BCP Research: Aurora Cannabis Inc (ACBCN) 2Q21 Results - Aggressive Guidance v. Robust Balance Sheet - Maintain 'Neutral'

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Summary: Canadian-based cannabis producer, Aurora Cannabis Inc (Aurora) released 2Q21 (Dec. '20) results marked by a decline in volumes offset by improved pricing. Inventory grew, yet to reflect capacity reductions implemented in 4Q20 (June '20), amidst continued signs of an oversupplied market. Negative US$13 mm in adj. EBITDA was an improvement but missed guidance. Cash burn improved to US$46 mm (v. 1Q21 US$93 mm). Net debt decreased to US$175 mm on higher cash, driven by equity raises and asset sales. Estimated liquidity totaled ~US$450 mm at end-2Q21.

Aurora's previously issued guidance implies sales volume doubles from current levels to ~31,500 kg, hinging on international market growth. BBG Consensus continues to see dramatic margin expansion with ~US$80 mm in estimated adj. EBITDA generation (17% margins) by 2023. Meanwhile, missed 2Q21 adj. EBITDA targets, and continued sequential increase in inventory days, suggest any near-term guidance may be overly optimistic. Nevertheless, we estimate US$690 mm in est. total available liquidity, and an additional US$190 mm remaining from Aurora's ATM program (detailed below), will be more than sufficient to support near-term cash burn or strategic M&A.

ACBCN 24s have rallied strongly alongside other cannabis names, likely on hopes for broad legalization in the US, as underlying fundamentals are improving, but remain weak. Using a credit spread of 975 bps spread on ACBCN '24s, suggests bonds are fairly priced. In our view, spread between IVOL on the convert (46%) and 100D (162%) and IVOL (136%) offers the most attractive opportunity for investors looking to hedge against a shortfall in sales targets, though borrow appears expensive and difficult to transact at present. Therefore, we maintain a 'Neutral' rating on ACBCN 5.5% '24s at 87c within our convertible coverage universe.

	Amt Out (US$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	ACB US Price
ACBCN 5.5% 2/28/2024	345	87.0	10.71%	45.87%	0.14%	7.44%	$86.72	$13.14

Source: Equity information sourced from Bloomberg. Convertible pricing as of February 17, 2021

2Q21 (12/20) Financial Results:

- Sales increased 61% y/y, but decreased 5% q/q to 15,253 kg, balanced by a 12% y/y decrease and 10% q/q increase in average net selling price of dried cannabis to US$3.07/gram
- Cannabis inventory was 19% higher y/y and 30% higher q/q at US$118 mm, with delayed reflection of ongoing planned production and capacity reductions in 2Q21 results
- Inventory days, totaling 272, decreased 33% y/y, following the charge to inventory which occurred in 4Q20, but increased 9% q/q, again due to delayed impact of ongoing adjustments to production output

ACBCN (US$MM)	2Q21	1Q21	4Q20 (1)	3Q20	2Q20 (2)	y/y	q/q
Kilograms produced, net	n/a	n/a	44,406	36,207	30,691	-	-
Kilograms equivalent sold	15,253	16,139	16,748	12,729	9,501	61%	(5%)
Average net selling price of dried cannabis	3.07	2.79	2.60	3.45	3.49	(12%)	10%
Cash cost to produce dried cannabis / gram (USD)	n/a	n/a	0.64	0.91	0.78	-	-
Harvested Cannabis	69	48	31	62	52	32%	43%
Extracted Cannabis	33	30	28	36	24	34%	10%
Capsules	-	-	-	-	-	-	-
Hemp Products	1	1	1	12	12	(95%)	0%
Supplies, Consumables & Other	15	12	12	12	10	51%	25%
Cannabis Inventory	**118**	**91**	**71**	**123**	**99**	**19%**	**30%**
Cannabis COGS	39	32	33	35	22	77%	20%
Cannabis Inventory Days	**272**	**251**	**195**	**312**	**403**	**(33%)**	**9%**

(1) 4Q20 cost of goods sold adjusted to exclude US$76 mm (CAD 106 mm) non-cash charge related to charge to net realizable value of inventory
(2) 2Q20 reflects originally reported results. Restated 2Q20 results reflect changes in accounting policy related to dried cannabis by-product and associated costs. We note restated results' kilograms equivalent sold and average net selling price were unchanged.

