What Canopy Growth Corp. Investors Can Take Away From Warren Buffett's Annual Letter

Description

Recently, Warren Buffett released his annual letter to the shareholders of **Berkshire Hathaway Inc.** These letters offer an incredible amount of wisdom and insight from the Oracle of Omaha, and there was one particular topic from this year's edition that should resonate with **Canopy Growth Corp.** (TSX:WEED) investors: share-based acquisitions.

Buffett laments over share-based acquisitions

Buffett begins by lamenting over two of his rare duds: his purchase of **Dexter Shoes** and **General Reinsurance**. But it's not just the heavy losses borne by these investments that Buffett was so critical about; rather, he was critical of the fact that he used Berkshire Hathaway shares to fund them.

When Buffett bought the now defunct Dexter Shoes for $434 million in 1993, he issued 25,203 BKB.A shares to pay for the purchase. Now those shares are worth nearly $6.5 billion, by Buffett's own admission, 1.6% of a fantastic company was given up to buy a worthless business with zero competitive advantages.

Now, in the case of General Reinsurance, Berkshire fared much better; currently, "General Re" is still around and providing Berkshire with a stable cash float. However, when it was first purchased, Berkshire's total shares outstanding increased by 21.8% to pay for the acquisition. Moreover, following the buyout, General Re's operating earnings dropped to $151 million from $250 million in the wake of the 9/11 attacks.

There are, of course, clear parallels that can be drawn from Warren Buffet's experiences and Canopy. For example, Canopy is nowhere near profitable and has continued to issue shares to make further acquisitions. Of course, this raises the question of how much of a great company like Canopy are shareholders willing to give up for the occasional dud.

After all, even if someone as highly regarded as Warren Buffett, who only goes after stable, cash-generating enterprises, is not immune to underperformance, who is to say Canopy might not stumble on a speed bump or two in this still very nascent industry?

And, as a matter of fact, some of those speed bumps have already begun to show themselves. Canopy's last earnings report saw a write-down of $800, 000 in the wake of its Mettrum acquisition following a high-profile recall of pesticide-tainted plants. Moreover, supply-chain issues continue to plague Mettrum, which contributed to less than 10% of Canopy's inventory being available for sale in the last quarter.

Do these latest developments mean that we should write off Canopy completely? Absolutely not; Canopy (and its 50,000 patients) is still the best overall bet for the legalized marijuana market in Canada. However, investors, current and prospective, must be willing to ask how much dilution they are willing to put up with in Canopy's bid for dominance.

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