



## Why Did HEXO (TSX:HEXO) Report Lower Revenue on Higher Volumes Last Quarter?

### Description

Canadian marijuana producer **HEXO** ([TSX:HEXO](#)) surprised the market with a 3% sequential decline in quarterly net revenue during its fiscal third quarter to April 30, 2019.

Financial results were released on June 12, and the stock traded 13% lower over the following four trading days, as investors expressed their disappointment, but the revenue decline came from a not-so-obvious source which was beyond the company control.

Just when the marijuana investment community is expecting some revenue-growth fireworks after the October recreational legalization last year, the company's three-month sales to April came in weaker than those realized between November 2018 and January this year.

Surprisingly, shipped volumes increased during the quarter. A few things could have caused the frustrating revenue drop. Let's have a look.

### High volume, lower average prices

The company shipped 8% more cannabis volumes over the three months to 2,900 kilograms, but gross revenue booked at \$15.93 million was still 1.5% lower than previous quarter invoices.

The gross revenue decline can be explained by the 9% fall in the average price obtained on recreational marijuana to \$5.29 per gram equivalent.

Recreational product sales contributed the bulk (92%) of the company's shipments during the quarter, just as was the case in a previous period, but the average price per gram of marijuana equivalent was at \$5.83 for the prior quarter. However, this does not adequately explain the 3% fall in net revenues.

Something else exacerbated the decline.

## Blame high excise taxes

The company paid more excise taxes than before, even as gross revenue declined.

Total excise taxes increased by 6% quarter over quarter, and the average tax rate increased to nearly 19% of gross invoices during the quarter, up from just 17% in a previous period.

Levied excise taxes are sticky at \$1 per gram sold at any price below the \$10 mark, with the excise tax rate remaining flat at 10% of revenue thereafter. Any further declines in product prices below the \$10-per-gram mark will mean an ever-increasing excise tax rate on dried marijuana sales, as long as the \$1 a gram tax remains that inflexible.

That said, there are some recent excise tax law changes that could allow for flexibility in the tax rate, depending on THC content in the product sold, but that may benefit the CBD-rich medical marijuana segment, yet HEXO sells heavily into the recreational use segment, where the psychoactive THC ingredient is the most attractive product attribute.

## Can we blame weaker medical cannabis volumes too?

Yes and no.

HEXO has sold an average 148 kilograms of medical cannabis over five solid quarters. Management has a big room to toggle this price-resilient segment, and the company could have done better than the 145 kilograms sold during the quarter.

That said, although medical cannabis volumes contracted by 4.6% sequentially, the total contribution of this revenue segment has been dwarfed by adult use sales since October 2018. The sequential volume decline of just seven kilograms in this segment was totally insignificant when compared against the 2,904 kilograms sold.

## Foolish bottom line

HEXO's revenue performance disappointed, yet the company actually sold more cannabis during the quarter. Higher shipped volumes were at lower prices, and higher excise taxes were incurred, leading to weaker net sales for the quarter, and revenue growth suffered.

The company needs to up its game going forward and sell more product. That is very much possible, as productive capacity increased recently after the licensing of a one-million-square-foot, new facility and the closing of the Newstrike acquisition.

That said, the Canadian market demand growth is falling short, and new markets are necessary to absorb increased production. The partnership with **Molson Coors** could still come in handy, even if [regulation will inflict some pain](#), but an earlier estimated billion-dollar provincial supply agreement in Quebec is a priced intangible asset.

Investors need not emotionally dump their HEXO stock positions after a momentary decline in quarterly

revenue.

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