HEXO (TSX:HEXO) Is Now a Top Marijuana Stock

Description

The marijuana industry is in the midst of an impressive comeback. After crashing post-legalization, the Canadian Marijuana Index is now up 53% year to date. One company that has been making headlines for all the right reasons is **HEXO** (TSX:HEXO).

In 2019, the company has surged almost 90% and is among the big winners of the year. In the past week alone, the company's share price has jumped almost 10%. Why? It has been a transformative week for the company.

Prior to releasing strong second-quarter results, the company announced a deal to acquire Newstrike Brands.

Why is the Newstrike Brands deal a good move?

Let's start with the basics. HEXO has agreed to acquire Newstrike in an all-stock transaction. Newstrike shareholders will receive 0.06332 of a HEXO common share in exchange for each Newstrike share they hold. Although I am not a fan of these types of all-stock transactions, HEXO does not have a history of diluting shareholders on a regular basis.

One of the knocks against HEXO was that it was a regional play. Its distribution was largely dependent on the province of Quebec. Although it had distribution agreements in Ontario, it was not as diversified as some of the larger industry players. This all changed with the Newstrike deal.

The combined entity will have distribution agreements in eight provinces, significantly expanding the company's market reach. It is also expected that the deal will enable HEXO the capacity to produce approximately 150,000 kg annually. This is a 38% increase from previous peak capacity production of 108,000 kg annually. This vaults it ahead of companies such as **OrganiGram Holdings** and **Cronos Group**.

As with any acquisition, there are expected synergies to be had. HEXO has pegged these synergies at approximately $10 million annually, which is considerable for a company of this size.

Strong second quarter

In the second quarter, HEXO grew revenues by 143% over the first quarter of 2018 and by 13.74 times the first quarter of 2017. This is explosive growth — better than the industry leaders. It is worth noting, however, that revenue missed analysts' estimates by 4.41%. That's not a big miss, but it marks the fifth consecutive quarter in which it missed expectations. The company also posted a $0.05-per-share loss, missing by a penny.

Adult use is the main growth driver for HEXO, with sales in the segment increasing by 200% over the previous quarter. Interestingly, revenue per gram sold increased by 7% from the first quarter of 2019. This bucked a recent trend in which revenue sold per gram in the industry was declining. Does this mean prices are stabilizing? As other companies report, investors will get a better idea. It was certainly an encouraging sign.

Foolish Takeaway

HEXO is starting to position itself as one of the top marijuana companies in the country. It has an oft-forgotten joint venture with **Molson Coors** and has taken a cautious approach to production expansion. The company is also cheap when compared to its peers. It has a forward price-to-sales ratio of 5.9 times 2020 revenue estimates. When compared to industry leader **Canopy Growth**, which is trading at 25 times 2020 sales, HEXO is cheap.

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