



With CannTrust (TSX:TRST) Under Fire, Can Investors Trust Marijuana Stocks?

Description

This past Wednesday, battered-down **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) shares staged a major comeback, rallying 10% in the morning before cooling off later in the day. It's not clear why investors are suddenly warming up to the stock, because its regulatory problems are far from over. Possibly, investors are beginning to see TRST as a bargain, as it has become the cheapest stock in the marijuana space by far.

But between the 5,000 kg hold imposed by Health Canada and the 7,500 kg hold the company imposed on itself, CannTrust is going to have a hard time selling pot this quarter — that's without even getting in to the possibility of fines and other penalties.

This past week's rally notwithstanding, CannTrust is a toxic property, down over 50% year to date. With other marijuana stocks having followed a similar pattern, investors need to start asking themselves whether they can trust weed stocks not to collapse into oblivion. Before exploring that question, let's do a quick review of the CannTrust debacle and what it means for investors.

What the CannTrust scandal is all about

The CannTrust scandal got started when an informer tipped off Health Canada that the company had been growing pot in unlicensed rooms. After receiving the report, the agency [put a hold on 5,000 kg of the company's cannabis](#), preventing the sale of this product. In addition, the company put a voluntary hold on a further 7,500 kg of cannabis. In its most recent quarter, CannTrust harvested just 9,400 kg of weed, so with the holds in place, it's possible that the company will lose out on most of its revenue for this quarter.

If that turns out to be the case, then investors will have to brace themselves for a nasty surprise when earnings are released next month.

How it could affect other weed stocks

It's entirely possible that CannTrust's scandal could affect other marijuana stocks for three reasons.

First, it could weaken investor sentiment, leading to a selloff. Second, it could trigger a [Health Canada investigation into other producers](#), weakening sentiment even further. Third, such an investigation could potentially turn up real wrongdoing, not only hurting short-term sentiment but also threatening long-term fundamentals.

In the lead up to legalization, weed companies were under intense pressure to get their required approvals quickly, and it's totally within the realm of possibility that many other producers skirted the rules like CannTrust did. If that turns out to have been the case, then investors will have to prepare for disappointment.

The beginning of the end for weed stocks?

It's one thing to say that CannTrust is having some regulatory problems, but quite another to say that this is the beginning of the end for "Big Weed." So far, CannTrust is the only major producer facing significant grief from the regulators. The question is whether that will remain the case, and what the outcome will be if it changes. Personally, I'm staying away from weed stocks for the foreseeable future.

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