Aurora Cannabis Stock Is Giving Back Recent Gains: Hold or Bail Out?

Description

Aurora Cannabis (TSX:ACB)(NYSE:ACB) stock price went parabolic last week, and a favourable earnings report pushed the stock up 15% on Monday. The Monday gains built on top of much stronger rallies during the previous week, as ACB stock price gained 134% within five trading sessions. Shares have given up most of those gains during the week after a new equity raise was announced on Tuesday.

Given that the company has disappointed shareholders for a long time, early investors in Aurora Cannabis's stock are split on whether to continue to hold positions, buy more shares, or take this opportunity to finally bail out on long-held, underperforming position.

Buying more ACB shares after a recent rally could be dangerous. I would wait for a consolidation first. History has been a good teacher on this name, as traders fared much better than long-term investors. There could be good reasons to hold onto existing positions, though.

Why hold on to ACB stock?

If you managed to hold ACB stock during its tumultuous times, because you have faith in its future growth prospects, then holding on to the position now should be easy. Perhaps there's some more momentum to the play.

Aurora Cannabis's business is clearly turning a corner given the latest quarterly earnings results. Quarterly revenue held steady at $67.8 million during the quarter to September 30 this year. Adjusted gross margins before fair-value adjustments remain healthy at 48% of revenue. Operating costs have significantly declined after a painful restructuring exercise, which involved massive layoffs, the closure of five production facilities, and the disposal of non-core businesses.

Most noteworthy, the company is much closer to breaking even operationally after shedding much of the operating cost deadweight. Operating losses have narrowed significantly as compared to previous quarters.

The new CEO’s data-driven product strategy is yielding results after a 40% surge in high-margin vapes and extracts during the last quarter. Pushing high-value cannabis products will help the company protect its margins and become earnings and cash flow positive in a shorter time frame than the previous volumes-based strategy through value products could.

Encouragingly, if the company manages to realize its promised target to generate positive adjusted EBITDA during this current quarter to December 31, the market could be happy and stop punishing ACB stock price.

It’s important to take note of the slowing cash burn rate at Aurora. Capital expenditures have gone down, and cash flow from operations is improving after a restructuring exercise.

Moreover, as sentiment grows stronger now that a Joe Biden administration could federally legalize consumer cannabis in the United States, marijuana stocks could maintain speculative valuations for much longer in another greed-fuelled rally.

Some reasons to sell Aurora Cannabis stock right away

Some investors view the latest rally in ACB’s share price as the best opportunity to bail out of a position that has caused them sleepless nights. I don’t blame them.

The company has contained its operating costs. However, it still requires double-digit sales growth rates while maintaining healthy margins to become profitable. Yet it operates in an industry that faces significant threats to profitability.

Unfortunately, the company continues to lose significant market share in the consumer cannabis segment. Consumer cannabis flower sales were down 16% sequentially during the past quarter. This isn’t an encouraging data point on a turnaround stock.

Aurora’s quarterly revenue has been flat for six months. If it remains so by December, things could fall apart as mandatory adjusted EBITDA targets in debt covenants are violated. Shares could remain very volatile until the market becomes convinced the company is getting out of the woods.

Most noteworthy, the company has several investor lawsuits alleging misrepresentation by its principals. The total potential liability isn’t quantifiable yet.

Further, liquidity is still an issue at Aurora. The $250 million cash balance at the start of November will still require top-ups in the next few months. The company will thus continue to dilute shareholders.

The latest rally could be an opportunity to cut losses for those who have been waiting for a rebound. It’s a good idea to sell a stock if you no longer believe in its growth story.

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