Aurora Cannabis Inc. Buys MedReleaf Corp.: Will Current Shareholders Lose Out Again?

Description

It's official.

Aurora Cannabis Inc. (TSX:ACB) is buying **MedReleaf Corp.** (TSX:LEAF) — the largest transaction in the history of the cannabis industry.

I first brought this to your attention a couple of weeks ago. Although Aurora was quick to deny ongoing talks, it was clear that MedReleaf was seeking a buyer. In case you were wondering, yes, MedReleaf owners were looking to cash out. Had investors bought on the rumour, they would be looking at a 20% gain.

It marks the end of a remarkable one-year run for MedReleaf, which, less than a year ago, completed the largest marijuana IPO in North America.

The details

Aurora is purchasing MedReleaf in an all-stock deal worth $3.2 billion. The deal values MedReleaf at $29.44 per share, an 18.2% premium over Friday's closing price. With the purchase, Aurora effectively leapfrogs **Canopy Growth Corp.** (TSX:WEED) to become the largest player in the industry. Combined, the new entity can produce 507,000 kgs of marijuana annually.

Upon completion of the deal, Aurora shareholders will own approximately 61% of the new company, while MedReleaf shareholders will own the remaining 39%.

Aurora is the fastest-growing company in the industry. But is it the right approach for current shareholders?

Poor performance

On May 1, the company completed its $1.1 billion deal for **CanniMed Therapeutics** in an all-stock deal. At the time, it was the largest purchase in the cannabis industry. Since Aurora's closing offer was announced, its stock has cratered, losing approximately 40% of its value. Meanwhile, CanniMed shareholders profited handsomely. Why?

It’s simple. All-stock deals are dilutive to current shareholders, as they must now share in the new company’s profits. Research has shown that all-stock deals have a negative impact on the acquirer’s stock price, whereas the acquiree tends to come out on top. In both deals, Aurora shareholders lost a portion of their ownership.

Why not an all-cash deal?

Acquiring companies fare much better when the purchase is an all-cash deal. Unlike an all-stock purchase, the acquirer’s shareholders see no ownership dilution. They become the sole benefactors of the newly formed company.

Unfortunately, an all-cash deal of this magnitude is not possible for Aurora. It is currently burning through an intense amount of cash, as it ramps up marijuana production. Case in point, it has never posted positive cash flows.

Revenues may be increasing at an impressive clip, but they are nowhere near where they need to be to finance such an acquisition. In the three months ending March 31, Aurora had approximately $36 million in sales. No financial institution will finance such a large acquisition with so little revenue.

Dilution will continue

The deal is good news for MedReleaf owners. The offer price represents a 209% premium over the company’s IPO price of $9.50 per share. You can’t complain with that type of return on investment.

Aurora shareholders continue to see their piece of the pie shrink. The company should focus on rewarding current investors. It should not be a race to the top; it’s a long-term game.

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