



Is it Over for CannTrust (TSX:TRST)?

Description

Cannabis cultivator **CannTrust's** (TSX:TRST)(NYSE:CTST) revelations that it had breached Canada's marijuana growing regulations and was being investigated by the regulator Health Canada caused its stock to tumble. The company is down by a whopping 46% since the start of 2019, and a recovery may be some way off, despite CannTrust moving quickly to contain the damage.

Regulatory breaches

The core issue is that Health Canada identified that the cultivator had been growing cannabis in unlicensed rooms from October 2018 to March 2019. It is also claimed that the company gave false and misleading information to Health Canada and had intentionally misled the regulator. There are rumours that the company could lose its licence as a result of the compliance breaches.

Already, Health Canada has placed a hold on 5,200 kilograms of dried cannabis inventory while the cultivator has placed a voluntary hold on the sale and shipment of all cannabis products as the regulator reviews its facilities.

Clearly, the primary impact will be on earnings, and it is difficult to determine what the financial impact will be because the investigation is in its early days, and Health Canada has not released any further information.

Another factor is that Health Canada could order costly remediation activities and issue fines for the breaches. Again, it is difficult to quantify what the cost will be in this regard.

However, the greatest concern is that Health Canada [could revoke](#) CannTrust's licence, which would effectively make the cultivator worthless because it would no longer be able to grow, process, or sell marijuana. The regulator recently revoked the licence of **Agrima Botanicals**, which was the first company to have its producer and dealer licence, making it the first Canadian producer to have its licence suspended because of unauthorized activities at its operations. The revocation of Agrima's licence appears linked to its application for creditor protection, which it claims was caused by liquidity issues triggered by the licence suspension.

It is difficult to say whether a similar outcome is in store for CannTrust, but it does appear unlikely, given its size and the fact that the issues identified could be less severe; plus, it has taken a serious approach to resolving those matters. CannTrust — aside from placing a voluntary hold on sale and shipment of its cannabis products — has appointed a special committee to investigate the breaches and manage remediation.

There are also rumours that other larger cultivators are looking to acquire CannTrust, which, with an enterprise value of around \$467 million, would be relatively easy for one of the larger players to digest. According to a report from *Bloomberg*, at least one Canadian cannabis cultivator has approached Health Canada to determine if it is amenable to another company taking control of CannTrust. There have also been discussions among other cannabis companies, but at this stage, the outcome of the investigation is too uncertain and the risks too high for other cultivators to consider acquiring CannTrust.

The outcome of the Health Canada investigation may not lead to CannTrust having its licences suspended or revoked. A remedial action plan and fines could be the result, which, when combined with the lost revenue from sales being placed on hold, will have a sharp financial impact on the cultivator but will allow it to recommence operations. It should also be remembered that the unlicensed rooms met Health Canada requirements, but it is too early to gain insight into what the ultimate result from the regulator's investigation will be.

CannTrust, with almost \$43 million in cash and short-term investments at the end of the first quarter 2019, has sufficient financial resources to fund the completion of any remediation plan and payment of fines.

Foolish takeaway

The situation at CannTrust — while alarming — is certainly not as severe as some pundits believe. For a range of reasons, it is unlikely that it the cultivator will lose its licence, but this will be a costly lesson. While the outcome is highly uncertain, it creates a [speculative opportunity](#) for risk-tolerant investors to acquire CannTrust at an attractive valuation.

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