



Did Aphria Inc. Overpay for Broken Coast Cannabis Inc.?

Description

Here at Fool.ca, there's no shortage of coverage on **Aphria Inc.'s** (TSX:APH) latest acquisition of Broken Coast Cannabis Inc. for \$230 million. Fellow Fool contributors [Chris MacDonald](#) and [Will Ashworth](#) have both expressed their opinions on this latest deal, and their viewpoints appear to be on different ends of the spectrum. From a valuation perspective, MacDonald thinks that the deal "makes no sense whatsoever," and Ashworth seems to think that the deal is a "win/win" for both sides.

With very little visibility behind the deal, it's nearly impossible to get a grasp of the real value behind the Broken Coast acquisition, but let's attempt to anyway to determine whether or not the latest deal is a win or loss for Aphria shareholders.

Ashworth justifies the hefty \$230 million price tag by drawing comparisons to acquisitions that are common in the tech industry, which I personally don't think is a reasonable comparison to make because of reasons that MacDonald pointed out in his piece.

Sure, Aphria stands to benefit from the operational expertise of Broken Coast's "talent," but at this point, it's nearly impossible to quantify the value that's to be had from such a deal without taking a closer look under the hood.

Based on the limited knowledge that's currently available, MacDonald noted that each employee is valued between \$5 and \$21 million. While they don't tell the whole story, these numbers should be ringing alarm bells, since there's little to no visibility on potential synergies from the deal, and investors are putting all of their trust in the hands of CEO Vic Neufeld.

"Adding one of Canada's most sought-after premium brands represents a major triumph for Aphria and our shareholders and firmly establishes our position as a Canadian leader in premium indoor cannabis production," said Neufeld.

A "major triumph" for shareholders... That's a bold statement, to say the least. However, investors would be wise to take such executive comments with a grain of salt, at least until the numbers can show otherwise.

What's my view?

I think Aphria severely overpaid for Broken Coast. While I'm sure management did their homework, and the firm is probably the perfect fit given Aphria's fundamentally sound business model, I'm not at all a fan of the price it's paying.

With all of Canada's larger pot firms heading into "acquisition mode" going forward, I think the patience, and not complacency of management teams, will be rewarded in the grander scheme of things.

I believe all cannabis stocks are in bubble territory, and all investments or acquisitions made at these levels are subject to a ridiculously high premium, which I believe will be substantially lowered after the bubble gets popped. Acquisitions at these levels are taking into account the fact that the overly euphoric general public would be more than likely to pay up an absurd multiple for anything cannabis related in the public markets.

We're in the very early stages of a nascent industry, so there's no rush to buy everything at highly questionable premiums. Over the next few years, I suspect the cannabis market is almost guaranteed to experience a correction, as it did last year. After the hype fades is when I believe firms should begin consolidating the industry. So, contrary to popular belief, I think M&A inactivity is what investors should be favouring with cannabis valuations continuing to surge above and beyond what's considered realistic.

When combined with Aphria's potential delisting from the TSX, I'd avoid Aphria like the plague and opt for any of the three "Big Four" Canadian cannabis producers if you're keen on getting some skin in the game today. You don't need an in-depth analysis to see that the big cannabis players are severely overpaying to scoop up smaller firms at what I believe are "bubbly" levels.

Of course, I could be wrong if the industry isn't actually in a bubble that's on the verge of bursting. And if that's the case, props to Aphria on its latest "value" acquisition.

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Date

2025/08/16

Date Created

2018/01/24

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