



Why CannTrust Holdings's (TSX:TRST) Stock Price Fell 19.9% in August

Description

Crisis-stricken cannabis stock **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) continued to tumble a further 19.86% during the month of August, as new “incriminating” details in the latest and probably biggest marijuana industry scandal emerged during the past month.

Since the July exposure of illegal growing of cannabis in unlicensed rooms and the voluntary hold on 7,500 kilograms of marijuana after a 5,200 kilogram hold by Health Canada, the subsequent halt of sales and the ouster of a complicit founding CEO and the company's board chair in July, worse news emerged during the past month.

More bad news in August

The company warned that it will miss its August 14th reporting deadline for Q2 2019 results ended June 30 and applied for a management cease-trade order from the Ontario Securities Commission, which was granted.

The company is uncertain about its inventory, biological assets' valuation, and revenue recognition for the quarter ended June 30, as this will depend on Health Canada's ruling, but it estimates the value of inventory affected at \$51 million, or 53% of inventory, and the approximately 30% of biological assets could be written off.

To rub salt into an already messy wound, the company's independent external auditor KPMG revoked its audit report on the company's financial year results ended December 31, 2018, saying the report can no longer be relied upon. Audit reports are material endorsements of truthfulness of financial results, and the last financial statements from the company could have had some material misreporting.

Actually, the company will likely restate its financial reports for 2018 and for the first quarter of this year in light of new information a recently set up special committee is gathering.

The uncertainty on CannTrust Holdings stock is too high. Health Canada's exercise of its regulatory

powers will significantly determine the company's operational future and financial condition.

Further, new details emerged on the 12th that the company's second facility was non-compliant, too. Some operational areas were converted to storage areas without regulatory approval, and new storage facilities were constructed without the regulator's knowledge. The company wantonly ignored regulations in several respects, including sub-standard quality assurance.

News would also be released on the 15th that there could be a potential delisting of the company's securities from the New York Stock Exchange, a major world equities market.

The filed financial statements for 2018 are no longer recognizable and the U.S.-based exchange expects the company to file "proper" results. Yet the company requires the all-important Health Canada ruling, which shall determine the extent of the restatement ... yet the regulatory body is taking its time to mete out punishment.

The Ontario Cannabis Store then returned some \$2.9 million worth of product as it was non-conforming with the master supply agreement as it "did not comply with applicable law." This was the latest information from the company on the 19th.

There could be further sales returns and wide product recalls. Halted sales for this quarter are damaging, and product recalls could bring the company to its knees, and it's all up to Health Canada to make the call.

All reasons for holding shares in anticipation for a softer regulatory punishment are increasing becoming weaker with each passing day and the risk of astronomical contingent liabilities may be too much for any strategic buyer.

Foolish bottom line

The new details that emerged in August point to a stiffer penalty and increased chances for an operating licence loss at CannTrust Holdings, and it's becoming increasingly harder for a contrarian [buy-the-deep call](#) on this troubled cannabis play.

Criminal charges could be levied on some principals, investor lawsuits seem to have a winning chance, yet a licence loss could mean that valuation comes down to the company's net assets, and this is scaring investors with average risk-tolerance thresholds away from the ticker.

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