Why HEXO (TSX:HEXO) Stock Dropped 25% Today!

Description

HEXO (TSX:HEXO)(NYSE:HEXO) stock is down 25% this morning. Why is it getting smoked (pun intended)? Here's a closer look at the company's recent announcement that seems to have riled up its investor base.

What happened?

Ottawa-based cannabis giant HEXO has had an impressive run this year. Over the first half of 2021, the stock surged roughly 75%. It's still nowhere close to its all-time high of $31, but this rebound served as a reprieve for long-term shareholders.

Unfortunately, the surging stock price may have encouraged the HEXO team to raise capital. Management has announced it will issue stock to raise capital.

Issuing new shares to raise more capital is not uncommon. In fact, it's a necessity for rapidly growing cannabis companies that lack profitability. However, HEXO's announcement was particularly disappointing, because the company didn't say how many shares were being issued or at what price.

The statement simply claims the units "be priced in the context of the market." In other words, the company has adopted an opportunistic strategy to raise funds. That's bad news for investors. It means the shares they hold now will be diluted to make space for more investors. Worse, the extent of the dilution is unknown.

That's why HEXO stock dropped 25% this morning.

So what?

It's worth noting that the company's "context of the market" stipulation means they're going to try to get the *best* price for their stock. I can't predict the future, but I believe the recent drop may encourage the team to hold off from issuing units at this current lower price. The smartest move is to wait for investor sentiment to recover.

Regardless of the timing, HEXO needs more capital to keep investing in growth. The company recently spent $925 billion to acquire Redecan. It now has just $81 million in cash on its books. That's not enough to stay afloat, let alone invest in more acquisitions to sustain growth.

Meanwhile, capital is cheap and abundant. Interest rates are still at record lows, and institutional investors are willing to finance growth companies in the cannabis sector. The market needs more consolidation, and larger players like HEXO are in a favourable position to pull it off.

In short, an equity raise is essential. Investors now have the option to bear the dilution and take a long-term perspective. The stock is cheap, according to some of my colleagues. Alternatively, you could cut your losses and move on.

Now what?

HEXO stock has dropped 25% this morning. The management team has announced a share sale at an unknown price and quantity. That means investors face dilution that they can't measure yet.

The stock plunge could delay the share issue, but HEXO needs capital to finance growth. Investors could either cut their losses or hold on and take a long-term approach. In my opinion, there are better growth opportunities, so seeking an alternative doesn't seem like a bad idea.

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