Bird’s Eye View: Capital Allocation Analysis

All right, folks. Welcome to Investing for Beginners podcast. Today we're going to do a bird's eye view. We're going to do a.

00:00:38 Dave

Bird’s eye.

00:00:38 Dave

View of understanding capital allocation from an investor's point of view. So those of you unfamiliar with this capital allocation is job number one. For a CEO, this is where the rubber really meets the road.

00:00:53 Dave

And in a lot of cases, if capital allocation is done poorly, you don’t get a good return.

00:00:58 Dave

For investment, and this is not something that gets talked a whole lot about. But today we're going to kind of open your eyes to some good and some bad and maybe some ways you can look for some good or bad and some other companies that maybe might surprise you in regards to capital allocation. So Andrew, do you want to?

00:01:18 Dave

Kind of let everybody know, like, let's talk about cap allocation for Micah, a 30,000 foot view. What is it exactly?

00:01:26 Andrew

Yeah, I’d love to try and make it as simple as possible and not too simple. Business makes profits. Capital allocation is what is the CEO going to do with those profits? And so I think one of the reasons why capital allocation doesn’t get a lot of airplay, if you will, is.

00:01:47 Andrew

They are sowing the seeds of cap allocation and you don't see the results of that sometimes for years and years and years later, so you know.

00:01:56 Andrew

A business's success today could have those seeds of success could have been sown five years ago, and the same token.

00:02:04 Andrew

Wasting wasting capital might not show up now because the business is still growing and profitable. But when that grow.

00:02:12 Andrew

With Driver runs out and there was no good cap allocation done when they had the profits, that's when you can see the issue. So it is, it is hard to evaluate really because you don't see good the capital allocation until you're looking in the rearview mirror and that can make it really difficult to try to analyze, right.

00:02:32 Dave

Very hard and a lot of times you don't see it until you actually look for it. Sometimes it's happening.

00:02:39 Dave

Kind of under not underneath your nose, but it's happening in the background and it doesn't yield like you said, doesn't get a lot of airplay, maybe because sometimes it's happening so effortlessly. For a company that it's just taken for granted. And so it doesn't get a lot of discussion until it goes wrong or until something happens that.

00:02:59 Dave

Upsets the app.

00:03:00 Dave

Cart and people get upset about it. I think a perfect example is in today's world we are recording in the early part of August 2024 and there's lots of conversation right now about AI and CapEx spend for the hyperscalers and that has gotten.

00:03:20 Dave

Some investors spooked other ones are super bullish about it, so it's it's a bit of a controversy, but it's upset the apple cart. And so that's why it's in the news, if you will.

00:03:31 Andrew

So how would you summarize the different options that the CEO has for capital allocation?

00:03:38 Dave

Well, they're typically you could throw out five that companies can do. The first two are more related to giving back to the shareholders. Those would be dividends and the other one would be share buybacks.

00:03:53 Dave

So both of those are more shareholder friendly and then you have the the options of reinvesting in the business. You also have the ability to pay down any debt that you've accumulated.

00:04:06 Dave

You know, or you can just actually just sit on the money. You can just store it up for a rainy day, so to speak, kind of like Buffett does. So those are really the five choices that they have. Do you have any thoughts on on those? Like, what do you think are like the most important? Or does it depend?

00:04:23 Andrew

Yeah, all of them. I think reinvesting in the business is a good place to start. So once because you mentioned the hyperscalers.

00:04:30 Andrew

And.

00:04:31 Andrew

All the AI investment they're doing for.

00:04:34 Andrew

A lot of the big tech is reinvestments in their business. So what are the different types of reinvestments in the business and how are the cloud hyperscalers doing it right now?

00:04:43 Andrew

Is a good.

00:04:43 Dave

Example, it kind of depends on what the business is. They each company may have different opportunities to reinvest in a business. So for example, let's take a.

00:04:44

Hey.

00:04:54 Dave

The wall.

