# Brian Feroldi Explains Why Warren Buffett Thinks EPS is Overrated

Welcome to Investing for Beginners podcast. Today we have a special show. We have our friend Brian Feroldi back. Brian is a financial educator at Long Term Mindset. He is also a Wizard Financial wizard on X LinkedIn, YouTube, you name it. Brian's there and he's dropping lots of knowledge and he's going to share some.

00:00:51 Dave

Stuff with us today.

00:00:53 Dave

So Brian, thanks for joining us and welcome back to the show for the like 17th time.

00:00:57 Dave

I think, Dave.

00:00:58 Brian

Andrew, good to be here. As always. Thank you.

00:01:00 Dave

For having me, you're welcome.

00:01:01 Dave

Alright, so I thought.

00:01:03 Dave

Today, well, we thought today we could talk about Warren Buffett and why he thinks earnings per share is overrated.

00:01:10 Dave

So what are your?

00:01:11 Dave

Thoughts on that to kind of start our conversation today?

00:01:14 Brian

Yeah, that's a cheeky start, isn't it? Warren Buffett calling earnings per share. Overrated. I think that he has an excellent argument on his side, but the the I think the reason this is an important topic to call out is that if you watch financial media or if you just watch.

00:01:16

Yeah, a little.

00:01:16 Dave

Bit.

00:01:30 Brian

Headlines from companies reporting earnings. What gets all of the focus and all of the glory?

00:01:37 Brian

Earnings and earnings per share did it grow? Did it beat expectations? That is what the financial media hyper focuses on makes sense because it's a number that reflects the profitability of a company. Is it growing? Is it shrinking? However, in Buffett's 1979?

00:01:57 Brian

Letter to shareholders, he made a pretty compelling case for earnings per share, not being the primary thing that you focus on when judging how well a company is doing.

00:02:09 Dave

So what is the thing that he suggests you focus on?

00:02:13 Brian

So according to according to this letter, Buffett essentially said that earnings per share is important or should be looked at. But if you only focus on earnings per share, what you are effectively focusing on are the output of a business.

00:02:29 Brian

Right. The thing that comes out of the business, but just focusing on earnings alone ignores what went into the business to create those earnings per share.

00:02:40 Brian

Here, so Buffett says that actually, rather than solely focusing on earnings per share and output of the business, Buffett wants you to focus on the ratio of what went into the business to what comes out of the business. And he there is specifically talking about the return on capital that the business or.

00:03:01 Brian

More specifically, the management team gets from taking the capital that was put in and using that capital to create the profits.

00:03:10 Dave

So how can we how can we measure that ratio? He throws around return on equity and return on capital a lot. So maybe we could talk a little bit.

00:03:19 Dave

About both of those.

00:03:21 Brian

Yeah, there's there's actually multiple ways to measure what kind of return on capital a business is, is is generating and this is something that personally.

00:03:31 Brian

I struggled with for years like the math behind these numbers or these terms is not hard. It's very, very simple. It's it's just very simple.

00:03:40 Brian

What I personally struggled with was why this was important, like why this is a thing that investors should focus on at all, because it's very easy for me at least to be like, OK, earnings per share times PE ratio equals stock price, right? And that's the thing that I care about as an investor is what happens to.

00:03:59 Brian

The stock price.

00:04:00 Brian

Return on capital equations don't always relate to the company's stock price in the future, so it's more of an ethereal connection between the two to to focus.

00:04:11 Brian

But to answer your question, there are four ways or four primary ways of measuring a company's return on capital that that are fairly popular. There's more than this out there. I mean, there's lots of ways to to calculate this, but there are four primary ways. So return on invested capital ROI C, which I know you guys have covered on this show a lot.

00:04:31 Brian

And and I'm glad that you do. #2 is return on equity. This is the one that Buffett himself has been kind of beating the drum on for the last 40 or 50 years. I have a hunch, though, if you were to ask him about this today, he would say that this new.

00:04:47 Brian

There is less important because it's the easiest one for management teams to manipulate, or it's the most likely to be way off of giving you useful information. Then there's return on assets, which is primarily useful for measuring very capital intensive businesses like banks and insurance companies or industrial companies.

