



Village Farms (TSX:VFF) Battles Joint Venture Partner: Could Both Cannabis Stocks Suffer?

Description

Greenhouse farming expert **Village Farms International's** (TSX:VFF)([NASDAQ:VFF](#)) stock surged when it announced plans for cannabis production through a joint venture (JV) with technical partner **Emerald Health Therapeutics** (TSXV:EMH) in 2017, but rifts are emerging between the two partners and the situation could get ugly.

Village Farms and EMH hold a 50% stake each in the Pure Sunfarms (PSF) joint venture and on Wednesday, November 19, the former announced a further investment in PSF of \$5.94 million under a shareholder agreement, claiming that its partner EMH had failed to make a required equity contribution.

The news is that Emerald was obligated to settle the \$5.94 equity contribution balance by November 1, 2019, but had requested that this amount be set off against a portion of a \$13 million interest-bearing shareholder loan the company previously advanced to the JV, but Village Farms has offered to take up those unpaid shares, and claims it has rights to do so.

A dispute has therefore ensued, as Emerald claims that its partner has no such rights. The company maintains that it still holds a 50% interest in PSF, and management has since made a call for the immediate payment of the outstanding loan plus interest.

Actually, the issues could be much deeper.

The joint venture claimed a \$7.2 million payment from EMH in October as reimbursement under the terms of a supply agreement in which the partner is required to buy 40% of PSF's production at a fixed price or reimburse the JV of any foregone revenue being the difference between the fixed contract price and the realized wholesale price.

The contracted buyer couldn't purchase product as required last quarter, is disputing the amounts due, and making investigations into this liability.

There's some blood between the parties, especially when VFF management said in its Tuesday press release that "in light of Emerald's recent pattern of initiating disputes relating to Pure Sunfarms, no

assurance can be given that Emerald will not similarly initiate a dispute in respect of the VF Additional Equity Contribution.”

The partner did just as predicted the following day.

Foolish takeaway

Old supply agreements in the industry were entered when cannabis prices were much higher, but [pot prices have come under pressure recently](#) and may remain so as provinces reduce their orders, retail store roll-outs remains slow and effective demand lags channel supply in the near term. Thus, EMH’s liabilities under its supply agreement with the JV could get much worse going forward.

It appears the buyer entered into a forward contract as an insurer to the venture against industry low prices, and the market has gone against its position.

It could be better if Emerald accepted contracted deliveries, then on-sell the inventory to the wholesale market to avoid any potential conflicts of interests if it suspects that its partner has become too aggressive.

If relations have deteriorated between the parties, as can be felt from the latest press releases, PSF might not seek for the best prices for 40% of its production.

Management can sell at any low price, bill Emerald for the price differences, and the latter’s liabilities may consistently keep ballooning to a point that exiting the venture becomes a viable economic option.

That said, maybe it’s time the quoted supply agreement price was re-negotiated; otherwise, one party will end up with both control and ownership of a joint venture which has been churning out great numbers over the past four quarters.

The cannabis JV achieved a record low all-in production cost per gram of \$0.63 last quarter, reported a 69% gross margin and an EBITDA margin of a staggering 56% while selling cannabis at a price as low as \$2 a gram predominantly to the wholesale market.

Perhaps the announced loan recall could bring the two parties to the negotiating table, as it creates immediate financing requirements for the venture, but one of the parties is clearly more at risk of losing a stake than the other.

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