A Beginner's Tour of the Stock Selection Guide

NATIONAL ASSOCIATION OF INVESTORS CORPORATION

BETTERINVESTING™

Empowering Investors Since 1951

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San Francisco Bay Area Chapter

Better Investing

Disclaimer

BetterInvesting BELIEVES:

- **Invest Regularly**
- **Re-invest All Dividends**
- **Diversify**
- **Buy High Quality Growth Stocks at Affordable Prices**

THE STOCK SELECTION GUIDE HELPS US DETERMINE IF WE HAVE A HIGH QUALITY GROWTH COMPANY AT AN AFFORDABLE PRICE.

THE SSG IS:

- An aid to your judgment.
- A guide to your thinking.
- A way to organize your data.
- A document with a proven track record.
- A way to successfully choose stocks for purchase.

THE SSG IS NOT:

- A "Magic Box".
- A form to be used without your input and judgment.
- A way to evaluate non-growth stocks.

So, what is a Growth Stock and what are its characteristics?
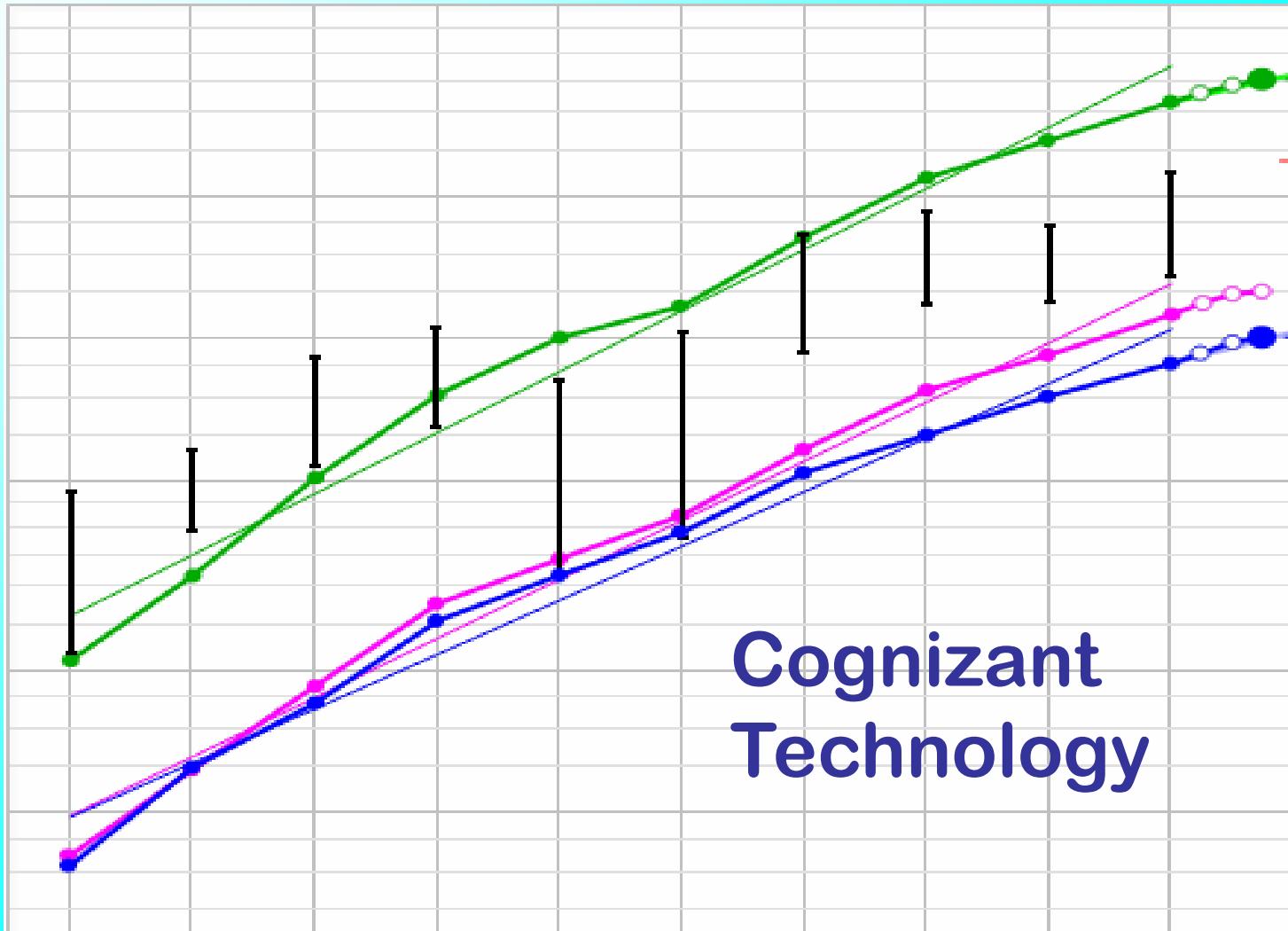
GROWTH STOCK

- **Sales increasing quarter-by-quarter**
- **Earnings per share increasing quarter-by –quarter**
- **Profit increasing quarter-by -quarter**

IF WE WERE TO GRAPH THE SALES, EARNINGS PER SHARE AND PROFIT OF A HIGH QUALITY GROWTH STOCK, WE WOULD SEE LINES THAT ARE ....

