Should Investors Sell This Cannabis Stock After a Health Canada Setback?

Description

It’s been a rough week for Canadian cannabis producer **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) and, of course, for its shareholders.

The Ontario-based company is the latest cannabis producer to join the list of pot companies involved in scandal. In CannTrust’s case, the company admitted before opening bell on July 8 that its Niagara greenhouse was found to be non-compliant by Health Canada. Not only that, but the company was also growing and selling cannabis out of five rooms that were unlicensed at the time but have since been fully licensed as of April.

After admitting to the findings, Health Canada placed a hold on 5,200 kilos of dried cannabis from the Niagara greenhouse until CannTrust becomes compliant with cannabis regulations. CannTrust also put a voluntary hold on 7,500 kilos of cannabis-equivalent productions (such as oils) that are held at its Vaughan facility. While both facilities remain fully licensed, Health Canada is now undergoing quality checks at both locations with results expected in the next week or so.

What does this mean for investors?

Immediately after the announcement, CannTrust’s stock tanked 17% at opening bell and was down 22% by the end of the day. Since that time, the stock has continued to plummet, with the trading price at writing at $3.64, making it a drop of 43% since before the announcement was made.

So, there are two options for investors right now: pick up a stock on the cheap or get out while you still can. If the former is going to happen, there are a few things CannTrust has to do, besides the bare minimum of complying with Canadian regulations.

First off, CEO Peter Aceto seems to have admitted that he knew this unlicensed activity was going on, stating, “We made errors in judgement, but the lessons we have learned here will serve us well moving forward.” Those “errors in judgment” have lost the trust of shareholders, therefore if the company is to truly move forward, Aceto should step down.

Next, the company will have to prove to investors that it can build back that trust and make up for the loss that is likely to happen after this announcement. The breach of regulations is likely to affect quarterly results significantly, but that won't be known until after Health Canada comes back with its report.

What next?

The main thing to note here is that this is a one-time issue, though it's absolutely a serious one. If CannTrust can convince shareholders that it's on the up and up moving forward, there should be no reason that, once things are back on track, investors can get back on board with this company.

Part of that comes down to the sheer amount of cannabis CannTrust is set up to produce in the future. The company should produce 200,000 to 300,000 kilos of cannabis per year when fully operational. That makes the 12,700 kilos currently being held at the moment look pretty insignificant, though it's more about what this non-compliance represents.

Foolish takeaway

Should you buy this stock now as the price drops? In my opinion, I'd wait it out. CannTrust will have to build its credibility, and that means proving it is compliant and able to produce the amount of pot it promised. In the short term, that means the share price could continue to go down as earnings take a hit from this news.

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