



Why Did This Pot Stock Lose 49% in 3 Months?

Description

Canadian cannabis cultivator **CannTrust** (TSX:TRST)(NYSE:CTST) saw its stock plunge after Health Canada found that one of its greenhouse facilities was non-compliant. This comes on the back of what has been a tough few months for the burgeoning legal marijuana industry with significant doubts emerging about its viability in the wake of **Canopy Growth's** shock fiscal fourth-quarter 2019 results. Those results were so [disappointing](#) that 40% owner liquor giant **Constellation Brands** was concerned and co-founder as well as co-CEO Bruce Linton stepped down and left the industry-leading cultivator.

These events have doused much of the enthusiasm and hype surrounding the legal cannabis industry and follow earlier allegations in 2018 that Canada's second-largest cultivator **Aphria** was essentially a fraud. As these types of events multiply, they will weigh on cannabis stocks and fan fears that the industry can never realize its true potential or achieve the massive growth touted by some analysts.

What happened at CannTrust?

In the case of CannTrust, the issues stem from a recent Health Canada audit, which found that its greenhouse facility in Pelham, Ontario, was non-compliant. Essentially, cannabis was cultivated in unlicensed rooms between October 2018 and March 2019.

As a result of the finding, Health Canada has placed a hold on 5,200 kilograms of dried marijuana inventory harvested from the non-permitted rooms, while CannTrust has voluntarily put a hold on 7,500 kilograms of dried cannabis at its manufacturing facility. The cannabis placed on hold is being sampled by Health Canada to ensure that it meets regulatory standards. Despite the incident, CannTrust continuing to grow, harvest, process, and sell cannabis at its facilities and having such a large amount of inventory put on hold means that there will be product shortages.

The company has been unable to determine what financial impact this will have, but it will clearly have a short-term negative effect on CannTrust's sales and hence earnings. While this is certainly a poor development, it shouldn't deter investors from acquiring CannTrust.

It has created an opportunity to boost exposure to the emerging, global legal cannabis industry, because since its sharp sell-off, CannTrust appears attractively valued compared to its peers. The cultivator reported some solid first-quarter 2019 results, including revenue more than doubling compared to a year earlier to almost \$17 million. Gross profit shot up by an impressive 55% and net income of \$12.8 million was 12% greater than a year earlier. Those solid results came on the back of a sharp uptick in medical and wholesale cannabis sales.

Unlike other major cultivators, CannTrust's core focus is on the medical marijuana market, making it superior investment to those cultivators providing marijuana for legal recreational consumption. While it is costlier to produce medical grade cannabis, there are greater opportunities to develop and market higher margin healthcare and pharmaceutical products, which also have a wider audience than recreational consumption.

By July 2019, CannTrust estimated that it has 72,000 Canadian patients and 2,500 physicians using its products. The focus on medical marijuana will give CannTrust an advantage over its peers because the potential global market for medical products has been estimated to be worth up to US\$100 billion or around double recreational sales.

The stricter licensing as well as regulatory requirements combined with the long lead times required to get products approved and recognized by the appropriate authorities for use as pharmaceutical treatments means that it is far easier to construct a wide economic moat. That will help to protect CannTrust's market share and hence earnings once the U.S. federal government finally recognizes the benefits of legalizing the use of marijuana triggering a surge in legal cultivation.

CannTrust remains focused on expanding its operations, despite the recent compliance incident. This saw it enter an agreement to acquire 3,000 acres of farmland for cannabis production in California and purchase 81 acres of land in British Columbia to be used for outdoor cultivation. By switching to [outdoor cultivation](#), CannTrust will reduce production costs, boosting margins and earnings.

Foolish takeaway

For the reasons discussed, CannTrust ranks among the best means of gaining exposure to the burgeoning global cannabis industry, especially with its latest pullback, leaving it attractively valued and making now the time to buy.

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