UP, STRAIGHT AND PARALLEL!
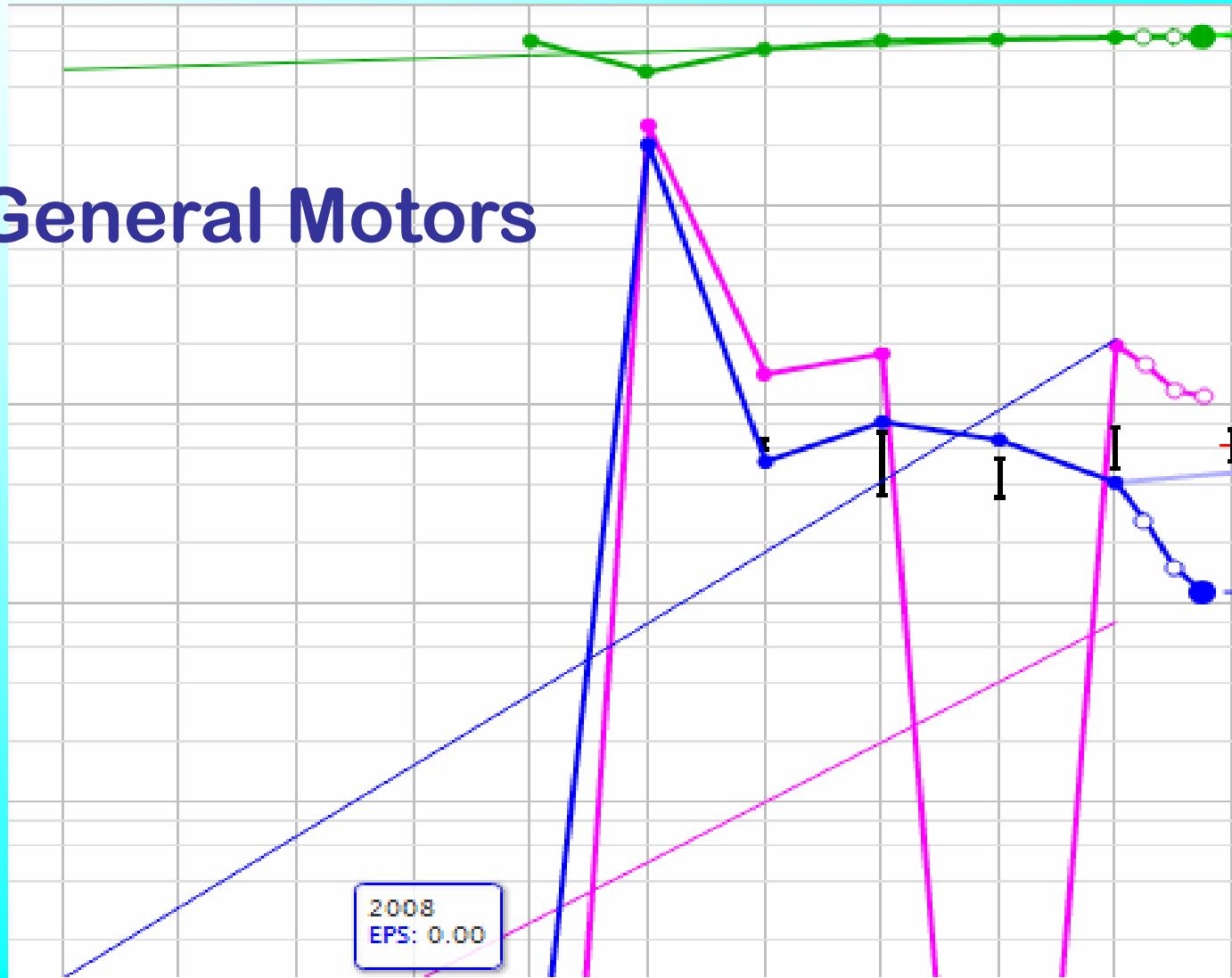
This is CHANT #1! Memorize and use frequently at club meetings!
