3 Ways the CannTrust (TSX:TRST) Scandal Could Play Out

Description

It's not often you see a stock lose nearly half of its value in just one week. However, for **CannTrust Holdings Inc** (TSX:TRST)(NYSE:CTST) investors, that scenario became a reality last week as the stock took a beating on news that it was producing cannabis in rooms where it wasn't yet licensed to do so.

This was followed by the news of fake walls being built to hide plants; the week ended with CannTrust announcing that it would halt sales of its products until a review was completed by Health Canada.

The soap opera is far from over, but the big question is how much lower the stock might go. Since February, the stock has lost two-thirds of its value, and investors have been eager to dump the stock as trading volumes reached more than 36 million this past week compared to less than four million in the week before, which was shortened as a result of the Canada Day holiday.

As bad as the situation looks today, it may not be all that dire.

There's more speculation than facts surrounding the company

All that we know right now is that Health Canada is reviewing the products it held back from CannTrust and that we'll get news likely later this month as to what the outcome is and any consequences that come of it. Many people have been jumping to conclusions and speculating on what may or may not happen, which has just made matters worse for the stock, as there's nothing like mass panic to send a stock into a tailspin.

The claim of fake walls from a former employee could prove devastating, but nothing has been proven at this point in time.

Possible scenarios

There are three outcomes that I can see happening at this point:

First, Health Canada may allow CannTrust to get away unscathed or with just a fine, the reason being is that CannTrust is a big producer in the industry and supply problems have already been a significant problem. It wouldn't be in the best interest for the young industry to see a major supplier taken offline.

With the company already putting corrective actions in place to improve its processes and voluntarily holding back additional product, it has demonstrated a commitment to correcting the issues. Those measures could go a long way with Health Canada and at the very least give CannTrust an opportunity to prove that it can fix the problems.

Second, the rapidly declining share price could inevitably make CannTrust an appealing acquisition target, if for no other reason than its assets. The company generated more than $45 million in sales over the past 12 months and could add a lot of value under another company.

New management could be just what it needs to turn things around and a company looking to acquire CannTrust could get it at a relatively cheap price. However, this is likely to happen after the Health Canada decision comes down and would probably be contingent on the last scenario not occurring.

The third possibility is a suspension in CannTrust's license. This is the worst-case scenario and one that would create the most uncertainty for the stock and the industry overall. Witnessing the impact CannTrust's problems have had on other stocks in the industry already would only make matters worse.

The government wants to see the industry succeed, and a license suspension could destroy the trust investors have not only in CannTrust but in other stocks as well. That would make it difficult for companies to grow and raise the capital they need and would have an adverse impact on the industry.

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