00:05:07 Brian

And then the 4th 1 is return on capital employed or ROCE. But using I would say all four of these return on capital ratios in conjunction with each other can actually give an investor a better idea for what kind of returns businesses are generating with the capital they have.

00:05:24 Andrew

Yeah, that's those are good. So do you have a favorite out of these?

00:05:29 Brian

So if I was to, if you forced me to pick a favorite, I would probably choose return on invested capital ROI C so the formula there is net operating profit after tax or nopat in the numerator, and then average invested capital in the Denon.

00:05:45 Brian

And what this shows you is what kind of return or what what what, what the interest rate is if you will that a company is getting from deploying the capital that it has so companies you know generate or raise capital from investors from from lenders they deploy that capital they use that capital to buy or build.

00:06:05 Brian

Assets.

00:06:06 Brian

Those assets then go on to create profits, which there is many ways to measure our profits. So it's really the ratio of what profits those assets generates to what capital went into creating those assets in the 1st place and of the four, I think that all I see is probably the most useful and the hardest.

00:06:26 Brian

The hardest to manipulate, so it's most likely to give you an accurate representation of the return on capital and invest of business is.

00:06:34 Andrew

So if we could back up for a second, you mentioned something I thought was fascinating. You said you kind of have this aha moment about. OK, I know the math, but This is why it matters. Can you walk us through that part? Because.

00:06:50 Andrew

I can see a beginner investor saying, you know what, if EPS is up and stock price is up, I'm happy. Who cares about anything else, but obviously there's more to that than this. So can you walk us through that enlightenment that you had?

00:07:02 Andrew

In the past.

00:07:03 Brian

Yeah. What? What really helps me is to put things in as simple terms as we possibly can. So what really turned me on to this concept was when I thought about went through this exercise with investing in in a bank account. So Andrew, pretend that I gave you $1,000,000.

00:07:20 Brian

Congratulations, by the way. Yeah. Yeah, you taste this.

00:07:20 Andrew

OK, I like this. I like this.

00:07:22 Dave

Start I like where this is starting can.

00:07:23 Dave

I get in on that too.

00:07:25 Brian

So I give you this $1,000,000 and I charge you 5% interest on this $1,000,000. So you have to pay me $50,000 per year in interest, OK. So you take this $1,000,000.

00:07:39 Brian

You go down to your local bank and you put that $1,000,000 into a CD certificate of deposit that pays you 3% interest so $30,000.

00:07:51 Brian

Is that a wise financial move for you?

00:07:55

No.

00:07:56 Brian

No, right. You're paying me 5% interest and then you're earning 3% interest. So effectively this what what you're doing with this investment strategy is you're destroying $20,000 in value.

00:08:11 Brian

Every.

00:08:13 Brian

I think everybody listening can understand that concept. Now let's pretend that I'm happy with this arrangement. So I say Andrew, here's another $1,000,000 right, $2,000,000. I'm now giving you and I'm charging you 5%. So I now make $100,000 per year. That's the cost to you. You invest that.

00:08:32 Brian

Extra million at 3%.

00:08:34 Brian

So Andrew, you've now doubled your earnings. You were earning $30,000 per year. Now you're earning $60,000 per year, right? So if you were running a a company, you'd be like, I need a bonus. I just doubled the earnings of this investment, but of course was giving you more capital a good.

00:08:55 Brian

Yeah, no, you are now destroying $40,000 worth of value every every year. So if you understand that if you understand that concept, you can apply that exact same logic to a business. So how do we figure out the the cost?

00:09:16 Brian

So that a company should be charged for raising capital from investors.

00:09:20 Brian

And for lenders?

00:09:21 Brian

There's lots of ways to answer this question. The academically correct answer is to use Wade. Average cost of capital or whack, and you take the the charge of the equity, the charge of the the debt. You weigh them appropriately and you get some number. Let's just throw a number out there and.

00:09:37 Brian

Just say 8.

00:09:38 Brian

Percent right, let's just say a company has an 8%.