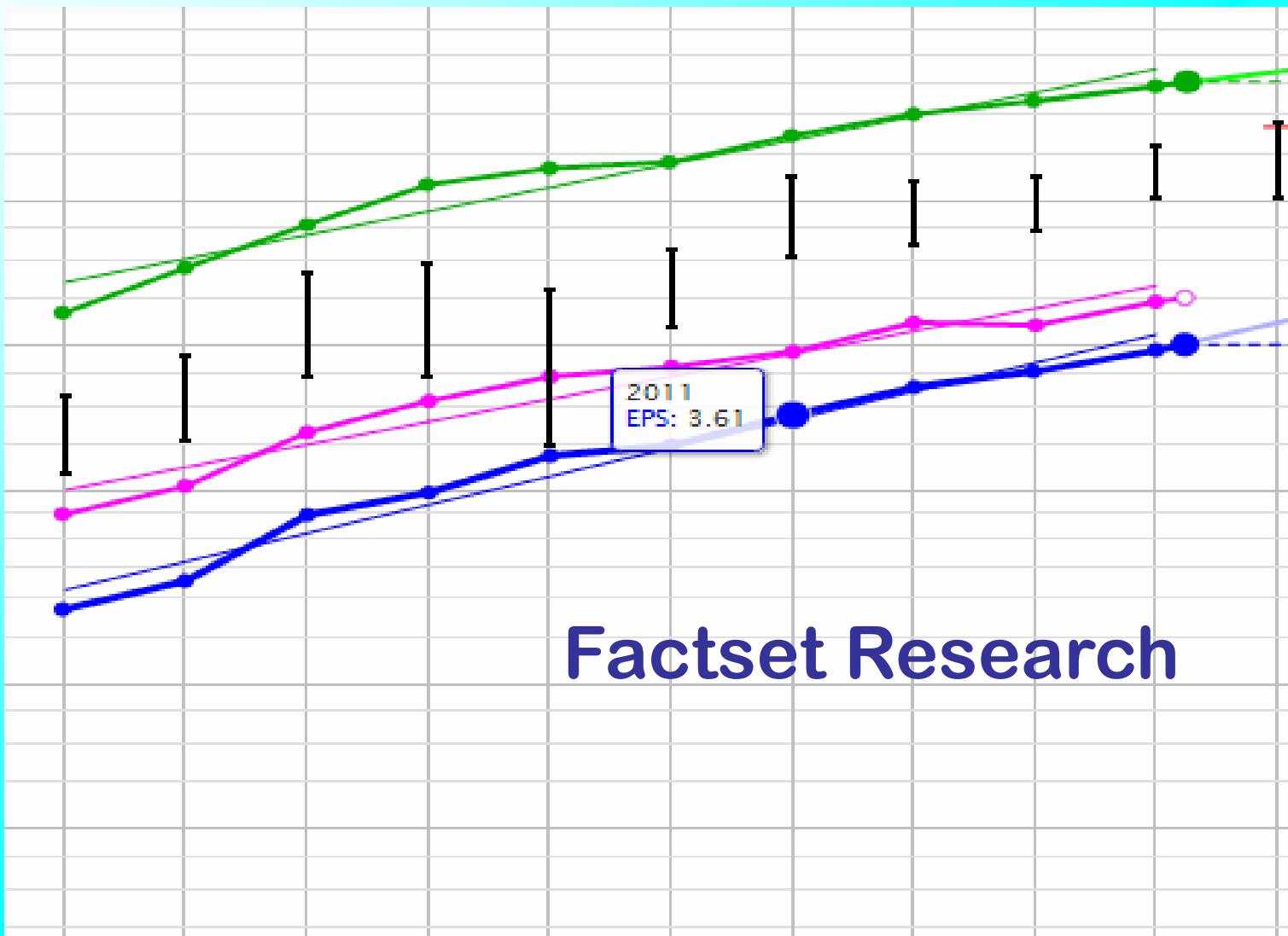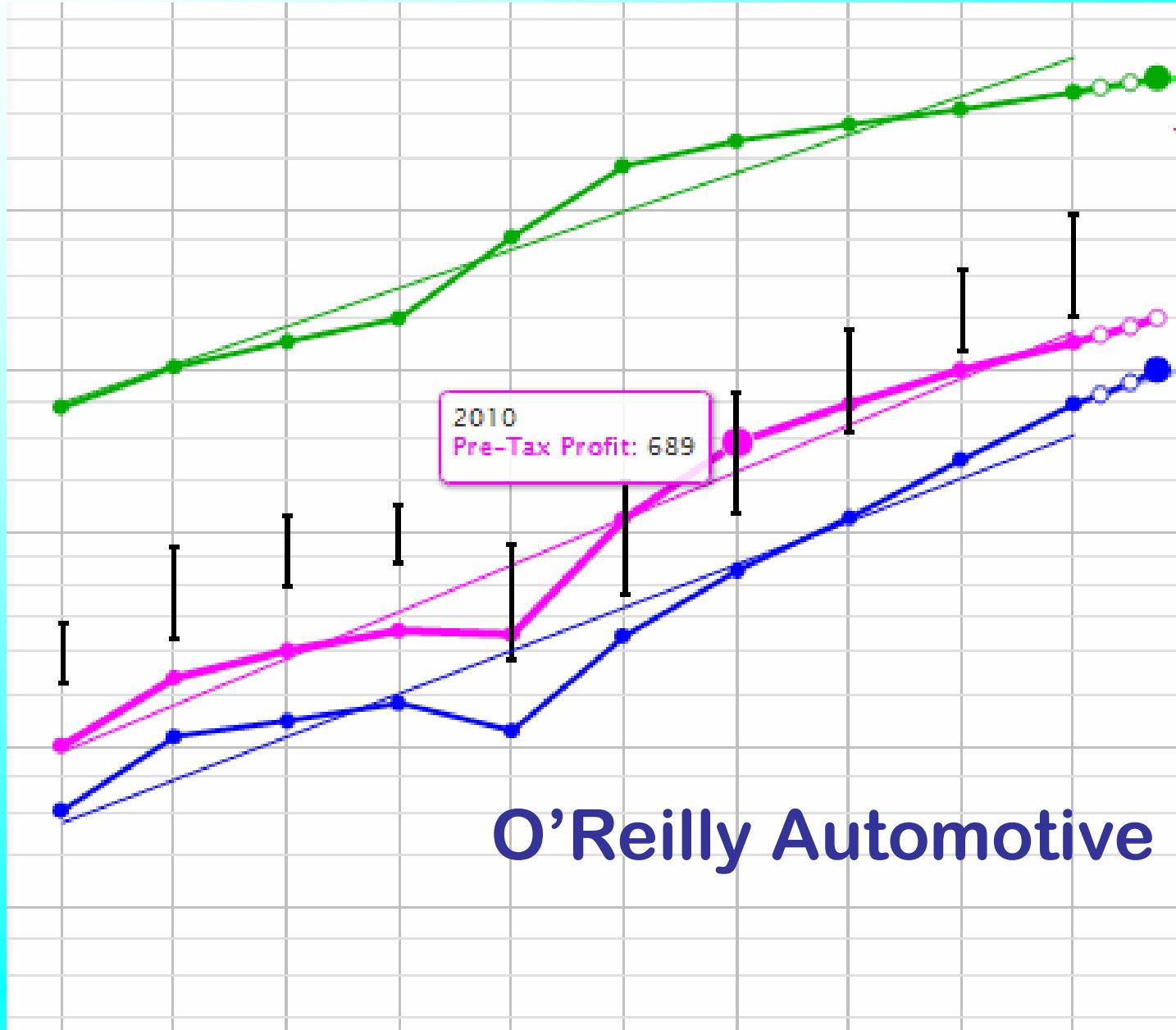
Cognizant
Technology