00:04:54 Dave

Art they a reinvestment for them. It may be tech related, it may be infrastructure related maybe improving their delivery systems or their inventory systems. It could also be buying inventory. So as they get closer to the holiday season for example, they may double down and buy more TV's for example, and have those in inventories.

00:05:14 Dave

And that for them is a reinvestment, because they're going to turn around and sell that for a profit, whereas a company like Microsoft.

00:05:22 Dave

They have several ways to reinvest. One is through the CapEx and the other one is through R&D. So they spend money for engineers and other smart people to build more fancy shiny stuff for the sales people at.

00:05:37 Dave

Microsoft to sell, but then they also have, as we mentioned the CapEx spend. So the capital expenditures that they're spending money on basically it's a land grab right now. And so all the big hyperscalers that are really focusing on AI, which is Google, Amazon and Microsoft, they are spending.

00:05:56 Dave

Oodles and oodles. I should mention meta, too. They're spending oodles and oodles and oodles of money, billions on buying land and starting to build data centers so that they can have more compute to compete in the AI space. And so that to them is an investment. And to Andrew's point.

00:06:17 Dave

With that particular investment, there's a chance they may not see a payoff for that spend for 2-3 five years down the.

00:06:25 Dave

Code and that's where some of the consternation comes into play. So you're spending, you know, 20 thirty $50 billion on these things, and you're not going to get a return for many, many years. And so that causes people to go well. Is that the right thing to do or not? So I guess those are some options. Do you have other options you want to throw out there?

00:06:45 Andrew

Sure, company can go through M&A mergers and acquisitions, so they can.

00:06:52 Andrew

Scoop up companies that can be.

00:06:55 Andrew

Unrelated businesses like a Berkshire Hathaway, Warren Buffett's company he bought GEICO outright and turned around and bought Dexter shoes. And you know, he's all over the economy buying this business and that business. Or it could be something that's more complementary, like going back to the big cloud.

00:07:16 Andrew

Alphabet owns Google, and they also bought YouTube at a certain point, and so.

00:07:22 Andrew

You know, not directly.

00:07:25 Andrew

Related to Google, but pretty similar similar core competencies, so you can see a lot of different types of acquisitions. Some of them work actually. Interestingly you had done a blog posts I think 3-4 years ago where you looked at some of the data behind MA and found that majority of them actually don't work out.

00:07:47 Andrew

In the sense that they the financial returns from the company make.

00:07:52 Andrew

I mean putting out that money and making the the acquisition doesn't actually make value for shareholders. And so that's, you know, that's something to be careful with, but of course.

00:08:04 Andrew

The CEO's who have done that for decades and have shown the track record that they know how to make good acquisitions, they tend to do better than.

00:08:16 Andrew

Maybe a company who is getting desperate for growth and so they out overreach and and try to buy the biggest thing they can find to cover up the bleeding nature of their current business. So you want to stay away from the latter and maybe look for more of the former if you're looking for businesses that are growing, reinvesting in their business in that way.

00:08:36 Dave

Right, yeah.

00:08:37 Dave

Exactly. The air cooled serial acquirers. You know, a company like Danaher or Thermo Fisher or Constellation Software that they've built, the infrastructure and the systems and the, I guess the culture to integrate other companies into their business is part of their business plan. And they're really good at it.

00:08:59 Dave

But then there's other ones that maybe are more ego driven, where the CEO decides that, hey, I want to buy this because I want to and they don't really have a plan or a I guess a a system to.

00:09:12 Dave

Integrate the systems and the culture and the employees of the other company and a lot of times can fail and and history is littered with you know, the dead carcasses of companies and CEO's that have tried to grow in that way. And yeah, the the study that I read, it was from McKinsey. And they said if I remember.

00:09:33 Dave

Right. I think it was upwards of 75% of acquisitions generate value for the seller, not the buyer. So the people you know, so if I'm selling a company to Andrew's, chances are he's not going to get as much value out of it as I.

