

Stock Investing Made Easy  
*GEE! I WISH I NOTICED THAT! (IDENTIFYING RED FLAGS)*  
Brian Altschul

## Stock Investing Made Easy

# Gee! I Wish I Had Noticed That!



Identifying Red Flags

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## Stock Investing Made Easy

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## Stock Investing Made Easy

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## Stock Investing Made Easy

# Identifying Red Flags

- Debt
  - To % of Total Capitalization
  - Debt to Equity Ratio
- Price Earnings Ratio
  - Visual Inspection

## Stock Investing Made Easy

# Identifying Red Flags

- Growth Rate
  - Historical Growth Rate
  - Quarterly Trend Analysis
- Profit Margin
  - Revenue-based EPS Estimate
  - Pretax Profit on Sales
  - Quarterly Trend Analysis

## Stock Investing Made Easy

# Identifying Red Flags

- Projected Price Computations
- Reality Checks
  - Projected High Price
  - Low Price
- Price Ranges
- Share Buybacks

## Stock Investing Made Easy

# Software Used

BETTERINVESTING™  
**SSG** PLUS

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## Stock Investing Made Easy

# Debt

- Evaluate Management
  - % Debt To Capital (third line)
- Value Line
  - Capital Structure Box
- Red Flag
  - Over 30% Debt to Total Capitalization



## Stock Investing Made Easy

# Debt

- Debt to Capital Ratio

$$\frac{\text{Debt}}{\text{Debt} + \text{Shareholders' Equity}}$$

- Debt to Equity Ratio

$$\frac{\text{Debt}}{\text{Shareholders' Equity}}$$

## Stock Investing Made Easy

# Debt - Examples

- Alphabet Inc. (Nasdaq: GOOG)
- Value Line
  - 6% of Cap'l
  - Great!




|  |
|--|
| <b>CAPITAL STRUCTURE as of 9/30/20</b><br>Total Debt \$13902 mill. Due in 5 Yrs. \$2482 mill.<br>LT Debt \$13902 mill. LT Interest \$100 mill.<br>(6% of Cap'l)<br><br>Leases, Uncapitalized: Annual rentals \$1757 mill.<br><br>No Defined Benefit Pension Plan<br>Pfd Stock None<br><br>Common Stock 676,426,200 shares (300,643,829<br>Class A shares, 45,915,231 Class B<br>shares, and 329,867,212 Class C shares) <sup>C</sup> <sup>D</sup><br><br>MARKET CAP: \$1.28 trillion (Large Cap) |
|--|

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## Stock Investing Made Easy

# Debt - Examples

- Alphabet Inc. (Nasdaq: GOOG)

| Evaluate Management       |       |       |       |       |       |          | Trend   |
|---------------------------|-------|-------|-------|-------|-------|----------|---|
|                           | 2016  | 2017  | 2018  | 2019  | 2020  | 5 Yr Avg |   |
| % Pre-Tax Profit on Sales | 26.8% | 24.5% | 25.5% | 24.5% | 26.3% | 25.5%    |  |
| % Return on Equity        | 14.4% | 8.0%  | 17.9% | 17.4% | 18.6% | 15.2%    |  |
| % Debt To Capital         | 2.8%  | 2.5%  | 2.2%  | 7.3%  | 10.7% | 5.1%     |  |

- Low, but up recently
- Worth watching?

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# Debt - Examples

- Southwest Airlines (NYSE: LUV)
- Value Line
  - 53% of Cap'l
  - Red flag!

|   |  |
|---|--|
| <b>CAPITAL STRUCTURE</b> as of 12/31/20 |  |
| <b>Total Debt</b> \$10331 mill.         | <b>Due in 5 Yrs</b> \$6000 mill.                   |
| <b>LT Debt</b> \$10111 mill.            | <b>LT Interest</b> \$430.0 mill.<br>(53% of Cap'l) |

**Leases, Uncapitalized** Annual rentals \$750 mill.  
**No Defined Benefit Pension Plan**  
**Pfd Stock** None




**Common Stock** 590,474,337 shs.

**MARKET CAP:** \$30.8 billion (Large Cap)

## Stock Investing Made Easy

# Debt - Examples

- Southwest Airlines (NYSE: LUV)

| Evaluate Management       |       |       |       |       |        |          |   |
|---------------------------|-------|-------|-------|-------|--------|----------|---|
|                           | 2016  | 2017  | 2018  | 2019  | 2020   | 5 Yr Avg | Trend   |
| % Pre-Tax Profit on Sales | 17.4% | 15.4% | 14.4% | 13.2% | -47.0% | 2.7%     |  |
| % Return on Equity        | 27.1% | 38.7% | 23.4% | 22.3% | -32.9% | 15.7%    |  |
| % Debt To Capital         | 28.6% | 26.0% | 25.5% | 28.9% | 57.9%  | 33.4%    |  |

- Well controlled until recently
- Any good reason for the sudden increase?

