



Is Aphria (TSX:APHA) a Fraud or Is It Time to Buy?

Description

Marijuana stocks have been some of the hottest performers over recent years, easily beating the TSX. Market [leader](#) **Canopy Growth** has gained 112% over the last year while **Cronos Group** shot up by a massive 131% compared to a pedestrian 8% return for the broader market. This has sparked speculation among investors that there is further strong growth ahead as the market for cannabis matures and the negative sentiment associated with its use declines.

Such strong returns have also led to claims of a market bubble and fraudulent companies. One cannabis company attracting considerable attention for all the wrong reasons is **Aphria Inc.** (TSX:APHA)(NYSE:APHA). It has lagged behind its peers, gaining a paltry 11% because of allegations from a renowned short-seller that the company is a fraud.

Herein lies the rub. For short-sellers to [make money](#) they need the stock they are targeting to significantly decline in value. Public claims of fraudulent accounting and misuse of company funds will certainly drive down their value, but they may not be totally based on fact.

What are the claims?

Short-seller Quintessential Capital Management claimed that Aphria is nothing but a shell company operating a marijuana business on the side where insiders are diverting funds from shareholders for their own benefit. There is nothing new about rapidly expanding newly emerging industries that are [entering a bubble](#) being populated by fraudulent companies. The late 1990s internet boom was littered with such companies with many being unable to generate real returns for investors despite having seriously over inflated valuations.

The key question for investors is whether Aphria's management is engaging in self-dealing behaviour and enriching themselves at shareholders' expense. Many of the core issues have arisen from a series of acquisitions made by the cannabis company. This includes the Nuuvera deal where according to the *Globe and Mail*, Aphria insiders did not disclose the interest they held in the company. And there's the Latin American deal that saw Aphria spend \$280 million acquiring holdings in Colombia, Argentina and Jamaica, which were financed by highly dilutive share issuances.

Quintessential's allegations centre on the claim that values of those assets were seriously overinflated. It is here that prospective investors should note that Aphria insiders CEO Vic Neufeld, co-chairmen and founders Cole Cacciavillani and John Cervini as well as board member Renah Persofsky held pecuniary interests in the business being acquired. However, they did disclose those interests.

The claims that those assets were overvalued could be true. For the fiscal third quarter 2019, Aphria announced that it had written down the value of the Latin American assets to the tune of \$50 million, and there could be further impairment charges ahead.

Painful results

Aphria's third-quarter results were disastrous. It reported a net loss of \$108 million compared to a \$13 million profit a year earlier despite net revenue growing more than seven-fold to \$73.6 million. That shocking performance can be attributed to a sharp 23% decline in the volume of marijuana sold to 2,637 kilograms and a worrying 45% increase in all-in sustaining costs to \$3.76 per gram sold. There have also been rumours of Aphria, producing poor quality marijuana and experiencing a range of quality issues at its production facilities. After that disastrous period, the company reached for the reset button, seeing CEO Vic Neufeld and Cacciavillani step down from their executive roles.

Management is focused on righting the ship and regaining investor confidence.

The cannabis cultivator is also the subject of a hostile takeover bid from **Green Growth Brands**, which management has urged shareholders to reject for good reason. The offer appears to under value Aphria and would see the company delisted from the TSX and NYSE because Green Growth is only listed on the second tier **Canadian Stock Exchange**. That offer appears to expire on April 25, 2019, and like Aphria's recent deals and results holds plenty of red flags for investors.

What does it mean for investors?

When choosing to invest these red flags and poor results should act as a deterrent. Clearly, the company overpaid for the Latin American assets, and it wouldn't be surprising if there were further impairment charges ahead. Then you have the worrying surge in operating expenses and decline in marijuana produced. It isn't difficult to see Aphria reporting further poor numbers over the remainder of 2019, as it heavily invests in turning its operations around, including making much-needed improvements to its growing processes and infrastructure.

Nonetheless, the very worst appears to be behind Aphria, and if management can regain the market's confidence, then its growth trajectory should recommence, particularly with large Canadian cannabis companies being the only quality bulk source of marijuana. It should be considered however that the

range of headwinds facing Aphria, along with it gaining a 31% for the year to date, means that investors seeking exposure to marijuana may do better to look elsewhere.

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