Cannabis Investors: 2 Takeaways From HEXO's (TSX:HEXO) Latest Earnings Guidance Revision

Description

Cannabis investors more than freaked out when **HEXO** (TSX:HEXO)(NYSE:HEXO) released a new guidance and withdrew its earlier financial outlook for fiscal 2020 on Thursday, leading to a 24% fall in the pot firm's stock price.

Management gave a new revenue guidance for the quarter ended on July 31 at $14.5 million to $16.5 million and fiscal year 2019 revenue projection of $46.5 million to $48.5 million.

This was a huge climb down from a net revenue guidance of $26 million given in June, implying that the company could miss its earlier forecast for the closed quarter by as much as 44%, and the company withdrew its overly ambitious revenue outlook for fiscal 2020 of $400 million in the 12 months to July 31 next year.

Investors are thus reminded of the significant uncertainty surrounding the cannabis industry at large while the latest news could also point to the elevated execution risk on this specific marijuana stock.

Significant industry uncertainty

The marijuana industry has just gone past birth pains, and the individual companies, the kids, are still taking baby steps towards maturity, but everyone, including industry executives and analysts, is still learning how to perfectly model this nascent sector.

The blame has been placed on "slower-than-expected store rollouts, a delay in government approval for cannabis derivative products and early signs of pricing pressure…" The company highlighted the regulatory uncertainty and "jurisdictional decisions to limit the availability and types" of derivative products, which has clouded future earnings visibility.

It's understandable why the company has decided to withdraw its $400 million revenue guidance for fiscal 2020, but the associated revelation of slower-than-predicted growth is startling.

Surprisingly, this firm holds the largest known five-year provincial supply agreement with Quebec for over 200,000 kilograms of product, which is bigger than **Aphria's** recently problematic deal, but management still touts a high level of market uncertainty, even if it has such a critical sales base covered.

One could pose the question that if the level of industry uncertainty is this high, how are management teams creating long-term financial and operational budgets? Are they all doing discovery learning? If so, there could be significant consequences for missing critical cash flow targets.

The company's chief financial officer abruptly left for "family reasons" last week after a fewer than four months' service.

Leading industry stocks also recorded double-digit losses for the day, but this scenario shouldn't be surprising for growth investors in a nascent industry. High uncertainty comes natural in these spaces, and this strengthens my argument of why pot names should not be picked as defensive investments when one is planning a recession-proof strategy, even if the business lines have some fighting chance of survive an economic downturn.

An elevated strategy execution risk?

The company couldn't sell enough product during the three months to July 31 this year to meet its own expectations, and management has decided to make significant changes to its sales and operating strategy "to drive future results."

This could be a big bright red signal that there's significant strategic risk at this company, and management thinks the company's poor go-to market strategy needs a revision. The company is changing its focus from growth to profitability in the near term, and that's a significant shift in priorities, operating budgets, and strategies.

What if the new focus fails to deliver?

The company could lag behind peers in growth and remain unprofitable, and that's not what investors desire.

I'm anxiously looking forward to management's earnings call on October 24, when changes could be discussed in more detail.

Foolish bottom line

The Canadian pot industry is still risky and promising, but both executives and analysts are still studying and learning the market's dynamics. Predictable trends are still to emerge, and no one knows what the future will look like.

Maybe it's better if management avoids issuing any ambitious revenue guidance during these primitive stages of a new industry, as the disappointments hurt.

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Date
2025/08/24
Date Created
2019/10/11
Author
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