UP, STRAIGHT AND PARALLEL!

General Motors

2008
EPS: 0.00

2011
EPS: 3.61

Factset Research

2010
Pre-Tax Profit: 689

O'Reilly Automotive

2012
Pre-Tax Profit: 3,228

DOW Chemical
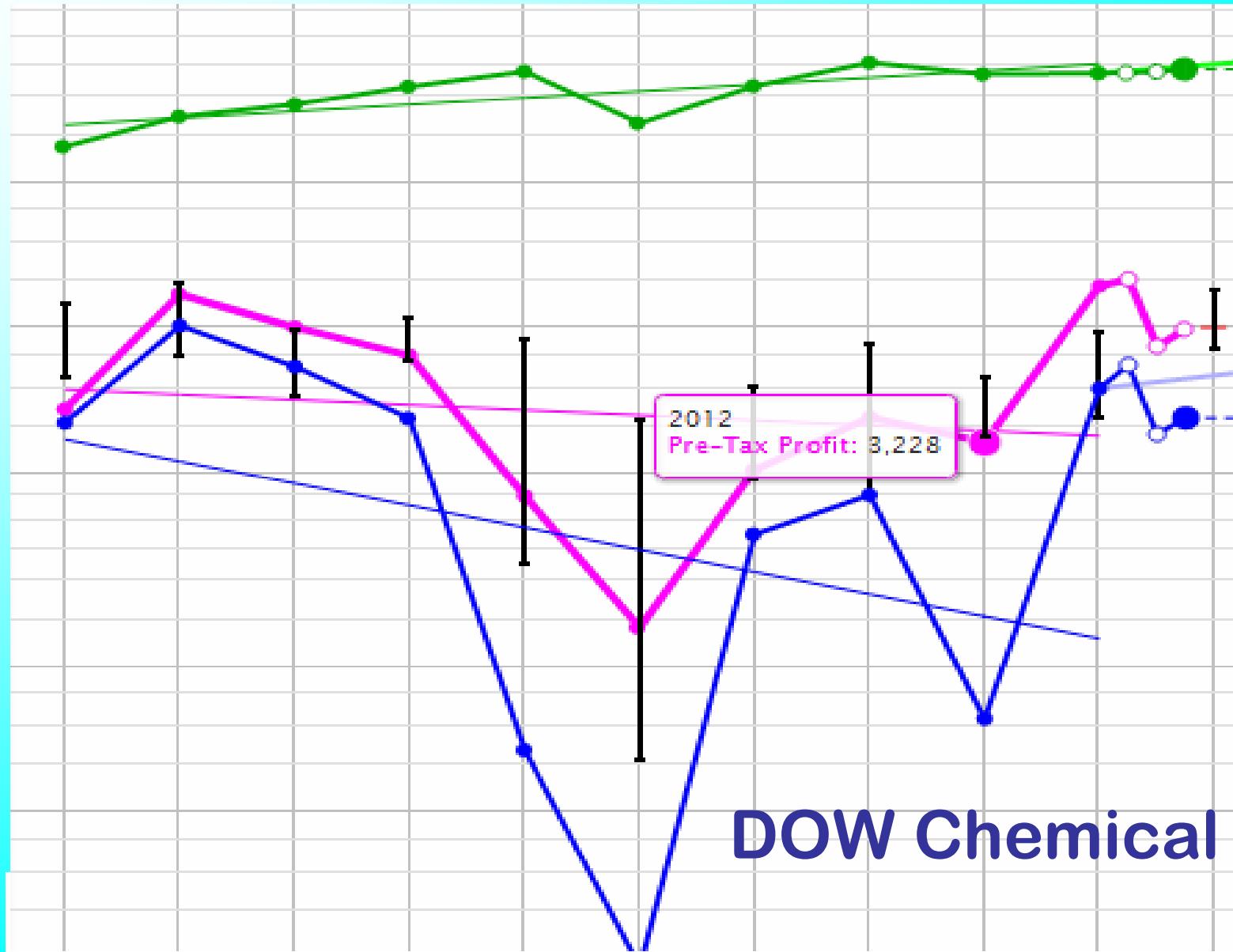
Straight lines on
SSG graphs signify
CONSISTENT, STEADY
growth!

WE ARE ESPECIALLY INTERESTED IN PREDICTING WHERE THE BLUE LINE WILL MOVE DURING THE NEXT FIVE YEARS.....

EARNINGS FOLLOW SALES AND STOCK PRICE FOLLOWS EARNINGS!

Here is Chant #2!

Let's check out an actual SSG!
Are the lines Up, Straight & Parallel?

A Closer Look...
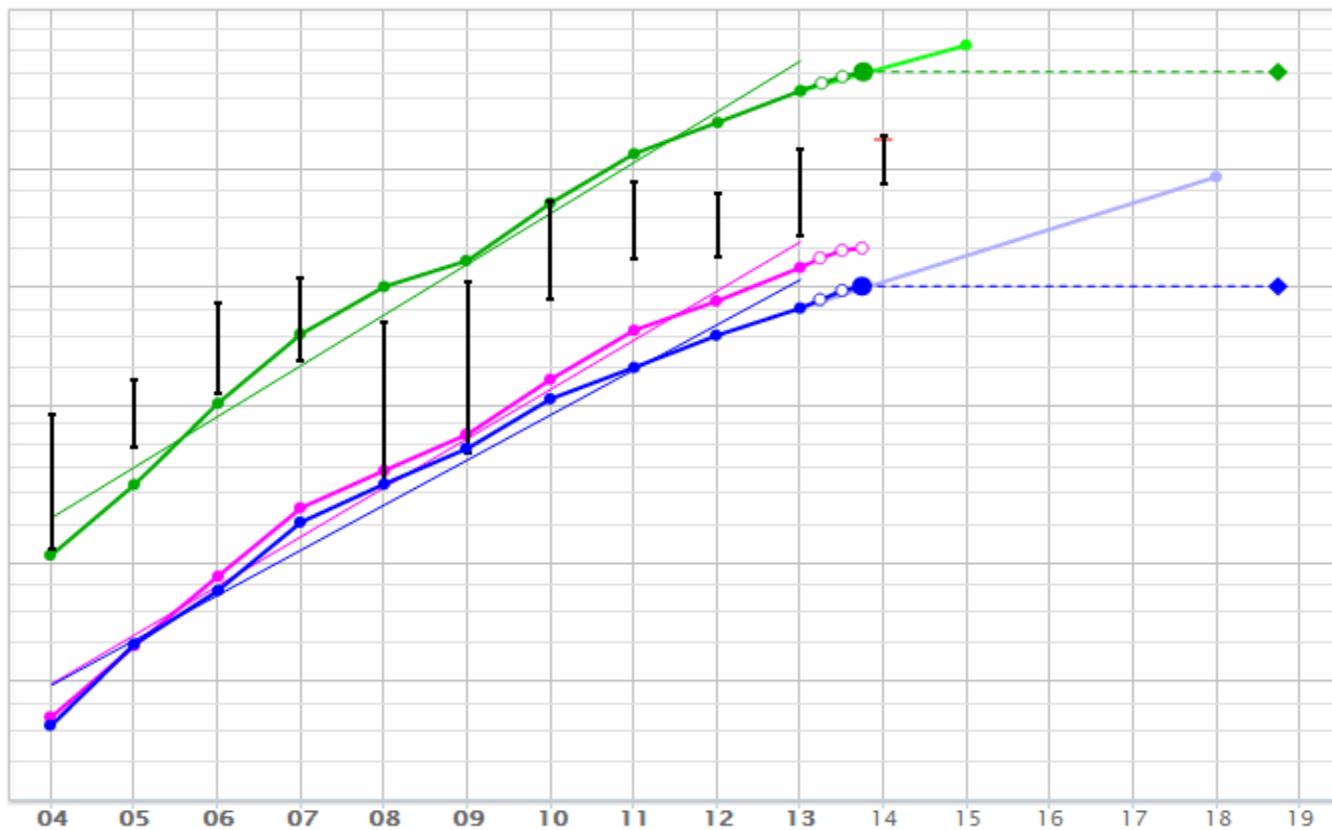
Projection Starting Point

