



Should HEXO (TSX:HEXO) Stock Be on Your Contrarian Buy List?

Description

Marijuana stocks took a big hit in the second half of 2019 and the [cannabis](#) sector continues to struggle as we begin 2020.

HEXO ([TSX:HEXO](#))(NYSE:HEXO) has really taken a hit, falling from \$11 per share last April to a below \$2. At the time of writing HEXO trades at \$1.80 and has a market capitalization of about \$450 million.

Let's take a look the reasons for the rout and try to determine whether HEXO deserves to be a [contrarian](#) buy for your portfolio today.

Industry woes

Investors piled into pot stocks ahead of the launch of the recreational market in October 2018 with high hopes for the industry. The initial rollout didn't go as planned, with supply shortages and distribution challenges hampering sales and frustrating potential customers.

The sector caught a second wind, however, in the first four months of 2019. The rebound in the share prices of the cannabis companies came as part of an overall recovery in equity markets.

Renewed enthusiasm about sales for the year also helped bring investors back into the sector, and some had an eye on getting in ahead of the launch of the second phase of Canada's recreational pot legalization.

Unfortunately, the quarterly reports coming from the cannabis producers started to indicate that challenges remained. Revenue growth began to stall out, while expenses and losses moved steadily higher. This made investors question their appetite for holding stocks with such lofty valuations.

In addition, the industry started to lose credibility as reports emerged that some companies were not following the rules. Production in non-licensed facilities and accusations of self-dealing by some industry executives gave investors and lenders another reason to take a step back.

HEXO's issues

HEXO's trouble began with its acquisition of Newstrike Brands in the first part of 2019. The deal was initially viewed as positive for HEXO as it expanded the company's licensing reach to eight provinces and added important production capacity and new brands to the portfolio.

At the time of the deal, HEXO said fiscal 2020 revenue could hit \$400 million. In June, the company maintained the optimistic guidance, even saying that it expected its fiscal Q4 2019 revenue, which covered the three months that ended July 31, to be close to \$26 million, or about double the previous quarter.

In October, the management team stepped back the guidance and painted a very different outlook for the 2020 fiscal year. HEXO cut 200 jobs and shut down a former Newstrike production site. When the fiscal Q4 2019 results actually came out, net revenue was just \$15.4 million.

The fiscal Q1 2020 report, showed net revenue of \$14.5 million and a net loss of \$62.4 million. On an annualized basis projected fiscal 2020 revenue at the same rate would be less than \$60 million, well off the \$400 million the company anticipated just six months ago.

HEXO recently raised US\$25 million through a share issue at US\$1.67 per share. This followed a \$70 million loan provided to the company by a group that primarily consisted of HEXO executives and board members.

Should you buy HEXO?

Given the ongoing high level of cash burn, investors should be careful. Revenue would have to pick up considerably to get the company to profitability and enable HEXO to start to attract new investors.

The recent launch of the edibles and drinks market could provide the revenue surge HEXO needs, but the early indication is that the market is adopting a wait-and-see approach.

The stock could certainly rally on reports of better-than-expected revenue in the coming quarters. Any rumours of a takeover could also drive the share price higher.

At this point, however, I would probably search for other opportunities.

CATEGORY

1. Cannabis Stocks
2. Investing

TICKERS GLOBAL

1. NASDAQ:HEXO (HEXO Corp.)
2. TSX:HEXO (HEXO Corp.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Cannabis Stocks
2. Investing

Date

2025/08/24

Date Created

2020/01/13

Author

aswalker

default watermark

default watermark