00:09:50 Dave

AM and so.

00:09:51 Dave

The sellers are all about it, of course, but the buyers?

00:09:54 Dave

They got to be careful, you know. Beware. You know, when you see your company starting to buy other companies a lot of times that doesn't end well. And so it could be a very, very poor use of of allocation of capital for.

00:10:11 Andrew

Hey, don't forget about the investment bankers. They they have free value as well as helping broker the deal.

00:10:13 Dave

Oh yeah.

00:10:15 Dave

Yeah, yeah, yeah, they do. Yeah, they.

00:10:17 Dave

They make lots of money from all their fees and whatnot. That's a big reason why they're probably not a big fan of of Warren Buffett because he's infamous for buying companies on a handshake. And so there isn't a lot of need for, you know, lawyers and investment bankers when you're doing it that way. That's the exception more than.

00:10:33 Dave

The rule for sure.

00:10:35 Andrew

Then we like have a phone call within 5 minutes, he said. We have a deal or something like that.

00:10:40 Dave

Yes, yeah, yeah.

00:10:41 Andrew

Call them up.

00:10:43 Dave

All of that? Yeah, it's crazy. You know, the. But you know, when you got a big checkbook and you know, reputation for integrity, I think it's probably a lot easier to do that than other ways.

00:10:54 Andrew

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00:11:05 Dave

So why is capital allocation so important? And then I guess, why do?

00:11:12 Dave

A lot of CEO's kind of fall down in this.

00:11:17 Andrew

Ohh yeah, that's tough.

00:11:20 Andrew

Like you said, it's it's critically important because over the long term that's really where the shareholders returns are going to come from. If you do capital allocation well, you're going to drive responsible growth for the shareholders and for the.

00:11:35 Andrew

Because if you don't do it well, you might have growth, but it might come at the expense of shareholders or the expense of the business itself. So I'll give you 2 examples if it's at the expense of the business itself, maybe sure, we grew you know 25% a year, but now we have 4 times more debt than we did.

00:11:56 Andrew

Five years ago. That's yeah. You have to go up. But it's at the expense of business. Another way you can do at the expense of shareholders is.

00:12:03 Andrew

This. Hey, we did this great big merger and we doubled the size of our company, but we also used share. You know, we diluted the shares. So now sorry shareholders, you only own 1/8 of what you used to own again didn't really give us a lot. So it came at the expense of something else and that's where it can get where it can go wrong.

00:12:23 Andrew

As far as like why or how it happens?

00:12:25

Yes.

00:12:26 Andrew

I wish I could tell you I think.

00:12:27 Dave

I I know I know about it. I know what Buffett says. If.

00:12:32 Dave

You want.

00:12:32 Dave

OK, sure that I would love that. So I've been reading through his annual meeting transcripts, so some white person decided to record all those starting in, I think 1995. And so you can read through all the transcripts and it's not short. So a lot of pages, but there's a lot of Nuggets in there and.

00:12:52 Dave

Somebody asked him about capital allocation a few days ago on one of the.

00:12:56 Dave

Sessions I was.

00:12:56 Dave

Reading and basically what he said was that.

00:13:00 Speaker 1

That.

00:13:01 Dave

The reason why many CEO's are very bad at it is because they're not. They aren't on it, and it isn't a lot of times isn't intuitive, and so they are. If you think about most CEO's of the company, they're usually really good at something else. So they they rise up in the company through.

00:13:21 Dave

The greatest sales, or their greatest operations, or they're a tech whiz. And so they have all this background and all those things that made them very successful and then they get into the position of being in charge of the company. And now they're told you got billions, you got to spend.

00:13:38 Dave

And they don't know how to do it because they've they never done it and B they don't have. They haven't had somebody to teach them how to do it, and it isn't a lot of times intuitive. And Buffett said that, you know, he above all is a businessman who also invests. And so because he's good at one also.