00:09:41 Brian

Average cost of capital.

00:09:43 Brian

Well, if it's.

00:09:44 Brian

Cost the company 8% who have access to that capital.

00:09:48 Brian

The company has to then take that capital and earn a return on it. That's higher than 8% in order to create value. If the company invests that capital and earns 8% or less, it's destroying value even if earnings are growing, even if it's earnings.

00:10:08 Brian

They're growing. If the company isn't earning at least an 8% return on this capital, then that is a terrible use of capital. That company does not deserve to have the capital that it has. So This is why Buffett says don't look at just earnings per share. If a company is raising more.

00:10:24 Brian

Capital, it should be growing earnings per share. That's not impressive, right? The company could be investing in a savings account and growing earnings per share with with zero skill. What matters is how much capital they raised in proportion to how much earnings they're actually generating with that capital.

00:10:42 Andrew

Do you have a long term mindset searching for safe compounders? So am I and I'm investing my entire life savings with the picks from valuespotlight.com.

00:10:54 Andrew

And to kind of bring it full circle then the ROI CRC, all of those are trying to tell you what business is earning and then you can compare that to a cost of capital or a WAC.

00:11:06 Brian

Exactly. So I like to think of that as kind of the interest rate that a company is generating on the capital that has been deploying. So as a very general statement.

00:11:18 Brian

If I'm looking at a company that is optimized for profits, that's a very key caveat. By the way, if the company is optimized for profits and it's generating returns on capital that are 10% or below that, to me is a company that is destroying value that is likely to be a stock that dramatically underperforms the market.

00:11:38 Brian

Over the long term, because it's not even earning the same rate of return on this capital that the stock market in general is delivering, if a company is earning say 10% to 20% return on capital, it's creating value not a ton of value, but it's creating value.

00:11:55 Brian

And if I see a company that's generating more than 20% return on capital, you should want that company to have all the capital that it can get and to reinvest that capital as high as possible because it is creating a tremendous amount of value from the capital that's been given.

00:12:11 Dave

So we're having an intelligent conversation about cost of capital, which as Charlie Munger said, is impossible. So this is kind of fun. What are your thoughts on the discount rate versus whack and and some of those, I guess, concepts in relation to what we're talking about?

00:12:28 Brian

Yeah, there's lots of ways to do it. Again, if you ask the academics, they will tell you that weighted average cost of capital should be calculated out to like 2 decimal places and it should be a function of the risk free rate of return times. The beta of the asset that's out there. I mean, if you want to do all that work, have at it. I personally believe that that's just extra work.

00:12:47 Brian

For not much gaining response, my personal rule of thumb is that I use a discount rate of a minimum of 10%, right? Because I can invest in.

00:13:00 Brian

SP Y or the S&P 500 and reasonably expect a 10% rate of return. So if I can do no work by the index and earn a 10% return over the long term, that to me is my cost of capital that I should charge. Any other investment that I make now if a company is higher risk.

00:13:20 Brian

Than the market in general, I want to charge even higher of a discount rate, so I know some investors that just apply a blank.

00:13:28 Brian

Hit 12% cost of capital across the board and they make all decisions based on a 12% total rate. So whatever you do doesn't doesn't really matter to me. I like to keep it simple and just say 10% cost of capital and that's what I use as my discount rate.

00:13:44 Dave

And then how do you adjust for a riskier company or maybe one that that is even like little risk like?

00:13:52 Dave

You know, I don't know. Throw out a name. Apple. Yeah. Microsoft perfect. So do you adjust that for a company like Microsoft versus maybe some small biotech micro cap that you may be looking at would?

00:13:53

Microsoft.

00:14:04 Dave

You adjust for.

00:14:04 Brian

That you certainly can. I personally don't, because if I'm again, if I'm going to be picking an individual.

00:14:11 Brian

Stock the first thing you need to know is, well, what do you want from that individual stock that you're not getting from the index? In general, right? Most of the time, the answer to that question is a higher return. I'm picking this individual stock because.