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# Debt - Examples

- Home Depot Inc. (NYSE: HD)
- Value Line
  - 96% of Cap'l
  - WOW!
  - Red flag!




| CAPITAL STRUCTURE as of 11/1/20                           |                                  |
|---|----------------------------------|
| <b>Total Debt</b> \$35322 mill.                           | <b>Due in 5 Yrs</b> \$9513 mill. |
| <b>LT Debt</b> \$32831 mill.                              | <b>LT Interest</b> \$1240 mill.  |
| (Total interest coverage: 13.3x. LT int earned: 13.3x)    |                                  |
| <b>Leases, Uncapitalized</b> Annual rentals \$1.773 bill. | (96% of Cap'l)                   |
| <b>No Defined Benefit Pension Plan</b>                    |                                  |
| <b>Pfd Stock</b> None                                     |                                  |
| <b>Common Stock</b> 1,076,600,781 shs.<br>as of 11/17/20  |                                  |
| <b>MARKET CAP:</b> \$283 billion (Large Cap)              |                                  |

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## Stock Investing Made Easy

# Debt - Examples

- Home Depot Inc. (NYSE: HD)

| Evaluate Management       |        |        |        |          |          |          | Trend   |
|---------------------------|--------|--------|--------|----------|----------|----------|---|
|                           | 2016   | 2017   | 2018   | 2019     | 2020 (p) | 5 Yr Avg |   |
| % Pre-Tax Profit on Sales | 13.2%  | 13.6%  | 13.5%  | 13.3%    | 12.9%    | 13.3%    |  |
| % Return on Equity        | 138.0% | 332.0% | 832.6% | -1033.4% | 837.4%   | 221.3%   |  |
| % Debt To Capital         | 84.5%  | 94.9%  | 106.9% | 109.1%   | 92.9%    | 97.7%    |  |

- Been that high the last 5+ years
- Definitely a RED FLAG!



## Stock Investing Made Easy

# Price Earnings Ratio

- Visual Inspection
- Price – Isobars
  - Vertical lines
  - High and low price for the year
- Earnings
  - Blue line on the SSG
- Compare the price to the earnings

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## Stock Investing Made Easy

# Price Earnings Ratio

- Valuation and Return Tab
- Section 3: Price Earnings History as an indicator of the future

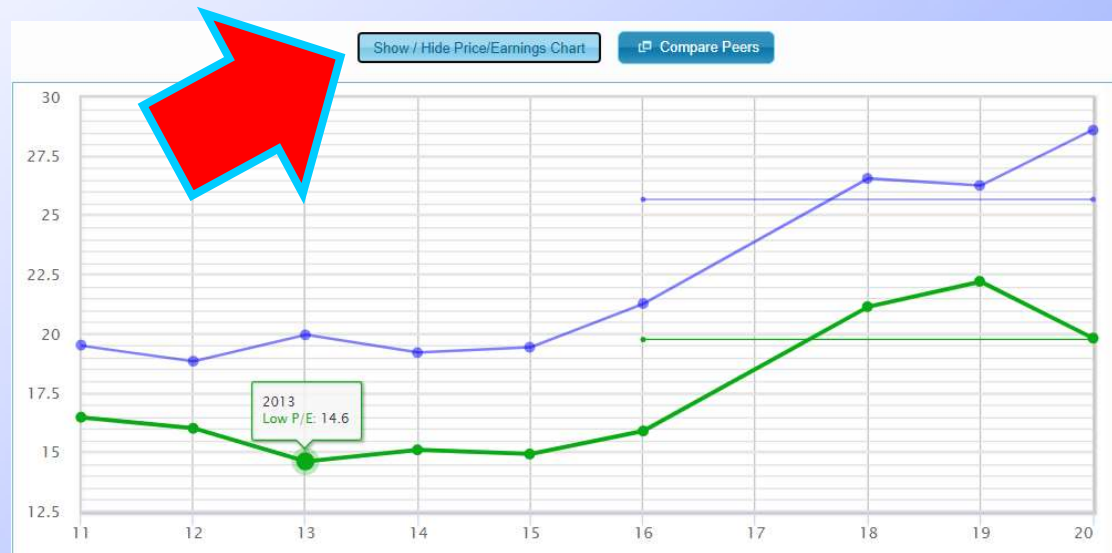
|    | D                           | E                |
|----|-----------------------------|------------------|
|    | <b>Price Earnings Ratio</b> |                  |
|    | High A / C                  | Low B / C        |
| \$ | 21.3                        | 15.9             |
| 7  | <del>307.1</del>            | <del>235.7</del> |
| 1  | 26.6                        | 21.1             |
| \$ | 26.3                        | 22.2             |
| 1  | 28.6                        | 19.8             |
|    | 25.7                        | 19.8             |

