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EVEN BUFFETT LIKES AI

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By Gordon Pape, Editor and Publisher

It seems like everyone is eager to get in on the artificial intelligence (AI) craze – even Warren Buffett.

I mention him specifically because the Oracle of Omaha has long been known as a tech denier.

"I never invest in companies I don't understand," he once famously told an interviewer who asked why he avoided technology.

So, what about the fact that his Berkshire Hathaway company has 47% of its portfolio invested in Apple? Not a problem: Mr. Buffett sees Apple as a consumer products business, not a technology company.

This explains why eyebrows were raised when Berkshire Hathaway made a $907 million

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investment in a little-known tech company with the unusual name of Snowflake (NYSE: SNOW). It's not a big position – only 0.3% of the Berkshire Hathaway portfolio, according to John Csiszar, writing for GOBankingRates.com.

"But it does reflect Buffett's evolving opinion of the types of stocks he should own, even though it's likely one of his portfolio managers did the actual buying," Mr. Csiszar writes.

So, what is Snowflake anyway?

The company, which is based in Montana, was founded in 2012 by Benoit Dageville and Thierry Cruanes, both of whom remain with the firm as President of Product and Chief Technical Officer, respectively. It went public in 2020, which is when Berkshire Hathaway took a position.

Together with a team of software developers, Dageville and Cruanes created what they call a Data Cloud. It's a global network where thousands of organizations can access and share data stored on multiple public clouds. According to the company, the Data Cloud "was designed from the ground up to support machine learning and AI-driven data science applications."

If you think of it as aiming to become ultimate source of human knowledge, you won't be far off the mark.

"Snowflake's platform is the engine that powers and provides access to the Data Cloud, creating a solution for applications, collaboration, cybersecurity, data engineering, data lake, data science, data warehousing, and unistore," the company says on its website.

Its partners include an impressive list of high-tech companies including Google Cloud, Amazon Web Services, Microsoft Azure, and IBM. Other companies using the service include AT&T, JetBlue, KraftHeinz, Under Armor, and Capital One. The system currently handles 2.9 billion queries a day and rising.

Snowflake's investor presentations show an impressive growth record. First quarter revenue (to April 30) for fiscal 2024 was just over $624 million (figures in US dollars), up 48% year-over-year. That looks impressive until you realize that in the year-ago quarter, the revenue growth rate was 85%. For the full fiscal year, the company forecasts revenue of $2.6 billion, a 34% increase over the previous year.

The question investors are asking is whether the new surge of interest in AI will drive those revenues higher, especially in the face of an economic slowdown. Right now, there's no indication of it. That said, the AI feeding frenzy is just starting.

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Another concern is that the revenue growth is not flowing through to the bottom line. Operating loss in the first quarter was $273 million, compared to $189 million in the same period last year. Net loss was $226 million, up from $166 million the year before.

The financial woes have been reflected in the share price. Snowflake traded at over $350 a share in the fall of 2021. Today it's about half that, closing Friday at $175.21. That's not unusual – most tech stocks are well down from their pandemic highs. But right now, Snowflake doesn't seem to have much traction.

Contrast that with AI superstock Nvidia (NDQ: NVDA), which last week passed the $1 trillion level in market capitalization, joining Apple, Amazon, Microsoft, and Alphabet. Nvidia, a recommendation of contributing editor Adam Mayers, is the leading manufacturer of GPU chips, which are used by cloud companies and AI developers.

The company recently reported a blow-out first quarter for fiscal 2024 (to April 30). Revenue was $7.19 billion, up 19% from the previous quarter but down 13% from the year before. Earnings per share were $0.82, ahead 28% from last year. But what really blew away investors was the projection of $11 billion in revenue in the current quarter. That's almost $4 billion more than analysts were estimating. The share price shot up 24% in a single day after the results came out.

Despite a pull-back last week, the stock has still more than doubled this year. The p/e ratio is unattractive at over 200, but the company is profitable and if revenues come in as projected, earnings should soar.

The bottom line is we appear to be on the brink of an AI bubble, with investors scrambling to get on board. That could lead to big profits but remember that all bubbles eventually pop. Right now, Nvidia has momentum on its side. Snowflake has potential and its revenue is growing. Just not by enough to impress the market.

