



CannTrust Holdings (TSX:TRST) Took a Risky Gamble: Buy the Dip or Sell?

Description

News on Monday is that Canadian cannabis producer **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) employees actually did the unthinkable: it was growing product in some unlicensed rooms and providing falsehoods to the regulator, Health Canada. The stock opened nearly 22% lower. Will the share price recover?

What happened?

According to a company news release on Monday, CannTrust staff members authorized themselves to grow cannabis in five completed but yet-to-be-licensed grow rooms at its Pelham greenhouse facility for about six months between October 2018 and March this year.

Although the grow rooms had been constructed and completed to expected regulatory standards, Health Canada was yet to license them for production, and this was subsequently done in April 2019.

The regulator has placed an inventory hold on 5,200 kilograms of product that was harvested from the affected rooms, and the company has placed a voluntary hold on about 7,500 kilograms of cannabis and dried product equivalents at its manufacturing facility as quality checks are made, so some customers may experience a temporary supply shortage.

The regulator's quality results are expected in 10-12 days from July 8.

Should investors be concerned?

The cannabis market is a highly regulated industry, and there's good reason for that to be so.

Aphria [was in great pains for months](#), as it had to endure long delays in the licensing of its key grow facilities, and the company's financials took a hit, but it was necessary for management to wait for a regulatory licence.

Actually, many other licensed producers had to endure licensing delays since last year. It hurt, but they still had to respect the law.

CannTrust has breached a significant code of trust with not only its industry regulator, but its customers too, and this can be a significant issue on the company's image and its future operations, including potential customer lawsuits.

That said, the financial impact on the company from this scandal is unknown. The regulator could hold the product for longer or order that the held inventory be destroyed, and there could be fines levied.

However, considering that the company produced product from facilities that were unlicensed but technically up to regulatory standards, and that the regulator subsequently licensed the affected grow rooms, there's minimal risk to the held inventory.

Further, the impact of potential customer lawsuits, if any, could still be limited since the sold product passed quality control tests in Health Canada-certified labs.

The company reportedly took corrective measures after the scandal, and management is looking at alternative inventory sources to temporarily close the sudden supply gap. Given the increasing inventory availability in the industry, wholesale product can be easily sourced.

The financial impact from this scandal could still be minimal from an operating perspective, but there's the risk of regulatory fines and penalties.

Dump the stock or buy the dip?

Breaches of trust can easily dent stakeholder relationships, including investor goodwill. However, the cannabis investor seems very forgiving, as exhibited recently on Aphria stock after short-seller revelations of management shenanigans in LatAm acquisitions.

CannTrust shares may trade lower as the market awaits updates on regulatory action going forward, but this is not the best time to offload a position. Unless one is expecting the worst to happen, doing nothing is the ideal action.

The fact that the company's production facilities remain licensed, cultivation is unaffected, and sales activities are still going on is reassuring. The dust may settle sooner than the market thinks.

Actually, contrarian investors may find this the best time to scoop cheap, beaten-down shares. The price is tempting.

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brianparadza

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