https://financialpost.com/cannabis/they-cant-flood-the-market-or-they-will-crush-the-price-explaining-tilrays-deal-with-privateer

FINANCIAL POST

Cannabis

'They can't flood the market or they will crush the price': Tilray's deal with Privateer explained

The complex transaction will see Privateer divest from all its holdings and become a shell entity, with major shareholders directly receiving Tilray stock

Author of the article:
Vanmala Subramaniam
Published Jun 10, 2019 • 3 minute read

Tilray's stock surged Monday on news of the transaction. PHOTO BY PATRICIA DE MELO MOREIRA/AFP/GETTY IMAGES

B.C.-based cannabis producer Tilray Inc. is planning to merge with its biggest shareholder, Privateer Holdings, in order to facilitate the controlled release of Privateer's stake onto the public markets.

The complex transaction will ultimately see Privateer divest from all its holdings and become a shell entity, with its major shareholders directly receiving Tilray stock in a "tax efficient" way.

News of the merger and extended lock-up sent Tilray's share price, which closed Friday at US$38.80, soaring by almost 15 per cent in the first few hours of morning trading.

"Privateer will disappear. Tilray will have a group of shareholders that own much of the stock for the next one year, and then there'll be a slow release of stock onto the market in the second year following the merger," said Michael McCloskey, who was formerly invested in Tilray through his investment firm GreensKeeper Asset Management.

The transaction involves the reorganization of 75 million shares — 77 per cent of Tilray's total share base — that are currently owned by Privateer, a Peter Thiel-backed private equity firm founded by Tilray CEO Brendan Kennedy.

"Privateer's problem is that it holds most of the company, so they can't flood the market or they will crush the price. So the longer they can draw out the period that they can sell, it will take selling pressure off the stock, which is what we had been seeing until today," McCloskey said.

Privateer had promised investors that it would not sell Tilray shares until the second half of 2019, following the expiration of a lock-up period in January this year.

But over the past six months, Tilray has seen its stock price erode dramatically — the shares are now worth half what they were worth in mid-January. They are also trading at just a fraction of the US$300 level they reached during frenzied trading last fall.

In the first year following the closing of the merger with Privateer, some of Tilray stock will be released only to institutional investors through block trades, or via stock sales to strategic investors, at the discretion of Tilray, according to a company press release.

"The biggest problem with Tilray's stock has always been its cap structure and that small float. You just never knew when Privateer was going to flood the market with stock," said Khurram Malik, Partner and Head of Research at Jacob Capital Management.

“So these lock-up extensions, and orderly release of shares will ensure that investors are not going to be caught off guard with the stock price. I’d say if this merger, and the eventual exit of Privateer from this structure makes Tilray much more on par with its peers, equity-wise,” Malik said.

Tilray’s chief financial officer Mark Castaneda said in this morning’s press release that the transaction “will give Tilray greater control and operating flexibility, while allowing us to effectively manage our public float.”

The conditional release of Tilray’s stock to certain chosen institutional investors could potentially pave the way for major alcohol, tobacco and pharmaceutical companies to become key partners in the pot firm, Castaneda hinted, in an interview with Bloomberg News. Tilray currently has a $100 million joint-venture agreement with European brewer Anheuser-Busch InBev to research and make cannabis-infused non-alcoholic drinks for the Canadian market.

Tilray has been the target of short sellers since its public debut — its small float did not help, and the company’s stock experienced sharp swings in volatility for the first three months of trading on the Nasdaq. Tilray’s most recent quarterly earnings have also failed to impress investors, contributing in part to the steady six-month selloff.

“The basis of the short thesis on this company is that there’s just been too much of an overhang with Privateer’s ownership. Tilray guys are taking away that factor, so the stock might stabilize. But I still think the company is grossly overvalued, and we’re going to see constant selling pressure,” McCloskey predicted.

The merger, and extension of the lock-up is still subject to a shareholder vote, which will take place “as expeditiously as possible,” according to the company.

• *Email: vsubramaniam@postmedia.com | Twitter: VanmalaS*