00:14:28 Brian

I want to outperform what I could bet by just investing in the index in general. That is the usual answer. It's not the only answer. Another answer could be I want lower volatility. I I want a stock that won't go down as much as the index when a bear market comes, which is why people invest in.

00:14:49 Brian

Consumer staples and utilities, and even a company like Berkshire Hathaway, like Berkshire Hathaway itself, is a very low volatility stock. So if the market goes down 20%, you can probably expect Berkshire to be down.

00:15:01 Brian

10% so just wanting a smoother ride is a reason to invest in in a company. Another one would just be income. You want a higher dividend yield or a higher shareholder yield than what the S&P 500 is providing. So assuming you the thing that you're after from an individual investment.

00:15:22 Brian

Is a higher than the higher rate of return. I see no reason to dip below a 10%.

00:15:28 Brian

Required rate of return even if the business is lower risk, because if the reason I'm investing in the stock is to get a higher then then market beating return, it doesn't make sense to me to lower my discount rate even if the company that I'm studying is lower risk or lower volatility.

00:15:46 Dave

Yeah, I want to hammer.

00:15:47 Dave

This.

00:15:48 Dave

Point home about the relationship between the return metrics and the cost of capital because I think a lot of people, especially newer investors, focus only on the art return metrics and don't think about the cost of capital. So can we kind of like I guess?

00:16:03 Dave

Hammer that home that point home about how important that relationship is. If you're going to invest in a company for more than five months.

00:16:11 Brian

Sure. Yeah. I mean the discount rate or the rate the this is the required rate of return that you have as an investor for buying an asset. So it is a critical input to the the equation to know if a stock, if the stock's current valuation will get you what you're after.

00:16:30 Brian

This is why so the discount rate relates very closely to the valuation you should be willing to pay. There's nothing wrong with quote UN quote overpaying or paying a premium valuation for a company. If an exchange you the investor are either willing to accept a lower rate of return or or a lower risk profile.

00:16:49 Brian

Or even if you're paying a premium, you think that the expectations built into the stock.

00:16:54 Brian

Are too low and the company will outperform even slightly elevated expectations. But ignoring the rate of return that you are that you want as an investor is is foolish because you could potentially be buying something that even according to your own model has no upside, which is not.

00:17:15 Brian

I would say a good use of capital.

00:17:18 Dave

So what are some good numbers when you're looking at return on capital ratios, like what ranges would you suggest people kind of keep an eye out for?

00:17:30 Brian

For me, I mean, there's there's lots of ways to to judge this and the returns on capital that you should expect from a company are very correlated to the industry that the business is in, right. Different industries have just different economic profiles. If you look at the tobacco industry or the Pharmaceutical industry.

00:17:49 Brian

Those are industries that historically have had very high returns on capital. If you compare those to commodity industries or the energy industry, by contrast, the latter have have much lower returns on CAP.

00:18:02 Brian

So the industry that you're looking in should have an impact on what you should deem as good or bad. However, with that caveat in mind, if a company is fully optimized for earnings, again a huge caveat there and it's earning a return on capital below 10%.

00:18:20 Brian

I'm not interested.

00:18:22 Brian

Like. No, thank you. That is a rate of return that is destroying value for uh for investors. So I want at least a 10% return on capital before we even consider it. I know you guys had Peter come out and quality on your show a week or two ago and he said 15% is his minimum. But I think between 10 and 20%.

00:18:43 Brian

Is.

00:18:43 Brian

A decent capital allocator, right? That that should be something that's considered and anything over 20% is is truly and a sign of likely a very excellent business. However, an important caveat with all return on investment calculators is that they are backward looking. They are what happened.

00:19:04 Brian

In the the past was a company, a good capital allocator in the past.

00:19:08 Brian

Best and what really matters for investors is what will the returns on capital be moving forward. So I think Oswald, the motor and warned about this, that if you just use return on invested capital to make decisions you your portfolio could be filled with zombie companies, right? Companies that are big established brands that were dominant decades ago. But their time has since.

00:19:29 Brian

Traded and if their returns on capital are poised to fall and stay low, you will not do well as an investor.

