

Would Warren Buffett Buy Marijuana Stocks?

Description

Warren Buffett is the most renowned investor of all time. Widely known as “the Oracle of Omaha,” his reputation for prescience and sound stock analysis precedes him. Over the years, Buffett has made billions making contrarian investments through his holding company, **Berkshire Hathaway**. It just so happens that the Oracle of Omaha tends to be less than enthusiastic about trendy investments, be they tech stocks, cryptocurrency, or hedge funds.

Enter cannabis stocks. Cannabis stocks are 2018’s trendy investment du jour. After the [collapse of cryptocurrency](#) earlier this year, investors seeking a quick buck began looking for greener pastures. With legalization set to sweep the nation, cannabis looked like the place to go. Indeed, investors who bought ahead of legalization fared well—assuming they sold before October 17.

Since then, things have not gone so well for cannabis stocks. Shortly after legalization hit, the sector went on a massive downswing that saw some of them lose as much as 48% of their value. Nonetheless, the hype train has not died down entirely. The persistent popularity of cannabis stocks raises the question of whether they may outgrow their former niche as 2018’s flavour of the week sector to become reliable long-term investments. And what better authority to consult than Buffett, the king of long-term investing?

Although Buffett has been reticent to comment on cannabis stocks, the consistency of his investing philosophy means that we can surmise what he might say. We can start with cash flow.

Free cash flow

When Buffett analyses a stock, he thinks of it as a piece of a company. So, he considers a good stock to be one that can generate cash flow for investors for the foreseeable future. Buffett specifically prefers the metric of free cash flow, which means cash from operating activities minus capital expenditures (although the specific formula varies).

By this metric, most cannabis stocks aren’t winners. Many of the sector’s darlings, such as **Canopy Growth Corp** ([TSX:WEED](#))(NYSE:CGC) and **Tilray Inc** ([NASDAQ:TLRY](#)) are not profitable in net income terms, let alone by a stricter standard like free cash flow. Nevertheless, Buffett is known to make exceptions for so-so businesses if they’re priced low. Do any cannabis stocks meet this test?

Price

The vast majority of cannabis stocks are priced high relative to earnings or, in the case of cannabis stocks with no GAAP earnings to speak of, sales. **CannTrust Holdings Inc** (TSX:TRST) is the one pot stock that has been able to generate positive net and operating income in recent years. Unfortunately, it’s priced high, as its trailing P/E ratio sits at about 45. The company’s earnings are also down, which

calls into question whether that high P/E ratio is justified.

Growth

One final factor that could make cannabis stocks Buffett worthy is growth. Although Buffett is not known for growth investing, it's possible that enough growth could bring a cannabis stock to the point where it finally meets Buffett's test. Unfortunately, it looks like the cannabis giants are [growing their expenses](#) even more than they're growing earnings, so that's out.

While we'd have to wait for the Oracle himself to weigh in to know for sure, my guess is that Warren Buffett doesn't much like cannabis stocks.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:CGC (Canopy Growth)
2. NASDAQ:TLRY (Tilray)
3. TSX:WEED (Canopy Growth)

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