○ Annual ◉ Quarter ○ Trend

Recent Quarterly Figures

FY2013 QuarterEnding (09/14)

	Sales	EPS
Latest Quarter	2,581	0.58
Year Ago Quarter	2,306	0.53
Percentage Change	11.9%	10.7%
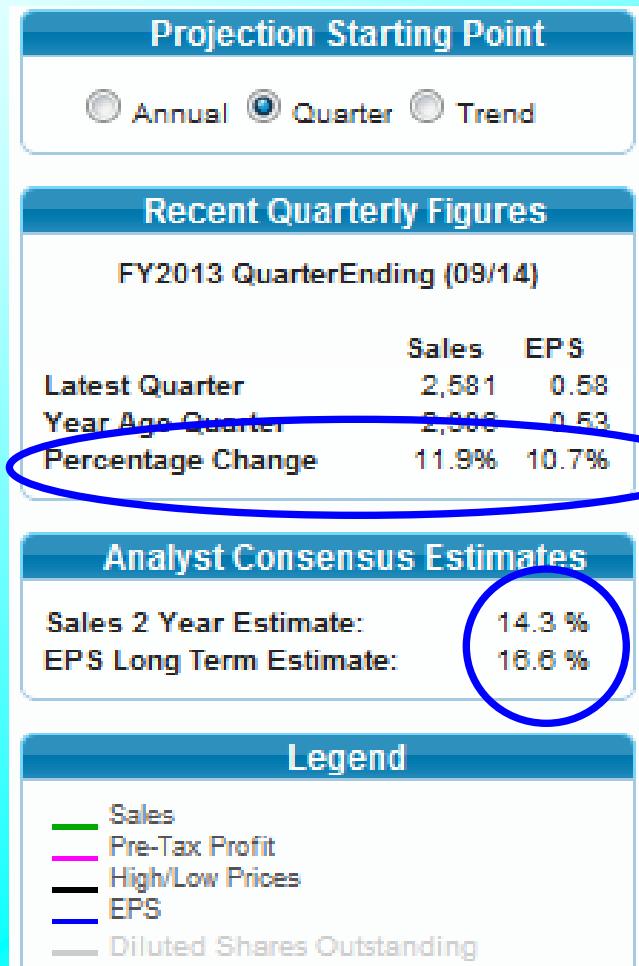
Analyst Consensus Estimates

Sales 2 Year Estimate:	14.3 %
EPS Long Term Estimate:	16.6 %

Legend

- Sales
- Pre-Tax Profit
- High/Low Prices
- EPS
- Diluted Shares Outstanding
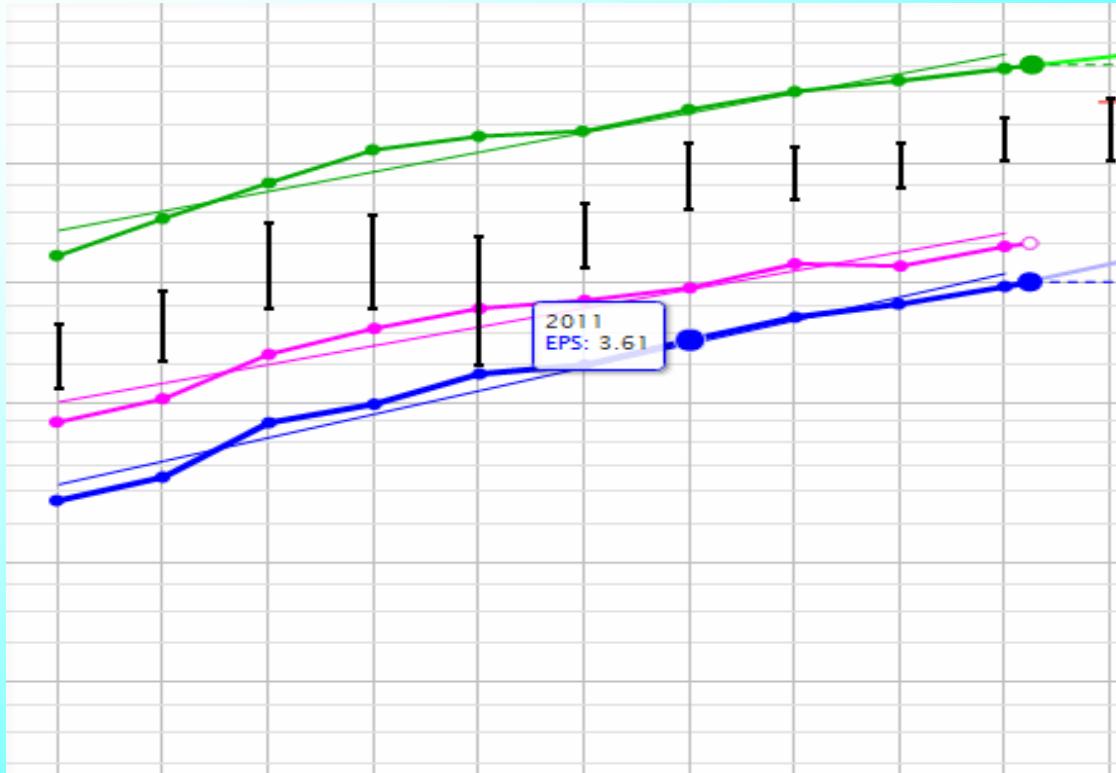
We are looking for **GROWTH** or **STABILITY** in most recent quarter. Values are not that important.

We are looking for positive Analyst Estimates

GREEN line is SALES.

PINK line is PRE-TAX PROFIT.

BLUE line is EARNINGS PER SHARE.

2011
EPS: 3.61

GRAPH SHOULD BE ...