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## Stock Investing Made Easy

# Price Earnings Ratio

- Valuation and Return Tab
- Show/Hide Price/Earnings Chart

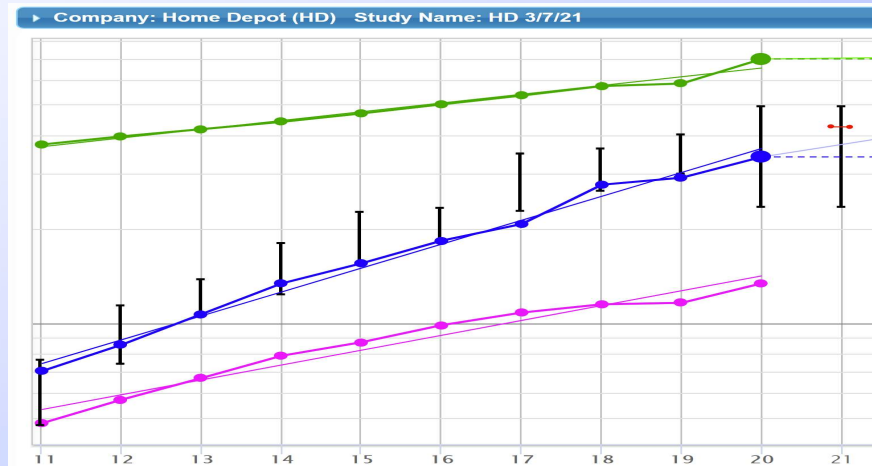


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## Stock Investing Made Easy

# PE Ratio - Examples

- Home Depot (NYSE: HD)



– PE Ratio steady?

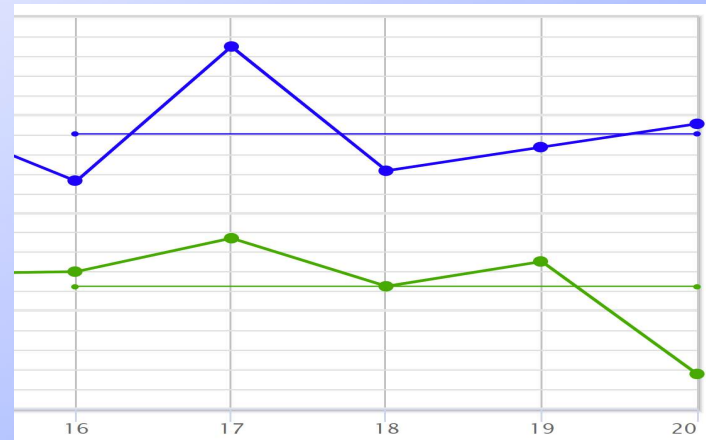
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## Stock Investing Made Easy

# PE Ratio - Examples

- Home Depot (NYSE: HD)

|   | D                    | E           |
|---|----------------------|-------------|
|   | Price Earnings Ratio |             |
|   | High A / C           | Low B / C   |
| 5 | 21.6                 | 17.0        |
| 3 | 28.5                 | 18.7        |
| 3 | 22.1                 | 16.2        |
| 5 | 23.3                 | 17.5        |
| 4 | 24.5                 | 11.8        |
|   | <b>24.0</b>          | <b>16.2</b> |
| 3 |                      |             |



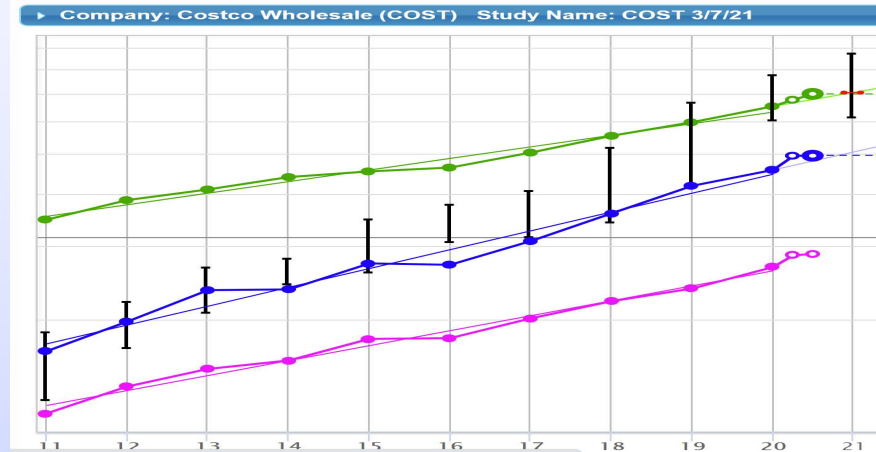
– Fairly steady over time

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# PE Ratio - Examples

- Costco Wholesale (Nasdaq: COST)



– PE Ratio rising?

