

BCP Research: Aurora Cannabis Inc (ACBCN)- Initial Thoughts and 4Q20 Results

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Summary: Aurora Cannabis Inc (Aurora) is a Canadian-based fully-integrated cannabis producer, focused on the production and sale of high-quality greenhouse-based medical and consumer cannabis products in Canada (85% of revenues) and Europe (15% of revenues). The company reported 4Q20 (June '20) results showing increased production, balanced by decreased cash costs y/y and q/q. Sales decreased y/y, but increased q/q, following the introduction of value-brand, Daily Special. Revenue declined y/y and q/q on lower net selling price of dry cannabis, reflecting market oversupply. Adj. EBITDA of negative US\$25 mm was lower y/y, but is showing sequential improvement as the company works to realign its cost structure. Cash burn of US\$8 mm improved substantially q/q, benefitting from working capital inflow and lower capex, which balanced weaker profitability. Cash decreased to US\$125 mm at 60% cash to LTM revenue, and net debt increased slightly to US\$371 mm. Assuming steady sales levels and based on cost reduction guidance, we think cash flow could approach breakeven in the current quarter, with expected release of results on November 9, 2020.

As with Canadian peer, Aphria Inc (Aphria), our key concern remains oversupply, reflected by continued deterioration of pricing trends. However, Aurora appears to be focused on rightsizing, with planned divestment of assets, rationalization of facilities, SG&A reductions and writing down inventory. Management is guiding to positive adj. EBITDA generation by 2Q21 (Dec. '20), a milestone required under Aurora's secured RCF agreements. BBG 2023 consensus anticipates a 2x+ increase in revenues at 21% EBITDA margins and manageable pro-forma net debt of 3.4x, which appears predicated on industry consolidation and improved supply vs. demand balance. We initiate our coverage of ACBCN 5.5% 24s at 47c with a 'Neutral' rating, awaiting evidence of stabilizing market trends which could help the credit emerge from its current distressed pricing levels. We note subordination to the US\$195 mm RCF of which US\$84 mm is drawn.

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Conv. Price	ACB US Price
ACBCN 5.5% 2/28/2024	345	47.25	32.91%	\$11.53	\$4.87

Source: Equity information sourced from Bloomberg. Convertible pricing as of November 3, 2020

Comparable Credits:

US\$MM	Aphria	Aurora Cannabis	Tilray	Trulieve Cannabis Corp
Region	Canada/ Int'l	Canada	Canada	US / Canada
Bond Ticker	APHACN	ACBCN	TLRY	TRULCN
Coupon	5.25%	5.50%	5.00%	9.75%
Maturity	6/1/2024	2/28/2024	10/1/2023	6/18/2024
Currency	USD	USD	USD	USD
Amt Out (US\$MM)	259	345	475	130
Maturity Type	Convertible	Convertible	Convertible	Fixed
Rank	Sr Unsecured	Sr Unsecured	Sr Unsecured	Secured
Mid Px	84.00	47.25	39.25	104.5
Mid YTW	10.76%	32.91%	43.98%	8.28%
Equity Ticker	APHA US	ACB US	TLRY US	TCNNF US
Share Px	4.87	4.57	6.36	24.73
Shares Outstanding	289	116	133	58
Market Cap	1,406	532	847	3,189
Minority Interest	32	(18)	-	-
Net Debt	71	371	375	80
TEV	1,509	884	1,222	3,269
Financial and Operating Results (US\$MM)	LTM 1Q21 (1)	LTM 4Q20 (1)	LTM 2Q20	LTM 2Q20
Net Revenue	418	208	200	367
Adj. EBITDA	19	(142)	(225)	192
Adj. EBITDA margin	5%	(68%)	(113%)	52%
Working Capital	(118)	(75)	-	(124)
Capex	(82)	(265)	(329)	(68)
Lease Liabilities	(1)	(6)	(96)	(5)
Free Cash Flow (excl. interest and tax paid)	(181)	(488)	(650)	(5)

Comparable Credits (Continue):