00:13:58 Dave

Helps them be good at.

00:14:00 Dave

The other and a lot of times CEO's don't get that kind of upbringing in training, and so unless he said they have, the caveat is if they have a really strong CFO or a really strong board room that can help guide the

CEO and they're open to it, he said. Then it can be a successful marriage, so to speak. But he said a lot of times. The reason why you see them.

00:14:21 Dave

Fail is because it's not in their background, and they've never been taught it, and now they're just thrust into this pose.

00:14:27 Dave

And he said it's not surprising that a lot of them struggle with it because it's just not their thing.

00:14:34 Dave

And I've never.

00:14:34 Dave

Thought about it, he said. You know, that's what Charlie and I do is that's our job is.

00:14:38 Dave

To allocate capital.

00:14:39 Dave

We have nothing else to do in the business and if we did all the other businesses would fail because that's not our strength is our strength is allocating the capital.

00:14:48 Dave

And so that's, that's what they do. And so I, you know, I probably tend to agree with everything he's saying. And I think that that's really what I think. If you think of the the top outstanding C.

00:15:00 Dave

Goes.

00:15:02 Dave

All of them have been good capital allocators and that's what's helps them stand out above the others.

00:15:08 Andrew

Yeah, it really can be subjective and it and it's hard because in different industries.

00:15:15 Andrew

Different capital allocation is better than others.

00:15:17 Dave

Right.

00:15:20 Andrew

You know.

00:15:22 Andrew

Maybe a hardware store doesn't need to be refreshed and remodeled as frequently as a high fashion store. It's just, you know there's no hard and fast rule on that stuff and and to your point like you do have to.

00:15:29 Dave

Right, Yep.

00:15:38 Andrew

Trying to be intuitive and it's not intuitive.

00:15:42 Dave

No, it's not. So let's talk a little bit about some metrics that we could pass along to people that could.

00:15:48 Dave

Some maybe understand how a company is is allocating capital, so I got a list of a few. I'll throw them out there and then we can kind of discuss them. So first one would be our favorite ROI C return on invested capital. Second one would be free cash flow, third one would be dividend yield and payout ratio. The 4th one would be share buyback effectiveness.

00:16:08 Dave

I think that's one of your favorites and debt ratios and leverage. So I guess do you want to you want to whiff on those a little bit?

00:16:16 Andrew

Yeah, I saw how my pen and paper out. So you're gonna have to remind me on them with three or four, but the first one, ROI C, it's a great metric. It's going to tell you what kind of earnings.

00:16:21

OK.

00:16:27 Andrew

In essence, you're learning what kind of earnings or profit is being generated from a company's reinvestment. So a company that's.

00:16:36 Andrew

Reinvesting well in general should see.

00:16:41 Andrew

Their profits growing as they're reinvesting. So you know if if they're throw money into all this heavy CapEx and and the business is not growing, that could be a problem. And for me, it's one of those yellow flags I like to look at. If I have a company that I own and I see the Roc starting to decline, decline, climb, I'm looking at, OK, what is causing that?

00:17:02 Andrew

And so that could be a signal that.

00:17:04 Andrew

You know, either they're doing stuff that's just not profitable or you're hoping that it becomes profitable one day. But as an investor, just like the CEO does, you have to use your own judgment as well to whether the changes in Roc are reflecting capital allocation. But they can definitely be a great way to signal.

00:17:24 Andrew

You. Hey, you should check this out because I can tell you that there's been good investments or poor investments.

00:17:32 Dave

Yeah, for sure. Yeah, I think that's a great, great way to look at it and it helps you measure the effectiveness like the higher the number is, the more effective they're reinvesting the money and that should lead to growth of the company as well. So oh, I see, I think it's a very critical one to understand and to help you.

00:17:52 Dave

Determine.

00:17:54 Dave

From the numbers how well a company potentially is doing with capital allocation, what are your thoughts on free cash?

00:18:00 Dave

Flow I like.