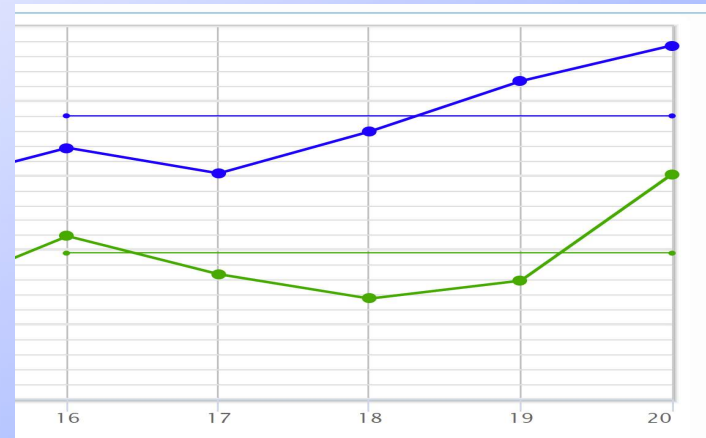
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## Stock Investing Made Easy

# PE Ratio - Examples

- Costco Wholesale (Nasdaq: COST)

| D                    | E           |
|----------------------|-------------|
| Price Earnings Ratio |             |
| High A / C           | Low B / C   |
| 31.8                 | 25.9        |
| 30.1                 | 23.4        |
| 32.9                 | 21.7        |
| 36.3                 | 22.9        |
| 38.7                 | 30.1        |
| <b>34.0</b>          | <b>24.8</b> |

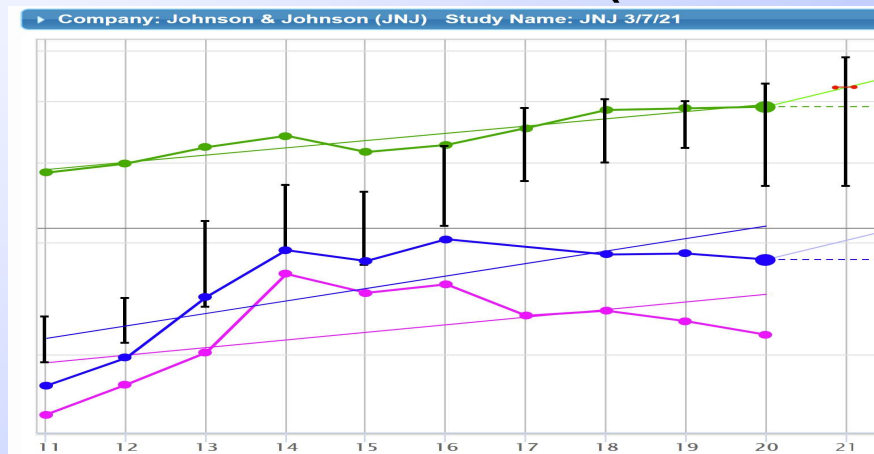


– Increasing over time

## Stock Investing Made Easy

# PE Ratio - Examples

- Johnson & Johnson (NYSE: JNJ)



– Flat earnings, rising PEs

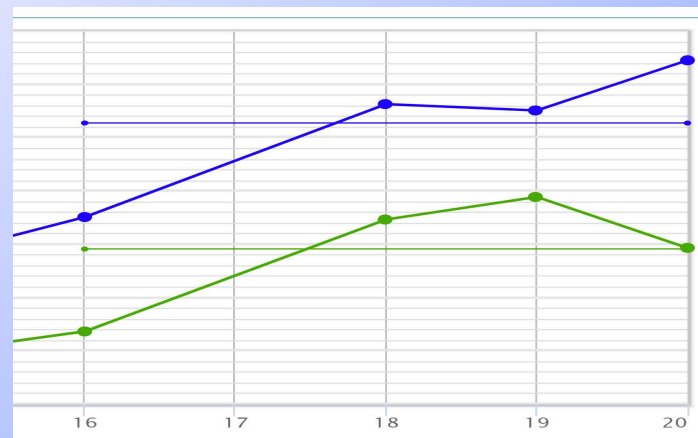
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## Stock Investing Made Easy

# PE Ratio - Examples

- Johnson & Johnson (NYSE: JNJ)

| D                    | E         |
|----------------------|-----------|
| Price Earnings Ratio |           |
| High A / C           | Low B / C |
| 21.3                 | 15.9      |
| 307.1                | 235.7     |
| 26.6                 | 21.1      |
| 26.3                 | 22.2      |
| 28.6                 | 19.8      |
| 25.7                 | 19.8      |



– Rising PEs!