00:19:36 Speaker 3

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00:19:57 Speaker 3

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00:20:08 Andrew

No, not at all. Something else you said I thought was really interesting and worth zooming in on. You said a company has to be optimized for profit. Can you explain what you're talking about there?

00:20:22 Brian

Yeah, this is when marrying investing with the concept of the business growth cycle is just so, so critical. So I believe that there are 6 distinct phases that publicly traded companies go through in their life. So early in their life, they're in the raised capital phase.

00:20:40 Brian

This is when they are reliant on outside funding sources such as selling equity to investors or borrowing from from lenders, and they are these companies are intentionally spending more money than they're pulling in revenue in an effort to to grow after a company graduates through through Phases 1 and Phase 2 when they're they're really growing and depending on outside.

00:21:01 Brian

Capital.

00:21:02 Brian

They reach the break even face right when they're not making money, but they're no longer losing money. And then after that, they focus on optimizing the business for profitability, really taking through and maximizing the margins of the the business. Only when they company has.

00:21:23 Brian

Fully maximized, its margin potential. Is it truly earning the profits that the business is capable of generating? And that's when a company.

00:21:33 Brian

Should have, should have gap profitability and free cash flow production and no PAT should be a number that you can easily see and and measure. So only when those those profit metrics are fully shining through and the company is optimized for profits do any of the return on on capital calculations.

00:21:54 Brian

Even.

00:21:54 Brian

Matter cause prior to that, if a company isn't optimized for profitability, then all of the numbers in the numerators of those equations will dramatically understate the company's true profit generation potential. So they'll all be far lower than than they would be otherwise. So yeah, it's it's critical that a company is fully optimized for.

00:22:14 Brian

Profits and in Stage 5, which I call the capital.

00:22:17 Brian

Return phase that any of these numbers.

00:22:20 Dave

Would looking at a company like Uber be a good example of how a company kind of moves through that life cycle because they for a long time they were? I don't think they.

00:22:30 Dave

Were really optimized.

00:22:31 Dave

For profits, but it seems like they're they're moving more towards that. So would that be a good example of a company if you looked at them five years ago?

00:22:40 Dave

And you looked at the return on on capital metrics, they wouldn't really tell you much, but now they, but now they could.

00:22:46 Brian

Uber is a great example of a company that has gone through the the business growth cycle. So when Travis Kalanick founded Uber was like 20/12/2013, somewhere around that, the company was completely dependent on investors outside capital in order to fund itself. In fact, it was subsidizing the cost of its rides. It was it was purposely underpricing them.

00:23:07 Brian

In order to grow and to reinvest in itself, and it was only really a year or two ago, it was not that long ago that the company even started to generate profits in the 1st place, so.

00:23:20 Brian

Looking at Uber on Simchat right now, I see that the company has a 32% gross margin, a 5% Net margin and a 12% free cash flow margin. Now, I haven't started Uber in depth. I don't know if you guys have, but let's assume that that 12%.

00:23:41 Brian

Free cash flow margin is sustainable, like let's assume that that is the actual free cash flow generation capability of the company. Well, the company's Net margin is only 5%.

00:23:52 Brian

So which of those numbers is accurate? Is is 12% free cash flow margin accurate or is 5% net net income margin accurate? Again, I'm I'm assuming the 12% free cash flow margin is accurate. So even when looking at Uber's return on capital and numbers now, you might have to make adjustments to the numerator.

00:24:12 Brian

If the company's profitability is still underrated, so it might still be too early to look at the return on capital numbers for Uber to draw any conclusion.

00:24:22 Brian

However, it's getting close to the point. Assuming the company stays on this profit trajectory where these numbers will become meaningful, hopefully in the.

00:24:31 Brian

Next 12 months or so.

00:24:33 Andrew

Any companies you'd be willing to throw under the bus as far as examples of?

00:24:41 Andrew

They kind of violate this kind of idea.

00:24:45 Brian

There's lots of examples that investors, investors can use, but yeah, one that I'll throw out there is Alcoa, Alcoa, the big deal maker in the US, The big aluminum maker. Excuse me, I think it's aluminum Corporation of America is what Alcoa stands for. But this is a commodity producer, right. It makes aluminum. It's by and large a pretty terrible.

