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Is This the Best Time to Buy HEXO (TSX:HEXO) Stock?

Description

The meltdown in the stock prices of marijuana companies in the second half of 2020 wiped out billions of dollars in market capitalization, resulting in difficulties for industry players seeking to secure new funding.

Issuing stock isn't advisable when the chips are down, and big investors with deep pockets are taking a step back to see how things shake out in the coming months.

A recent bounce in the share prices of the sector's key stocks, however, is attracting new interest from retail investors and contrarians who are wondering whether this might be a good opportunity to add cannabis stocks to their portfolios.

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

Wild ride

HEXO traded for $8.50 per share right before the launch of the recreational cannabis market in Canada last October.

Unfortunately, the rollout didn't go well, with supply shortages and distribution headaches quickly souring the mood and investors bailed out of the sector amid the disappointment. A broad-based equities sell-off also didn't help.

At the December 2019 low, HEXO was around $4.30 per share. A new rally in in the first part of 2019 took the stock to $10.50 at the end of April, but things turned ugly for HEXO in the following months.

What happened?

HEXO provided a very optimistic view on its fiscal 2020 revenue target when it announced the purchase of Newstrike Brands in March.

The deal increased the number of provincial supply agreements to eight and HEXO said it was targeting $400 million in revenue by the middle of the 2020 business year.

The company reiterated the guidance in June and said its fiscal Q4 results, which ended July 31, would show roughly $26 million in revenue.

On October 10, the company dropped a bomb. HEXO abandoned its rosy revenue forecast for the 2020 year and warned that its upcoming Q4 report would be much worse than anticipated.

When the final Q4 numbers came out on October 29, net revenue was just $15.4 million and the company said it expected fiscal Q1 revenue in 2020 to be $14-18 million.

In addition, HEXO cut 200 jobs in an effort to protect cash flow. The company suspended operations at its Niagara facility and at 200,000 square feet of its Gatineau site. The firm also announced $70 million in new convertible debentures that will carry an 8% interest rate.

On the surface the new funding might be viewed as a vote of confidence, but the money was provided by company insiders, including the CEO and four directors. This might suggest the business is having trouble finding new sources of cash.

To make matters worse, HEXO revealed it had discovered product had been grown in unlicensed areas at its Niagara facility that was formerly part of Newstrike. HEXO destroyed the product in question.

Should you buy HEXO?

The stock trades at $3 per share at writing, giving the company a market capitalization of $760 million. That’s still high for a business with no profits and annualized revenue expectations of roughly $65 million.

The huge miss on the revenue guidance means that HEXO has a credibility issue, which is likely why the CEO and board members had to provide it with a $70 million lifeline. Given the uncertain state of its cash flow, I wouldn’t back up the truck right now.

However, contrarian investors who are bullish on the sector might want to consider a small position. Those who bought the stock near $2.25 in November have picked up a nice gain, and there could be more upside with Ontario announcing plans to allow a large increase in the number of cannabis stores in the coming year.

In addition, it wouldn’t be surprising to see HEXO acquired in the near term. Whether or not investors would receive a premium is anyone’s guess.

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aswalker