UP, STRAIGHT AND PARALLEL!

Fundamental Company Data

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Growth(%)
Historical Sales	587	886	1,424	2,136	2,816	3,279	4,592	6,121	7,346	8,843	34.5%
Historical Earnings	0.18	0.28	0.39	0.58	0.72	0.89	1.19	1.42	1.72	2.02	30.1%
Pre-Tax Profit	122	185	278	414	515	637	879	1,169	1,388	1,688	33.3%

HISTORIC SALES GROWTH OVER TEN YEARS

HISTORIC EARNINGS GROWTH OVER TEN YEARS

These numbers should be similar because . . .

EARNINGS FOLLOW SALES AND STOCK PRICE FOLLOWS EARNINGS!

Fundamental Company Data

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Growth(%)	Projection(%)
Historical Sales	587	886	1,424	2,136	2,816	3,279	4,592	6,121	7,346	8,843	34.5%	
Historical Earnings	0.18	0.28	0.39	0.58	0.72	0.89	1.19	1.42	1.72	2.02	30.1%	
Pre-Tax Profit	122	185	278	414	515	637	879	1,169	1,388	1,688	33.3%	

OUR JOB IS TO ADD NUMBERS IN THE TWO GREEN BOXES!

Where do we get the "magic numbers" ?

MAGIC NUMBER SOURCES

- **The SSG historic numbers.**
- **The ACE number** **(Analyst Consensus Estimate)**
- **The company itself**
- **ValueLine, S&P, Morningstar, etc.**
- **Industry articles or proprietary research**
- **Business magazines and journals**
- **Annual report & Qrtly. earnings reports**

GUIDELINES FOR BEGINNERS

- **Never estimate future sales above 15% without a reason and never estimate above 20% .**

- **Never estimate earnings higher than sales**
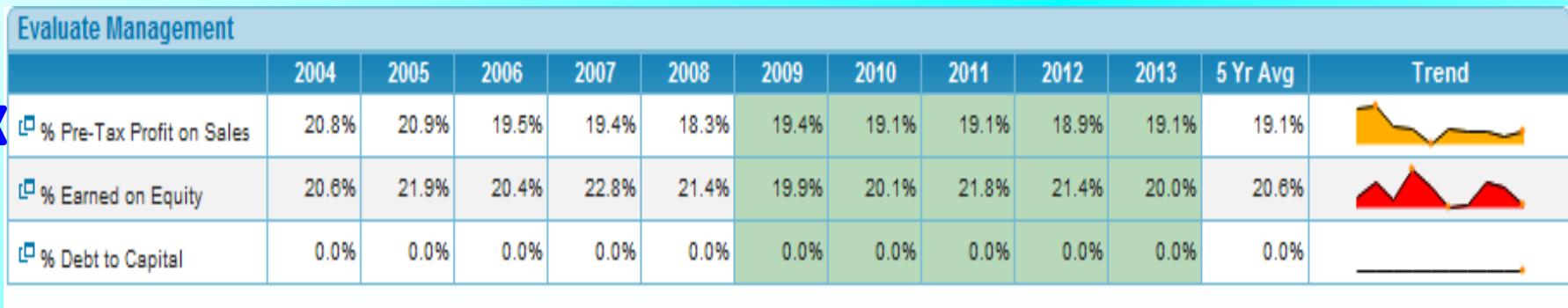
DO NOT GET PARALYZED AT THIS STAGE OF THE ANALYSIS!

Keep Repeating . . .

MY NUMBERS ARE AS GOOD AS ANYONE ELSE'S (UNTIL YOU CONVINCE ME OTHERWISE)!

ANOTHER CHANT!

The Trend Is Important –

VERY IMPORTANT!

Evaluate Management	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	20.8%	20.9%	19.5%	19.4%	18.3%	19.4%	19.1%	19.1%	18.9%	19.1%	19.1%	
% Earned on Equity	20.6%	21.9%	20.4%	22.8%	21.4%	19.9%	20.1%	21.8%	21.4%	20.0%	20.6%	
% Debt to Capital	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	

PTP shows the trend in MARGIN which is cents earned on the dollar. This example shows FDS earned 19.1 cents on every dollar sold and that the trend has been steady over the past five or more years.
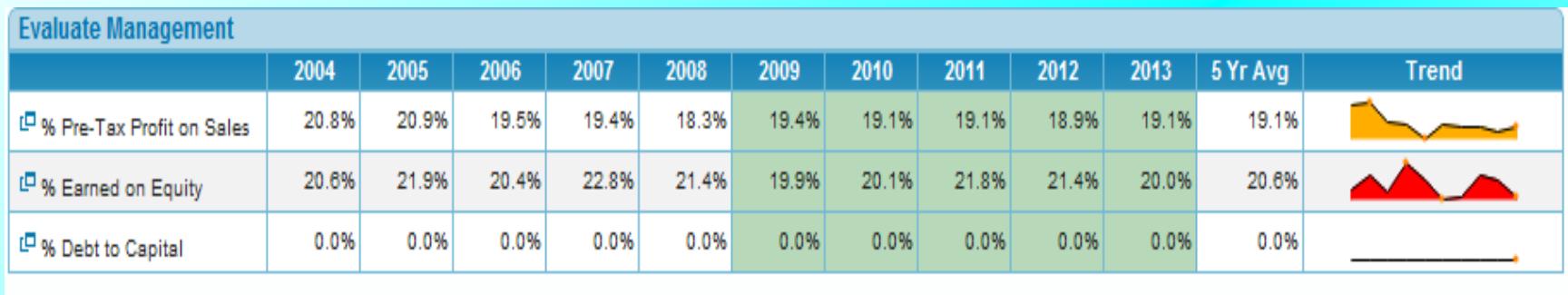
As shown by the graph, yellow = steady

As a BEGINNER . . .

When MARGINS are declining, stop the study and discard the SSG!

SECTIONS 1 AND 2 OF THE SSG TELL YOU WHETHER OR NOT YOU HAVE A HIGH QUALITY GROWTH COMPANY.

What About Debt?

