



## Can Cannabis Stocks Withstand the Next Recession?

### Description

Cannabis stocks haven't yet witnessed the test of a significant recession, but industry attributes point to a high potential for defensiveness and resilience during economic downturns. However, this is yet to be proven, as the new industry started reporting significant sales numbers during the recent stable growth periods.

The consumer benefits from psychoactive cannabis could be likened to the wise waters of alcohol and beer, enabling buyers to drown their sorrows and potentially escape the reality of a troubling recession; pot sales could thus potential surge during economic downturns.

Most noteworthy, marijuana was licensed and marketed first as a pharmaceutical product, and it could be argued that medical drugs manufacturers don't get punished much during times of financial distress when individuals cut back expenditures on non-essentials.

Health budgets are largely inelastic, and we could see firms with strong medical cannabis patient portfolios and an unwavering focus to this segment actually thriving in a distressed economy.

Valuations aside, it's possible that the pot industry could outperform other sections of the Canadian economy and continue to register strong sequential quarterly sales growth when other industries record slowing earnings growth numbers in a recession.

One [small-cap play](#) on spotlight could be a hot **Fire & Flower Holdings** ([TSX:FAF](#)), a fast-growing pot retailer with very ambitious growth plans over the next eight to 10 quarters after recently clinching a financing deal with international retail giant **Alimentation Couche-Tard**.

The company recently reported an impressive fiscal second-quarter report for the 13 weeks to August 3, 2019 (it has very weird quarter-end dates), revealing plans to expand its retail footprint six-fold from 22 locations in August 2019 to 135 locations by the end of fiscal year 2021.

If a recession were to happen during this time frame, FAF could be announcing better growth numbers when everyone else will be tightening their belts; its association with Couche-Tard could enable the small but promising growth stock to invade new international territories.

Arguments have been made that slower than anticipated growth in cannabis sales in Canada could actually be linked to less than desirable retail store presence that could have allowed the illegal pot market to hold on to a significant market share. An explosion in marijuana store fronts at convenient locations could change that situation quickly.

That said, not all marijuana stocks are created equal, and some will be more valuable than others during periods of economic decline. Those with a higher medical sales component, those with a significant direct retail presence in highly populated provinces, and those with significant international operations could fare better than others.

This brings the industry's aggressive giant **Aurora Cannabis** ([TSX:ACB](#))(NYSE:ACB) into the discussion.

**Aurora** has been growing its medical cannabis portfolio when its closest competitor, **Canopy Growth**, has been reporting negative growth in its medical portfolio. The company could benefit from spoils from embattled **CannTrust Holdings'** once resilient medical patient portfolio, while its cost to grow pot has been declining sequentially thanks to low cost production technologies at its flagship facility and some economies of scale realized.

International sales have shown strong signs of growth, while a local production tender win in Germany could help sustain exponential top-line growth and enhance revenue diversification at a time when the company is targeting operational profitability. The company could thus sustain double-digit growth rates even if a recession happens over the next two to three years.

Moreover, the other advantage that Canadian marijuana players may enjoy is the opening up of a new edibles market in December that could add some *oomph* to the explosive growth story.

## Foolish takeaway

Although medicines will still need be bought under all economic scenarios, and even if it's possible that retail consumers may actually demand more cannabis high moments during times of economic distress, valuations do not necessarily follow the same narrative.

Massive growth expectations are already factored into pot stocks, and a broad market flight away from high-risk assets like marijuana equities amid recession fears may result in depressed share prices during economic downturns.

I wouldn't buy these names for recession proofing an investment portfolio at this time.

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