adjusted EBITDA loss of \$34 million could even improve to about \$10 million this quarter.

An inventory charge of \$135 million, fixed asset impairments of \$86.5 million, and a goodwill writedown of \$1.6 billion were all below the issued guidance for \$140 million, \$90 million, and \$1.8 billion, respectively.

That said, the outlook for Aurora Cannabis stock isn't much better yet. Some things went wrong in a material way in some key areas.

Where did Aurora Cannabis get it wrong?

Everything about the company product mix has gone wrong.

The key to turning ACB's business around from a massive cash-burning machine to a viable cash-generating business lies not in cost management alone but in growing sales and margins. Investor confidence has gone too low on the revenue growth end.

Although medical cannabis performed very well, up 4% sequentially aided by a 14% increase in exports to Europe, and with growing gross margins, the consumer pot segment has shown serious shortcomings with a 9% sequential decline in revenue.

Aurora's new CEO Miguel Martin rightly pointed it out that the company got distracted during the past few months. Management's focus was disturbed during a massive reorganization and cost-cutting exercise.

So much effort was put into moving a value brand, Daily Special. The target was a gain in overall market share. A 36% surge in sales volumes sequentially was achieved, but a 30% decrease in average selling prices offset all benefits. Daily Special accounted for 62% of cannabis flower revenue, up from just 35% in the previous quarter.

Price competition alone has proven detrimental to the business, and total revenues have declined instead.

A persistent decline in revenue is a big threat to Aurora's near-term cash flow and profitability goals. It makes lenders to the business more uncomfortable after recent debt covenants re-negotiations. Equity investors are right to get more worried.

Could ACB stock recover?

The most discouraging news in the earnings release was management's guidance for the quarter ending this September.

Revenue is expected to drop by up to 12% sequentially into the \$60-64 million range. Even if operating costs and gross margins hold near 50%, the company's guidance for positive adjusted EBITDA during the December 2020 quarter is severely under threat.

Investors want growth, and they want to see it now. The market could punish ACB stock severely for lack of clear visibility to this near-term profit target.

Little hope lies in CEO Miguel Martin's data-driven product portfolio strategy. He intends to revive the company's premium, high-margin products portfolio and win back market share lost to close competitors.

The challenge is, competitors are using data analytics too, and they are working tirelessly to defend their market share gains.

Recovery could be slow, and tough, but still likely given a growing marijuana market in Canada.

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