Is HEXO Stock a Buy After Restated Earnings?

Description

Cannabis producer **HEXO**'s (TSX:HEXO)(NYSE:HEXO) stock has been on a strong rebound lately since the start of the new year and the share price closed nearly 16% higher on Wednesday as the pot industry received an **Organigram Holdings** powered valuation boost.

The company recently filed restated financial reports for its fiscal year which ended July 31, 2019 as well as amended quarterly earnings results for fiscal Q1 2020 ended on October 31, 2019.

The restatement wasn't entirely new information, as management had hinted on an accounting error concerning the treatment of deferred taxes on two subsidiaries in December while presenting quarterly results but the backdating of some impairment charges was a fresh data point.

This isn't the first time that the company has restated its financial results though.

Management had previously restated some balances for the company's fiscal year 2018 ending July 31, 2018 where the company later identified an error in the classification of cash, cash equivalence and short term investments for the year ended July 31, 2018.

Company identified that $98.21 million of high interest-bearing cash accounts were previously classified as short-term investments and $38.5 million of term deposits previously classified as cash and cash equivalents.

To rectify the problem, cash and cash equivalence were increased and short term investments decreased by $59.7 million for fiscal year 2018.

What has changed now?

Concerning the recent fiscal year 2019 results, management determined that the deferred tax liability was overstated by $14.4 million due to an earlier decision not to net off one subsidiary's deferred tax assets against the other's deferred tax obligations at July 31, 2019. New information has also led executives to increase inventory impairment charges for the past year by a further $2.4 million.

The company subsequently reduced its deferred tax liability by the stated amount, and levied new inventory charges thereby reducing previously reported gross margins, increasing operating losses, but lowering the total net loss and accumulated deficit for the year and increasing shareholders equity for 2019.

The restatement has had some impact on the company's fundamentals and valuation metrics for the affected periods, especially any ratios that deal with assets, book value of equity, and profitability.

Further, concerning the inventory impairment charge, an operating loss has been pushed back to a prior financial period and operating results for fiscal 2020 will be better by $2.4 million, as has been shown in the restated Q1 2020 results where the operating loss and total net loss have both declined.

Is the stock a buy now?

The need to restate prior reported earnings results because of identified errors is a significant source of embarrassment to the finance team, yet this scenario keeps recurring at this cannabis firm. The departure of key executives in the department shouldn't therefore be so surprising.

It appears that the company has been a bit too cautious for its own benefit and couldn't take advantage of a legal tax loss recovery benefit to reduce reported losses and better portray its financial performance and status in 2019.

That said, should one buy a stock just for its restated financial results?

I'd be more keenly focused on future financial prospects more than the repainted past picture, but the restated results look a little better, however.

I'd hold old positions and keep watching how the company's chosen hub and spoke business strategy and resultant partnerships perform going forward.

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Date
2025/08/16
Date Created
2020/01/16
Author
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