



## Could Aphria Inc (TSX:APHA) Be Under Pressure to Accept Green Growth Brands's (CNX:GGB) Hostile Bid?

### Description

**Aphria** (TSX:APHA)(NYSE:APHA) stock rallied [in the double digits](#) on Thursday and Friday last week after news that **Green Growth Brands** (CNX:GGB) is open to negotiation on the terms of its open all-stock hostile takeover bid for the big target, and investors began anticipating better terms in a prospective deal that had previously undervalued the target's stock.

My interest was aroused by the Green Growth CEO's comments to *Bloomberg* on the deal, which suggested that negotiations may not only need to focus on and be based on the economics (valuation issues), but the talks may also include how Aphria can be "helped" to finance its businesses.

In the aftermath of a scathing short-seller report on a purported LATAM acquisitions scandal that accused company insiders of using shell companies to front run retail investors for huge personal gains, it may be relatively more difficult for the target to raise fresh equity capital, especially considering that the company is yet to convincingly refute the strong allegations.

If Green Growth intends to take the financing angle of trying to "help" its target by unveiling up to \$300 million in liquidity, how strong could Aphria's position be in defending its valuation if it seriously needs a fresh capital injection?

It's critical that investors assess how desperate Aphria could be for the scarce cash resource that Green Growth is dangling to management right now. A glimpse of the target's latest balance sheet could give us a model answer to this question.

### How desperate for cash is Aphria?

As of November 30, 2018, the company had \$152 million in cash and cash equivalents on its balance sheet, \$290 million in total current assets, and a net working capital position of \$182 million. However, its current liabilities included some \$35 million in deferred revenue, which I would expect the company to earn over two or more quarters just by simply growing and delivering more cannabis, but will the

available liquidity be sufficient to cover spending and investment needs in the near term?

The company has commitments for \$94 million in 2019, which include nearly \$82 million in purchase orders related to asset expansions, and it later paid €19 million (almost \$29 million) in its acquisition of Germany-based CC Pharma, which closed in January.

Moreover, the company's operations are still cash flow negative, and they consumed \$16 million during the most recent quarter. Capital expenditures topped \$56 million, of which almost \$5 million was maintenance capex, which could reasonably be expected to recur going forward.

At a cash burn rate of \$21 million per quarter, the company may have not enough to cover more than eight quarters of operations at the current run rate without making some drastic investment and financing decisions.

The fact that Health Canada has been too slow to licence the company's recently completed grow facility expansions and retrofits may continue to limit productivity and hence constrain any efforts to grow revenues and operating cash flows in the near term.

That said, the company had \$162 million worth of long-term investments in its portfolio and could consider liquidating some of its positions to free up some liquidity if necessary, and new growth plans may be suspended as management tries to get by with a limited cash budget, but the pain of foregoing significant growth opportunities in the nascent marijuana industry may be too much for management and investors alike and may lead to a tanking stock price.

## Foolish bottom line

Management maintains that the company is adequately financed to complete its announced capital-expenditure programs, and I believe it, but the extrapolated cash position is less than ideal for an operating cash flow negative company, and this may give Green Growth a strong bargaining position such that negotiated deal terms may potentially come below current stock valuation.

Further, investor class-action lawsuits against the company with respect to the LATAM deals scandal may drain some precious cash resources in defending the company and further weaken the balance sheet. This is another compelling reason for Aphria management to accept hostile acquisition offers.

I wouldn't be surprised if the target ends up accepting a slightly improved acquisition offer from Green Growth if negotiations do take place. Let's watch how the script develops.

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