Why Is Hexo (TSX:HEXO) Stock Down 22% in 2020?

Description

Shares of cannabis company **Hexo** (TSX:HEXO)(NYSE:HEXO) have fallen over 20% year to date. The stock has underperformed broader markets as well as cannabis peers in January 2020.

While the indexes are trading close to record highs, pot stocks are trying to make a comeback after a horrendous run last year. **Horizons Marijuana Life Sciences ETF** has gained 6.4% year to date. Top marijuana stocks such as **Canopy Growth**, **Charlotte's Web Holdings**, and **Aurora Cannabis** have returned 18.8%, 6%, and -4.5%, respectively, this year.

The ongoing pullback in Hexo stock has meant shares are currently trading 85% below 52-week highs. What has impacted Hexo investors this year?

Analyst downgrades

Hexo shares are trading lower in 2020 after a couple of investment banks lowered price targets on the stock. According to multiple reports from *The Fly*, MKM Partners downgraded Hexo from buy to neutral with a 12-month price target of $1.50, down from $5.

MKM Partners analyst William Kirk has attributed the downgrade to Hexo's CFO exit in October 2019. According to Kirk, soon after the exit, Hexo has been grappling with problems including a preliminary revenue and earnings miss for Q4, employee layoffs, and certain breaches of contracts.

Kirk also believes these uncertainties cannot be offset by strong sales of its lower-priced Original Stash product line or the opening of additional retail stores in Quebec.

On January 17, 2020, Roth Capital maintained a neutral rating on Hexo and lowered its price target from $2.25 to $1.75. According to Roth Capital analyst Scott Fortune, the lower price target was driven by an ongoing weakness due to the slow rollout of retail stores.

Earlier this month, Hexo also agreed to sell 12 million common shares to institutional investors at an offer price of $1.67, resulting in gross proceeds of $20 million. Hexo agreed to issue warrants to purchase six million common shares on the competition of their five-year term for an exercise price of $2.45.

This capital raised also drove shares lower, as it resulted in dilution of existing shareholder position. Hexo stock is currently trading at $1.68.

What next for investors?

In fiscal 2020, Hexo aims to reduce operating expenses by 25%. The company expects cost control coupled with its multi-brand approach, low product price, and updated strain mix to help it increase market share. While investors can expect short-term weakness to impact share prices, is it prudent to take a long-term view on Hexo?

The legalization of cannabis-infused products will increase demand over the next few months. The cannabis market for edibles in North America is estimated at $1.56 billion, while the global figure stands at $5.04 billion. Hexo, similar to most other pot companies, is bullish about the market opportunity here and is slated to launch new products in the first half of 2020.

These products will include vapes, confectionery and baked goods, cosmetics, and non-alcoholic beverages. Hexo has partnered with **Molson Coors Canada** to create a line of cannabis-infused beverage products.

Hexo is also optimistic about its distribution scale and market penetration in Canada. The company has supply agreements with private retailers and government-run outlets, giving it access to 98% of the population.

Hexo has a market cap of $432 million. It is valued at 5.33 times fiscal 2020 sales. This valuation seems reasonable for a company expected to grow sales by 70% in 2020 and 108% in 2021. In case Hexo reports strong quarterly results and manages to beat consensus estimates, there can be a shift in investor sentiment, which will drive the stock higher.

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araghunath