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## Stock Investing Made Easy

# Growth Rates

- View Historical Growth
  - Within the Fundamental Company Data box
  - Click on Forecast (%) EPS

| Fundamental Company Data |        |        |        |        |        |           |                      |
|--------------------------|--------|--------|--------|--------|--------|-----------|----------------------|
|                          | 2011   | 2012   | 2018   | 2019   | 2020   | Growth(%) | Forecast (%)         |
| Historical Sales (\$M)   | 65,030 | 67,224 | 81,581 | 82,059 | 82,584 | 2.7%      | <input type="text"/> |
| Historical EPS (\$)      | 3.49   | 3.86   | 5.61   | 5.63   | 5.51   | 4.6%      | <input type="text"/> |
| Pre-Tax Profit (\$M)     | 12,361 | 13,775 | 17,999 | 17,328 | 16,497 | 2.8%      |                      |

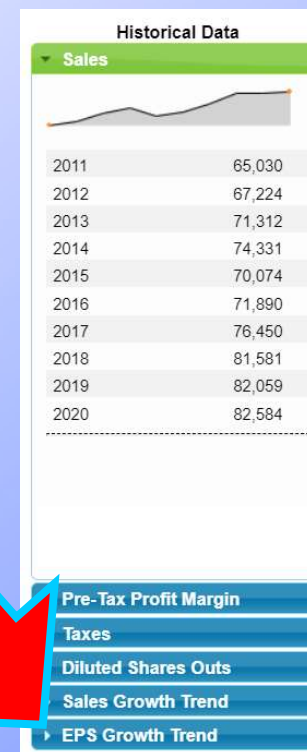


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## Stock Investing Made Easy

# Growth Rates

- View Historical Growth
  - Historical Data on the right
  - Click on EPS Growth Trend
  - Down does not mean negative!



## Stock Investing Made Easy

# Growth Rates

- Use Quarterly Trend Analysis
  - Quarterly Data Tab
  - Select Data Type – Trailing 4 Quarters



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## Stock Investing Made Easy

# Growth Rates - Examples

- Costco Wholesale (Nasdaq: COST)



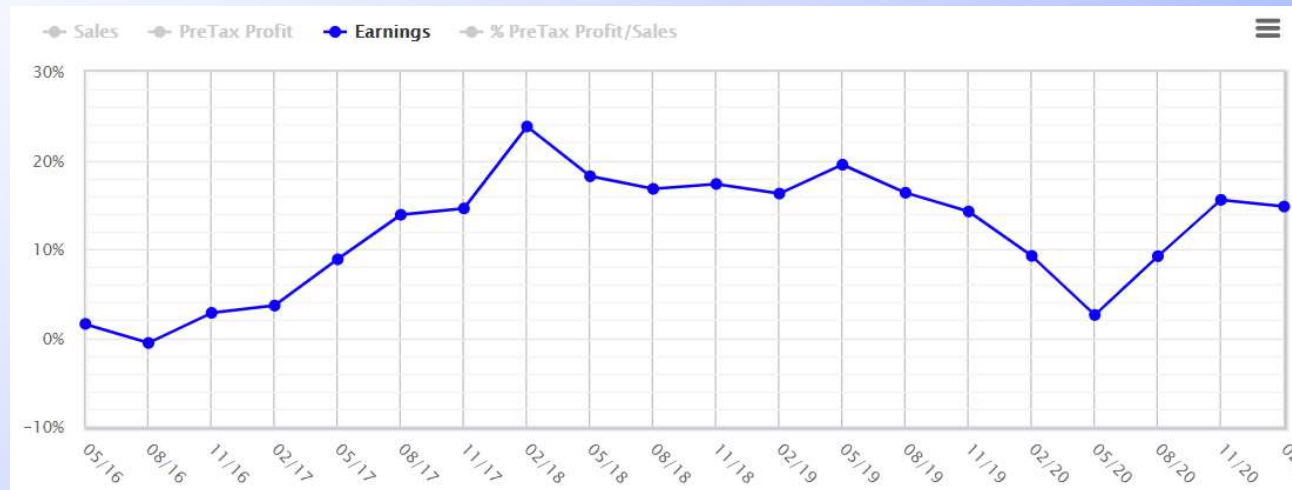
- Fairly steady
- Looks good!
- Will also include the most recent quarter and Trailing Twelve Months (TTM)

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## Stock Investing Made Easy

# Growth Rates - Examples

- Costco Wholesale (Nasdaq: COST)



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## Stock Investing Made Easy

# Growth Rates - Examples

- Alphabet Inc. (Nasdaq: GOOG)



