Aphria Inc. Investors: What's Another $826 Million in Monopoly Money?

Description

As the valuation multiples of Canadian cannabis producers continue to climb, acquisition fever has overcome most of the CEOs in charge of long-term strategy for various producers, with the near-term costs of acquisitions being ignored in favour of the perceived near-term benefit that additional production capacity appears to be providing to valuation multiples in a pre-legalization environment.

The race to acquire smaller producers and further consolidate an industry which is still in its infancy has been supported by a fear of missing out (FOMO) mentality among many of the country's largest producers. It's understandable — considering whether or not a company makes sense at a ridiculous premium matters less and less when considering what the potential negative impacts of not moving forward are with a given acquisition. The thought that competitors could potentially snap up the same company that one is considering buying and paying what may seem like a high price today, but which may turn out to be a "steal" tomorrow, makes sense.

The psychology of these transactions may somehow be justified; however, I just can't see how the fundamentals supporting these premiums will make sense in a post-legalization world. With acquisitions happening at more than 15 times the all-in build out cost of a new facility, buying companies for production capacity or a clientele list alone just doesn't make sense.

The recent acquisition of **Nuuvera Inc.** (TSXV:NUU) by **Aphria Inc.** (TSX:APH) for $826 million, as covered by fellow Fool contributor Joseph Solitro, is just another example of how a cannabis producer has found a way to leverage its paper valuation gains in paying what anyone in their right mind would believe is a ridiculous premium for a very small producer.

Unlike Mr. Solitro, who believes Aphria is "one of the best investment options in the market today," I believe the exact opposite is true at its current valuation. As with the company's Broken Coast acquisition, the multiples being dished out have in no way changed the long-term potential of Aphria, and on a sum-of-the-parts analysis, the company is worse off by completing these acquisitions than it would have been by purchasing a piece of land and showing investors renderings of a new facility that would be ready to go in 12-18 months.

As fellow Fool contributor Joey Frenette has pointed out, the CEOs of cannabis producers may be better served by waiting on the sidelines at this point in time for a pullback in the industry before acquiring smaller firms. The multiples don't make sense, and it appears that many investors are starting to see this — to the detriment of stock prices in recent weeks.

Instead of focusing on an acquisition-growth model, cannabis producers should be growing production capacity organically, using debt instead of issuing more shares. It's at least 15 times cheaper, after all.

Aphria is destroying long-term value for its shareholders with these acquisitions. I don't know when investors will wake up to this reality, but when they do, the story won't be so rosy.

Stay Foolish, my friends.

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chrismacdonald