00:25:04 Brian

Business right. The company has to spend billions upon billions of dollars to build these huge, massive factories. The demand for its its products are cyclical, right? It depends. It needs really a strong economy to sell, to sell into and its profit picture fluctuates up, up and down. So this company does not have predictable.

00:25:25 Brian

Profitability. So if you look at its return on capital averages over the last five years, I mean this, this is a business that was started in 1886. So it should be optimized for profits now, right? It's 140 years old. You would think it would be fully optimized for profits.

00:25:37 Dave

Good thing.

00:25:42 Brian

When I look at the last five year average, I see return on capital employed of 7.4%. So this is a business that over the last five years the average over the last five years has earned a 7.4% return on the capital that that's been invested in which its return on invested capital by the way is 4%.

00:26:03 Brian

And return on equity is -4% and that is a five year average. So none of these numbers are anywhere close to minimum the minimum of 10%. And if you look at what Alcoast stock has done over the last couple of years, it's not been a good investment.

00:26:20 Brian

By any stretch.

00:26:23 Dave

That's a good one, one that I've always interested in is Amazon, and that's because the company, whenever I look at companies and I try to explain how to look at financials, Microsoft's an easy one because their

financials are clean. It's a profitable company. It's just easy to use. But Amazon is, I think a great case study.

00:26:42 Dave

Because it's none of those things. And so how do you think about these kinds of concepts with a company like Amazon?

00:26:49 Brian

So the first, the first thing you have to answer is, is Amazon fully optimized for profits? Are Amazon's financial statements, its income statement, and its cash flow statement fully optimized to show to show profitability? I would argue even today the answer is no.

00:27:10 Brian

Right. They're much closer today than they were five years ago and certainly way closer than they were ten years ago. But Amazon?

00:27:17 Brian

On to my mind is not fully optimized for profitability, so I would argue that even today, Amazon's true earnings power is not truly reflected in its financial statements. But even with that caveat out there, I see that Amazon is earning a return on equity of 18.7% return on capital.

00:27:38 Brian

Of 10.6% and a return on invested capital of 8.3%. Now I think that Amazon.

00:27:46 Brian

If it truly does start to really focus on on profitability, that all of those numbers are understated and they should rise over time as the company continues to optimize the business for for profitability. But this is the type of analysis that if you used it at any time over the last 20 years would have given you the wrong answer.

00:28:06 Brian

With Amazon simply because it hasn't been optimized for profits really at any point in its operating history, so this type of analysis, while very useful, does not apply to companies that are not optimized for profits.

00:28:21 Andrew

I like this example. It's a business you're pretty familiar with. I'm pretty sure. What is it about Amazon that makes you reasonably confident that they're maybe not in the optimizing profit stage yet? Is it something glaringly obvious? Is it depend on the business? Is it?

00:28:41 Andrew

Specific to Amazon, like what? What goes into your.

00:28:44 Andrew

Said there.

00:28:45 Brian

Well, Amazon is a bit a bit of unique case study in many ways. I mean, Bezos himself basically said that our goal is to minimize our reported net income and really focus on our our cash flow. In fact, he said many like I think it's 1997 letter to shareholders said we're going to optimize for with a free cash flow per share.

00:29:04 Brian

For operating cash flow per per share, that's the thing that he set up the business for. So in an effort to minimize his tax bill this entire time and reinvest as much as possible.

00:29:15 Brian

He has purposely understated the company's true earnings power. Now, if you combine that with the last four years, which have just been crazy, right, 2020 the companies sales went parabolic in response the company way over built way overspent on distribution centers and then in response to the next year.

00:29:35 Brian

To pull back on that spending and right size its sales force. So because of that its expenses were overstated compared to to its revenue. So if you look at the last few years, that fact alone makes the company not be able to shine through on how much profits that it has.

00:29:51 Brian

And then in addition to that, you have to add this other wrinkle, which is Amazon made an equity investment in Rivian and that now makes the companies net income a useless number, completely useless, because now the company's net income reflects what what rivian stock just did, which has nothing to do with Amazon.

