



Should You Buy HEXO (TSX:HEXO) Stock at \$3?

Description

The rout in the share prices of Canadian marijuana stocks continues to drive down valuations in the cannabis sector, which has contrarian investors wondering if the sell-off might be overdone.

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

Revenue woes

HEXO has a credibility issue.

The company just reported a loss of \$56.7 million for its latest quarter of operations compared to a loss of \$10.5 million in the same period last year.

Negative cash flow in the marijuana sector is not new and companies are expected to spend heavily to ramp up production capacity in a bid to capture as much of the market as possible in the battle to secure an early foothold.

Nonetheless, revenue has to meet guidance, or at least come close to the levels the [cannabis companies](#) are forecasting to the market, which is where HEXO has run into trouble.

Revenue in fiscal Q4 2019, which ended July 31, came in at \$15.4 million. That's a big improvement from \$1.4 million a year ago and up nicely from the previous quarter's tally of \$13 million.

Going forward, the company says revenue in the next quarter, which is fiscal Q1 2020, will be \$14-18 million.

Assuming the company hits the upper end of the target, that would put it on track to generate \$72 million on an annualized basis.

This would be fine if management had indicated the trend would follow that projection.

However, just a few months ago the company said it was targeting \$400 million in net revenue for fiscal

2020, and anticipated fiscal Q4 2019 revenue of \$26 million.

Investors who bought the stock in the summer based on the rosy outlook provided by the CEO in June aren't happy campers today. The share price is down from \$7.50 in the middle of June to below \$3 per share at writing.

The slide in the share price really picked up steam in recent weeks. On October 10, HEXO gave the market a heads up that its fiscal Q4 numbers would actually be much lower than the roughly \$26 million the CEO predicted. We now know how badly they missed the mark.

In hindsight, investors should have realized something was out of whack when the CFO abruptly left the company a few days before the update, after only being in the position for four months.

Industry executives are pointing the finger at a number of challenges in the market, including a lack of physical stores to sell recreational cannabis products and the emerging health concerns around vaping.

In addition, compliance scandals in 2019 have resulted in tighter regulatory oversight. Finally, the black market continues to flourish.

These problems might be causing the weak performances, but blaming them doesn't make investors feel better about being misled.

Risks

HEXO is cutting 200 jobs and just secured \$70 million in private placement financing, led by the CEO and a number of board members.

This might suggest that outsiders are giving the company the cold shoulder and are unwilling to commit additional funds until the smoke clears on the revenue situation. Given the rising losses and lower cash flow, there is a risk HEXO could face a funding shortage.

Should you buy HEXO?

The stock now has a market capitalization of just \$750 million, which might be reasonable if the new revenue guidance is reliable and the focus on profits pans out over the course of the next 12 months.

Given the production assets and the strong position in Quebec, HEXO might even become a takeover target. This could lead to a premium if a bidding war emerges.

That said, the downward trend across the cannabis industry might still have room to run before the latest crash hits a bottom. Big percentage moves are common when stocks trade below \$5 per share, so investors should be careful. For example, HEXO is down 45% in the past four weeks.

I would keep any contrarian bet very small, or simply search for other oversold stocks in the market today.

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