



Has Activist Pressure Inflated Hexo Corp.'s (TSX:HEXO) Stock Price?

Description

The marijuana industry has been white-hot as of late. Over the past month, the Canadian Marijuana Index has risen by 40% over the past month. It's been a wild ride for pot investors, and it's very difficult to predict where the industry will go from here.

As of late, one stock has been standing out above all others: **HEXO** ([TSX:HEXO](#)). Previously Hydropothecary, this Quebec-based company has been the top performer in the industry since it underwent its name change in late August.

Its 39% share price appreciation tops all the major players in the industry. No, it's not because of its name change. So, what gives? The bulk of the company's sudden jump came after a major U.S. shareholder went public to press the company to increase its value or find a buyer.

Undervalued pot stock?

New York investment firm Riposte Capital is listed as being HEXO's second-largest shareholder. Riposte has expressed concern that HEXO is grossly undervalued compared to its peers. The activist shareholder also trashed HEXO's poor communications and investor relations management.

At the time of the report, HEXO was trading at eight times its forecasted 2020 earnings before interest, taxes, depreciation, and amortization (EBITDA). In comparison, the industry average of the top 10 Canadian licensed producers is 30 times EBITDA.

Riposte argues that it should be, at the very least, trading in line with the average, which would imply a \$18 share price.

The bear argument

Riposte's arguments appear to have merit. HEXO has the largest and longest government contract for recreational marijuana. It has a five-year, \$1 billion agreement with the province of Quebec. HEXO is also one of only two cannabis companies to have struck a deal with major beverage company (**Molson Coors Brewing** is the partner in question).

However, to call it severely undervalued is a bit of an overstatement. The entire cannabis industry is in euphoria mode, and valuations are hard to justify. Although the Molson deal is a positive, we won't see any real development from the joint venture until well into 2019 or beyond.

It is also important to note that the partnership with Molson is a joint venture and not a direct investment in the company. As such, it is not directly comparable to **Constellation Brands's** stake in **Canopy**.

Hexo is trading at almost 350 times sales; this is by far tops in the industry. It is also the least diversified of the top 10 companies. The company has only secured supply agreements with provinces of Quebec, British Columbia, and Ontario — the fewest such agreements among major players.

Buyout potential

I don't think Riposte needs to press the company to find a buyer, nor is that in the company's best interest. After MedReleaf's acquisition, I pointed out that HEXO could [be acquired at a high premium](#). Given its contract and presence in Quebec, there is no doubt it makes an attractive takeover target for a national player.

Riposte believes that the company should sell 20% of itself to raise cash. The problem, however, is that HEXO doesn't need cash. It has one of the best balance sheets in the industry with approximately \$250 million cash in hand. The majority of its future production is fully funded. Likewise, Riposte's argument is contradictory.

If Riposte believes it is chronically undervalued, why would it push HEXO to find a buyer? The answer is simple: activist investors usually have the short game in mind.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. TSX:HEXO (HEXO Corp.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise

4. Yahoo CA

Category

1. Investing

Tags

1. Editor's Choice

Date

2025/09/28

Date Created

2018/09/11

Author

mlitalien

default watermark

default watermark