- Net revenue of US$52 mm (+27% y/y, +2% q/q), was mainly driven by improvements in medical cannabis
    - Medical cannabis net revenue was US$30 mm (+46, +19% q/q), driven by a spike in sales of international dried cannabis to US$9 mm (+565% y/y, +82% q/q), as well as continued growth in Canadian cannabis extracts to US$10 mm (+22% y/y, +14% q/q), which occurred despite rollout of consumer retail cannabis in international markets
    - Consumer cannabis net revenue was US$22 mm (+29% y/y, -15% q/q), with y/y improvements reflecting reduction in net provisions, and pacing of y/y growth of Cannabis 2.0 products with decline in consumer dried cannabis. Meanwhile, continuation of q/q net revenue decline of dried cannabis reflected ongoing pressure on Aurora's Daily Special value brand, following the recent influx of other value brands into the domestic consumer market
        - We note consumer cannabis net revenue includes US$2 mm in net returns, price adjustments and provisions related to Aurora's "Product Swap" at certain provincial distributors from lower potency to higher potency and higher-quality flower products
- Adjusted EBITDA of negative US$13 mm, while significantly improved on a y/y and q/q basis, fell below guidance of near adj. EBITDA breakeven by 2Q21
    - The company attributed lower than anticipated adj. EBITDA performance to higher costs associated with investment in higher quality product, and delayed translation of scaling back of lower quality production into costs
    - We note the elimination of minimum EBITDA covenants under Aurora's Bank of Montreal (BMO) credit facilities (detailed below), which had included adj. EBITDA positive attainment by 2Q21
- Cash burn reduced to negative US$46 mm in 2Q21, benefitting from improvements in adj. EBITDA, timing of convertible bond interest payments and slight reductions in working capital outflow and capex
    - Working capital use was US$21 mm in the quarter, mainly driven by a US$13 mm increase in A/R, balanced by an US$18 mm decrease in accounts payable and accrued liabilities
    - Capex was US$11 mm, a 10% reduction q/q v. 1Q21
        - Capex includes US$7 mm in total cash outlays, in line with the company's updated guidance, detailed below
    - Lease liability payments were US$1 mm
- Cash (incl. marketable securities) increased 169% q/q to US$305 mm at 144% cash to LTM revenue, with cash outflow balanced by inflow of net cash proceeds raised from issuance of shares
    - Net proceeds from issuance of shares includes US$298 mm (CAD 379 mm) in net proceeds raised under Aurora's ATM program and November '20 unit offering, and US$5 mm (CAD 6 mm) in net proceeds from the sale of investments
        - The ~US$170 mm (CAD 215 mm) raised via Aurora's November 16, 2020 unit offering resulted in the issuance of 23 mm units,
            - Each Unit entitles the holder to one common share and a warrant for half of a common share
                - Each whole warrant entitles the holder to purchase one common share of the company at a price of US$9.00 per warrant until March 16, 2024

- Liquidity (cash + A/R) decreased 117% q/q to US$366 mm at 172% liquidity to LTM revenue
    - Total available liquidity was ~US$450 mm, including US$86 mm (CAD 110 mm) in remaining borrowing capacity from credit facilities at the end of 2Q21
- Gross debt decreased 1% q/q to US$480 mm, driven by slight reductions in loans and lease obligation payments
    - Debt is comprised of the US$375 mm senior unsecured convertible ACBCN 5.5% 24s, the US$72 mm (CAD US$91 mm) drawn portion of Aurora's secured credit facilities and US$64 mm (CAD 81 mm) in lease liabilities
        - Secured credit facilities (US$76 mm drawn) are senior to convertible bonds, with first ranking general security interest in Aurora's assets, and subject to certain financial covenants under agreements with BMO and other lenders
        - A second amendment to Aurora's BMO credit facilities was executed on December 17, 2020, following its initial 1Q21 amendment, and resulting in restructuring of financial covenants and adjustment to repayment terms, most notably:
            - Maturity extension from August 29, 2021 to December 31, 2022
            - Maintenance of a minimum restricted cash balance of US$50 mm, available for use to repay outstanding principal on Facility B at any time at the company's discretion
            - Maintenance of a minimum unrestricted cash balance of the lesser (a) US$58.9 mm (CAD 75.0 mm) or (b) 225% of outstanding principal on Facility B less any cash collateral
            - Required use of 100% of net proceeds from the sale of certain Canadian facilities to repay a maximum of US$28.9 (CAD 36.5 mm) of outstanding principal on Facility B
            - Required use of 75% of net proceeds received in excess of US$3.9 (CAD 5.0 mm) from the sale of other properties to repay outstanding principal on Facility B
- Net debt decreased 53% q/q to US$175 mm, reflecting the aforementioned increase in cash
- In addition to unit offerings, in 2Q21, Aurora issued 467,817 and 2,639,172 common shares to acquire Anandia Laboratories Inc. and Whistler
- As of end-2Q21, the company has a total of 12,338,889 mm warrants, valued at a weighted average price (WAP) of US$12.43 (CAD 15.82), based on 2Q21 end-f/x of 1.2725
    - We highlight the current price and WAP of warrants remains well below the conversion price for ACBCN 24s (US$86.72) which, unless operational results or supply/demand were to change drastically, supports our view of ACBCN 24s as a straight bond in the near to medium-term

