Could Aphria Inc (TSX:APHA) Stock Soar After New Pharma Deal?

Description

Aphria (TSX:APHA)(NYSE:APHA) is gearing up for yet another acquisition. And this time, it's a pharmaceutical company. On November 8, Aphria management announced their intention to acquire **CC Pharma GmbH**, a company that distributes drugs to more than 13,000 German pharmacies. CEO Vic Neufeld touted the deal's value to Aphria's international expansion efforts, saying that it strengthens the company's position in "one of the most highly sought-after medical cannabis markets."

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Neufeld is certainly right that Germany is a lucrative cannabis market. The country has fully legalized cannabis for medical purposes and is ranked 13th in the world for per-capita cannabis use. Not only will the CC Pharma acquisition give Aphria more access to this market, but it could also help the company break into broader pharmaceuticals.

But will the deal send Aphria's stock higher?

First, we need to look at how it will impact Aphria's ability to penetrate the German market

Distribution effects

CC Pharma is a pharmaceutical distributor, meaning it delivers drugs to pharmacies (but does not manufacture them). The company is involved in importing and exporting drugs to and from Germany. Its supply chain reaches 13,000 German pharmacies in a country that has about 20,000 pharmacies in total. This is a significant reach. By supplying cannabis to its new subsidiary, Aphria could potentially reach just shy of 75% of all German pharmacies. This could make Aphria a dominant player in the German medical cannabis market — one of the most important in the world.

A cash flow positive investment

One of the virtues of CC Pharma, according to Vic Neufeld, is its cash flow position. In a press release, he was quoted as saying that the company is cash flow positive, meaning that its cash inflows are greater than its cash outflows. Free cash flow is often considered a better measure of financial performance than net income, because it shows how much income the company can actually pay to shareholders. CC Pharma's strong cash flow position indicates that it will quickly start producing income for Aphria. This is important because Aphria has been criticized for making some very speculative investments in the past.

Where Aphria stands now

Aphria is already one of the more profitable cannabis makers — as measured by net income, not free cash flow. The company's positive net income is mainly thanks to gains on its investment portfolio, which includes a diverse array of TSX holdings (not just cannabis stocks). Though the company has had positive earnings in a few recent quarters, it is still running at an operating loss. In other words, its expenses are greater than income from operations. In this regard, Aphria is very similar to its peers in the cannabis industry.

One thing that could help Aphria win over investors is generating more income without more expenses. Depending on the cost of acquisition, the CC Pharma deal could help it do just that. The main reason to be optimistic here is that CC Pharma is a cash flow positive business. Although the cost of acquiring the business will result in one-time expenses for Aphria, these will not be recurring costs. In the long run, this deal should make Aphria more profitable. If that comes to pass, then we could see the company's stock start to rise.

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