



Could Investors' Rejection of Canopy Growth Corp's (TSX:WEED) Recent Offer Be Bullish for the Stock?

Description

The leading global cannabis grower **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC) recently had its tender offer to buy back its \$600 million convertible debentures unanimously turned down by holders of the outstanding notes, as no single investor tendered their notes for redemption by December 4. Could this be a bullish sign on the stock?

What?

Canopy issued \$600 million convertible 4.25% debentures in a deal that closed in June 2018. The debentures will fall due in 2023 and every \$1,000 in principal is convertible into 20.7577 common shares for an effective conversion price of \$48.18 a share.

Pursuant to the highly publicized \$5 billion investment by **Constellation Brands** into the common equity of Canopy, which closed on November 1, and the issuance to the investor of nearly 140 million share purchase warrants in the deal, Constellation Brands has about 56% voting control in Canopy, and that triggered a material change provision in the company's convertible debentures indenture.

Then the repurchase offer

Due to the fundamental change in control noted above, Canopy announced on November 2 an offer to redeem the outstanding debentures and pay all accrued interest, and this was a legal right to investors the indenture had provided for so that debt holders had a chance to exit the debt instrument if they no longer perceived that the company's risk profile was still the same after a material change in control.

As if to induce a conversion, Canopy offered to increase the conversion price during the offer period by 14% to 23.7423 shares per each \$1,000 in principal debt for an effective conversion price of \$42.12 a share, and that was a lucrative offer as the company's share price closed at \$48.92 on the day of the announcement.

...And no one participated

Canopy announced the results of its tender offer to repurchase the convertible senior notes on December 6. No single investor tendered their debentures back to the company and none took up the sweetened conversion offer.

What could this investor action imply for the stock?

First, Canopy now has a boatload of cash after the \$5 billion investment by Constellation Brands, so there is an even lower risk profile attached to the company's debt. The company is in a much better position to pay all interest obligations as they fall due, so the material change that triggered the repurchase offer was actually a bullish development, both to debt holders and stock investors in the leading cannabis firm.

Second, it can be argued that the debt redemption offer was inferior to the value of holding the initial position. The holders of Canopy's debt are all institutional investors, and these money managers usually have long investment horizons. They opted to hold their positions and enjoy the 4.25% yield instead of jumping on to a potential 16% one-time gross gain, which could have been wiped off before final settlement as the share price closed below \$42 on December 4.

Most noteworthy, as prospects for Canopy's business growth were elevated by the Constellation Brands deal, the call option feature in the convertible debentures even became more valuable as the share price may grow with the company over the next five years. Hence holding the convertible notes was again the more superior proposition.

That said, it is also possible that convertible debenture holders saw too much near-term risk on the company stock and could not give up an almost guaranteed interest income return for unknown capital gains, even when the conversion terms had been made more compelling. This could pose a bearish near-term sentiment on the company's share price

Investor takeaway

Institutional investor mandates may sometimes disallow prompt decisions to jump on to highly risky short-term gain proposals, unless the big picture has changed. Canopy's big picture became more colourful after the Constellation Brands investment, and there's lower default risk on the outstanding debt instruments.

Why then would an investor give up the seemingly lucrative 4.25% annual yield on the debentures and give up the better upside in a later conversion? The notes have over four-and-a-half years remaining to run.

The cannabis firm's convertible notes are of a higher quality today, and [the same could apply to its common stock](#).

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