



What We Learned From the CannTrust (TSX:TRST) Scandal

Description

While cannabis stocks have not performed well since early April, the month of July was especially brutal for the sector. There is no doubt that the drama surrounding **CannTrust Holdings** (TSX:TRST)(NYSE:CRST) had a lot to do with this catastrophic performance. However, there may be a silver lining — or at least an important lesson to glean — from this scandal, one of the many that have rocked the marijuana sector in the past few months.

Reviewing the CannTrust debacle

Despite marijuana now being legal in Canada, companies that engage in the cultivation, processing, and sale of various strains of cannabis have to abide by some strict regulations. These regulations include obtaining a licence for all the marijuana-related activity a firm plans to engage in. Obviously, failure to comply with these laws can result in severe consequences. That is precisely the situation CannTrust is currently facing. A Health Canada inspection at one of the firm's Ontario facilities revealed that CannTrust grew cannabis in unlicensed rooms for months.

Although these rooms eventually received the green light necessary for cultivation, that still constitutes a violation. That wasn't the end of the matter, though, as another inspection at another facility was found to be [in transgression of several regulations](#). According to a report, CannTrust converted several rooms into storage areas and constructed two new areas in the facility without obtaining permission. Further, the company did not maintain the proper security measures in the facility and did not keep documents in such a way as to allow Health Canada to "complete its audit in a timely manner."

A warning to investors

The situation surrounding CannTrust is far from being resolved. The firm made several moves to gain the trust of investors back. Not only did the company's CEO resign — a necessary step in the process of leaving this unfortunate episode behind — but CannTrust also formed a special committee to investigate these violations. Investors are now waiting to see what sanctions will be imposed on the company.

This is yet another reminder that the stringent marijuana regulations will be an obstacle moving forward — something investors have to constantly keep in mind. Take our neighbors to the south for instance. The marijuana market in the U.S. will likely be exponentially larger than that of Canada. But the laws in the U.S. are even more complicated.

Many local and state governments have legalized medical or recreational uses of marijuana, but the federal government still considers it a schedule one substance. As a result, it is illegal to transport marijuana across state lines, which puts added pressure on companies to grow the necessary products they need within a particular state. Of course, the passage of the Farm Bill at the end of last year was a big deal. Hemp and hemp-derived products are now legal in the U.S. However, even this market is heavily regulated, as **Curaleaf Holdings** [recently found out](#). Investors looking to jump on the cannabis bandwagon have to price this important factor into their valuation of cannabis stocks.

The bottom line

Just a few months ago, CannTrust seemed like an excellent prospect due to its ability to grow marijuana at very low costs (among other things). Shareholders couldn't have predicted this drama would befall the firm, and they now have to deal with the aftermath. Even if a cannabis company isn't directly caught in such a scandal, it could still be negatively affected if one of its peers is. In short, it is essential to proceed within the cannabis industry with extreme caution.

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