Easiest Double-Digit Profit You’ll Ever Make?

Description

Have you ever heard of the term *arbitrage*? In the stock market, many investors look for arbitrage opportunities following merger and activity (M&A) news.

The concept is simple. You want to look for a to-be-acquired company that is trading below the acquisition price. This price differential is an arbitrage opportunity.

You might be asking yourself why these opportunities exist. The answer is risk — risk that the acquisition will fall through. The higher the degree of risk, the higher the price differential, and vice-versa.

Last week, **Aurora Cannabis Inc.** (TSX:ACB) announced its intention to purchase **MedReleaf Corp.** (TSX:LEAF) in an all-stock transaction worth $3.2 billion. MedReleaf shareholders will received 3.575 Aurora common shares for each MedReleaf common share they own.

Trading below its acquisition price

Surprisingly, MedReleaf’s share price has not reacted in concert with its purchase price. On Friday, it jumped 10.41%, as the market realized it was undervaluing the stock.

Despite Friday’s jump, the company is still trading a 15% discount to Aurora’s proposed purchase price. Hence, the arbitrage opportunity.

Will the transaction close?

There are many factors that can affect an impending transaction. In this case, there are two major requirements; shareholder and regulatory approvals. The transaction needs approval from 66.66% of MedReleaf shareholders and a simple majority of Aurora shareholders.

Is this a significant risk? At the time of announcement, MedReleaf had already locked up support from holders of 56% of the company's outstanding shares. Thus, it's unlikely the company won't achieve the necessary votes.

Likewise, only a simple majority or 50.1% of Aurora shareholder are required to vote in favour of the transaction. This is all but a guarantee given the company's past acquisitions have all been well supported by shareholders.

As far as regulatory approvals are concerned, I believe the risk to be minimal here as well. The industry is young. There are over 20 pot-listed TSX companies, and this is despite rampant industry consolidation.

I haven't come across a single purchase in the industry that has been held up by regulatory approvals. M&A is healthy for the sector, and I can't see regulators standing in the way of the transaction.

Don't let this opportunity pass you buy

At this point, MedReleaf's stock price is tied to Aurora's. Because it's a fixed all-stock deal, they should rise and fall in lock-step with each other. However, MedReleaf is currently trading at a discount to Aurora's shares.

Think of it this way: if you are interested in buying Aurora and believe the transaction will close, you are better off buying MedReleaf. Why? Each share of MedReleaf is worth 3.575 of Aurora shares. As of Friday's close, that would be $6.88 per Aurora share ($24.60/3.575), more than a dollar cheaper than buying Aurora on the open market.

In an efficient market, these types of buying opportunities would not exist. Fortunately for us, the market is overestimating the risk involved.

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