



What Does Aphria Inc.'s \$100 Million Capital Raise Mean For Investors?

Description

Aphria Inc. (TSX:APH) announced last Friday that it has officially secured a capital raise of \$100 million to support the company's growth initiatives moving forward. This offering will include a \$75 million bought deal equity round, as well as a \$25 million term loan with WFCU Credit Union.

I'll be taking a look at what this capital raise could mean for investors moving forward, as this investment round represents one of the largest of its kind in a red-hot investment environment for cannabis-related companies.

Production capacity addition to be completed in 2018

This large amount of capital will all but guarantee the completion of Aphria's phase IV expansion of the company's production facilities. The marijuana company has indicated that approximately \$50 million of the \$100 million raised will be devoted to fully funding this expansion of production capacity.

The marijuana industry is one which has seen the rise of a few large producers who are in a race to add capacity and increase margins faster than their competition.

Upon completion, Aphria estimates that it will be able to produce approximately 75,000 kilograms of high-quality cannabis per year, allowing the company to continue to grow its market share domestically and abroad. Additionally, the production improvements and scale adjustments will allow for improved economics within the business, furthering Aphria's cost advantage over other smaller producers.

Investors in other unicorns such as **Canopy Growth Corp.** and **Aurora Cannabis Inc.** have let their money do the talking; these companies' ability to produce lots of high-quality product at a lower price than other competitors have led to massive increases in these companies' valuations due to the belief that the long-term advantage from gaining market share today will be worth significantly more in the future.

Strategic investments

Here's what gets investors really excited about this capital raise. While some of the remaining \$50

million will be put aside to maintain working capital levels after the production expansion is complete, a significant portion will be available to pursue strategic opportunities that Aphria's management deems suitable for its long-term success.

Acquiring other small producers has been the name of the game of late, and is one of the ways Aphria and its competitors have grown to such a large market capitalization in such a short period of time. The expectation of further bolt-on acquisitions in the coming months may continue to be yet another driver for Aphria's stock price following the raise, which is expected to close on May 9.

So what's the catch?

Raising \$100 million is no small task, and the addition of more debt and equity to the company's books means investors will have to come to terms with two inevitable outcomes: (1) dilution and (2) slowing growth rates over time.

Doing the math, any time \$75 million of new shares are added to the existing pool, the dilutive effect of the equity offering will provide downward pressure on the outstanding shares. That said, the fact that this offering is expected to close at \$6.50 all but sets a price floor for short-term investors based on increased market validation of the current market capitalization of Aphria.

The other major consideration for shareholders should be that Aphria, Canopy, and Aurora will all have approximately 1 million square feet of production space as of 2018, and each of these companies will be competing vigorously to take over the domestic and export markets for cannabis in Canada. The growth rates these companies are able to attain now, through frequent acquisitions and increased market share every quarter is likely to slow down when the market equalizes some time after production levels are solidified (I'm betting on 2018).

Stay Foolish, my friends.

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