US\$MM	Aphria	Aurora Cannabis	Tilray	Trulieve Cannabis Corp
Total Debt	378	495	512	230
Cash	307	125	137	150
Net Debt	71	371	375	80
Cash to LTM Revenue	73%	60%	69%	41%
Gross Leverage	19.4x	n/a	n/a	1.2x
Net Leverage	3.6x	n/a	n/a	0.4x
TEV / LTM EBITDA	77.5x	n/a	n/a	16.4x
2021 BBG Consensus Estimates (2)				
Revenue	564	260	347	702
EBITDA	75	15	4	314
EBITDA margin	13%	6%	1%	45%
TEV / EBITDA	20.2x	59.6x	328.5x	10.4x
2022 BBG Consensus Estimates (2)				
Revenue	690	411	501	945
EBITDA	131	62	45	491
EBITDA margin	19%	15%	9%	52%
TEV / EBITDA	11.5x	14.3x	27.3x	6.7x
2023 BBG Consensus Estimates (2)				
Revenue	769	536	672	1,244
EBITDA	181	108	91	662
EBITDA margin	24%	20%	14%	53%
TEV / EBITDA	8.3x	8.2x	13.4x	4.9x

(1) APHACN reflects 1Q21 (end Aug '20) reporting period, ACBCN reflects 4Q20 (end June '20)

(2) Based on Calendar Year (end December 31st). Reflects BBG consensus as of November 3, 2020

Source: Equity information sourced from Bloomberg. Convertible pricing as of November 3, 2020

Background:

- Aurora Cannabis Inc (Aurora) is a Canadian-based cannabis company, focused on the production and sale of high-quality greenhouse-based medical and consumer cannabis products in Canada and Germany (ACB, TSX and NYSE)
 - Aurora is a vertically integrated company, with operations in 20+ countries in the Americas and Europe through Aurora's sixteen (16) wholly owned subsidiaries, and ten (10) strategic partnerships
 - Building (greenhouses), cultivating, extracting, R&D and distribution functions are performed through Aurora's sixteen (16) wholly-owned subsidiaries:
 - Anandia Labs, Aurora Deutschland, Aurora Larssen Projects, Aurora Portugal Lda, BC Northern Lights, CanniMed Therapeutics Inc., CanvasRx, Chemi Pharmaceutical Inc., H2 BioPharma, Hempco Food and Fiber Inc., HotHouse Consulting Inc., ICC Labs Inc., MedReleaf Corp., MED Colombia SAS, Peloton Pharmaceuticals, Whistler Medical Marijuana Corporation
 - In addition, the company has established strategic investments, providing similar functions through Alcanna, Cann Group Limited, Capcium Inc., Choom Holdings, CTT Pharmaceuticals, Evio Beauty Group Ltd., FloraFotonica Ltd., High Tide Inc., Micron Waste Technologies and Radiant Technologies Inc.

○ Production Facilities:

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 1H21
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	Under development
Aurora Sky	Alberta, CA	800,000	> 100,000	Yes	No	Yes	Complete, consolidating
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 1H21
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 1H21
Aurora Vie	Quebec, CA	40,000	4,000	Yes	No	Yes	Closing 1H21
Aurora Prairie	Saskatchewan, CA	97,000	19,000	Yes	Yes	Yes	Closing 1H21
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

- The company holds a top three market position in the domestic consumer market, while noting market share erosion in 4Q20 in flower, vape and pre-rolls
- Product offerings range from discount to ultra premium quality, sold under brand names: Aurora, Aurora Drift, San Rafael '71, AltaVie, MedReleaf, CanniMed, Whistler, Reliva CBD, and recently launched lower-potency value brand, Daily Special
- Recent Developments:
 - Aurora recently appointed new CEO, Miguel Martin, as part of business transformation plan, which aims to rationalize facilities, refocus capital investments and reset cost structure to meet current demand, through:
 - Winding down and closing operations at five (5) Canadian facilities, including Aurora prairie, Aurora Mountain, Aurora Ridge, Aurora Vie, and Aurora Eau over next 2 quarters
 - Consolidating Canadian production and manufacturing at Aurora Sky, Aurora River (EU-GMP certified), Whistler Pemberton and Polaris
 - Scaling back production at Aurora Sun to six grow bays to allow for scale up of production as needed, based on demand
 - Acquired US-based Reliva, LLC (Reliva) in May '20, which focuses on distribution and sale of hemp derived CBD products, to gain entry into US CBD market (cost: CAD 53 mm (~US\$40 mm), comprised of 2.5 mm shares and cash held in escrow)
 - Sold entire 5.3 mm shares of EnWave for US\$4.1 mm net proceeds in April '20, and disposed of investment in Acanna (9.2 mm shares or 24.8% ownership interest) for gross proceeds of ~US\$20 mm (CAD 27.6 mm)
 - Disposed of Aurora Hemp Europe, Lithuanian subsidiary focused on hemp seed contracting and processing, in July '20, aligning with the company's strategy to focus on core cannabis operations