My recommendation is to buy Nvidia on any significant price pull-back. The shares closed Friday at $393.27.

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Our team of experts have the answers!

Send your questions to
gordonpape@hotmail.com

QUALITY TRUMPS VALUE IN THE LONG RUN

By Shawn Allen, Contributing Editor

It's been my experience that the best returns come from holding high quality companies for the long run as opposed to investing in lower quality companies even when they appear to be significantly undervalued.

By high quality companies, I mean those with an established track record of strong returns on equity (for example over 15%) and a history of consistent growth. These are companies with competitive advantages that tend to endure.

These companies are usually not available at what appears to be bargain prices, but their earnings growth usually ends up justifying their higher valuations.

Looking back at all the companies I have recommended in this newsletter, the top three long-term gainers are all high-quality companies. Here's a look.

WSP Global (TSX: WSP)

This company's compounded average annual price increase is a stellar 23% per year, for a total of 196% since I took over coverage of it on Feb. 26, 2018. In my first report, I noted that the valuation was somewhat unattractive, and that the ROE was "acceptable" at 10.75%. WSP's share price growth has come from its highly ambitious growth-by-acquisition strategy. Its ambition and its strong execution on both acquisitions and its projects make it a high-quality company and its ROE has improved to about 13%.

Visa Inc. (NYSE: V)

In the six years since I added Visa to the IWB's recommended list the shares have delivered a compounded average annual capital gain of 18%, for a total of 183%. In my initial report I called Visa Inc. "a financial toll bridge" and said it had "enormous competitive advantages". I also noted that its ROE was very good at 22%. I rated it a Buy despite its high valuation – it had a p/e of 28 and was trading at six times book value. Even so, I was a bit cautious, recommending an initial small position.

Costco (NDQ: COST)

Costco's shares have gained a compounded average of 16% per year, for a total of 333%, since I added it to our recommended list in July 2013. In that first report I extolled the virtues of Costco as a business but was only lukewarm on the stock due to its relatively high valuation, with a p/e of 25.

These are my three best performers for IWB and in all three cases the high quality of each company was apparent (especially Visa and Costco) but the valuations did not appear to be

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Quality—continued from page 4...

particularly attractive. Subsequently their high quality has easily trumped their somewhat high valuations.

In contrast, some of my worst performers were stocks that looked good on their valuation measures but were not the highest quality companies. Here are two examples.

Melcor Developments (TSX: MRD)

I introduced Melcor Developments as a Buy at $19.33 in September 2013 based on its price to book value of 0.91 and its low price to earnings ratio of 10.2. I also based the guidance on very strong results in the previous decade that I had been following the stock. Unfortunately, it has turned out that Melcor is fundamentally not a high return business. I ultimately recommended selling this company at a loss and moving on. As of today, the stock languishes under $12 and sells at about 30% of book value. It continues to be a value stock that refuses to rise.

Canadian Western Bank (TSX: CWB)

I introduced Canadian Western Bank to our recommended list back in September of 2014 at $40.54. It had just reported strong earnings growth and I thought the valuation was reasonable with a p/e of 15.9 and a price to book value ratio of 2.1. It has continued to grow its earnings and book value, but it does not achieve the high ROEs of the big banks. It has mostly not been in favour with the markets and its $25.46 price today is down about 37% from the original recommendation. It now trades at the very low valuation of about 7.2 times trailing earnings and a price to book value ratio of 0.71. I continue to have faith in this investment but the big banks with their higher ROEs and higher quality may continue to be the better bet even at their higher valuation ratios.

Overall, it has been my experience that stock investors are wise to hold a significant portion of their investments in high quality companies with higher returns on equity that can reliably be predicted to grow over time. Even when purchased at prices that seem somewhat expensive, these companies tend to be great investments over the long term.

The alternative approach of chasing bargains can be rewarding but is too often more frustrating. Profiting from an undervalued but lower-quality company is likely to require selling at an opportune time whereas the highest quality companies can often simply be held indefinitely.

Contributing editor Shawn Allen provides stock picks and investment education on his website at www.investorsfriend.com. He is based in Edmonton.

SHAWN ALLEN'S UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

Canadian Tire Corporation Ltd.