00:30:11 Brian

The business.

00:30:13 Brian

So Amazon would be a great example of why you can't look at return on equity at all, right? Because the company's net income is in the numerator. So I think that my hunch is that if you Fast forward maybe two or three more years, business will start to be optimized, truly optimized for for profitability and then these return on capital.

00:30:33 Brian

Metrics will start to shine through, and I for Amazon I would ignore return on equity altogether and I would just look at return on invested capital and return on capital employed. So we're getting close, but we're still not there.

00:30:45 Dave

So what are your thoughts on this potentially slippery slope of?

00:30:50 Dave

Making adjustments when you're looking at different companies because yes, it it logically makes sense to, for example, look at the income statement for Amazon and adjust those equity and investments out. But then if you do that on one company, why don't you do it on this company and this company and this company? So what are your thoughts on that kind of?

00:31:10 Dave

Concept.

00:31:11 Brian

Well, to me, every investment that you're gonna make is always a one off, right? There's always something unique about that particular business.

00:31:17 Brian

That that attracts you. So it's more important to me that you understand the nuances here when looking at any of these these numbers, you can't just simply set up a screen saying show me the highest return on invested capital companies. There's the companies I want to invest in that doesn't work. I wish it worked. That doesn't work.

00:31:37 Brian

By the way, if that did work, there'd be no advantage to us as investors, because if it was just a matter of screening and buying based on a simple.

00:31:45 Brian

Stream computers would be the best investors in the world, so there's always, there's always extra caveats that go into interpreting anything about a business and investing isn't just the numbers, it's the marriage of the numbers and the art, that of of interpreting the numbers.

00:32:02 Andrew

So the AI is not going to come and and take all the stock picking opportunities away from us.

00:32:06 Brian

It's getting closer, but I would say not yet.

00:32:13 Dave

Is there anything else that we maybe have not touched on today that would be important in relation to return on capital metrics and earnings and?

00:32:24 Dave

Cost of capital.

00:32:26 Brian

I think we touched on the main things. Again, the thing that I personally struggled with for years was just understanding why this was even important in in in the 1st place. If a company is optimized for profits and it is not earning return on capital that exceeds its cost of capital and I'll just throw out there again the number of.

00:32:46 Brian

Of 10% then, if that company grows, it's literally destroying value faster than. If it's not so, not all growth.

00:32:58 Brian

Is good. Not all growth is good and the way that you can tell good growth from bad growth is, is that growth coming where where the returns on capital exceed the cost of capital or they or they do not. So to me that's the key take away from this type of analysis. You want to know is growth producing value or destroying value.

00:33:19 Dave

Yeah, well, well said. And that's why one of my favorite statements is the capital allocation is job number one for CEO's and this really goes a long ways towards telling you whether they're good at their job or not.

00:33:32 Brian

Yep, well said. So this is exactly why we started this with Buffett, quote about return earnings per share is overrated. It is overrated. It needs to be married with what is the return on capital that the management team is getting. So it's a paired metric. It's not just, it's not just one.

00:33:47 Dave

Yeah, yeah, that's awesome. Well, Brian, this has been a fantastic conversation as always. Where could people find more of you online? I know there's a few places.

00:33:58 Brian

Any any social platform, you can pretty much name them on X, Instagram, TikTok, LinkedIn. So wherever you want to connect with me, Brian Feroldi following.

00:34:07 Dave

Yeah, yeah, for sure, definitely, definitely follow him. He's well worth your time. YouTube is a great place. They do lots of great explainer videos as well as some stock ideas as.

00:34:17 Dave

Well, so it's a.

00:34:18 Dave

It's lots of great places for Brian. So Brian, again, thank you very much for taking the time out of your day to come join us and share your knowledge with our.

00:34:25 Dave

Nurse. And with that, we'll go ahead and sign us off. You guys go out there and invest with the margin of safety and sits on the safety. Have a.

00:34:31 Dave

Great week and we'll talk to you all next week.

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