

BCP Research: Aphria Inc (APHACN -/-/-) 2Q21 Results, Positive - Maintain 'Positive-Swap' on APHACN '24s and 'Positive-Outright' on TLR Y '23s

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Summary: Canadian-based cannabis producer, Aphria Inc (Aphria) released 2Q21 (11/20) results, showing impressive y/y and q/q growth in revenue and adj. EBITDA. Sales volumes continued to rise and, though production was not disclosed, elevated inventory days (365) showed sequential decline. Reported cash burn (-US\$12 mm) neared Aphria's 3Q21 free cash flow breakeven target. The company completed its acquisition of SweetWater in the quarter, driving net debt higher (US\$260 mm v. US\$71 mm in 1Q21) and expanding LTM net leverage to 9.5x (v. 3.7x in 1Q21). Pro-forma reported cash of US\$245 mm reflects a capital raise for the SweetWater acquisition post-2Q21.

APHACN 5.25% '24s have appreciated more than 2.7x from our initial upgrade to "Positive-Swap" at 82c (October 20, 2020) to 220c. APHAs current stock price (US\$18.82), at an estimated 700 bps spread, suggests bonds are slightly rich to FV of 213c and parity of 201c. We anticipate APHACN '24s will be restruck at US\$7.86 (TLRY) at the close of the TLR Y merger, to reflect the exchange ratio for APHACN '24 bondholders, who would acquire 27.6 mm new TLR Y shares, pending anticipated conversion (currently in-the-money) and merger consummation. Based on this assumption, APHA stock should trade in line with TLR Y (US\$25.86) which, at the same 700 bps spread, implies attractive upside on APHACN '24s, at 22% cheap to FV of 284c v. parity of 239c. Meanwhile, current IVOL on the convert of 73% IVOL v. 100D (131%) and listed calls (115%) on the common offers opportunity to hedge downside risk at a reasonable carry, should the merger not go through. Therefore, we maintain our 'Positive-Swap' rating on APHACN 5.25% '24s in our convertible coverage universe.

We note APHA 5.25% '24s' counterpart, TLR Y 5% '23s, will not be restruck for antidilution purposes, leaving them well out-of-the-money. Nevertheless, we maintain our 'Positive-Outright' rating on convertible TLR Y 5% 23s, which have appreciated 6% since our initial upgrade at 86c (January 11, 2021), and continue to trade below the bond floor, at 9% YTW with modest 3% upside from current levels (92c) to FV (95c).

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	Stock Price
APHACN 5.25% 06/01/2024	259	220.4	(19.54%)	72.34%	(4.12%)	83.97%	\$9.38	\$18.82
TLRY 5% 10/1/2023	278	91.8	8.64%	N/A	2.36%	4.47%	\$167.41	\$25.86

Source: Equity information sourced from Bloomberg. Convertible pricing as of March 1, 2021.

2Q21 (11/20) Financial Results:

APHACN (US\$MM)	2Q21	1Q21	4Q20	3Q20	2Q20	y/y	q/q
Kilograms produced, net	n/a	n/a	52,243	31,086	13,866	-	-
Kilograms equivalent sold	26,730	20,882	12,567	14,014	7,062	278%	28%
Cannabis	82	76	59	33	17	387%	8%
- Harvested Cannabis	n/a	n/a	53	23	13	-	-
- Purchased Cannabis	n/a	n/a	6	10	4	-	-
Cannabis trim	6	5	3	7	3	80%	13%
Cannabis oil	20	25	22	22	16	23%	(20%)
Purchased CBD distillate	-	-	4	6	-	-	-
Softgel capsules	n/a	0	0	0	0	-	-
Cannabis vapes	6	5	4	1	-	-	20%
Cannabis Inventory	113	110	93	68	36	211%	2%
Cannabis Inventory	113	110	93	68	36	211%	2%
Cannabis COGS	28	24	18	24	11	152%	17%
Cannabis Inventory Days	365	418	467	253	296	23%	(13%)
Avg. Retail Selling Price - Medical Cannabis	5.28	5.49	4.74	4.87	6.17	(14%)	(4%)
Avg. Retail Selling Price - Adult-Use Cannabis	3.26	3.09	3.74	4.15	3.95	(17%)	5%
Cash cost (USD / gram)	0.60	0.65	0.63	0.71	0.84	(29%)	(7%)
All-in cost of sales (USD / gram)	0.99	1.05	1.21	1.28	1.50	(34%)	(6%)