TSX: CTC.A, OTC: CDNAF

BUY

Originally recommended by Tom Slee on June 13/11 (#21121) at C$61.58, US$62.90. Closed Friday at C$168.29, US$124.83.

Background: In addition to its over 500 Canadian Tire stores, Tire also owns Mark's with 379 stores and 372 sports stores (SportChek, Sports Expert, Atmosphere, Athlete's World, and others). As well, it has 282 gasoline bar locations, plus PartSource, Party City, and Pro Hockey Life, which total 161 stores. It also owns Helly Hansen, which is primarily a wholesaler and is a global brand based in Oslo, Norway.

Canadian Tire also has very significant financial operations as a MasterCard credit card issuer with over 2.3 million active card holders.

Performance: Canadian Tire has provided very strong gains over the long term but does exhibit volatility. The stock was down 22% in 2022 but is up 19% this year to date.

Recent results: In the latest quarter reported, ended Apr. 1, revenues per share were up 1% but adjusted earnings per share were down 66%. The weak results were attributed to a fire at a distribution center, an unseasonably mild winter, and an increased allowance for credit card losses. The Canadian Tire store same-store sales were down 4.8% but its sports store same-store results were up 3.7% and Mark's were up 4.8%. Revenues and earnings had been essentially flat for the year in 2022.

Dividend: Last November, the company announced a 6% dividend increase to $1.725 per quarter ($6.90 annually). The dividend has been increased annually for many years.

Valuation: Analyzed at its recent price of $164.15. The dividend yield is attractive at 4.2%. The return on equity is very strong at a recent 19%. Given the high ROE, the price to book value ratio is attractive at 1.9 and is also at the low end of its historic range. The trailing 12 months adjusted

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Canadian Tire—continued from page 6…

earnings p/e is attractive at 9.8. Overall, the valuation is quite attractive.

Risks: Sales could slow as consumers face elevated costs for gasoline, food, and energy. The company also faces higher supply chain costs. Increased bad debt on its credit card operations are also likely to be a drag on earnings in the near term.

Quality: Canadian Tire is a high-quality company. It has a high return on equity and has been very well managed. Its various acquisitions have been successful, and it has adapted well to a more digital world.

Outlook: Canadian Tire may be facing little or no growth in the upcoming quarters but in the longer term, management is targeting continued strong growth.

Action now: Buy. Despite some risks, the valuation suggests a good buying opportunity. As a high-quality company, Canadian Tire is likely to bounce back from any further declines.

Starbucks Corporation NDQ: SBUX

BUY

Originally recommended on May 30/22 (#22221) at $76.71. Closed Friday at $99.50. (Figures in US dollars.)

Background: Starbucks now has 36,634 locations. Half the stores are company-operated, and half are run by licensed operators. About 43% of the stores are in the US. The company also has a large presence in China, which has 15% of their total stores all company operated. Outside of the US, Canada, and Japan, almost all stores are run by licensed operators. Starbucks rarely does one-off franchise style licenses; instead, licensees operate many stores.

Performance: Starbucks has been an absolutely stellar long-term performer, although of course not without some volatility. The shares were down 15% in 2022 to $99.20. They are relatively unchanged in 2023 to date. The stock has suffered due to concerns about unionization drives as well as from the weaker pandemic recovery in China.

Recent developments: In April 2022, founder Howard Schultz returned as temporary CEO. Subsequently, Schultz chose a new CEO, Laxman Narasimhan, who has extensive experience as a consumer products executive including with PepsiCo. Together they have embarked on a “Reinvention Plan” which involves modernizing the stores and investing in their staff through higher wages and additional training. The store

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Starbucks—continued from page 7...

count has been increasing fairly rapidly in China and other international markets.

Recent earnings: Revenue per share growth has been very strong for the past four quarters averaging 9% and reaching 14% in the latest quarter. After three quarters of declining adjusted earnings per share, growth resumed in the latest two quarters and was exceptionally strong at 25% in the latest quarter.

Dividend: The quarterly dividend is $0.53 ($2.12 per year) for a yield of 2.1%.