- Terminated contract with UFC via a one-time US\$30 mm payment in 1Q21 (Sept. '20), with termination expected to free-up ~US\$110 mm (CAD 150 mm) over the next 5 years to be reallocated to Aurora's core markets

4Q20 (6/20) Financial Results:

- Production increased 53% y/y and 23% q/q to 44,406 kg, while cash costs decreased 29% y/y and 25% q/q to US\$0.64/gram
- Sales decreased 6% y/y, but increased 32% q/q to 16,748 kg, balanced by a decrease of 29% y/y and 25% q/q in average net selling price of dried cannabis to US\$2.60/gram
- Cannabis inventory was 28% higher y/y, but 42% lower q/q at US\$70 mm, following the non-cash charge to net realizable value of inventory (primarily trim), reflecting decreased selling price and excess inventory relative to projected market demands
- Inventory days, totaling 263, remained high relative to 4Q19 (+102% y/y), but improved in the quarter (-16% q/q) following the non-cash charge to net realizable value of inventory

APHACN (US\$MM)	4Q20	3Q20	2Q20	1Q20	4Q19	y/y	q/q
Kilograms produced, net	44,406	36,207	30,691	41,436	29,034	53%	23%
Kilograms equivalent sold	16,748	12,729	9,501	12,463	17,793	(6%)	32%
Average net selling price of dried cannabis	2.60	3.45	3.49	3.71	3.67	(29%)	(25%)
Cash cost to produce dried cannabis / gram (USD)	0.64	0.91	0.78	0.80	0.90	(29%)	(29%)
Harvested Cannabis	31	62	52	42	30	3%	(51%)
Extracted Cannabis	28	36	24	10	9	198%	(23%)
Capsules	-	-	-	3	2	-	-
Hemp Products	1	12	12	7	7	(86%)	(92%)
Supplies, Consumables & Other	12	12	10	9	7	61%	(3%)
Cannabis Inventory	71	123	99	72	56	28%	(42%)
Cannabis COGS *	24	35	22	22	38	(37%)	(31%)
Cannabis Inventory Days	263	312	403	291	130	102%	(16%)

* 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

- Net revenue decreased 28% y/y and 7% q/q to US\$52 mm on lower consumer cannabis net revenue, balanced by higher medical cannabis revenue
 - Consumer cannabis net revenue of US\$25 mm was 21% lower y/y and 9% lower q/q resulting from a lower average net selling price per gram of consumer dried cannabis following the launch of Aurora's value brand, Daily Special
 - Daily special accounted for 62% of total net consumer revenue from flower in 4Q20 v. 35% in 3Q20, while consumer cannabis extract net revenue decreased following lower sales of Aurora's vape products
 - Medical cannabis net revenue of US\$23 mm increased 5% y/y and was flat q/q as the company shifted its sales mix towards the European market
- Adjusted EBITDA was negative US\$25 mm, lower y/y but improved q/q, while reflecting continued operating losses as the company works to realign its cost structure
- Free cash flow was negative US\$8 mm in the quarter, attributable primarily to weak profitability, which was balanced by working capital inflow and reduced capex
 - Working capital turned positive US\$36 mm in the quarter, mainly driven by a US\$16 mm decrease in A/R, and a US\$19 mm decrease in prepaid and other current assets

