Why You Should Start Loving Hexo (TSX:HEXO) Stock

Description

I wasn't a fan of cannabis stocks, and there were reasons for that. The industry is still in its infancy, has restricted access to capital, and competes with a thriving illicit market, which continues to hurt the prospects of the companies operating in cannabis space. Further, slow store openings and lower pricing levels also remain a drag.

However, with **Hexo** (TSX:HEXO)(NYSE:HEXO), I see a substantial long-term growth opportunity. Hexo's progress on revenues and costs have been absolutely fantastic. The company is inching towards being adjusted EBITDA positive and continues to roll-out new products that are performing exceptionally well. Besides, its industry-leading cost structure and growing market share provide a strong foundation for stellar growth in the long run.

Improving financials

Hexo's recent operating performance was impressive. The company's net revenues jumped about 30% on a sequential basis. Meanwhile, net revenues soared 70% year over year. The phenomenal growth in Hexo's top line reflects strong growth in Original Stash, its newly launched value brand. Also, the launch of Hash and oil extract drops further supported sales.

While the top line jumped, Hexo's gross margin and adjusted EBITDA also improved significantly. Hexo's adjusted EBITDA loss narrowed to $4.3 million from $8.5 million in the previous quarter.

Growth drivers

Hexo's Original Stash brand, launched to counter the black market sales, is emerging as a key growth driver. The brand appeals to the masses through its high quality and low price. Its small packaging format and pricing should continue to drive its market share and should compete effectively with the black market.

Also, the success of Hash, ready-to-drink beverage drops, the launch of beverages with Truss, and vape line should further support sales. Further, the company is also planning to launch a new premium product, which should drive margins. While Hexo continues to introduce new products in the coming quarters, increased activities at its Belleville facility should allow it to drive down costs and expand margins over the long run.

Hexo recently got the full licensing for its Belleville facility. The Belleville facility capacity should help Hexo in creating more Cannabis 2.0 products. Besides, the cost of goods sold is likely to go down significantly, reflecting automatic packaging and reduction in labour costs.

The company expects to report a positive adjusted EBITDA in the first half of fiscal 2021. Also, its positive EBITDA is not dependent on store openings, which is encouraging. Hexo should be able to report positive EBITDA through the expansion of its market share from its existing stores and cost reduction.

Bottom line

While structural problems could continue to be a hurdle, Hexo's growing product line, pricing advantage over peers, and improving cost structure should help it in gaining market share and report positive adjusted EBITDA.

Investors should note that fierce competition puts a significant amount of pricing pressure on cannabis companies. However, Hexo is not worried about pricing pressure, as its Belleville facility should drive down costs significantly.

So far, Hexo stock has declined by about 39% this year. The sharp decrease in its stock price and strong future growth catalysts make me love Hexo, and you should too for stellar long-term gains.

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