Value ratios: Analyzed at its recent price of $98.53. The price to book value ratio is not meaningful because the company has paid out all of its equity in dividends and share buy backs. This was deliberate and demonstrates the financial strength of the company. The p/e ratio is unattractively high at 31. The dividend yield is moderately attractive at 2.1%. Its return on assets is very strong at 12.6%. Overall, the valuation is expensive.

Risks: In addition to the unionization drives there is the potential for consumers to cut back on Starbucks purchases as they deal with inflation. But historically people have not given up this “affordable luxury” to any great extent during downturns.

Quality: Starbucks is a very high-quality company based on its growth and its high returns on capital. It’s able to grow organically by adding stores and simply steadily repeats its profitable store format in more countries and locations.

Outlook: Starbucks is almost certain to remain a global brand powerhouse and to grow over the years. In the short term it appears that earnings per share are set to grow in comparison to the weaker comparable quarter results of the prior year.

Action now: Buy. Starbucks is a very high-quality company that is likely to be a good long-term investment despite its somewhat high valuation ratios.

Linamar Corporation TSX: LNR, OTC: LIMAF

Originally recommended on Nov. 27/17 (#21742) at C$68.36 US$53.66. Closed Friday at C$62.36, US$46.49.

Background: Linamar is a Canadian-headquartered global auto parts manufacturer with 29,000 employees and 66 plants in 11 countries. Its manufacturing processes are increasingly highly engineered and technologically advanced and include 3,600 robots. In addition to vehicle parts, which account for about 76% of its revenues, its other

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products include aerial work platforms, telehandlers, booms, certain large agricultural harvesting equipment, and, more recently, certain medical equipment.

Annual revenues are about $9 billion. In 2022, sales were 53% in Canada, 26% in Europe, 13% in the US and Mexico together, and 8% to Asia/Pacific.

Performance: Linamar's stock price has been volatile over the years. It had a huge runup past $85 in 2015 but has not regained that level since. In 2022, the stock was down 18% to $61.30. The stock is relatively unchanged this year to date.

Recent earnings: Revenue per share growth has been very strong averaging over 30% in the past four quarters. Earnings per share growth has soared to over 70% in each of the past two quarters.

Recent developments: Linamar was in the news last week, announcing it will acquire three EV battery enclosure plants for US$325 million in cash.

Dividend: In March 2023, the quarterly dividend was increased by 25% to $0.22 per share ($0.88 per year) for a yield of 1.4%. The payout ratio is only 12% of trailing earnings as the company strategy has been to retain earnings for organic growth and periodic acquisitions.

Valuation: Analyzed at $62.73. The price to book value ratio at 0.8 is quite attractive and is still attractive at 1.1 times after deducting purchased goodwill.

The dividend yield is relatively minimal at 1.4%. The trailing p/e ratio is very attractive at 8.9. The analyst forward p/e is highly attractive at 7.6 and implies significant near-term profit growth. The trailing return on equity is relatively modest at 9.4% but appears set to improve. Overall, the valuation is attractive.

Outlook: The near-term outlook appears strong. However, there are many variables, so this is difficult to forecast. And perhaps the predicted recession will weaken results in 2023. Linamar has credible plans for growth, including the transition to electric vehicles.

Quality: I judge Linamar to be of reasonably good but not the highest quality. It is very well managed and in the past has had periods when its ROE has been very strong at about 20%. But it is also an inherently cyclical business and is in a competitive market.

Action now: Buy. Linamar's valuation is attractive, and it is a reasonably good quality business with a good near-term outlook.

BIG BOX STORES DIVERGE

By Gordon Pape

Big box stores often provide guidance into how the US consumer, and hence the retail economy, is faring. But right now, we're getting mixed messages. Walmart is holding up well. Target and Home Depot, not so much. Here's a closer look.

Walmart NYSE: WMT

BUY

Originally recommended on June 24/12 (#21222) at $67.30. Closed Friday at $148.82. (All figures in US dollars.)

Background: Walmart is the world's largest bricks and mortar retailer with 10,500 stores in 24 countries, plus an expanding e-commerce operation. It employs some 2.3 million people worldwide and had revenue in the 2023 fiscal year of $611 billion.

Performance: Walmart shares are down about 5% from their 52-week high, which is a good performance in the current market context. The stock is up 121% since our original recommendation.

