Launching of JV Could See 2 Weed Stocks Soar 50%

Description

Health care is the second-worst performing sector thus far in 2022, thanks to underperforming cannabis stocks. Industry leaders **Canopy Growth** and **Tilray Brands** (TSX:TLRY)(NASDAQ:TLRY) are losing year to date. However, the latter announced a strategic partnership with **Hexo** (TSX:HEXO)(NASDAQ:HEXO).

Once Tilray secures shareholders' approval, it will have a significant minority stake (37%) in its rival through a debt deal. The transaction calls for Hexo to sell US$211 million of its senior secured convertible notes to Tilray at 90 cents on the dollar.

Besides the debt deal, Tilray and Hexo will enter into and launch a joint venture (JV). Each company will produce pre-rolls, beverages, and edibles within the next two years. The tandem expects to realize $50 million in cost savings.

Tilray and Hexo trade at $7.35 and $0.73 per share, respectively, and are down by an identical 17% year to date. The two cannabis producers have yet to report net profits. Their priorities are to cut costs to help improve cash flows. The future partners need a boost badly to lift their sagging fortunes.

Market share opportunities

Tilray's CEO, Irwin Simon, said the deal will strengthen both companies not only in Canada but also in Europe's medical cannabis market. They are also awaiting the federal legalization of marijuana in the United States. He said, "Doing this with Hexo creates tremendous market share opportunities with consumers and helps get the right message out to the market."

Simon expects a lot of change to happen in the market place if the companies work together. According to Scott Cooper, Hexo's resident and CEO, the partnership is the most optimal agreement to strengthen the balance sheet. It should also preserve value for shareholders and provide capital to execute Hexo's "Path Forward plan."

Cooper adds that the strategic alliance will help lower costs and preserve Hexo's stand-alone optionality. Simon is confident to secure shareholder approval within 90 days from the announcement.

Critical first step

Hexo's board chairman, Mark Attanasio, said, "Restructuring HEXO's debt is a critical first step in allowing the Company to move forward with its Path Forward strategy and to begin to unlock significant shareholder value." He adds that the company has been through a crippling overhang for the past 12 months.

The punitive redemptions and discounted dilutive financings were the problems that need solutions, Attanasio said. Fortunately, the new deal with Tilray can place Hexo solidly on a path to growth. An agreement between Hexo and KAOS Capital is in place.

KAOS will provide $180 million in equity to ensure HEXO maintains a strengthened balance sheet. The equity should also cover all interest and operational costs in the near term.

Financial and strategic benefits

The parties to the JV cite three financial and strategic benefits. Hexo will have operational flexibility with the purchase of the notes. It will likewise free previously-restricted US$80 million in cash. As mentioned earlier, the substantial synergies will result in $50 million in cost savings.

Third, Tilray and Hexo commit to leveraging their innovation, brand-building, and operational efficiencies. Sharing of expertise and know-how should strengthen market positioning, while capitalizing on growth opportunities.

Not a buy

The benefits sound interesting, if not exciting. However, weed stocks are risky investments and highly speculative. Investors were burned before by empty promises.

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