Cannabis Stock Alert: Can Hexo (TSX:HEXO) Get Back to $5?

Description

Cannabis stocks are getting crushed. If you've been waiting to jump in, this could be your best opportunity. Most analysts expect the global cannabis market to exceed $100 billion in sales by 2030. Some believe it could ultimately be worth more than $200 billion. If that's true, the recent downturn could be a once-in-a-lifetime chance to scoop up stocks that could soon enter hyper-growth.

One of my favourite pot stocks is **HEXO** (TSX:HEXO)(NYSE:HEXO). We'll dive into the reasons for my optimism in a minute, but with a market cap of just $700 million, few investors are looking at this company. It's even off the radar of many top analysts. That's a big mistake. Looking at the unique strategy HEXO is pursuing, it could be creating one of the most iconic businesses in Canadian cannabis history.

Differentiation is critical

What's the number one rule of cannabis investing? It is to understand how commoditization works.

Imagine you're the only person in your region that grows corn. You can probably fetch a decent price, at least compared to regions with more competition. But the thing with corn is that it's pretty easy to grow. Almost anyone can do it.

If you're achieving attractive returns, others are going to copy you and compete directly. Eventually, your product will become commoditized. That is, the end-user treats the good (in this case, corn) equally no matter who produces it. This almost always results in a pricing collapse.

Corn is completely different when compared to non-commoditized goods. Consider **Coca-Cola** and **PepsiCo**. Do people care whether they receive a Coke or Pepsi? Absolutely. Millions of consumers love one brand and hate the other. That's how you know it's not a commodity. What's your favourite corn company? You likely don't have one, because it's a pure commodity.

When a good gets commoditized, it gets difficult for *anyone* to make money selling it. It’s a race to the bottom. If you think this can’t happen to cannabis, think again, because it’s already happened.

In 2018, news outlets reported that Oregon was “drowning in one million pounds of excess weed.” State-wide prices plummeted for every producer. Local companies worried about going out of business. Demand was strong, but supply surged, causing a massive market imbalance.

Cannabis is a bit different than corn due to regulations, but don’t be fooled; regulators don’t exist to prop up pricing for existing producers. If you want to succeed with pot stocks, choose companies that won’t face severe commoditization.

Why HEXO is different

HEXO does cultivate commoditized cannabis, but that’s only a small part of the business. In reality, the company is building something no other competitor will be able to match: a cannabis *platform*.

HEXO is establishing the first cannabis platform in the industry, complete with grow facilities, research and development centres, and packaging capabilities. It’s essentially building a one-stop shop for consumer goods companies to create safe, effective, and regulatory compliant cannabis products quicker than ever before. You see, HEXO isn’t focused on being a standalone pot company. Instead, it’s partnering with existing brands to leverage each company’s expertise and existing market reach.

In 2018, it partnered with **Molson Coors Canada** to co-create cannabis-infused beverages. Next year, it wants to secure additional partners for areas like cosmetics, edibles, sleep aids, and more.

If HEXO can succeed, its business will be highly differentiated. No other competitor can give Fortune 500 companies instant access and ability to create cannabis-based products. These customers will be paying HEXO for its infrastructure and resources, not simply for its weed.

In October, HEXO stock breached the $5 mark and currently trades at just $3 per share. Yet in 2021, analysts anticipate the company earning more than $200 million in sales. That’s still a small fraction of what the company will be capable of if it secures the right partners.

Revisiting the $5 mark won’t be difficult for the company if sentiment shifts, but new investors really should be targeting a price above $10 per share, which is good for a 350% return. HEXO is perhaps the best-positioned company for a rapid rise, considering its strategy would take years to emulate and largely mitigates shareholders from the effects of commoditization.

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