Did Aphria Inc (TSX:APHA) Convincingly Address Short-Seller Claims?

Description

In the face of a scathing short seller report that violently shook the marijuana stock in December last year, **Aphria Inc** (TSX:APHA)(NYSE:APHA) urgently set up a committee of independent company directors to review troublesome Latin American acquisition transactions.

Short sellers Quintessential Capital Management and Hindenburg Research claimed that Aphria insiders unethically created shell companies that bought “largely worthless” cannabis assets in Argentina, Colombia and Jamaica and quickly sold the same assets to the company’s shareholders at exorbitant prices for hefty personal gains.

Some overwhelming “incriminating evidence” of the purported misdeeds was then provided in the short seller report; the market had no option but to panic sell the stock. The company’s board did well to announce an independent inquiry into the allegations, and hired well-respected professional teams in December to look into the matter.

There was even some suggestion that some of the purchased assets could be fictional, as the short sellers’ researcher could not locate a farm.

Paid prices were acceptable, but…

On February 15, Aphria reported on the independent committee’s findings, and much to the investing public’s relief, the acquired Latin American assets were confirmed to be in place, licenses have been verified, and development is taking place just as the company had previously announced.

Most noteworthy, the consideration paid for these assets was “within an acceptable range” when compared to similar transactions by competitors, “be it near the top of the range of observable valuation metrics.”

The fact that comparable competitor transactions in Latin America had valuation multiples close to Aphria’s is reassuring indeed, and the idea that the assets are present, growing and actually “worth” something calms a lot of nerves.

However, the qualification that the consideration was near the top of observable valuation metrics is a slight setback, especially given that the company's acceptance of poor internal disclosure and the presence of conflicts of interests among some company directors. These findings could give some merit to the recently filed investor class action lawsuits.

The resignation of three key company insiders during the inquiry period seems like an internal corporate disciplinary action.

Did Aphria adequately refute short seller claims?

The company's board has done well in carrying out a thorough review of Latin American transactions, and the wording in the report seems carefully crafted to avoid further hurting the stock price.

Instead of directly commenting on accusations that insiders unethically created shell companies to front-run common shareholders, the company commented on general corporate governance deficiencies instead and stated some recommendations for corporate governance enhancements.

It appears that the independent board is keen on preserving shareholder trust and confidence in the company, and publicly condemning senior executives, or suing them like what recently happened at **Namaste Technologies.** Namaste decided to fire its CEO and sue him for damages at the same time, causing a massive selloff on its shares, which was not the most ideal route.

The special committee isn't necessarily refuting short seller allegations of insider shenanigans to line their pockets; it's only arguing that the considerations paid by Aphria were somewhat in line with comparable competitor transactions, and the company will improve its corporate governance practices and disclosure policies to better manage conflicts of interests.

Further, the company will also confirm the independence and qualifications of external advisors prior to engagement on transactional matters. This appears to confirm that the advisors used in the Latin American deals were conflicted too, just like the short sellers claimed.

Foolish bottom line

One could conclude that Aphria has softly acknowledged the existence of problems in its Latin American deals. The company slightly overpaid for acquired assets, but not enough to warrant a write-down of the assets' carrying values as the consideration was "acceptable."

The company is working on repairing its corporate governance reputation, and I applauded its earlier decision to improve the profile. Adopting strong ethics codes and guidelines like the those of highly regarded CFA Institute could help tackle the ethical dilemmas that many small marijuana firms face as they undergo an industry consolidation phase, and this could preserve the investing public's hard-earned trust in the nascent industry.

The fact that the company's flagship production facility is current Good Manufacturing Practices(cGMP) certified makes me less concerned about claims of low product quality at Limington, andthe company's use of independent board members, independent legal advisors, independent forensicadvisors, and independent financial advisors in attempting to debunk short seller claims gave enoughcredibility to the report.

Investors will like that very much.

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