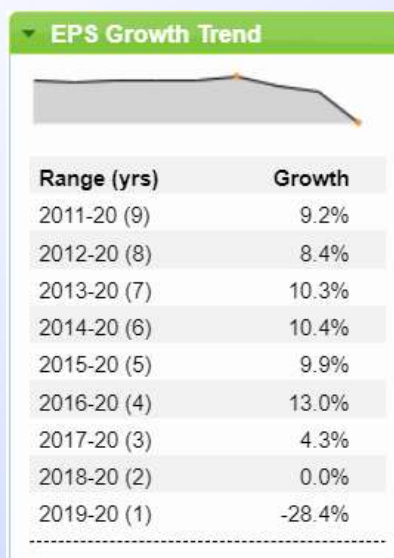
- Down a bit recently
- Is it a problem?
- Probably not

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# Growth Rates - Examples

- Carlisle Cos. Inc. (NYSE: CSL)



- Significant drop recently
- Is it a problem?
- Worth more research

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## Stock Investing Made Easy

# Growth Rates - Examples

- Carlisle Cos. Inc. (NYSE: CSL)



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# Growth Rates - Examples

- Starbucks Corp. (Nasdaq: SBUX)



- Not so good
- Consistently going down
- Definitely a Red Flag!

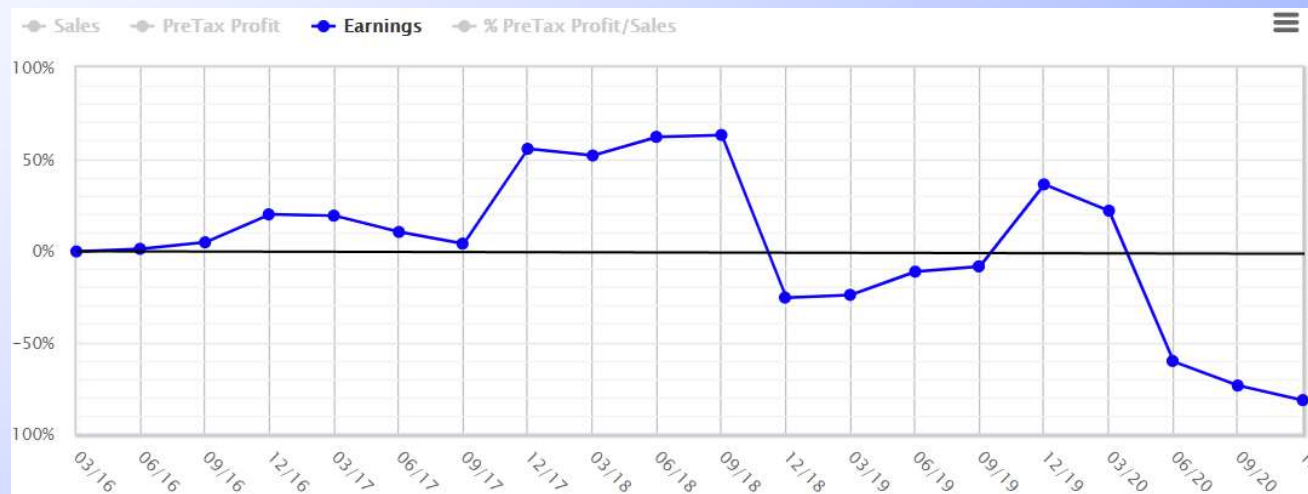


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## Stock Investing Made Easy

# Growth Rates - Examples

- Starbucks Corp. (Nasdaq: SBUX)



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## Stock Investing Made Easy

# Profit Margin

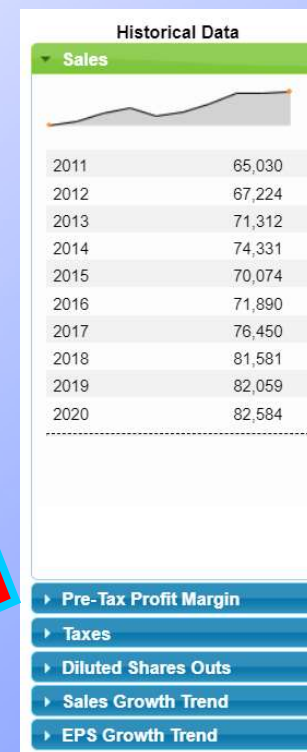
- No rule on percent
  - Comparison over time
  - Grocery Stores – under 2%
  - Drug Manufacturers – over 15%
- Going up or steady
  - Ability to control costs
- Decreasing → Red flag

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## Stock Investing Made Easy

# Profit Margin

- View Profit Margin
  - Click on Forecast (%) EPS
  - Historical Data on right
  - Pre-Tax Profit Margin tab



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## Stock Investing Made Easy

