Aurora Cannabis Inc.'s Risk Profile Has Drastically Improved

Description

There was some real drama on April 11, 2017, when **Aurora Cannabis Inc.** (TSXV:ACB), one of the country's leading marijuana producers, announced to the market its bought deal private placement of $40 million in 7% convertible debentures.

Within just five hours from that announcement, Aurora came back to the market with another announcement of an up-size of the convertible debentures private placement from the previously announced $40 million to a staggering $75 million.

What an increase within such a short time!

Most interesting, in its first announcement, Aurora had stated that it was granting the underwriters an option to purchase an additional $20 million aggregate principal amount of convertible debentures on the same terms pursuant to the offering.

If the underwriters' option was to be fully exercised, the aggregate gross proceeds of the offering were to be just $60 million.

However, not only was the underwriters' option fully exercised, but Aurora was offered $35 million more hard cash in the transaction within hours, and the company's management was "forced" to extend their transaction limit from a cap of $60 million to $75 million.

Most noteworthy was that this debenture offering is at a lower interest rate of 7% per annum than in the company's last convertible debentures transaction on November 1, 2016, in which it completed a $25 million convertible debenture offering at 8% per annum paid semi-annually.

Furthermore, not only is the latest debenture offering at a lower interest rate, but the current transaction is three times bigger than the last. It's evident that the lenders (which are most likely big, smart, and prudent institutional money managers) had to scramble to get a piece of the deal, and Aurora was compelled to up its $60 million transaction cap by 25% more.

Why would lenders scramble to lend to Aurora at this juncture at an interest rate that is 100 basis points lower than the previous offering? It comes down to three possibilities: a lower credit risk profile, a higher share price potential, or both.

It's possible that Aurora's offered interest rate at 7% is perceived to be higher than it should given its perceived corporate risk profile at this time. The debentures could be mispriced. This would mean that Aurora's credit risk profile has drastically improved and it can now borrow at a much lower interest rates than the 7% quoted and still get subscribers to its unsecured debt offerings.

It's possible that the lenders scrambled to get their hands on Aurora's convertible debt because of a "low" quoted conversion price. At a $3.29 per share conversion price, the lenders are confident Aurora's share price will rise significantly and they will convert their debentures at a locked-in gain within the next two years.

Both the above possible explanations could indicate that for valuation purposes, Aurora’s corporate risk profile, as assessed by institutional lenders, has significantly improved from its November 2016 levels and that there could be upside potential in Aurora’s current $2.83 share price.

Investor takeaway

While a reduction in the corporate risk profile could be great for corporate borrowing going forward, $75 million in convertible debt is a significant sum for Aurora.

Investors: beware the potential dilution effect.

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