Company Profits and Returns

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December 2, 2022

Over the long term, whether it is a real estate investment, an investment in a public or private company or an infrastructure project, our return should correlate very closely with the profit growth of the underlying project.

Here is a table that supports this reality:

Entreprise	**Profit growth over 10 years**	**Annualized return of stock over 10 ans**
Berkshire Hathaway	22%	15%
Couche-Tard	22%	22%
Dollarama	21%	26%
Home Depot	20%	20%
TFI (Transforce)	20%	25%
Google	19%	19%
Costco	13%	22%
Honeywell	11%	15%
Intact	11%	12%
Canadian Tire	11%	11%
Royal Bank	10%	9%
TD Bank	10%	8%
CN	10%	15%
Metro	9%	13%
UPS	9%	12%
Suncor	2%	2%
Under Armour	4%	1%
Coca-Cola	0%	6%
Exxon Mobil	-5%	0%
Corus (TV stations)	-7%	-12%
Average	**11%**	**12%**

In the short term, however, the reality is quite different. “Market law enforcement” can be distorted by events that play on people’s fear and euphoria. Stock prices in trendy sectors can rise wildly unrelated to their fundamentals and vice versa.

These two realities of the short term and the long term lead us to have to make a choice between return or control of volatility. The vast majority of the industry makes the 2nd choice.

Many people have difficulty with temporary drops. Most people don't understand this relationship between profits and the long-term value of a company (whether public or private).

A good example is in real estate. Profits in this case come from rents. Most real estate investors were aware that real estate profits in 2021 were very low compared to the historical average. For example, for a triplex in Montreal with a “market value” of $1M, we could expect profits of $15,000 or $20,000 assuming no debt on the building. If we add the mortgage debt, we did not make a profit in 2021.

All the same, many people continued to say the same thing: “Yes, but at least I will get the capital gain on the value of my building when I sell it. » The problem with this is that we ignore the tight link between the profits of an asset and its true value. Cheap and easy money is a powerful way to distort the link between the true value of a building and its ability to generate profits. I think over time, market forces (probably interest rates in this case) bring things back to normal.

So people too often focus on short-term returns and try to draw conclusions from this information. In my opinion, we must first focus on profits and the future profit-generating capacity of a company. You have to be wary of short-term fluctuations and use them as an opportunity. We must always remain humble and realize that sometimes the market is right even if past profits say the opposite.