00:18:01 Dave

It. Yeah, it's good stuff. It's a basic building block of reinvesting. So if the company can't generate free cash flow, it can't buy back shares or it can, but it it's.

00:18:14 Dave

They're not going to be as effective if they use other means to buy back the shares, and so the more free cash flow the company can generate, the more options it has to allocate.

00:18:27 Andrew

What's?

00:18:28 Speaker 5

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00:18:58 Dave

All right. So #3 the threw out there was dividends. So like a dividend yield or dividend growth?

00:19:05 Andrew

Yeah. And the payout ratio as.

00:19:07 Andrew

Well, yeah, the payout.

00:19:07 Dave

Ratio. Yeah, that's a big one too.

00:19:10 Andrew

Definitely plays a role into kind of the company signaling what they're doing with their capital allocation. You get some companies that have a payout ratio of like seventy 8090%. They're kind of telling you.

00:19:23 Andrew

Either they're.

00:19:25 Andrew

One of the best businesses in the world and they don't need to reinvest hardly anything in order to get growth, and there are a few exceptional cases like that. I would other guys like sees Candy is as one in hindsight that was like that. So unless it's one of those exceptional cases.

00:19:42 Andrew

It could be just them signaling to you that, hey, we're probably not going to grow as much as a company that's maybe reinvesting all their free cash flow and not paying the dividend. And so that can help you as an investor set your expectations on on what the future might look like. And you know some businesses are just.

00:20:03 Andrew

Better suited for that. I mean the idealist to me wants to see so many more businesses just do that rather than try to build an empire or take over the world and just chase growth, growth, growth. But a business that can recognize that. OK well.

00:20:19 Andrew

We're pretty matured in our industry here. There's not much market share left to take, but running this company is still valuable for.

00:20:27 Andrew

The employees, the shareholders, the stakeholders and so they rather than.

00:20:32 Andrew

And.

00:20:34 Andrew

Earn money and light it on fire. With expensive reinvestments. They just give it back to shareholders and that can be a great way to generate market beating returns. If you buy at.

00:20:45 Andrew

The right price?

00:20:46 Andrew

And if you see something that the market's not seeing, so that's kind of how I look at the whole dividend thing. How do you how?

00:20:53 Andrew

Do you look at it?

00:20:54 Dave

The same way it's. I think you know without them actually having to say something, it can tell you a lot about how they think of not only their future prospects, but maybe where they sit in the market and in their industry and maybe where they are in their evolution as a business.

00:21:12 Dave

And.

00:21:13 Dave

They also you want to think that as an insider in the business and knows it better than I do, that they have a better.

00:21:23 Dave

Handle on. OK. I got this lump of money. How can I best serve the investor? The shareholder? Is it reinvesting in something that may or may not do much? Like move the needle much for us? Would the return be better for the investor to give them a?

00:21:41 Dave

And that to me is kind of how I look at them and it, you know, depending on where the company is, like if you look at a Coca-Cola or a Pepsi, they're in a different spot with their dividends and why they pay them versus Google, who was just started paying a dividend or meta, meta, meta, right and meta started paying a dividend to.

00:22:00 Dave

Yeah. So you know where they are is completely different than where Pepsi and Coke are. And so it signals different things. But you know, as a shareholder, if I own a company and they start paying a dividend, I'm like, yes, or if I buy it and they're growing the dividend, yes, that's, you know, that's more money.

00:22:18 Dave

For us and that's always good. All right. So the next, the last one is the share buyback effectiveness. What are?

00:22:19

Yeah.

00:22:26 Andrew

Your thoughts? Yeah. Let me just jump into that, that's what.

00:22:28 Andrew

It's all about here.

00:22:29 Andrew

How long do we got right. I'm sure it's about a quote that you probably have on the top of your head about how when you buy back shares, it really depends what price.

00:22:38 Andrew

Management is paying and so the effectiveness of a buyback.

