HEXO Stock: A Warning on Potential Bankruptcy?

Description

Investors in marijuana firm **HEXO** (TSX:HEXO)(NYSE:HEXO) stock received the shock of their lives early morning Tuesday when the company discussed the "ultimate" *Going Concern* reporting concept in its latest news release.

Before getting to the sacred accounting concept, which usually comes up when discussing potential bankruptcy, here are the mildly concerning issues in the company's news release on Tuesday.

An earnings delay

The company has delayed the filing of its fiscal Q2 2020 results for the three months to January 31 this year. Management hasn't been able to confidently quantify an impairment charge for the quarter and is seeking a *Management Cease Trade Order* from the Ontario Securities Commission.

The sustained plunge in HEXO's stock price over the past few months necessitated an impairment test as the book value of net assets significantly exceeded the company's market value.

Investors sold off the Canadian pot company's shares after its striking announcements of revenue charges, asset write- downs, production facility suspension and massive staff layoffs since October 10, last year. Shares closed over 80% lower than their October 9 closing prices on Monday.

Impairment charges in the range of $265-280 million is expected in the upcoming but delayed earnings reports.

Yet another financial reports restatement

The amendments to this company's financial reports have been just too numerous over the past few months, and a sudden auditor departure recently added to my concerns on this company.

Management will file yet another amended MD&A for the company's fiscal year 2019 results due to some continuous disclosure issues identified by securities regulators. The same amendment will apply to its quarterly results for the October 2019 quarter.

Continuous disclosure issues threatened to cripple mortgage lending giant **Home Capital Group** not so long ago.

An asset sale in a hopeless situation

Management has decided to dispose of the company’s suspended Niagara production facility due to “excess cultivation capacity in the market and estimated demand for cannabis products.”

The company has no hope of ever requiring the facility’s production licenses and capacity ever, and selling the facility is the better option.

This brings us to the big question: Is the company still hopeful of continuing its business as a going concern?

Then a tough “Going Concern” discussion!

In the statement’s last bullet point, management brought up the chilling discussion when it decided to touch on the going concern concept.

The *Going Concern* accounting basis assumes that the company will continue running its business operations indefinitely. A going concern “…will be able to realize its assets and settle its liabilities in the normal course of business as they become due in the foreseeable future,” explains the company’s management.

The company has historically financed its working capital from new equity issuances and debt financing.

Given a jittery investor community that has been “dumping” stocks since the final trading week of February due to fears of a global economic recession triggered by the coronavirus, financing for high risk start-ups may dry up completely.

If availed, financing may come at very “unreasonable” terms due to higher risk premiums being charged by fewer willing financiers.

In that light, the company’s ability to continue operating is dependent upon its ability to generate cash flows from internal profitable operations and ability to raise external funding to meet liability obligations.

“These conditions combined with the accumulated losses to date indicate the existence of a material uncertainty that may cast doubt on the company’s ability to continue as a going concern.”

What is management trying to warn us about here?

Foolish takeaway

We don't normally have to read such statements when things are fine. This discussion usually comes up when evaluating distressed companies that may go bankrupt any time.

I'm not predicting that HEXO is going bust, but personally, I would seriously consider management's final discussion bullet point and sell the stock before the worst news headline hits my screen.

Here are three more names you may want to sell today.

CATEGORY

1. Cannabis Stocks
2. Investing

POST TAG

1. Cannabis

TICKERS GLOBAL

1. NASDAQ:HEXO (HEXO Corp.)
2. TSX:HCG (Home Capital Group)
3. TSX:HEXO (HEXO Corp.)

PARTNER-FEEDS

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

Category

1. Cannabis Stocks
2. Investing

Tags

1. Cannabis

Date
2025/08/16
Date Created
2020/03/17
Author
brianparadza