Will HEXO Stock Get High in June 2021?

Description

Canadian pot producers have underperformed the broader markets in the last two years. The majority of domestic marijuana companies have been impacted by massive losses and cash burn, which has led them to raise capital and boost liquidity while diluting shareholder wealth. **HEXO** (TSX:HEXO)(NYSE:HEXO) is one such stock on the TSX; it is down 80% from record highs.

Let's see if this Canadian pot heavyweight is a good contrarian bet or a stock to avoid right now.

HEXO stock was up 10% on Friday

Shares of HEXO gained 10% on May 28 after the company announced the acquisition of Redecan for $925 million. Redecan is Canada's largest privately owned LP (licensed producer), and HEXO disclosed it will pay $400 million in cash and $525 million in stock to complete the acquisition.

According to HEXO, this deal will allow it to lead the Canadian recreational cannabis market. The company is optimistic it will also benefit from "improved future financial performance and [a greater] potential to generate cash flow" after this acquisition. While investors cheered this news, it seems HEXO is betting big on the chance to generate a positive cash flow.

The purchase of Redecan will also mark HEXO's third acquisition in 2021. In February, it acquired **Zenabis Global** for $235 million in an all-stock deal. Earlier this month, it bought 48North Cannabis for $41 million.

By the time HEXO and Zenabis complete the merger, the combined entity is forecast to deliver over $150 million in sales and generate $20 million in cost synergies in the next 12 months.

HEXO stock is up 82% year to date and is well poised to gain market share in Canada's cannabis segment. It already leads the cannabis-infused beverage space given its joint venture with **Molson Coors**.

A look at recent quarterly results

In the fiscal second quarter of 2021, HEXO's sales were up 94% year over year at $32.8 million. It sold 11,419 kilograms of dried cannabis in Q2 compared with just 6,579 kilograms in the prior-year period. HEXO also claimed the company is getting better in terms of predicting demand-supply dynamics, as it harvested an additional 6,000 kilograms of cannabis in Q2 compared to its total sales. In the prior-year period, it harvested an additional 16,000 kilograms.

Further, HEXO increased its gross margin by 600 basis points to 40% in Q2. This improvement in gross margin helped HEXO reported a positive EBITDA of $202,000 compared to a loss of $419,000 in the year-ago period. HEXO's management explained the company finally achieved a positive EBITDA after seven consecutive quarters of improving margins. In Q2, the pot producer decreased operating expenses by a staggering 91% year over year.

HEXO should continue to enjoy stellar top-line growth driven by the opening of retail stores in major Canadian provinces. At the end of April, Ontario had 613 open legal cannabis stores while Alberta had 600 stores. In June 2020, Ontario had fewer than 100 stores while Alberta had just 483 stores.

HEXO might turn profitable in fiscal 2023

Analysts expect HEXO to increase sales by 77% to $143 million in fiscal 2021 and by 60% to $228 million in 2022. This will allow HEXO to improve loss per share from $7.08 in fiscal 2020 to $0.05 in fiscal 2022. However, there is a good chance for these estimates to increase once the above-mentioned acquisitions are over.

HEXO stock is trading at a forward price-to-sales multiple of 7.6, which might seem steep. Alternatively, its leadership position, improving profitability, and focus on acquisitions make it a good bet for investors with a high-risk appetite.

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