00:22:43 Andrew

Depends on how low the PE ratio is, so the lower the P/E ratio, the higher the effectiveness of the buyback. And there's really no getting around that. That's kind of that comes down to does why do you think buybacks or why do you feel like buybacks are so effective or why do you like why do?

00:23:02 Dave

You like them?

00:23:04 Dave

So much.

00:23:05 Andrew

Well, it gives me more of an ownership stake as a current shareholder. And so again, if it's like serving two purposes, it's giving you that earnings per share growth that you get or owning the stock. And then you're also understanding that management's not.

00:23:26 Andrew

Taking this money.

00:23:27 Andrew

And just lighting it on fire here the margin for error for that is reduced and then when the P is low while they're doing that, you just have a compounding effect and so it can tell you not only that, but it can tell you if they're able to put more through buybacks.

00:23:46 Andrew

That could signal a strong business because it maybe it signals that they don't need to reinvest as much and they still get the growth. Again, there's a few select companies and industries where they kind of just grow alongside the economy and.

00:24:00 Andrew

That's just the nature of what they sell or the service they provide, and it's a blessing. Not not every company, not every industry, has that that significant long term tailwind which allows them to buy back more stock or pay back more dividends. And it takes away some of the uncertainty of that investment.

00:24:21 Andrew

When you have that now the the downside to of course is if the stock price gets so high. Now the PE is high and then you can be.

00:24:30 Andrew

Burning, sending the money on fire because now the buybacks not as effective, that's a good problem to have. If you buy a stock at at 10:00 PM and it goes to 30P.

00:24:39 Andrew

You're not complaining? No.

00:24:41 Dave

No, no, no, you're not. No, you're not. And you know, to your to answer your question, yes, I do have a a buffet ISM.

00:24:50 Dave

So somebody asked him in the.

00:24:52 Dave

Shareholder meeting, I was listening to or reading asked them basically that question. How do you feel about buybacks and how do you view them as a company that may be potentially overvalued versus undervalued? And to basically paraphrase him, he said we like share buybacks basically in any flavor.

00:25:10 Dave

We can get.

00:25:10 Dave

Them any time that we can get.

00:25:13 Dave

More of a company.

00:25:15 Dave

Any.

00:25:16 Dave

Whether it's how do you put whenever we can get more of a wonderful company for not having to do anything, we're all for it, so.

00:25:24 Dave

If I can grow my ownership of a business without having to lift a finger, that to me is ideal, and he was referring to at the time, GEICO, which he didn't own fully at that time. And then there was another company he mentioned. I think it was Coca-Cola because I think the question, yeah, the question was about coke because they at the time in.

00:25:44 Dave

90 something they felt like Coke was overvalued but was still buying shares back.

00:25:48 Dave

And Buffett basically said, you know, hey, Coke is a great company. I'm all for owning more of that shares because to Andrew's point, the PE is going to change from time to time, but the ownership is not. And so if I own it for 20 or 30 years, if the PE goes down and then goes back up, then you don't, like you said, I'm, I'm not complaining.

00:26:09 Dave

So.

00:26:10 Dave

And anytime you can get more ownership of a wonderful company, he felt like that was more than worth it.

00:26:15 Andrew

I feel like sometimes investors can split hairs with the whole. Like what's the valuation that a company is buying back shares at? If you're getting a consistent stream and it's almost like their dollar cost averaging their share buybacks, you're going to be in a good spot.

00:26:30 Dave

Shareholder usually, yeah, yeah, for sure. What are your thoughts on, I guess debt as far as like a capital allocation like debt reduction or even taking on debt to potentially buy back shares? That's a whole other can of worms.

00:26:45 Andrew

The can of worms that I tried to look for to avoid so Starbucks before.

00:26:53 Andrew

I would say Starbucks from like 20/16/2015 to like 2019-2020. They did that and the shareholders paid the price they basically.

00:27:06 Andrew

Took on so much debt and took a big chunk of that debt and.

