Terra Tech Corp. (OTCQX: TRTC) Be Afraid – Massive Stock Dilution Eroding Shareholder Value

The massive stock dilution that has taken place over the past years greatly limits the chance that this stock will deliver any long-term growth for investors.

Emerging Growth Companies

MIAMI, FLORIDA, USA, January 12, 2018 /EINPresswire.com/ -- Over the past few weeks, Terra Tech Corp (OTCQX: TRTC) has been one of the most highly followed cannabis stocks in the U.S. This follows its +17% rally to a high of $0.45 a share on January 2nd. The rally, which was captured on financial media outlets such as Seeking Alpha, was prompted by an announcement that TRTC had received temporary authorization from the State of California to distribute recreational marijuana.

This news coincided with California's landmark move to legalize recreational marijuana at the beginning of 2018, giving the stock additional impetus. Many businesses are angling for a piece of the California pie, which is considered to be the largest marijuana market in the U.S.

Competitively positioned

As of January 9th 2018, there were 134 businesses licensed for "recreational sales" in California. However, TRTC is competitively positioned due to the fact that it will distribute recreational marijuana through its Blüm retail dispensaries in Oakland and Santa Ana, both of which already have a strong footing in the market due to their relative success in medical marijuana.

In addition to the good prospects in California, TRTC also has a lot of positive indicators from an operational perspective. It is has an expansive brick-and-mortar footprint, with one dispensary in Reno (Nevada) and three in Las Vegas (Nevada). It is currently constructing a Blüm dispensary in San Leandro (California), which is expected to open to the public in early 2018.

The retail segment of TRTC's business is currently focused on medical marijuana, with the exception of California. But with legalization of recreational marijuana expected to accelerate across many states, despite Attorney General Jeff Session's stiff opposition, TRTC will be able to increase revenue per store by adding recreational marijuana to its shelves—just as it has already done in California.

TRTC is also involved in the agricultural side of cannabis, a move that exposes it to every stage of the marijuana value chain from seed to sale. This, coupled with the fact that it was one of the first publicly traded companies in the space, have competitively positioned the stock, paving the way for in-depth coverage on tier-1 financial outlets such as Bloomberg and The Wall Street Journal.

TRTC can actually tout terms such as “early mover” or “integrated player” in its external communication without being guilty of riding on buzzwords in order to capture investor and stakeholder attention. Moreover, TRTC’s SEC filings, which are all available on its website, show that revenues have increased from just over half a million in 2012 to $25 million in 2016.

Despite this seemingly strong bull case, TRTC’s share price paints a different picture. There has been no sustained share price improvement, nor has the stock moved into new price territories since listing. Its five year price chart, shown below, puts this into clearer perspective.

Since 2014 TRTC share price has remained invariably suppressed
Why is TRTC not recording any significant capital gains for investors, despite being one of the most hotly followed cannabis stocks churning out high revenues year after year?

Convertible note junkie

The reason why TRTC has failed to deliver strong returns for investors, despite a strong business case, is because of its myopic financing strategy. The company is heavily reliant on convertible notes.

Why are convertible notes a red flag?

A convertible note is a financial instrument through which a lender gives money to a company with the option to convert the debt into shares of common stock at any time. Usually, these agreements are popular with small caps that face challenges accessing financing, either because they are in early development stages or because they operate in legally ambiguous industries like cannabis.

The catch with a convertible note is that the share conversion rate is always less than the prevailing market price—sometimes even at discounts as high as 70% of the prevailing share price. That way, when the lender converts their debt into shares and sells the shares, they always profit, regardless of the market price. A holder of a convertible debt is therefore always inclined to convert their debt into shares and sell them to the public at a profit, a process that mints them money but leads to the creation of more shares. In summary, the more convertible debt a company takes on, the higher the possibility that the number of outstanding shares will increase commensurately.

An increase in outstanding shares results in a decline in share price. This dilutes stock. If a hypothetical company’s share price is $10 and it has 1000 outstanding shares, it is worth $10,000 ($10 multiplied by 1000). If the worth of the company remains unchanged at $10,000, creating an additional 1000 shares (to bring total outstanding shares to 2000) will automatically cause the share price to decline to $5 (as $5 multiplied by 2000 is $10,000). This hypothetical example illustrates the dilutive impact of creating new shares on a company’s share price.

