

Hostile Takeover bid Indicates Aphria's (TSX:APHA)(USA) True Value

Description

Aphria (TSX:APHA)(NYSE:APHA) stock has been on a roller coaster for much of the past year. The stock kicked off 2018 priced at \$19, touched an all-time high of \$22 in September, dipped down to its 52-week low at \$4.97 by December and is now hovering around \$9.45.

It's fair to say that Aphria is the most volatile stock in the world's most volatile industry at the moment. A series of good and bad news have dragged the stock around throughout 2018.

On the plus side, recreational marijuana has been legal in Canada since mid-October and the company is already the third-largest producer in North America. On the downside, short sellers Quintessential Capital Management and Hindenburg Research released a report that called the company a "shell game," which prompted the co-founder and chief executive officer to resign.

Meanwhile, a rival has launched a hostile takeover bid for the company. U.S.-based cannabis producer Green Growth Brands expressed interest in acquiring Aphria a few weeks ago, but only published details of the takeover bid recently.

The company is willing to offer 1.5 shares of Green Growth for each outstanding Aphria share. The all-stock deal would value Aphria at roughly C\$2.8 billion or slightly lower than the current price per share.

On paper, the match between an American company with vertically integrated operations including cultivation, manufacturing, and retail and a Canadian firm with supply and wholesale agreements makes sense. However, Aphria's board of directors believe the deal severely undervalues the company and have asked shareholders to reject it.

Given that Aphria's annual production is set to grow from 35,000 kilos a month ago to over 225,000 kilos by the end of the year, I agree with the board. Aphria is the only cannabis producer to deliver 12 consecutive quarters of positive earnings from operations. Coupled with the fact that the company has \$152 million in cash, no debt, and 54% gross margins, Aphria is one of the most robust weed stocks in Canada.

Another interesting factor is the valuation. Aphria's stock trades at a price-to-sales ratio of just 41.2, while most of its rivals have ratios far above 100. The company's US\$1.78 billion market capitalization is a mere fraction of the US\$200 billion the global market for recreational and medical marijuana could be worth by 2030.

In other words, investors need to take a closer look to see if Aphria is the most undervalued investment opportunity in an exciting industry or if it indeed is a shell game like the analysts at Quintessential Capital Management and Hindenburg Research suggest.

That's where I think the recent takeover bid offers investors a cover. If a company is willing to make an offer for the stock at close to the current market value and management ignores it, that indicates internal confidence that the stock is worth much more and that there could be other [potential buyers with better offers](#)

in the future.

Bottom line

Regardless of the red flags raised by short sellers, the money on the table now indicates that investors with an appetite for risk have an investment opportunity with limited downside and attractive upside.

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