If Warren Buffett Were Going to Buy 1 Marijuana Stock, it Would Be Aphria Inc.

Description

Warren Buffett is well known as the most successful investor of all time. Buffett spent his formative years under the tutelage of Benjamin Graham, who is known today as the "father of value investing."

Graham had seven criteria when considering a stock for purchase. Let's review them and see whether or not **Aphria Inc.** (TSX:APH) passes the test.

Criteria #1: Highly rated companies

Graham suggested that investors review the rating agencies' recommendations before making a purchase in an equity security. This helped to "weed out" companies that had too much debt in their capital structure or faced liquidity issues.

As of Aphria's most recent quarterly filing, it had cash balances of $122 million versus debt of only $9 million. Clearly, solvency is not an issue for this company.

Result: PASS

Criteria #2: Current assets-to-total-debt ratio > 1.10

Here we are looking at the ratio of a company's current assets to total debt.

Aphria easily passes this test as well, holding current asset balances of $129 million compared to debt of $9 million, meaning the company could pay off all of its outstanding maturities tomorrow if it wanted to.

Result: PASS

Criteria #3: Current ratio

Graham wanted to see a current ratio of 1.50 times or more to give the company a buffer in terms of its short-term liquidity.

If you're starting to catch on, good. Aphria easily passes this test as well with a current ratio of 21.5 — well above Graham's threshold.

Result: PASS

Criteria #4: Positive earnings per share

The key here is to avoid companies that are persistently operating in the red.

Unlike virtually every other marijuana company in the market today, Aphria is already profitable, having posted five consecutive quarters of net profits with a positive trend of earnings growth over that span.

If there is one element that makes Aphria stand out among its peers in the market today, this is it.

Result: PASS

Criteria #5: P/E ratio less than 22 times

Graham wanted to only buy securities that had an earnings yield that was at least twice as great as a AAA-rated bond. Today, a U.S. 10-year Treasury yields 2.20%, meaning Graham would only consider those stocks with P/E ratios under 22 times.

Aphria's forward P/E is 25 times, meaning it just misses the cut. But keep in mind that Aphria operates within a rapidly growing segment of the market, so this "sight miss" should be taken with a grain of salt.

Result: FAIL (barely)

Criteria #6: Price-to-book ratio < 1.20

Graham felt that a conservative investor should not pay much more for a security than the book value of its equity.

Aphria today has a price-to-book ratio of 3.9 times, so it clearly fails this test.

However, keep in mind that Aphria's book value grew by 6.75 times over the past year alone. While Graham's rule is well intended as a conservative one, it fails to account for companies growing at Aphria's current pace.

Result: FAIL

Criteria #7: Invest in companies that pay a dividend

Aphria fails this test as well as the company does not currently pay a dividend.

But keep in mind that most companies that do pay dividends are mature companies with limited growth prospects. A company like Aphria is probably better served by reinvesting its profits in the business to grow shareholder's wealth over the long term.

Result: FAIL

Conclusion

Aphria passes four of the seven criteria Benjamin Graham would use to screen stocks when he was investing, which is far better than most marijuana companies today.

While the company fails to meet three of the seven criteria, these are easily accounted for given that the company is still in its infant stages.

It’s also important to note that Warren Buffett usurped Graham as the most successful investor of all time by taking a more open-minded approach to investing than his mentor and making room in his criteria for more growth-oriented businesses.

Thinking outside the box can often pay dividends for investors, and so even the great Warren Buffett may suggest you keep room in your portfolio for Aphria Inc.

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