Moreover, if a company makes convertible notes its sole financing strategy, it inevitably goes into a death spiral—it becomes hooked to convertible notes and its share price remains perpetually suppressed due to continual stock dilution and selling pressure. TRTC’s heavy reliance on convertible notes is therefore a cause for alarm.

To get an inside look at TRTC’s reckless dalliance with convertible notes, go no further than its quarterly reports. Its 10-Q for the quarter ended June 30, 2017, notes that “during the six months ended June 30, 2017, senior secured convertible promissory notes and accrued interest in the amount of $8,839,084 were converted into 50,710,473 shares of common stock.”

How bad is the impact of TRTC’s convertible note addiction on common shareholders? The table below, which illustrates the rate at which outstanding shares have increased over the past five years, answers this question.

Year TRTC shares outstanding
2012 76.89 million
2013 99.04 million
2014 174.3 million
2015 240.19 million
2016 389.36 million
As of December 11th 2017 903.17 million
Shares outstanding nearing authorized shares of 990 million

In five years, TRTC's shares outstanding have increased more than tenfold and are now inching dangerously close to its authorized shares of 990 million. This means that going forward there is very limited room for TRTC's debt holders to convert their debt into new shares. This heightens the prospect that TRTC may default on its debt. In case this happens, shareholders will be first to lose as debt owners will foreclose on the assets. This is the benefit of being a debt holder as opposed to being a shareholder. Debt holders usually have the first claim on a company's assets in the event of foreclosure.

To avert foreclosure and stay in business, the only foreseeable play for TRTC will be to effect a reverse split. A reverse split is where a company merges existing shares using a ratio—for example 1 share for every 20—in order to reduce the outstanding shares. This action increase the share price, but reduces the shares outstanding, meaning that it has no effect on the company's overall value. Fewer outstanding shares also gives a company—in this case TRTC—room to create new shares in future, opening the way for more convertible notes and continued dilution of common shareholders.

Poor management

When looking at a development-stage company, especially one in an emergent industry like cannabis, an important determinant of future success is management. This is one of the points that supported our bull case for Medical Marijuana Inc. (OTCMKTS: MJNA). The CEO, Dr. Stuart Titus, has relevant experience in healthcare and understands the sector's regulatory and stakeholder landscape well. He also has demonstrable integrity and is an esteemed member of several prestigious health associations.

The same cannot be said Derek Peterson, the CEO of TRTC. He has skills and experience, but ethics does not appear to be his strong point. A former banker handling a $100 million fund at Morgan Stanley, according to a feature on The Telegraph, it is difficult to understand why Peterson does not see the correlation between convertible notes and eroded shareholder value.

Under Peterson, TRTC has become a bona fide convertible bond junkie—the cannabis player has the 'munchies' for convertible debt, pun intended. TRTC may, of course, rationalize this appetite for convertible debt by pointing to the retail expansion and revenue growth. However, a company that readily turns to stock dilution in order to fund its operations cares little for its common shareholders and even less for its business. It makes you wonder what the objective of the company is, if not to enrich a few people.

To add insult to injury—as far as common shareholders are concerned—TRTC also routinely awards its CEO and CFO in shares, a move that further dilutes shareholder value.

As noted in a bullish analysis of TRTC by a writer on Seeking Alpha in July 2017: "On June 20, CFO

Michael James was gifted 185,724 shares @ .17 ($31,573) by the company. Derek Peterson, CEO, was “granted” or “awarded” 324,993 shares @ .2313 ($70,171) on June 30. On the same day, Terra Tech’s CFO was also “granted” or “awarded” 244,133 shares.” Notice that these shares are awarded at a discount to the market price, presenting the executives with an incentive to liquidate.

The Seeking Alpha writer naively expressed their hope that the two senior executives would hold on to their shares instead of liquidating them. The writer would be dismayed to know that CEO Peterson swiftly offloaded more than 4 million shares between September 2017 and January 11th, 2018.

Cash out

Whether or not Derek is cashing out after having realized that the massive stock dilution has significantly reduced the odds of a sustained rally in future is anyone’s guess. What is certain is that TRTC is a strong sell. The massive stock dilution that has taken place over the past five years greatly limits the chance that this stock will deliver any solid long-term growth for investors.

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