



3 Impacts of the CannTrust (TSX:TRST) Debacle

Description

CannTrust Holdings (TSX:TRST)(NYSE:CTST) stock has been plummeting ever since it was revealed that the company sold unlicensed cannabis and circumvented regulations for selling legal marijuana. The stock has shed over three-fourths of its value since March, and it doesn't seem like the end is in sight just yet.

Reports suggest that the company was cultivating and selling unlicensed cannabis from the date of legalization to early March 2019 at a Niagara greenhouse that only received appropriate licences in April. The discovery prompted Health Canada to suspend CannTrust's licences, which means it can no longer sell the 5,200 kilos of dried cannabis it has already harvested.

Now heads are rolling. Chief executive Peter Aceto lost his job and one of the most lucrative pay packages in the marijuana industry, which included \$8.4 million in stock options. The company has also asked Chairman Eric Paul to step down. Meanwhile, top officials are offloading their stakes in the company even as prices fall.

Whether or not the company bounces back from this severe crisis is beside the point. The damage to the as-yet-nascent legal marijuana industry and the portfolios of its many stakeholders has already been done. Here are three lessons investors can walk away with.

The industry is facing a credibility issue

CannTrust isn't the only cannabis producer facing a crisis. Major producers like **Canopy Growth** and **Aphria** have faced their own challenges this year. Both companies have lost their chief executive officers under dramatic circumstances.

Allegations of overpaying for acquisitions and skirting regulations have dented the entire industry's reputation. Marijuana now faces a credibility issue, which means investors must ask themselves if their own holdings could have some nasty surprises lurking underneath the surface.

I believe investors can mitigate the risks by taking a closer look at the background and credibility of management teams. Potential conflicts, excessive compensation, or involvements in previous scandals should be immediate red flags for investors.

Investors should also focus on tangible assets that can support valuations and help companies recover from scandal. Canopy Growth, for example, has \$4.5 billion in cash on the books that can place a floor on the stock price if another crisis hits.

Prepare for tighter marijuana regulations

It seems likely that government regulators like Health Canada will turn up the heat on the industry over the foreseeable future. Production facilities and financial transactions could come under closer scrutiny. This could raise the barriers to entry for the market and increase costs for producers.

Yet again, bigger players like Canopy could benefit. Higher barriers mean less competition and more room to grow. Meanwhile, premium cannabis producers with wider margins could absorb some of the added costs of tighter regulations.

More modest valuations could be an opportunity

The ongoing chaos could finally deflate the [valuations in the cannabis sector](#). It could be argued that valuations were too high ever since the prospect of legalization was raised. Now, however, the pendulum could swing the other way and some excellent companies could start trading below intrinsic value.

Savvy investors should have no trouble finding attractive opportunities in this chaotic market.

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