Aphria Acquires American Craft Brewer: Implications for the Cannabis Stock

Description

Cannabis firm **Aphria** (TSX:APHA)(NASDAQ:APHA) has made inroads into the United States market. This is happening through the acquisition of an Atlanta-based craft beer brewer SweetWater Brewing Company announced on November 4. Management is upbeat about the $300 million deal which closes next month. Should Aphria's stock investors view it in the same way?

What is Aphria buying in the U.S. beer brewing space?

Aphria is acquiring a leading U.S. craft beer brewing firm that generated over US$66.6 million in sales, US$22.7 million in net income, and US$22.5 million in adjusted EBITDA in 2019. SweetWater has been growing at twice the rate of the market so far in 2020. Most important, the deal is immediately accretive to APHA's net income.

SweetWater brewing operates from a leased 158,000 square feet building with 20 years remaining on the lease agreement. The company produces over 23.5 million gallons of craft beer a year. Its brands are distributed through 10,000 restaurants and bars as well as 29,000 retail locations across the United States.

The acquisition target was a top 14 craft beer brewer in America by 2019 sales volume. It also ranked number 24 on a list of top 50 largest brewers in America. That position wasn't that far from market leaders **Anheuser-Busch**, **Molson Coors,** and **Constellation Brands.**

The mention of Molson Coors leads me to another talking point – is the company paying a fair price?

Is Aphria paying a fair price for the American brewing firm?

Molson Coors disposed of its Irwindale brewing operation early this month. The transaction closed at a total price of US$150 million (C$195 million). The Irwindale facility produced over 148.8 million gallons of beer in 2019, or 6.3 times more volume than SweetWater's operation.

It may appear as if Aphria overpaid for SweetWater. However, it's worth considering that APHA is buying a profitable running business. The transaction covers a full operation, proven brands, existing distribution agreements, and it retains a full team of skilled personnel. It's only fair to pay a premium for such a running business.

In contrast, Molson Coors has disposed of a 40-year-old asset in a negotiated legal settlement. The acquirer is still conducting a feasibility study to determine whether it can reopen and operate the brewery. I would assume that the buyer wasn't prepared to offer much given such viability uncertainty.

On the contrary, Aphria is a strategic buyer which sees the acquisition of SweetWater as an expansion step into a new growth market. Strategic buyers usually pay premium prices for assets. The purchase consideration is quite reasonable at 12.5X annualized adjusted EBITDA.

What's in it for APHA stock investors?

A U.S. craft brewer could be of some strategic value to a Canadian marijuana firm. Through the acquisition of SweetWater, Aphria plans to tap into the beer maker's robust distribution network and its fast-growing cannabis culture.

SweetWater has a hot selling 420 beer brand which smells like cannabis. APHA plans to introduce its Canadian marijuana brands into the U.S. market through the brewer's vibrant ecosystem.

If the speculation that a Joe Biden administration will federally legalize cannabis consumption in America ever comes true, the company will have put the best foot forward into the world's largest recreational marijuana market.

As a bonus, the US$29 billion craft beer market is growing in America, and the acquired business is already profitable and immediately accretive to the bottom line. Investors stand to share in the beer segment's growth, cash flows, and profits.

Potential challenges and implications for valuation

Management is speculating, just like everyone else. The expansion plan may not pan out as anticipated if federal legalization doesn't happen in the United States.

The company risks becoming a holding company of a beer manufacturing operation that offers no synergistic benefits with its existing cannabis and pharmaceuticals distribution assets. For that, a conglomerate discount that reduces its valuation might be necessary.

Until U.S. federal legalization happens, Aphria should be viewed as a conglomerate with cannabis roots that holds a diversified portfolio of slower growth non-marijuana businesses. I still like it, but it's no longer a pure pot play.

Resultantly, whenever pot stocks rally, APHA may underperform peers. Whenever marijuana names fall, it could prove resilient due to the cushion from a resilient beer operation and a potentially stable pharmaceuticals distribution business in Europe.

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