



Aphria (TSX:APHA) Loses its Biggest Customer: Sell the Cannabis Stock?

Description

News on Tuesday is that cannabis firm **Aphria** (TSX:APHA)(NYSE:APHA) has lost a major supply deal that could have materially benefited the company and its stock investors over the next five strong years, and the company could be liable to refund the customer and pay damages.

What we know

- Aphria entered an initial five-year wholesale cannabis supply agreement with Emblem Corp in September 2018;
- The agreement was for the supply and delivery of 175,000 kilograms of marijuana products;
- Shipments were supposed to commence by May 1, 2019; and
- The customer says there's a default.

As the latest news claims, Aphria failed to meet its supply obligations to Emblem, a subsidiary of **Aleafia Health** (TSX:ALEF), and the big customer has thus terminated the deal effective October 7, 2019, and has highlighted its rights to demand a refund for the unused balance on its deposit as well its rights to seek damages as a result of the supplier's default.

The big question is whether the company willingly defaulted on its biggest supply agreement.

The biggest supply agreement?

The Emblem deal was probably the biggest long-term supply contract for the company and was several times bigger than its quantified provincial supply agreements in Canada by August 2018.

Total provincial supply deals announced by management in the run up to recreational cannabis legalization in October 2018 reached 24,000 kilograms per annum by August last year, yet the Aleafia deal asked for 25,000 kilograms in the first year, rising to 45,000 kilograms in the fifth year ending in April 2024, making it potentially the biggest single supply deal for the company.

Why did APHA default?

Management quickly expressed its disappointment with the contract termination as “the company had every intention to fulfilling its obligations under the agreement.”

Evidently, Aphria may not have willingly defaulted on this wholesale deal, and we can only speculate on the company’s potential incapacitation due to significant production licensing delays on both its facilities by Health Canada.

Management anticipated the company’s annual production capacity to reach 255,000 kilograms this year, but that was depended on licences from Health Canada, and things went wrong.

The company’s flagship facility [only received full licences recently](#), while the largest Diamond facility is yet to be licensed for production, even if retrofitting and construction works were completed way back in 2018 for and a first harvest could have been made by January this year.

The company is possibly getting punished for its failure to obtain critical regulatory licences on time.

Sell the stock?

In a statement, Aphria claims that this agreement is not a material part of the company’s business and operations and hinted that the “parties are contractually obligated to negotiate for a period of 30-days following the receipt of a formal notice of termination” and that it will vigorously defend itself should Aleafia claim for any damages.

Maybe the loss isn’t significant, but if the company were to be caught up in a supply glut when everyone else ramps up to full production next year, management could regret ever losing this legacy five-year deal that could significantly boost revenue growth.

Further, this isn’t just a customer loss. Aphria could lose its shareholding in Aleafia as a result of this fallout. The initial agreement resulted in a \$22.8 million deposit composed of a \$12.8 million cash payment and 6,952,169 in shares, which were locked up and would be released in five tranches, as the company met its supply obligations during the term of the contract.

While I wouldn’t rush to the exits, the loss is big, and contrary to what management claims, the combined revenue and equity losses could be somehow material.

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