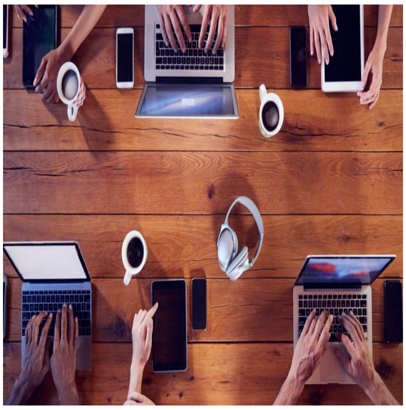

Learn From Buffett's Mistakes and Invest in Tech

Description

Warren Buffett has been in the investing world for more than 65 years. He has seen many recessions and revolutions and profited from them. However, the billionaire investor didn't gain from the COVID-19 crisis. Instead of buying stocks amid the pandemic, when the market was fearful, he sold many shares for a loss. Hence, **Berkshire Hathaway** stock fell 11% year to date (YTD), underperforming the **S&P 500 Index** and **NASDAQ-100 index**.

Stock Returns	**YTD**	**2015-2019**	**2010-2020**
Berkshire Hathaway Class A	-11.30%	51.10%	505.80%
S&P 500 Index	-1.50%	58.20%	122%
NASDAQ-100	10.00%	106%	139.30%

Even in the pre-pandemic time between 2015 and 2019, Berkshire Hathaway stock rose 51%, underperforming the tech-heavy NASDAQ-100 index, which rose 106%. He always shied away from investing in tech stocks, which kept Berkshire Hathaway away from two of the three tech companies, which reached trillion-dollar market caps — **Microsoft** and **Amazon**. As of today, Berkshire's most profitable investment is the third trillion-dollar company **Apple**.

He realized this mistake and purchased $861 million worth of Amazon shares last year. He also admitted missing out on investing in Google, even though his auto insurance company Geico was a customer of Google ads.

Investing in tech stocks

It is not too late to learn from Buffett's mistakes. The world is in the technology revolution, and missing out on tech stocks can cost you thousands of dollars in lost opportunities. The pandemic has highlighted the growing dependence on technology from the cloud to gaming to online streaming to video conferencing to e-commerce.

In the Canadian market, e-commerce platform **Shopify** (TSX:SHOP)(NYSE:SHOP) has become the poster child of digitization growing as high as 120% this year. Many analysts termed the stock as the next Amazon. However, don't blindly jump into the stock without knowing its fundamentals and future growth opportunity.

What do Shopify's fundamentals say about its future growth?

The fundamentals of software companies are different from traditional companies. It is not a capital-intensive business because software companies have low leverage. But low capital requirement reduces entry barriers, thereby increasing competition. A software service model earns from economies of scale, repeat subscriptions, and upsell and cross-sell to existing customers.

Unlike other stocks that are valued based on earnings, software stocks are valued based on revenue growth rate and cash flows. A software stock grows exponentially during its hyper-growth stage, as it invests a lot in acquiring new customers. If it succeeds in retaining most of these customers, the marketing cost converts into years of recurring revenue.

Shopify is currently in the hyper-growth stage, with quarterly sales growing above 45% YoY (year over year). It is spending more than 65% of its revenue on operating expenses, and because of which, it is not yet generating profits. One good thing about Shopify is that it has no debt and more than $2 million in cash reserve. The stock is trading at 66.5 times its sales, which is way above its rival **Square's** valuation of 8.2.

Shopify has a robust financial position and growth potential. But it has still not achieved the economies of scale, which can make it profitable. Investors have already priced the stock for the next 10 years, thereby making it a risky investment at the current price.

Is Enghouse Systems a good tech buy?

A better investment is **Enghouse Systems** (TSX:ENGH), which earns revenue by acquiring small software companies. It targets companies operating in niche markets with limited competition, earning healthy recurring revenue. This way, it mitigates the most significant risk of competition and accelerates the strength of recurring revenue.

Software companies have low overhead costs, which help them turn profitable once they have a large customer base. Enghouse has achieved the scale where it has not only become profitable but is steadily increasing its margins. It improved its adjusted EBITDA margin from 25% in fiscal 2016 to 30% in fiscal 2019. It has more than $167 million in net cash, which it can reinvest in purchasing new companies. The stock is currently trading at 48 times its earnings, which is lower than its peer **Constellation Software's** valuation of 96.

Foolish takeaway

As Warren Buffett says, don't invest in a stock you do not want to hold for 10 years. Enghouse can generate 1,000% returns in 10 years by steadily increasing its revenue and profit margins. Shopify is also a good stock at its pre-pandemic price of around $500.

CATEGORY

1. Investing
2. Tech Stocks

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Author
pujatayal