00:27:09 Andrew

Just bought back.

00:27:09 Andrew

Stock. So in the short term that was great for management because they got all these.

00:27:17 Andrew

Like the the mechanics of a share buyback, as the stock goes up in the short term, because there's there's stock buying going on. So as a management you can cash out from that and that definitely set back the business for a while. And if you look at the performance of Starbucks kind of.

00:27:36 Andrew

Like.

00:27:37 Andrew

Before and after it outperformed for as long as they were able to kind of keep those chairs spinning. And then as soon as the music stopped.

00:27:46 Andrew

The the and then the market realizes what's going on. The stock absolutely crashed, and if you had held during that time, now you've underperformed and that is one of the dangers in that kind of capital allocation. We're running still out of you know how that affects the business loan term, if it has.

00:28:07 Andrew

Longer effects. I put my money on it not having longer effects and that the new management has learned that lesson and can.

00:28:15 Andrew

Take the business forward, but.

00:28:18 Andrew

It is something that, yeah, now the company has to pay back some of that debt and that has affected the valuation of the stock and.

00:28:27 Andrew

You know that knock on effect for the valuation is what helped the stock come down and made it more attractive for it. It makes it more attractive for new people who are coming in. It's definitely not attractive if you've been the long term shareholder because now you're paying the.

00:28:43 Andrew

Price for all of that right.

00:28:45 Dave

Exactly. All right, so.

00:28:47 Dave

We talked.

00:28:48 Dave

About.

00:28:49 Dave

What to look for? We've talked about why it's a good thing. Talk about some of the kinds of CAPA allocation. Maybe we could talk about some companies that we have seen that we like, that we feel like do a good job and maybe one or two that don't, right.

00:29:03 Dave

So guess.

00:29:03 Andrew

I just said love.

00:29:05 Dave

Right. What about like a company that's really good at buybacks?

00:29:09 Dave

For example, I know that's kind of your jam.

00:29:11 Dave

So maybe you could.

00:29:12 Dave

Talk about Psalm one or two.

00:29:15 Andrew

There's a lot of them, one that gets bandied about a lot, which I really like for several reasons, but home builder MVR, they have a long, long track record of buying back stock and doing it in a way that benefits shareholders. So over a 10 year period, they did not even double their debt.

00:29:35 Andrew

But we're able to grow their book value by over three times and buy back a bunch of stock. And so that's just win win because you're growing the business and you're buying back stock and so shareholders are getting a good balance of growth and capital return.

00:29:54 Andrew

It's not. It doesn't appeal to some people because it's not.

00:29:59 Andrew

Get rich quick. I just grew 300% in two years, but it's more of that slow and steady growth.

00:30:05 Andrew

And it's just a fantastic way to compound your capital as an investor. And and I like MBR in particular. What's cool about them is like there's still so much market share for them and all the other home builders to potentially take. But a lot of them are being prudent and not getting over their skis or overextending themselves.

00:30:26 Andrew

And it's good for for them because it keeps them from making big mistakes with capital allocation and these companies are all still growing. So you know if your shareholder is making.

00:30:37 Andrew

15% a year. Why? You know there's no reason to complain on that. And that's what can happen when you have good businesses run by good manager.

00:30:46 Dave

Yep. Yep, exactly. That's, I mean, that's a fantastic example. I'd like to throw Microsoft on fire for a company that I think does a really good job of allocating capital. And they do it in.

00:30:58 Dave

I think a myriad of different ways they invest through their income statement by having spending money on R&D in particular, and they continue to make sure that they stay because they're a cutting edge company. They have to spend the money to stay on top of what.

00:31:16 Dave

They're doing, and if they fall behind then that could be detrimental to the business and to us as shareholders. So it's prudent that they continue to spend money on R&D because it's important to them. They also spend through the balance sheet by spending a lot of money on CapEx as we talked about earlier for this.

