The Wrap Up

Earnings Miss, So I Dub Thee Unforgiven

Earnings, earnings, earnings; that's our week in a nutshell. It's been an interesting set of days which saw many companies we own and follow report their quarterly results and set their guidance for the quarter ahead. We haven't yet had the opportunity to pour through all the information, as there are simply too many companies that reported in a short span time, however, it is our commitment that we will review every single result in great detail. This week, we look at the nuances of quarterly earnings.

Over the past 40 years, the market has evolved to become more sensitive to quarterly reporting. It can be argued that this has forced executives to take a short-term view in their decision making and to some extent, we would agree. That being said, there are many companies who eschew this approach and stay focused and committed to their long-term vision. Look no further than Amazon as the prime example of a company executing its long-term vision rather than pleasing analysts. The company share price has suffered over the last three years as result; the stock is flat after having pursued an overly aggressive expansion strategy throughout the pandemic. Yesterday's quarterly results posted surprise profits, showed some cost discipline, and reminded us more of the Amazon whose stock is up 2600% over the last 15 years.

Each earnings narrative is unique to the company's reporting; some are more sensitive to gross margins, some to free cash flow generation and others to outright growth forecasts – it really depends on the ongoing narrative around the company. Solar micro inverter firm Enphase was punished with a 25% share price drop after beating first quarter expectations on margins, revenue and profit growth but forecasting second quarter results below expectations. . While most companies would dream of a 35%

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year over year growth rate, the expectations for this company were slightly higher. All the more surprising is that the company's earnings multiple has already come down to reflect a slowing (but still elevated) growth rate. This reaction is a reminder of how some company's earnings are seen as proxies of the future; companies whose value is derived because of future growth expectations are more sensitive in times of lower market confidence.

Confidence levels fluctuate greatly from company to company and quarter to quarter; this market is rewarding companies seen as sure bets with higher-than-normal earnings multiples. McDonald's, a company whose earnings per share have a sub 10% growth rate, trade at earnings multiples higher than the faster growing Alphabet, Broadcom and Caterpillar. What McDonald's was able to show this quarter was that it can pass along its higher costs to customers without any major consequence to demand: their gross margins hit 56% (up from 38% a decade ago) with profit margins up to 29.36% (compared to 19.8% in 2013). You can see why market participants are willing to pay more to own the company. Especially if we are to head into a recession, it is likely that McDonald's will see smaller earnings fluctuations than other companies (we believe that the premium price paid for the stock today leaves little upside for the future, however).

Sometimes, we find ourselves with companies which are able to achieve the perfect blend of quarterly outperformance and long-term earnings growth. Yes, we are talking about Microsoft. The 2.2 trillion-dollar company was rewarded with a more than 10% rise in share price this week (bringing the annual total to 27%) after topping earnings and revenue expectations. The company's cloud division keeps outperforming while growing faster than expected despite the difficult macro environment. Investors today take for granted the opportunity that exists in cloud. It is worth remembering that CEO Satya Nadella was promoted from his role as Microsoft's executive vice president of cloud in 2014, it therefore seems to be no coincidence that, 9 years later, the cloud division is contributing to earnings beats. Not only is Microsoft exceeding quarterly expectations; it is laying the groundwork for the future with big initiatives in AI (its 11 billion investment in Open AI and the integration of AI into its Bing search engine) and gaming (its attempted $69B purchase of Activision Blizzard, which took a blow this week). The company pursues shareholder friendly policies, consistently returning more than $40B per year in the form of buybacks and dividends and does so without sacrificing its long-term vision, having spent $84B on capital expenditures and $35B on acquisitions over the last four years. These figures are in comparison to Apple which spends more than $110B per year in buybacks and dividends but has only spent $39B in capex and less than $2B in acquisitions over the same four-year span (Apple shares are outperforming Microsoft this year despite growing at half the rate and reinvesting at a significantly slower pace).

Over the next few weeks, we will be busy pouring through the data, the earnings call transcripts and revised analysts estimates, where we will continue to formulate and refine our opinions and views about the companies that we invest in.

Healthy Distraction
We are happy LinkedIn provides us with analytics regarding these weekly Wrap-Up posts. We are averaging close to 1500 impressions while the articles are being read over 400 times weekly. First, we say thank you to our readers! Second, to quote Mark Hanna as played by Matthew McConaughey in *The Wolf of Wall Street*: 'those are rookie numbers, we need to pump those numbers up!"

Over 50% of our readers are finance professionals. We in Canada work hard to be included in the category of and to remain finance professionals. We have continuous education requirements; we learn the hard way through good and bad experiences, we have mentors and leaders that challenge and guide us, we have clients with whom we build trust over several years, all this as we try to find our niche and climb the echelons of the financial world. Although our work is laborious and stringent, we feel fortunate to find ourselves in an environment that promotes growth and success. With success comes the responsibility to give back or to 'pay it forward'.
Aside from reading our weekly posts, which puts a smile on our faces, how do you pay it forward?

How the team gives back

Leon: I like my 1L of coffee in the mornings and once a week I pay for the drive thru order behind me. Sometimes it's a $2 coffee and sometimes, when I'm lucky, it's breakfast for 4. Also, I was inspired by David to start a scholarship fund with my wife.

David: I give back to the world by talking less (lol). As Leon mentioned, my wife and I have a scholarship with Concordia University. We are also very keen on mentorship: I spend a lot of time speaking with finance students and aspiring finance professionals and try to provide life and career guidance. For anyone reading this, I invite you to reach out if you are looking for advice.

Myles: Though I firmly believe that charity and giving back should remain anonymous, in the spirit of this week's Healthy Distraction and to perhaps inspire others to do the same, I donate monthly to (currently) three charities that invest in or focus on: the education of First Nations, Inuit and Métis people in Canada; environmental law; and female education and empowerment in Africa.

Have a great weekend!