



Cannabis Investors: This \$700 Million Time Bomb Could Sink Aphria (TSX:APHA)

Description

There's a time bomb lurking on marijuana companies' balance sheets, and it could cost them \$4 billion.

That's the thesis behind a recent *MarketWatch* article that claimed that major weed companies would end up having to write off up to \$4 billion from their books. Citing the example of **RavenQuest**, which had an impairment charge more than 20 times its quarterly revenue, the article went on to say that weed stocks would soon have to pay for their past acquisitions.

The article's thesis was essentially that many marijuana stocks had made acquisitions that loaded up their balance sheets with goodwill that will never pay off. Once it becomes clear that these acquisitions were, in fact, worthless, then the companies will take impairment charges, resulting in losses that will wreak havoc on their balance sheets. One company that could be hit particularly hard is **Aphria** (TSX:APHA)(NYSE:APHA), which has just recently begun posting profits but has a lot of [questionable goodwill](#) on its balance sheet. To understand how the company could be affected, we first need to look at how goodwill and impairment charges work.

Goodwill

In the simplest terms, goodwill is the premium an acquiring company pays for a target company above the fair value of the latter's assets. However, accounting rules require that companies periodically "test" their goodwill to make sure it is generating a benefit to shareholders. If it's not, then the companies have to take impairment charges on that goodwill and write it down.

Why Aphria has \$700 million worth of goodwill on its books

In the lead-up to marijuana legalization, big weed companies had acquisition fever, and Aphria was one of those most affected. In just a few years prior to October of 2018, the company acquired over a dozen companies — some for hundreds of millions of dollars. The accumulated goodwill from all those acquisitions was about \$700 million.

Why it may have to be written down

As stated earlier, companies have to periodically “test” their goodwill to make sure that the figure is justified. If acquisitions aren’t producing the results that were expected, then impairment charges may occur.

Unfortunately for Aphria, [some of its acquisitions have been pretty questionable](#). Although the company had runaway hits with ABP and CC Pharma, which now generate most of its revenue, its other acquisitions haven’t been so fortuitous. If Aphria doesn’t start generating results from some of at least some of those “other” acquisitions, a portion of its \$700 million in goodwill will have to be written down. The writeoffs would be less than \$700 million, because at least two of the company’s acquisitions are paying off, but according to **CIBC** analyst John Zamparo, they could be substantial.

Long-term effects

The most obvious long-term effect of massive writeoffs on Aphria would be the loss of book value. Aphria has about \$2 billion in total assets, so a \$700 million chunk taken off of that would be a large hit. However, the long-term consequences could be even worse. If the company has to take impairment charges on its goodwill, then that suggests some of its subsidiaries are failing to deliver shareholder value, which could be bad news for its long-term growth prospects — and, ultimately, its stock.

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