- Capex was US\$25 mm in the quarter, 61% lower q/q v. 3Q20
- Based on published results, the company saw an inflow of US\$6 mm in lease liability obligations in the quarter
- Cash (incl. marketable securities) decreased 28% q/q to US\$125 mm at 60% cash to LTM revenue
- Liquidity (cash + A/R) decreased 28% q/q to US\$165 mm at 80% liquidity to LTM revenue
 - Total available liquidity was US\$276 mm, including the US\$111 mm undrawn portion of the company's US\$195 mm secured RCF
- Gross Debt decreased 7% q/q to US\$495 mm, driven by a reduction in loans and borrowings, and net Debt increased 2% q/q to US\$371 mm
 - Debt is comprised of the US\$375 mm senior unsecured convertible ACBCN 5.5% 24s, US\$84 mm drawn portion of Aurora's secured RCF and US\$67 mm in lease liabilities
 - The US\$195 mm secured RCF (US\$84 mm drawn) is senior to convertible bonds and subject to certain financial covenants under agreements with syndicate banks, including Bank of Montreal and other lenders
 - Aurora reached an agreement with syndicate banks in the quarter to amend certain financial covenants, including the extension of positive adj. EBITDA attainment to 2Q21, and reducing the size of its secured revolving credit facility to US\$195 mm
 - Other revised financial covenants include:
 - Total funded debt to shareholders' equity \leq 0.25:1 from Dec. 31, 2020 forward
 - Total senior funded debt to EBITDA \leq 3:1 at June 30, 2021
 - Minimum unrestricted cash maintenance of US\$35 mm
 - Minimum EBITDA threshold of: -US\$8 mm (-CAD 11 mm) for 1Q21, US\$3 mm (CAD 4 mm) for 2Q21, US\$7.5 mm (CAD 10 mm) for 3Q21, US\$13 mm (CAD 17 mm) for 4Q21, and US\$15 mm (CAD 20 mm) for FY21
- Guidance:
 - 1Q20 net revenue totaling ~US\$45 mm (CAD 60-64 mm), expected to be comprised exclusively of cannabis net revenue
 - 1Q20 Adj. gross margin before FV adjustments for cannabis net revenue is expected to be 46-50%
 - 1Q20 SG&A is anticipated to be below US\$29 mm (CAD 40 mm), with a focus on Canadian consumer/medical market, established international medical markets, and US market initiatives
 - Announced 25% reduction in SG&A staff (effective immediately)
 - Planning a 30% reduction in production staff over the next two quarters to focus on production and manufacturing at larger-scale facilities
 - 1Q20 capex below US\$14 mm (CAD 20 mm), and below US\$72 mm (CAD 100 mm) for 1H21
 - Positive adj. EBITDA generation by 2Q21 (Dec. '21)

APHACN (US\$MM)	4Q20	3Q20	4Q19	y/y	q/q
Net Revenue	52	56	72	(28%)	(7%)
Adjusted EBITDA	(25)	(38)	(9)	185%	(33%)
<i>Adjusted EBITDA margin</i>	<i>(48%)</i>	<i>(67%)</i>	<i>(12%)</i>	<i>(3,583bps)</i>	<i>1,879bps</i>
Interest Paid	n/a	n/a	n/a	-	-
Taxes Paid	n/a	n/a	n/a	-	-
Working Capital	36	(42)	9	278%	(185%)
<i>Accounts receivable</i>	16	9	(24)	(164%)	69%
<i>Biological assets</i>	(7)	(21)	(17)	(62%)	(69%)
<i>Inventory (1)</i>	2	(24)	9	-	(108%)
<i>Prepaid and other current assets</i>	19	(10)	0	-	-
<i>Accounts payable and accrued liabilities</i>	3	10	41	(93%)	(71%)
<i>Deferred revenue</i>	(1)	(2)	0	-	(65%)
<i>Provisions</i>	3	(3)	-	-	-
Capex	(25)	(62)	(125)	(80%)	(61%)
Lease Liability Payments	6	(7)	-	-	-
Free Cash Flow	(8)	(149)	(124)	(94%)	(95%)
Cash (2)	125	172	241	(48%)	(28%)
Accounts receivable	40	57	79	(50%)	(30%)
Liquidity	165	229	320	(49%)	(28%)
Loans and Borrowings	150	191	108	-	(21%)
Convertible Debentures (3)	345	345	345	0%	0%
Total Debt	495	536	453	9%	(8%)
Net Debt	371	363	212	75%	2%
Cash to LTM Revenue	60%	76%	131%	(7,028bps)	(1,556bps)
Liquidity to LTM Revenue	80%	101%	173%	(9,378bps)	(2,145bps)

(1) Excludes non-cash charge to net realizable value of inventory

(2) Includes cash and equivalents, ST investments and marketable securities

(3) Convertible debentures valued at par

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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.

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

"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.

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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.

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