# Profit Margin

- Use Quarterly Trend Analysis
  - Quarterly Data Tab
  - Turn on % Pre-Tax Profit / Sales



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# Profit Margin - Examples

- Amazon.com, Inc. (Nasdaq: AMZN)

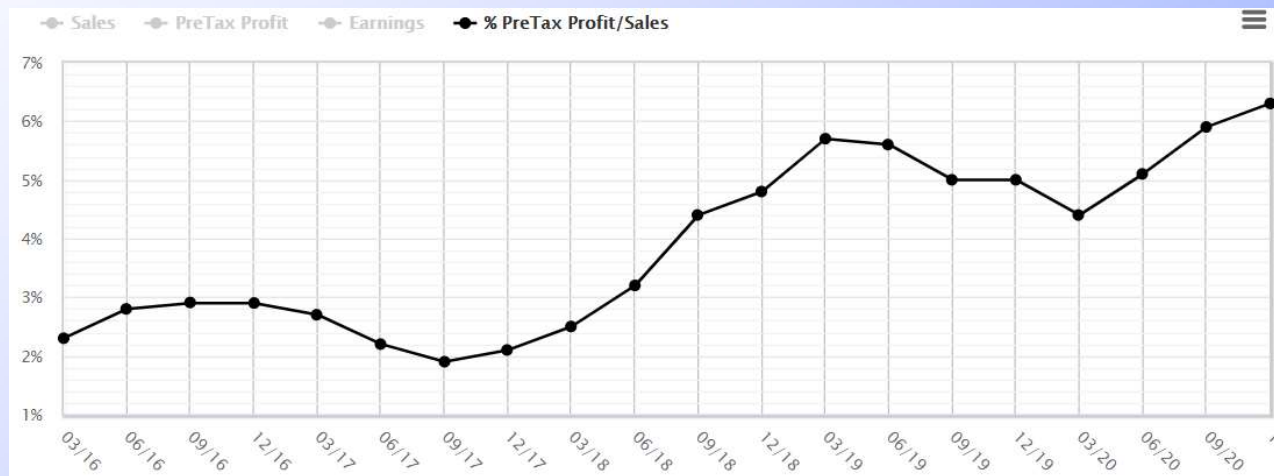


- Low Profit Margin
- Is that a problem?
- Not for Amazon

## Stock Investing Made Easy

# Profit Margin - Examples

- Amazon.com, Inc. (Nasdaq: AMZN)



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# Profit Margin - Examples

- Southwest Airlines (NYSE: LUV)



- Recent Drop
- Is that a problem?
- Yes, but is there a reason?

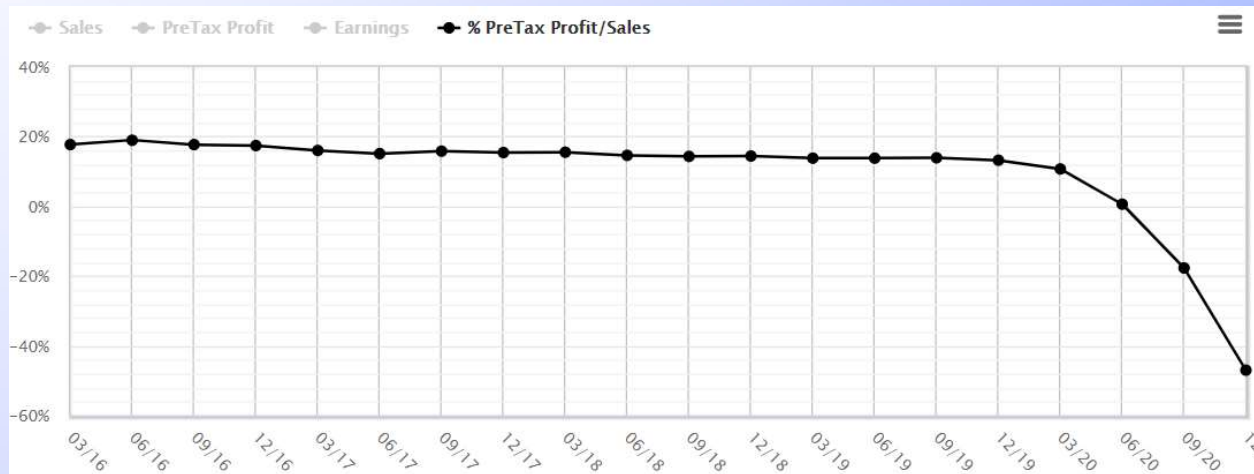
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# Profit Margin - Examples

- Southwest Airlines (NYSE: LUV)



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# Profit Margin - Examples

- Bed Bath & Beyond (Nasdaq: BBBY)



