Why Is Hexo (TSX:HEXO) Optimistic About Long-Term Growth?

Description

Cannabis stocks have been volatile right through 2019. Shares of Canada-based **Hexo** (TSX:HEXO)(NYSE:HEXO) rose from $3.84 at the start of CY 2019 to $8.4 at the end of April. The stock is currently trading at $2.15 at writing, which is 75% below its 52-week high.

Cannabis companies including Hexo that are targeting the adult-use recreational marijuana space have been impacted by the slow rollout of retail stores and competition from illegal sellers. This has resulted in lower than expected demand and a considerable rise in inventory levels for cannabis companies.

These factors have led to cannabis companies missing quarterly consensus estimates resulting in an extended weakness in this space.

However, Hexo and peers are investing heavily in capital expenditure to increase manufacturing capacity as the total addressable market continues to expand.

Let’s take a look at why is Hexo optimistic about growth despite a lackluster performance in 2019.

Focus on partnerships

Similar to most marijuana companies, Hexo is banking on agreements and partnerships to gain traction in the domestic cannabis market. It has supply agreements in nine Canadian provinces, which include a five-year supply contract with Quebec’s Société québécoise du cannabis (SQDC).

Hexo has access to about 95% of the Canadian population. It views itself as a consumer-packaged-goods (CPG) cannabis technology company with a global focus. Hexo now wants to build a brand with a strong distribution and emphasis on product quality.

Hexo already has partnered with **Molson Coors** targeting the Cannabis 2.0. It now want to extend similar partnerships with other Fortune 500 companies to further penetrate the CPG space forcannabis-infused edibles.

The company's press release states, "Fundamentally, we bring our brand value, cannabinoid isolation, formulation and delivery technology, licensed infrastructure and regulatory expertise to established companies, and in turn, we plan to leverage their international distribution, base products and their deep understanding of consumer markets."

The U.S. provides a huge growth opportunity

Hexo is optimistic about the opportunity for expansion south of the border. Though cannabis is still illegal at the federal level in the U.S., the House of Representatives just passed a bill to legalize recreational and medical use. Hexo shares rose close to 40% on November 21, following this announcement.

The bill needs to be approved by the Senate. While this will increase the addressable market for Hexo and peers, it will also give them access to capital for expansion and growth.

Currently, most top banks are wary to lend to cannabis companies due to the above-mentioned legalization issues.

As the U.S. market continues to develop, Hexo aims to bring innovative and high-quality hemp-derived cannabidiol infused products to the market. Hexo will focus on large-scale CBD extraction from hemp and provide high-quality ingredients to current and potential Fortune 500 partners.

As mentioned earlier, Hexo is investing heavily to increase production capacities. It already has about 1.3 million square feet of operating space in Gatineau and has leased 579,000 square feet of industrial real estate for manufacturing, distribution and product research in Ontario.

Analysts estimated Hexo's capital expenditure to rise to $103 million in fiscal 2020 (year ending in July). Comparatively, company sales are estimated at $114 million for 2020.

Hexo has estimated the global cannabis market to reach $250 billion in the next decade. It expects just a handful of companies to control 70% of this market and aims to be one of these companies.

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