

Analyzing Aurora Cannabis Inc.'s Convertible Debenture Offering

Description

Aurora Cannabis Inc. (TSXV:ACB) will raise \$75 million through a Convertible Debenture offering scheduled to close on April 26, 2017. And, **Aphria Inc.** (TSX:APH) is raising \$100 million in capital comprising of a \$75 million equity financing and \$25 million in debt financing through a five-year term loan by May 9, 2017.

While Aurora's two year tenure convertible debentures require 7% per annum in interest, Aphria's senior secured term loan asks for just 3.95% in interest and has a 15 year amortization period. Aphria's debt is cheaper, probably because it is secured with the company's assets.

Not only is Aurora's new debt more expensive for the company's current investors, it could have some further costs to investors and favours the lending syndicate.

Aurora is borrowing at a higher cost at the expense of profitability and, at the same time, the company has opened up a huge gap for current shareholders' stake to be diluted. Potential conversion to commons shares by debenture holders will significantly dilute current shareholders interest in the firm.

The lenders will take part in the company's profits after converting, while they will also enjoy a high yield return of 7% for the entire holding period until conversion.

The debenture holders seem insulated from losses, too.

Here is why:

If Aurora does not do well as a business going forward, it will most likely default on the debentures and the stock price would suffer too.

To protect themselves from the downside, the convertible debenture holders could short sell the stock if they anticipate a likelihood of an Aurora default.

As the stock price falls, they benefit from their short positions, cover at a low stock price and make a profit, then later recover some loaned debenture funds in a liquidation or other settlement options.

On the other hand, if Aurora does well, it won't default on the debentures and pay the high 7% debenture yield for as long as the holders don't convert.

If Aurora does well, the debenture holders will even benefit more.

The stock price may continue to rise as Aurora grows. Due to the locked in conversion price of \$3.29 per common share, the lenders' conversion option will be deeply in the money. They will only be forced to convert to ordinary equity when Aurora's share price reaches \$4.94 and stays above this price for any 10 consecutive trading days.

That's a **50% locked in return** on investment per share at conversion, plus any surplus as the share exceeds the forced conversion price.

Then add the the 7% debenture interest per annum!

There is potentially no way the lenders could lose out, but the same can't be said for current ordinary share holders who shall shoulder the high interest payments and also face the imminent threat of dilution of their stake in the company, all that in just a single transaction.

The potential increase in short interest on the stock price may magnify price volatility. Coupled with an already high number of leveraged day traders and swing traders placing their bets on the stock, there could be a swarming attack on Aurora stock and the share price volatility may spike.

High share price volatility will be bad for long term investors, and some may end up panic selling when the low price swings are magnified by short selling.

A stable share price is desirable for long-term company valuation

Investor takeaway

There are a number of negatives brought about by the Aurora convertible debenture offer including a potentially sure dilution. However, unsecured debt always comes at a high cost.

If you can stomach the high stock price volatility, a long term play on Aurora's stock could be rewarding. Be careful not to allow emotions to get the better of you should the stock price fall 10% or more in a single trading day and you are "compelled" to quickly bail out in a panic.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ACB (Aurora Cannabis)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

Category

1. Investing

Date

2025/09/04

Date Created

2017/04/25

Author

brianparadza

default watermark

default watermark