Why Did HEXO's Stock Price Fall 26% on Wednesday?

Description

Canadian marijuana producer **HEXO**'s (TSX:HEXO)(NYSE:HEXO) stock price fell more than 26% on Wednesday as investors reacted to a news release the company issued that morning.

What happened?

HEXO announced a $40 million underwritten public offering of its common stock early on Wednesday. The latest offering was priced at $0.77 per share. This is a 20% discount to the previous day's closing price of $0.96 per share. Investors will also receive common share warrants that will allow them to buy shares at $0.96 each over the next five years.

The 52,000,000 shares offer will close by April 13. Even during an Easter Holiday, quick investment decisions have to be made.

The marijuana firm is desperate to recapitalize during this down market.

Why is HEXO desperate for new capital?

Management is battling to beat very tight deadlines imposed by the company's bankers. A banking syndicate including the **Canadian Imperial Bank of Commerce** and the **Bank of Montreal** extended the company a $65 million credit facility. HEXO has drawn $35 million of that facility. The loan isn't due yet, but the bankers have changed the term loan's covenants twice this year.

The bankers have made new demands as the company's liquidity position has deteriorated.

A March 27 update to the loan covenants brought tight conditions. It requires that management secures at least $15 million in firm equity financing agreements by April 10, and the company has to raise more than $40 million in net proceeds from an equity offering by April 30 this year.

Time is ticking, and I applaud management for showing serious efforts in complying with the banks' new demands.

So what?

There's a high likelihood that the latest offering will be successful. It is being underwritten by good investment bankers anyway. Underwriters usually commit to purchase any "left-over shares" if an offering gets under-subscribed.

The company could exceed its financing target if the underwriters take up the option to buy 7,800,000 shares.

A successful capital raise will be a good result. It will dampen bankruptcy alarms set-off by the *Going Concern* notice in the company's latest financial statements. It'll also prove that, for now, HEXO has the capacity to raise new financing and shore up its liquidity coffers even during a market crash.

Most noteworthy, HEXO stock public offering's success today could show that investors still believe in the future prospects of the company, and management's ability to deliver on its long-term goals.

That said, take note that investors are being offered free warrants and a significant equity discount. The warrants' exercise price is set at the stock's closing price on the previous day. Yet under normal circumstances, warrant exercise prices are set significantly above ruling market prices. And the shares are priced at a deep 20% discount to the previous day's closing price. Such asset pricing speaks volumes about a distressed company's desperation for new liquidity.

The deep discount and favourable pricing on warrants is a steep price for the company to pay to incentivize new investors to buy into the offering. It speaks to the desperation in management's voice when asking for a bailout from shareholders.

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