00:31:36 Dave

You know great land expansion, if you will, for the coming AI revolution. And that may or may not pan out and the the CEO for Microsoft, Satya Nadella, he's been upfront about that. He says that basically we don't have a choice if we want to stay in the game, we have to spend the money.

00:31:56 Dave

And there's no guarantee at the other end that we're going to get a great return from this. But I you know, I trust him based on his past.

00:32:06 Dave

Statements and his past execution and decisions have all borne a lot of fruit, but they don't just do those things, they also.

00:32:14 Dave

Pay a dividend. Granted, it's not a great, you know, huge one, but it's a dividend and they also acquire companies and they have a really good history of acquiring companies. So although they may not.

00:32:26 Dave

Be what you would consider a serial acquirer. A company like Constellation Software, where the majority of their business is built on acquiring others. Microsoft is really good, has been really good at doing.

00:32:39 Dave

Not tuck in, but like add-on kinds of acquisitions that enhance their business, something like LinkedIn or GitHub. And now recently Activision, it's still early to tell how that's.

00:32:53 Dave

All going to play out but.

00:32:55 Dave

The past track record has been really good and really especially exceptionally good since Satya Nadella took over Steve Ballmer and and jobs were a little more middling on those. All those, you know, not jobs. Bill Gates, Bill Gates. You know, he built Microsoft on acquisitions, you know, buying the precursor to word, buying the precursor to.

00:33:17 Dave

Office. You know, those were all things that he acquired and then assimilated and then made great.

00:33:23 Dave

And so they have a history of that. So anyway, all that to say. And if you look at the ROI C for this company, it's 2535%. So it's well above the cost of capital and shows a very good efficiency and it's, you know, those have been steady. And so all those things we need to feel like Microsoft is a great example of a company that.

00:33:45 Dave

Allocates capital very, very well and I hope will hopefully continue as long as Satya is at the helm.

00:33:52 Andrew

Yeah, it's a great example. Like you said, there's so many different ways they reinvest and they have all worked out very well.

00:33:58 Andrew

For them.

00:33:59 Dave

Yeah, they have. What are your thoughts on meta and their capital allocation?

00:34:06 Andrew

Oh boy. Well, I've got Instagram over here, sitting sitting next to me, listening to me. So there's there's that text picking up.

00:34:14 Dave

Better speak nicely.

00:34:17 Andrew

Color me a skeptic. I can envision the future with another verse. I just who wants to be the bearer of, like, pushing that into the world? That's the path they basically chosen, and we'll see if it plays out. I it's. It's been enough to keep me away from the stock.

00:34:34 Andrew

I'll say that much.

00:34:36 Dave

They have mixed feelings. I know they've done a great job of acquiring businesses like Instagram and WhatsApp, for example, and those have been really successful for them. And but then you have again, you know, like you said, the the Metaverse thing, and now they're spending a boatload of money on.

00:34:54 Dave

AI as well, and that's great. I mean it's potentially a very good investment for them, but you also have the whole the controversy or I'm not sure how I feel about the.

00:35:09 Dave

Buy backing and you know they spend a lot of money to buy back shares, but it really offsets all the shares that they offer to employees. So it's a wash. So they're spending a lot of money to offset dilution, but they're not really offsetting dilution. So is that really best for us as the shareholders?

00:35:25 Dave

And I I don't think so, but the company has been successful so far. So I guess I'm kind of middling on that. And so you know, if I had to give him a grade, I probably would say C all right, folks. Well with that, we will go ahead and wrap up our conversation for today. I hope you enjoyed our bird's eye view of capital allocation.

00:35:47 Dave

And after today you understand the importance of how much you need to focus on this and.

00:35:54 Dave

Pay attention to how well your CEO allocates capital. It a lot of times it will make or break your investment. So with that, we'll go ahead and sign us off. You guys go out there and invest with the margin of safety. If this on the safety have.

00:36:05 Dave

A great week and we'll talk to you next week.

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