Evaluate Management	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	5 Yr Avg	Trend
% Pre-Tax Profit on Sales	20.8%	20.9%	19.5%	19.4%	18.3%	19.4%	19.1%	19.1%	18.9%	19.1%	19.1%	
% Earned on Equity	20.6%	21.9%	20.4%	22.8%	21.4%	19.9%	20.1%	21.8%	21.4%	20.0%	20.6%	
% Debt to Capital	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	

DEBT PERCENTAGE IS AN *IMPORTANT* VALUE! THE DEBT ON A TYPICAL COMPANY SHOULD NOT EXCEED 30%.

As a BEGINNER . . .

YOU DON'T HAVE TO READ EVERYTHING TO BE SUCCESSFUL!

Yet another chant pertaining to the SSG – and maybe LIFE in general!

Section 3 Shows What Actually Happened!

3. PRICE EARNINGS HISTORY as an indicator of the future

PRESENT PRICE: 53.93   **HIGH THIS YEAR:** 54.89   **LOW THIS YEAR:** 41.51

		A	B	C	D	E	F	G	H
	Year	Price		Earnings	Price Earnings Ratio		Dividend	% Payout	% High Yield
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2009	23.3	8.6	0.89	26.2	9.7	0.00	0.0	0.0
2	2010	37.4	21.0	1.19	31.5	17.7	0.00	0.0	0.0
3	2011	41.7	26.8	1.42	29.3	18.8	0.00	0.0	0.0
4	2012	39.0	27.0	1.72	22.7	15.7	0.00	0.0	0.0
5	2013	50.6	30.5	2.02	25.1	15.1	0.00	0.0	0.0
	AVERAGE		22.8		27.0	15.4			
	CURRENT/TTM			2.29				0.00	0.0

AVERAGE PRICE EARNINGS RATIO: 21.2   **CURRENT PRICE EARNINGS RATIO:** 23.6

Examine Columns D and E, looking for trends.

What is P/E?

▶ 3. PRICE EARNINGS HISTORY as an indicator of the future

PRESENT PRICE: 53.93   HIGH THIS YEAR: 54.89   LOW THIS YEAR: 41.51

		A	B	C	D	E	F	G	H
	Year	Price		Earnings	Price Earnings Ratio		Dividend	% Payout	% High Yield
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2009	23.3	8.6	0.89	26.2	9.7	0.00	0.0	0.0
2	2010	37.4	21.0	1.19	31.5	17.7	0.00	0.0	0.0
3	2011	41.7	26.8	1.42	29.3	18.8	0.00	0.0	0.0
4	2012	39.0	27.0	1.72	22.7	15.7	0.00	0.0	0.0
5	2013	50.8	30.5	2.02	25.1	15.1	0.00	0.0	0.0
	AVERAGE		22.8		27.0	15.4			
	CURRENT/TTM			2.29			0.00	0.0	
	AVERAGE PRICE EARNINGS RATIO: 21.2					CURRENT PRICE EARNINGS RATIO: 23.6			

Average P/E – Add the average P/E in Column D & E together and divide by 2!

Current P/E – Today's price divided by TTM earnings

P/E is how much the market is willing to pay for the company.

It's expressed in terms of earnings. A P/E of 30 means you would be willing to pay 30 times what the company earned in the past four quarters to own the stock!

WHAT'S YOUR *GASP* LEVEL?

Gasp: An audible intake of breath!

		A	B	C	D	E	F	G	H
	Year	Price		Earnings	Price Earnings Ratio		Dividend	% Payout	% High Yield
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2009	9.4	8.0	0.46	20.4	17.4	0.00	0.0	0.0
2	2010	17.0	7.4	0.26	64.4	27.9	0.00	0.0	0.0
3	2011	28.6	15.8	0.38	74.8	41.3	0.00	0.0	0.0
4	2012	28.8	17.5	0.40	71.7	43.6	0.00	0.0	0.0
5	2013	25.4	16.3	0.26	96.4	61.9	0.00	0.0	0.0
	AVERAGE		13.0		65.5	38.4			
	CURRENT/TTM			0.18			0.00	0.0	
	AVERAGE PRICE EARNINGS RATIO	52.0				CURRENT PRICE EARNINGS RATIO	172.1		

GASP!

		A	B	C	D	E	F	G	H
	Year	Price		Earnings	Price Earnings Ratio		Dividend	% Payout	% High Yield
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2009	61.7	28.8	1.98	31.1	14.5	0.00	0.0	0.0
2	2010	206.8	48.5	2.96	69.8	16.4	0.00	0.0	0.0
3	2011	304.8	62.4	4.16	73.3	15.0	0.00	0.0	0.0
4	2012	133.4	52.8	0.29	458.5	181.5	0.00	0.0	0.0
5	2013	389.2	90.7	1.85	210.4	49.0	0.00	0.0	0.0
	AVERAGE		56.6		168.6	55.3			
	CURRENT/TTM			3.76			0.00	0.0	
	AVERAGE PRICE EARNINGS RATIO	112.0				CURRENT PRICE EARNINGS RATIO:	90.8		

		A	B	C	D	E	F	G	H
	Year	Price		Earnings	Price Earnings Ratio		Dividend	% Payout	% High Yield
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2009	24.3	12.7	0.52	46.7	24.5	0.00	0.0	0.0
2	2010	25.0	12.1	0.61	40.6	19.7	0.00	0.0	0.0
3	2011	33.7	18.3	0.84	40.1	21.8	0.00	0.0	0.0
4	2012	60.9	27.3	1.07	57.0	25.5	0.00	0.0	0.0
5	2013	61.5	31.9	1.17	52.4	27.2	0.00	0.0	0.0
	AVERAGE		20.5		47.4	23.7			
	CURRENT/TTM			1.00			0.00	0.0	
	AVERAGE PRICE EARNINGS RATIO: 35.6					CURRENT PRICE EARNINGS RATIO: 50.7			

Gasp!

When P/E's leave you breathless, use lower values for your future estimates!

Section 4 asks you to predict future High P/E values.

Determine High Price - Next 5 Years

Forecast High Stock Price

5 Year Average High P/E: **47.4**   5 Year Average P/E: **35.5**   Current P/E: **50.73**

Your Average High P/E Forecast: [   ] X High EPS Forecast: [0.00] = High Stock Price Forecast: [0.0]

Closing Price (12/29/2014): **50.73**

Update Study

Use the historical values as a guide and remember your GASP level!

