



Will HEXO Inc. (TSX:HEXO) Become a Takeover Target?

Description

Consolidation in the cannabis industry is expected to continue and the recent pullback in the stock prices of marijuana companies has investors wondering which [pot stocks](#) might be the best buys to play a potential takeover premium.

Let's take a look at **HEXO** ([TSX:HEXO](#)) to see if it deserves to be on your buyout radar.

Quebec

HEXO is based in Quebec and is the top [marijuana company](#) in the province with a supply agreement for 20,000 kilograms of cannabis for the first year of the recreational market. The other major competitors in the Canadian market have contracts that are smaller, so the acquisition of HEXO would vault the buyer into the pole position in the province.

HEXO also has the contract to manage Quebec's distribution centre for all of the sales that occur through the province's online store.

HEXO currently has 310,000 square feet of production space, with an additional one-million square feet set for completion by the end of 2018. Supply shortages have been an issue in the first six weeks of the recreational market in Canada, so scale is important in this business, and buying completed production facilities could be a main driver of further deals.

Ontario

HEXO recently formalized its acquisition of a 25% interest in a two-million square foot facility in Belleville. The company will initially lease 579,000 square feet of the space and has the first right of refusal on the remaining area. The building will be used as a centre for the development of a wide range of cannabis products. HEXO intends to partner with leading global companies to develop cosmetics, vapes, and edibles.

Beverages

HEXO has already partnered with **Molson Coors Canada** to develop and market cannabis-infused beverages for the Canadian market once it opens up next year. The two firms have created a new company, Truss, which will produce and sell the products.

Canopy Growth is 38% owned by **Constellation Brands**, so there could be an interest from one of the other top cannabis companies to acquire HEXO for its beverage business to compete with Canopy Growth.

International

HEXO is expanding its international reach to take advantage of the emerging medical marijuana market in Europe. The company is building a 350,000 square foot facility with a partner in Greece to establish a base for the production, processing, and distribution of medical marijuana in the region.

Market capitalization

HEXO trades at close to \$6 per share, giving it a market capitalization of about \$1.2 billion. The stock had treaded near \$9 in October, so the valuation has come down significantly in the past six weeks. The company is small enough that it could be easily acquired by one of its larger peers.

Who might buy?

Tilray and **Aurora Cannabis** would probably be the most likely candidates. They are two of the largest companies in the sector, along with Canopy Growth, and have not announced beverage partnerships. Tilray is based in British Columbia, and Aurora Cannabis is located in Ontario, so acquiring a strong presence in Quebec might be strategically beneficial.

The bottom line

Cannabis stock prices remain high, so investors should be careful buying on the hopes of a large takeover premium. However, if you like the outlook for the sector, HEXO might be worth considering for a small position in your portfolio today.

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aswalker

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