Recent developments: First quarter 2024 results (to April 30) came in better than analysts' expectations. Revenue was $152.3 billion, up 7.6% from the year before. eCommerce growth was strong, up 26% globally year-over-year. Operating income was $6.2 billion, ahead 17.3% from a year ago. Comparable same store sales growth was 7.4% year-over-year. Net income attributed to shareholders was $1.7 billion ($0.62 per diluted share). Adjusted earnings were $1.47 per share, well ahead of consensus estimates of $1.32 and ahead 13.1% from the year before.

Dividend and buybacks: The quarterly dividend is $0.57 a share ($2.28 annually), to yield 1.5% at the current price. The company repurchased 4.8 million shares in the quarter.

Outlook: Net sales are expected to increase 3.5% over the fiscal year. The company raised fiscal 2024 guidance for earnings per share from $5.90- $6.05 to $6.10- $6.20. Analysts' consensus is $6.14.

Action now: Buy.

Target Inc. NYSE: TGT

HOLD

Originally recommended on Nov. 25/19 (#21941) at $127.02. Closed Friday at $133.22. (All figures in US dollars.)

Background: Target is a Minneapolis-based operator of big box stores, with almost 1,900 outlets in all 50 states and the District of Columbia. The company opened its first store in 1962 and now employs 350,000 people.

Performance: The stock hit a 52-week high of $183.59 in January but has been trending sharply lower since.

Recent developments: In contrast with Walmart's strong first quarter revenue growth, Target's sales were ahead only 0.5% in the first quarter, although that was in line with estimates. Earnings per share were $2.05, down 4.8% from $2.16 last year. Adjusted EPS was $2.05, a decrease of 6.2% from $2.19 in 2022.

One of the key problems the company struggled with is inventory reduction. It was down 16% compared to the same quarter last year.

"As we look ahead, we now expect shrink will reduce this year's profitability by more than $500 million compared with last year," said CEO Brian Cornell. "While there are many potential sources of inventory shrink, theft and organized retail crime are increasingly important drivers of the issue. We are making significant investments in strategies to prevent this from happening in our stores and protect our guests and our team. We're also focused on managing the financial impact on our business so we can continue to keep our stores open, knowing they create local jobs and offer convenient access to essentials."

Target has also been in the crosshairs of hate mongers who have urged people to boycott the store because of its displays of Pride merchandise. It's not known if this has had any significant effect on sales, although there have been reports that some stores withdrew or rearranged their displays, especially in the US south, citing concerns about employee safety.

Dividend and buybacks: The quarterly dividend is $1.08 per share ($4.32 annually) for a respectable yield of 3.2%. The company did not repurchase any stock in the quarter.

Outlook: Not great. The company projected a low single-digit drop in comparable sales in the current quarter and says that earnings will miss estimates. For the full year, the company is maintaining its prior guidance, which includes expected comparable sales in a wide range from a low-single digit decline to a low-single digit increase. Earnings per share and adjusted EPS should come in between $7.75 and $8.75.

Action now: Hold.

The Home Depot NYSE: HD

HOLD

Originally recommended on April 25/22 (#22217) at $300.23. Closed Friday at $295.94. (All figures in US dollars.)

Background: Home Depot is the largest home improvement retailer in the world. It was founded in 1978 and now has a total of 2,322 retail stores in all 10 provinces, all 50 US states, the District of Columbia, Puerto Rico, the US Virgin Islands, Guam, and Mexico. The company generated $157.4 billion in revenue in 2022. It employs approximately 500,000 workers.

Performance: The stock has been trading in a range of $280-$300 since March.

Recent developments: To put it bluntly, the first quarter was a horror show for Home Depot. Same stores sales growth was down 4.5%. Revenue was $37.3 billion, a billion dollars below the Street's estimate of $38.3 billion. Net earnings were $3.9 billion, ($3.82 per diluted share). That beat estimates of $3.80 per share but was down from net earnings of $4.2 billion ($4.09 per share) in the same period of fiscal 2022.

"After a three-year period of unprecedented growth for our sector, during which we grew sales by over $47 billion, we expected that fiscal 2023 would be a year of moderation for the home improvement market. Our sales for the quarter were below our expectations primarily driven by lumber deflation and unfavorable weather, particularly in our Western division as extreme weather in California disproportionately impacted our results," said CEO Ted Decker. “"We also observed more broad -based pressure across the business compared to when we reported fourth quarter results a few months ago.”