ACBCN (US$MM)	2Q21	1Q21	4Q20	3Q20	2Q20 (1)	y/y	q/q
Net Revenue	**52**	**51**	**53**	**56**	**41**	**27%**	**2%**
Adjusted EBITDA	**(13)**	**(43)**	**(23)**	**(38)**	**(52)**	**(75%)**	**(70%)**
Adjusted EBITDA margin	*(25%)*	*(85%)*	*(44%)*	*(67%)*	*(127%)*	*10,187bps*	*6,054bps*
Interest Paid on Convertible Bonds	-	(9)	-	(9)	(6)	-	-
Taxes Paid	n/a	n/a	n/a	n/a	n/a	-	-
Working Capital	(21)	(27)	35	(41)	(40)	(47%)	(22%)
Accounts receivable	*13*	*(10)*	*13*	*12*	*6*	112%	-
Biological assets	*(7)*	*(16)*	*(4)*	*(23)*	*(24)*	(72%)	(58%)
Inventory (2)	*(1)*	*(3)*	*2*	*(24)*	*(4)*	(81%)	(67%)
Prepaid and other current assets	*(9)*	*5*	*19*	*(10)*	*3*	-	-
Accounts payable and accrued liabilities	*(18)*	*(2)*	*4*	*9*	*(24)*	(24%)	951%

Deferred revenue	*1*	*(1)*	*(1)*	*(2)*	*4*	(69%)	-
Provisions	-	*(0)*	*3*	*(3)*	-	-	-
Capex	(11)	(12)	(25)	(62)	(94)	(89%)	(10%)
Lease Liability Payments	(1)	(1)	6	(7)	(3)	-	4%
Free Cash Flow	**(46)**	**(93)**	**(7)**	**(158)**	**(194)**	**(76%)**	**(51%)**
Cash (3)	**305**	**113**	**125**	**172**	**130**	**135%**	**170%**
Accounts receivable	60	56	40	57	59	3%	8%
Liquidity	**366**	**169**	**165**	**229**	**188**	**94%**	**117%**
Loans and Borrowings	135	139	150	191	214	(37%)	(3%)
Convertible Debentures (4)	345	345	345	345	345	-	-
Total Debt	**480**	**484**	**495**	**536**	**559**	**(14%)**	**(1%)**
Net Debt	**175**	**371**	**371**	**363**	**429**	**(59%)**	**(53%)**
Cash to LTM Revenue	**144%**	**56%**	**60%**	**76%**	**60%**	***8,441bps***	***8,767bps***
Liquidity to LTM Revenue	**172%**	**84%**	**80%**	**102%**	**86%**	***8,592bps***	***8,841bps***

(1) 2Q20 reflects restated amounts in line with changes in accounting policy related to dried cannabis by-product and associated costs
(2) Excludes non-cash charge to net realizable value of inventory
(3) Includes cash and equivalents, ST investments and marketable securities
(4) Convertible debentures valued at par

<u>Post 2Q21 Events and Guidance</u>:

- Production guidance of 35,000 kg in production per quarter, based on previous disclosures, is measurably reduced (-21%) from the most recent documented output of 44,406 kg (4Q20),
- Management has targeted sales-to-production ratio of 90% by 3Q21 (v. 38% in 4Q20), taking several aggressive measures to address supply v. demand dislocation, including
    - Planned closure of five (5) smaller cultivation facilities, already underway, and estimated to reduce capacity by ~80,000 kg/yr
    - Termination of construction at Aurora Sun, a 230,000 kg/yr facility in Alberta, CA
    - Consolidation of smaller non-EU-GMP cultivation facilities Aurora Polaris, Whistler Pemberton 1 and Aurora River
    - And reduction of capacity utilization by 75% at Aurora's Sky facility, in line with the company's plan to focus on the sale of higher margin premium quality flower, vape and pre-rolls while de-emphasizing focus on lower-potency value branded products