Next: Section 4 asks you to predict future Low P/E value

1.

Determine Low Price - Next 5 Years

Select Low Stock Price Forecast

○ Your Low Stock Price Forecast: [0.0]

○ Low P/E X Low EPS Forecast:

Average Low P/E Forecast: [0.0] X Low EPS Forecast: [1.17] = Forecast Low Stock Price: [0.0]

5 Year Average Low P/E: **23.7**   Last 4 Qtr EPS: **1.00**   Closing Price (12/29/2014): **50.73**

5 Year Average P/E: **35.5**

Current P/E: **50.73**

○ Recent Market Low Price: [27.25]

2012 Low Stock Price: **27.25**   52 Week Low Stock Price: **36.54**

2013 Low Stock Price: **31.94**

○ Average Low Price of Last Five Years: [20.4]

○ Price Dividend Will Support: Present Dividend = 0.00 = [NMF]
                                  High Yield   0.00%

[Update Study]

Use the historical values as a guide and remember your GASP level!

Adjust low EPS to match most recent four quarters. The default is the most recent fiscal year earnings.

▶ Determine Low Price - Next 5 Years

Select Low Stock Price Forecast

○ Your Low Stock Price Forecast: [23.4]

2. ◉ Low P/E X Low EPS Forecast:

    Average Low P/E Forecast: [20.0] X Low EPS Forecast: [1.17] = Forecast Low Stock Price: [23.4]

    5 Year Average Low P/E: **23.7**   Last 4 Qtr EPS: **1.00**   Closing Price (12/29/2014): **50.73**

    5 Year Average P/E: **35.5**

    Current P/E: **50.73**

For growth companies use the calculated Low Price

○ Recent Market Low Price: [27.25]

    2012 Low Stock Price: **27.25**   52 Week Low Stock Price: **36.54**

    2013 Low Stock Price: **31.94**

○ Average Low Price of Last Five Years: [20.4]

○ Price Dividend Will Support: Present Dividend / High Yield = 0.00 / 0.00% = [NMF]

Update Study

C. ZONING using 25%-50%-25% (click to toggle)

Forecasted High Price: 68.7 Minus Forecast Low Price: 23.4 = 45.3 Range. 25% of Range: 11.3

Buy Zone:	23.4	to	34.7
Hold Zone:	34.7	to	57.4
Sell Zone:	57.4	to	68.7

Present Stock Price of 50.73 is in the **HOLD** Zone

D. UPSIDE DOWNSIDE RATIO (POTENTIAL GAIN VS. RISK OR LOSS)

$$\frac{\text{Forecasted High Price} - \text{Present Price}}{\text{Present Price} - \text{Forecasted Low Price}} = \frac{(68.7 - 50.73)}{(50.73 - 23.4)} = \frac{17.97}{27.33} = 0.7 \text{ To } 1$$

E. PRICE TARGET (Note: This shows the potential market price appreciation over the next five years in simple interest terms.)

$$\frac{\text{Forecasted High Price}}{\text{Present Price}} = \frac{68.7}{50.73} = (1.3542 \times 100) = (135.42 - 100) = 35.4\% \text{ Appreciation}$$

The rest is reading!

▶ **5. FIVE-YEAR POTENTIAL**

A. PRESENT YIELD

$$\frac{\text{Present Full Year's Dividend}}{\text{Present Price}} = \frac{0.00}{50.73} = 0.0000 = 0.0\%$$

B. AVERAGE YIELD – USING FORECAST HIGH P/E

$$\frac{\text{Avg. \% Payout}}{\text{Forecasted High P/E}} = \frac{0.0\%}{30.00} = 0.0\%$$

AVERAGE YIELD – USING FORECAST AVERAGE P/E

$$\frac{\text{Avg. \% Payout}}{\text{Forecasted Average P/E}} = \frac{0.0\%}{25.00} = 0.0\%$$

C. COMPOUND ANNUAL RETURN – USING FORECAST HIGH P/E

Annual Appreciation	6.3%
Average Yield	0.0%
Annualized Rate of Return	6.3%

COMPOUND ANNUAL RETURN – USING FORECAST AVERAGE P/E

Annual Appreciation	2.4%
Average Yield	0.0%
Annualized Rate of Return	2.4%

SSG Results Summary

Zone:	**HOLD**
Upside Downside Ratio:	0.7 To 1
Total Return (High P/E):	6.3%
Projected Return (Avg P/E):	2.4%
Buy price to satisfy US/DS of 3 to 1 and 15% total return:	34.2
Closing Price (12/29/2014):	50.73

It all gets summarized in the above box
In order to purchase, it should say Buy

To Learn More Visit the BI Website
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Class	Class Date	Watch Now	Last Viewed	Class Materials
Introduction to the SSG Series (WM-140721S)		Member Benefit		
Selecting the Best Companies	n/a	Play Recording		TJX Companies Completed SSG (PDF) Ross Stores Completed SSG (PDF) Selecting the Best – 1 slide per page (PDF) Selecting the Best – 4 slides per page (PDF) Quality Worksheet (PDF) Practice Companies (PDF) Reference: Quality Check List (PDF) Practice Answer Key (PDF)
Determining a Fair Price	n/a	Play Recording	09/10/2014	Fair Price – 1 slide per page (PDF) Fair Price – 4 slides per page (PDF) Valuation Worksheet (PDF) Practice SSGs (PDF) Answer Key Valuation (PDF)
Estimating Future Growth	n/a	Play Recording		Estimating Growth – 1 slide per page (PDF) Estimating Growth – 4 slides per page (PDF) TJX Value Line dated 11/2/2012 (PDF) ROST Value Line dated 11/2/2012 (PDF) Estimate Growth Worksheet (PDF) PRACTICE: Costco Value Line (PDF) Answer Key: COST Growth Worksheet (PDF)
Estimating Future P/Es	n/a	Play Recording		Estimating P/Es – 1 slide per page (PDF) Estimating P/Es – 4 slide per page (PDF)

After viewing the SSG class, sign up for the Judgment class using research tools to aid your judgment.

Thank you for your attention!

I have left time for questions.