Dividend: The shares pay $2.09 per quarter ($8.32 per year) to yield 2.8% at the current price.

Outlook: CFO Richard McPhail said the company expects further softening of demand and continued uncertainty regarding consumer demand as the rest of the year unfolds. As a result, the company updated its guidance for the rest of 2023.

It now expects sales and comparable sales to decline between 2% and 5% compared to fiscal 2022. Operating margin rate will be between 14-14.3%. Diluted earnings per share will decline between 7% and 13% compared to fiscal 2022.

Not a pleasant outlook.

Action now: Hold. It will be a tough year, but the company will bounce back. In the meantime, you’re pocketing a decent dividend.

GORDON PAPE'S ETF UPDATES

Recommendations are colour-coded:
Green indicates Buy
Yellow indicates Hold
Red indicates Sell

iShares USD Green Bond ETF NDQ: BGRN

HOLD

Originally recommended on May 25/20 (#22020) at $53.90. Closed Friday at $46.50. (All figures in US dollars.)

Background: This fund invests in a portfolio of investment-grade global green bonds. This means the use of proceeds is directly tied to environmentally sustainable projects.

Performance: Like most bond funds, this was a loser in 2022, although the drop of 13% wasn't as bad as some other fixed income ETFs. This year, it was up 2.63% as of May 31.

Key metrics: This ETF has about $314 million in assets under management. That's up from our last update in July, so investors are still pumping in money despite rising interest rates and weak bond performance. The management expense ratio is 0.2%. The fund was launched in November 2018.

Portfolio: There are 315 positions in the portfolio. All are rated BBB (credit quality) or higher. Just over half the holdings have a maturity date of five years or less. The portfolio's effective duration (a measure of risk) is 5.51 years, down from 7.9 years at the time of the original recommendation and 5.85 at the time of our last update. The longer the duration, the more vulnerable a bond or a fund is to interest rate movements, so the shortening of the duration in this ETF has reduced the risk.

Distributions: The fund makes monthly distributions, which are currently around $0.13. The trailing 12-month distribution to June 1 was $1.367, for a yield of 2.9% at Friday's closing price.

Tax status: Withholding tax of 15% will apply on distributions to units held in a non-registered account, TFSA, or RESP. No tax will apply for RRSPs, RRIFs, or LIFs.

Outlook: Bonds have staged a modest recovery this year, but more interest rate hikes would be a headwind.

Action now: Hold. This is a suitable investment for investors who want to hold US dollar green securities.

iShares Core S&P/TSX Capped Composite Index ETF TSX: XIC

HOLD

Originally recommended on March 25/12 (#21212) at $19.58. Closed Friday at $31.98.

Background: This fund is designed to replicate the performance of the Capped S&P/TSX Composite Index, net of expenses. In other words, in invests in a broad portfolio of Canadian stocks.

Performance: The fund touched a 52-week low of $28.44 last October. It has staged a choppy recovery since and is up 2.24% this year (to May 31).

Key metrics: The fund was launched in February 2001 and has $8.7 billion in assets under management. That's about the same as at the time of our last review in September. The management expense ratio is very low at 0.06%.

Portfolio: The fund holds 232 positions. Royal Bank is number one at just under 6% of the assets. Other top five holdings are TD Bank (5%), Enbridge (3.4%), Canadian Pacific Kansas City (3.4%), and CN Rail and Shopify (each 3.3%). Financials at 30% are the top sector in the portfolio, followed by energy (16.6%), industrials (13.9%), and materials (11.9%).

Distributions: Payments are made quarterly. The most recent distribution, in March, was $0.259 per unit. Over the past year, distributions have totaled $0.997 per unit, for a trailing yield of 3.1%.

Outlook: We've been anticipating a recession for almost a year, but it hasn't happened yet. In fact, GDP growth in the first quarter came in higher than expected. This fund tracks the overall market, so if we do see a recession, it will hurt returns. If not, expect modest growth.

Action now: Hold. This ETF is a good choice if you want a diversified position in the broad Canadian economy, but concerns of a recession suggest prudence.