- Production volumes were not disclosed in 2Q21, though output has reportedly been temporarily reduced at Aphria One (as of June '20), a higher-cost facility, with certain older cannabis inventory

liquidated at a loss. We anticipate these reductions were offset by higher sales of pre-roll products (selling 7-8 mm / quarter), which resulted in tripling of daily supply capabilities by the end of 2Q21

- Cannabis inventory expanded slightly q/q to US\$113 mm (+211% y/y, +2% q/q), while cannabis inventory days, totaling 365 (+23% higher y/y, -13% q/q), showed ongoing sequential improvement from their peak in 4Q20 (5/20)
- Kilogram equivalent volumes sold increased 278% y/y and 28% q/q to 26,730 kg, with y/y driven mainly by higher sales of adult-use cannabis products, and q/q reflective of higher medical cannabis sales, which were impacted in prior quarters by COVID-19
 - Aphria executed its first EU-GMP shipment of cannabis products to Germany and Malta in 2Q21
 - The company also completed its first shipment of medical cannabis to Canndoc, to be distributed in Israel
 - In addition, the company has executed a supply agreement with ODI Pharma AB, providing access to Poland's cannabis markets
- Cash costs continued to improve, at US\$0.60 / gram for 2Q21 (-29% y/y, -7% q/q), as did all-in cost of sales, at US\$0.99 / gram (-34% y/y, -6% q/q)
- Average selling price for medical cannabis (before excise tax) decreased 4% q/q to US\$5.28 / gram (CAD 6.96 / gram) from US\$5.49 / gram (CAD 7.38 / gram) in 1Q21
- Average selling price for adult-use cannabis (before excise tax) increased 5% q/q to US\$3.26 / gram (CAD 4.29 / gram) from US\$3.09 / gram (CAD 4.15 / gram) in 1Q21, reflecting changes in sales mix

APHACN (US\$MM)	2Q21	1Q21	4Q20	3Q20	2Q20	y/y	q/q
Net Revenue	121.9	108.5	108.8	109.6	91.2	34%	12%
Adjusted EBITDA	9.5	7.4	6.1	4.4	1.4	563%	28%
<i>Adjusted EBITDA margin</i>	<i>7.8%</i>	<i>6.9%</i>	<i>5.6%</i>	<i>4.0%</i>	<i>1.6%</i>	<i>625bps</i>	<i>96bps</i>
Cannabis Revenue	51.6	47.3	37.9	42.6	25.8	100%	9%
Cannabis Gross profit	23.7	23.5	20.1	18.4	14.8	60%	1%
Cannabis gross margin	45.9%	49.7%	52.9%	43.3%	57.2%	(1,128bps)	(377bps)
Cannabis Adj. EBITDA	9.8	7.7	6.7	4.6	2.6	282%	26%
Cannabis Adj. EBITDA margin	19.0%	16.4%	17.6%	10.7%	9.9%	906bps	260bps
Beverage Alcohol Revenue	0.7	-	-	-	-	-	-
Beverage Alcohol Gross profit	0.4	-	-	-	-	-	-
Beverage Alcohol gross margin	60.5%	-	-	-	-	-	-
Beverage Alcohol Adj. EBITDA	0.2	-	-	-	-	-	-
Beverage Alcohol EBITDA margin	33.9%	-	-	-	-	-	-
Distribution Revenue	69.7	61.2	70.9	67.0	65.4	7%	14%
Distribution Gross profit	9.2	8.8	8.5	8.7	8.3	10%	4%
Distribution gross margin	13.1%	14.4%	12.1%	12.9%	12.7%	46bps	(122bps)
Distribution Adj. EBITDA	2.0	1.8	1.4	1.9	1.6	26%	9%
Distribution EBITDA margin	2.8%	3.0%	2.0%	2.9%	2.4%	43bps	(13bps)

