Short Seller Sends Aphria Inc. (TSX:APHA) Down 27%: Here's Why You Shouldn't Give Up on the Stock Just Yet

Description

Aphria Inc. (TSX:APHA)(NYSE:APHA) stock plunged 27.69% on December 3 after short seller Quintessential Capital Management's Hindenburg Research released a scathing report. Since legalization I fingered Aphria as my top option for cannabis investors but have warned of volatility in the sector that is unlikely to subside until production ramps up in 2019.

In the report, Hindenburg Research has targeted one of Aphria's most encouraging developments; its international acquisitions. Hindenburg alleges that these acquisitions are largely bogus. For example, the report says that its recent $50 million Argentine acquisition publicly stated sales of $11 million. Hindenburg's research on the ground indicates that 2017 revenues were closer to $430,000. The report also alleges that its $150 million Jamaica acquisition is nothing more than a foreclosed and empty building.

It goes on to point the finger at Aphria's leadership, accusing it of artificially inflating asset prices in order to enrich "insiders." These are serious allegations, to put it lightly. Yesterday afternoon, Aphria released a state which called the report "malicious and self-serving". Investors should expect a more in-depth rebuke of the Hindenburg Research report in the coming days. According to Aphria communications VP, "The company is preparing a comprehensive response to provide shareholders with the facts and is also pursuing all available legal options against Quintessential Capital."

How are investors to make of this mess? The stock closed near a 52-week low. Aphria is one of the largest producers in Canada, and the company has boasted that it is on track to reach production capacity of 255,000 kilograms per annum. This will make it one of the key suppliers in the domestic market, and a power in international markets as well.

The report also took aim at Aphria's product, alleging that Aphria's facilities are in bad shape and have failed audit inspections. Hindenburg research said the cannabis produced is of poor quality. It is difficult to come away with concrete conclusions with commentary from unnamed sources. However, QCM's May report on the Greek retailer Folli Follie saw the company's stock crater, and this summer it filed through protection from creditors through the Greek bankruptcy code.

How should investors respond?

If you hold shares of Aphria, now is not the time to panic. For one, this is not the first time Aphria has been accused of malfeasance. Earlier in 2018, Aphria acquired the smaller medical cannabis firm Nuuvera. CEO Vic Neufeld, CFO Carl Merton, and vice-presidents and directors Cole Cacciavillani and John Cervini held shares in Nuuvera, but did not publicly disclose these holdings. This came to light in a *Globe and Mail* report and was also cited by investor advocacy group FAIR Canada.

Aphria leadership stood its ground and was backed up by the Ontario Securities Commission. "In an arm's-length transaction, there would typically not be disclosure of shares held by insiders of the acquirer," an OSC spokesperson said.

The QCM report calls into question the intrinsic value of Aphria and whether its international acquisitions will contribute to growth going forward. Volatility is here to stay in the cannabis sector, and Aphria stock holders should be equipped to wait out a comprehensive response from the company before throwing in the towel.

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