Production Facilities	Location	Size (sq ft)	Capacity (kg/yr)	Domestic Licensing	EU-GMP Certified	Constructed to EU-GMP Standards	Status
Domestic							
Aurora Mountain	Alberta, CA	55,200	4,000	n/a	Yes	Yes	Closing FY21
Aurora Polaris	Alberta, CA	300,000	n/a	n/a	No	No	Under development, consolidating
Aurora Sun	Alberta, CA	1,620,000	> 230,000	n/a	No	Yes	Construction terminated
Aurora Sky	Alberta, CA	800,000	> 100,000	Yes	No	Yes	Complete, 75% reduction in capacity utilization
Whistler Alpha Lake	B.C., CA	12,500	500	Yes	No	No	Complete
Whistler Pemberton 1	B.C., CA	62,000	4,500	Yes	No	Yes	Complete, consolidating
Aurora Ridge	Ontario, Canada	55,000	7,000	Yes	Yes	Yes	Closing FY21
Aurora River	Ontario, Canada	210,000	28,000	Yes	Yes	Yes	Complete, consolidating
Aurora Eau	Quebec, CA	48,000	45,000	Yes	Yes	Yes	Closing FY21
Aurora Vie	Quebec, CA	40,000	4,000	Yes	No	Yes	Closing FY21
Aurora Prairie	Saskatchewan, CA	97,000	19,000	Yes	Yes	Yes	Closing FY21
International							
Aurora Nordic 1	Odense, Denmark	100,000	8,000	Yes	Yes	Yes	Complete
Aurora Nordic 2	Odense, Denmark	1,000,000	> 120,000	Yes	No	Yes	Under development
MED Colombia SAS	Bogota, Colombia	n/a	n/a	Yes	No	No	Complete
ICC Labs Inc.	Canelones, Uruguay	21,000	1,000,000	Yes	No	No	Complete

- Together, production and sales-to-production ratio guidance imply anticipated doubling of sales by 3Q21, which is seemingly hinged on international market growth
- In January '21, Aurora entered into sale agreements for two of its production facilities for an aggregate US$19.3 mm (CAD 24.6 mm), subject to closing, with 50% of proceeds to be received upon closing, and the remaining 50% following the obtainment of certain licensing by the purchaser
    - We note aggregate proceeds in USD reflect avg. f/x for January '21 (1.2721)
- The company plans to continue its "Product Swap", focusing on increasing premium and high-quality product offerings at certain provincial distributors and across all brands
- Adj. EBITDA positive targets appear to have been eliminated in lieu of "steady improvement", which the company expects to be driven by facility adjustments, and a shift to higher margin premium products and a more variable cost structure, including contracting of exclusive third-party sales via Great North Distributors Inc. for its Canadian consumer market
- Capex guidance has been adjusted from US$40 mm in capital spending to US$40 mm in total cash outlays
- We estimate current cash (incl. marketable securities) of ~US$405 mm (~CAD 515 mm) based on
    - Estimates are based on management reported cash and equivalents (incl. restricted cash, excl. marketable securities) of ~US$445 mm (~CAD 565 mm) and spot f/x (1.2696) as of February 12, 2021
- We estimate pro-forma total available liquidity of ~US$690 mm, including US$405 mm in BCP calculated cash, US$61 mm (CAD 77 mm) in 2Q21 reported A/R, US$87 mm (CAD 110.0 mm) from Aurora's Bank of Montreal (BMO) credit facility, and US$138 mm (CAD 175.2 mm) raised via a second unit offering under the company's 2020 shelf prospectus post 2Q21
    - We note amounts reflected in USD, excluding reported amounts raised from the second unit offering, are based on spot f/x (1.2696) as of February 12, 2021
    - Estimated available room under the ATM reflects utilization for Aurora's US$173 mm unit offering in November '20 and subsequent US$138 mm unit offering in January '20
        - Aurora raised US$137.9 mm (CAD 175.2 mm) in proceeds post-2Q21 (January '21), resulting in the issuance of 13.2 mm units, at US$10.45 per unit, via a second unit offering under its ATM program
            - Each unit includes a warrant to purchase one common, and half of a common share purchase warrant of the company
                - We note each whole warrant entitles holders to purchase share at US$12.60 a warrant for 36 months post-issue date
            - Proceeds from the offering are being used to improve ST liquidity and repay certain debts, as well as for general corporate purposes, including funding of working capital requirements and potential acquisitions
- In addition to total available liquidity, we estimate ~US$190 mm in remaining available room from Aurora's US$500 mm ATM program ("2020 Shelf Prospectus"), implying US$880 mm in potential unrestricted cash available for use

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"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

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"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's total return relative to the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

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“Market Overweight” – The spread of the bond to its similarly duration sovereign controller bond is expected to decrease over the next 3 – 6 months.

“Market Weight” – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

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“Not Rated” or no comment – Currently, the analyst does not have adequate conviction about the bond’s spread to its similarly duration sovereign controller bond over the next 3 – 6 months.

High Octane Universe
“Speculative Buy” – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

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“Neutral” – Bonds that in our view have an equity investment risk profile and we think risk/return is balanced

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“Swap” – Convertible bonds that, in our view, offer attractive volatility differential between implied volatility of the convertible bond option call v. the 100D realized volatility and listed calls in the option market for the corresponding equity

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