- Net revenues were US\$122 mm, up 34% y/y and 12% q/q, driven primarily by higher cannabis and distribution revenues
 - Cannabis revenues increased 100% y/y and 9% q/q to US\$52 mm, following an increase in average gross selling price of adult-use medical cannabis products, related to sales mix, and the introduction of international sales to Aphria's revenue mix
 - Cannabis revenues include insurance and excise taxes, and represent 42% of total net revenues (pre-excise tax)
 - Domestic adult-use cannabis sales continued growth, which now accounts for 83% of total cannabis revenues (pre-excise tax),

- Cash (cash and equivalents + marketable securities) decreased 53% q/q to US\$145 mm (32% cash to LTM revenue)
 - Reduced cash levels reflect use of ~US\$260 mm (CAD 352 mm) towards the SweetWater acquisition, balanced by cash inflow of ~US\$98 mm (CAD 127 mm) as a result of equity financing received in the quarter
 - Post-2Q21, Aphria closed financing of US\$120 mm related to its recently completed SweetWater acquisition, including a US\$20 mm revolving credit facility (undrawn) and a US\$100 mm term debt (fully drawn), which is guaranteed by Aphria and secured by SweetWater assets
 - Following, pro-forma cash is reported to be US\$245 mm (~CAD 320 mm) at pro-forma 55% cash to LTM revenue
- Liquidity (cash + A/R) totaled US\$219 mm (-41% q/q) at liquidity to LTM revenue of 49%
 - We estimate pro-forma liquidity of US\$339 mm (76% of LTM revenue), reflecting the aforementioned capital raise and additional US\$20 mm undrawn RCF
- Gross debt increased to US\$405 mm (+7% q/q), following incorporation of lease liabilities related to SweetWater operations
- Net debt increased to US\$260 mm (+42% q/q) at LTM net leverage of 9.5x (v. 3.6x at 1Q21)

APHACN (US\$MM)	2Q21	1Q21	4Q20	3Q20	2Q20	y/y	q/q
Net Revenue	122	108	109	110	91	34%	12%
Adjusted EBITDA	10	7	6	4	1	563%	28%
<i>Adjusted EBITDA margin</i>	8%	7%	6%	4%	2%	625bps	96bps
Working Capital	15	(43)	(9)	(38)	(28)	(156%)	(136%)
Capex	(15)	(13)	(20)	(29)	(20)	(26%)	16%
Lease Liability Payments	(0)	(0)	(0)	(0)	(0)	77%	170%
Free Cash Flow (excl. interest and taxes paid)	10	(49)	(23)	(63)	(47)	(121%)	(120%)
Cash (1)	145	307	361	384	375	(61%)	(53%)
Accounts Receivable	74	63	40	59	46	62%	17%
Liquidity	219	370	401	443	420	(48%)	(41%)
ST Bank Debt	4	6	0	5	2	-	(35%)
ST Lease Liabilities	1	1	1	1	1	-	39%
ST Debt, Other	12	8	6	5	5	152%	41%
LT Lease Liabilities	35	4	4	4	4	-	685%
LT Debt, Other	94	99	94	97	100	(5%)	(4%)
Convertible Debentures (2)	259	259	259	350	350	(26%)	0%
Total Debt	405	378	365	462	461	(12%)	7%
Net Debt	260	71	4	78	86	202%	267%
LTM Net Revenue	449	418	405	392	338	33%	7%
LTM Adj. EBITDA	27	19	13	7	(8)	(425%)	42%
LTM Gross Leverage	14.7x	19.5x	28.8x	68.6x	n/a	n/a	(4.8x)
LTM Net Leverage	9.5x	3.7x	0.3x	11.6x	n/a	n/a	5.8x
Cash to LTM Revenue	32%	73%	89%	98%	111%	(7,871bps)	(4,111bps)
Liquidity to LTM Revenue	49%	88%	99%	113%	124%	(7,576bps)	(3,976bps)

(1) Cash and equivalents and marketable securities

(2) Convertible debentures valued at par

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“Market Weight” – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

“Market Underweight” – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

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