– Decreasing over time

– Red Flag

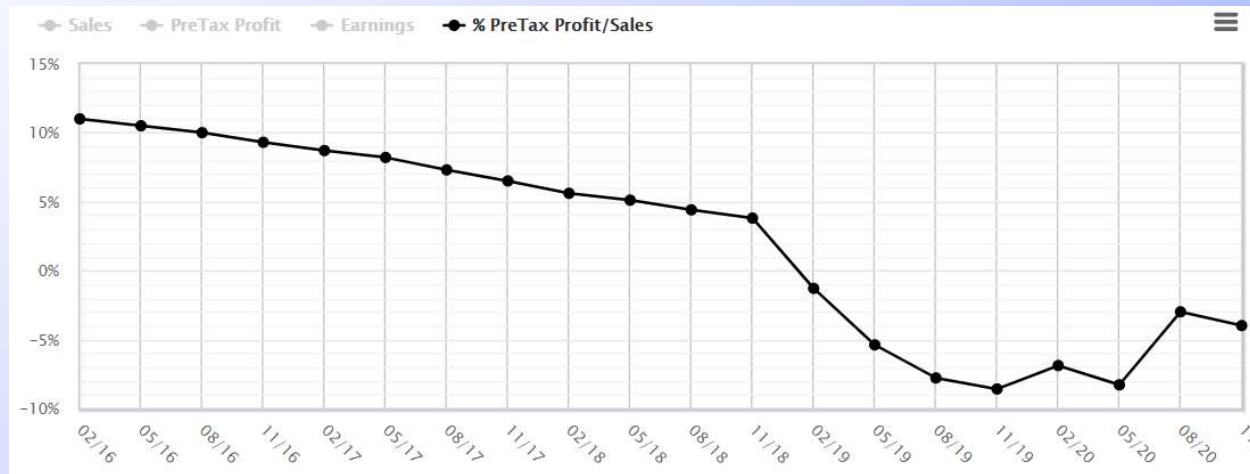


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## Stock Investing Made Easy

# Profit Margin - Examples

- Bed Bath & Beyond (Nasdaq: BBBY)



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## Stock Investing Made Easy

# Price Computations

- High Price – Section 4, Line A
- Low Price – Section 4, Line B(a)

### ▶ 4. EVALUATING RISK and REWARD over the next 5 years

#### A. HIGH PRICE - NEXT 5 YEARS

Avg. High P/E: 32.4 X Estimate High Earnings / Share: 13.85 = Forecasted High Price: 448.6

#### B. LOW PRICE - NEXT 5 YEARS

(a) Avg. Low P/E: 24.8 X Estimate Low Earnings/Share 9.78 = Forecasted Low Price: 242.5

(b) Avg. Low Price of Last 5 Years: 179.0

(c) Recent Market Low Price: 189.5

2019 Low Stock Price: 189.5

52 Week Low Stock Price: 276.3

2020 Low Stock Price: 271.3

(d) Price Dividend Will Support:  $\frac{\text{Indicated Dividend}}{\text{High Yield}} = \frac{2.80}{1.4\%} = 201.6$

Selected Forecasted Low Price: 242.5

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## Stock Investing Made Easy

# Price Computations

- PE Ratio x Earnings = Price

$$\frac{\text{Price}}{\text{Earnings}} \times \text{Earnings}$$

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## Stock Investing Made Easy

# Reality Checks

- High Price
  - More than double 52-week high?
  - More than double recent highs?
- Low Price
  - Higher than 52-week low?
  - Higher than recent lows?

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## Stock Investing Made Easy

# Reality Checks

- Section 3: Price Earnings History as an indicator of the future

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

CLOSING PRICE (03/05/21): 317.32

HIGH THIS YEAR: 393.15

LOW THIS YEAR: 276.34

| 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  |
| 2016                                      | 169.7 | 138.2        | 5.33        | 31.8                                      | 25.9        | 1.70        | 31.9%        | 1.2%         |
| 2017                                      | 183.2 | 142.1        | 6.08        | 30.1                                      | 23.4        | 1.90        | 31.3%        | 1.3%         |
| 2018                                      | 233.5 | 154.1        | 7.09        | 32.9                                      | 21.7        | 2.14        | 30.2%        | 1.4%         |
| 2019                                      | 299.9 | 189.5        | 8.26        | 36.3                                      | 22.9        | 2.44        | 29.5%        | 1.3%         |
| 2020                                      | 349.1 | 271.3        | 9.02        | 38.7                                      | 30.1        | 2.70        | 29.9%        | 1.0%         |
| <b>AVERAGE</b>                            |       | <b>179.0</b> |             | <b>34.0</b>                               | <b>24.8</b> |             | <b>30.6%</b> |              |
| <b>CURRENT/TTM</b>                        |       |              | <b>9.78</b> |   |             | <b>2.80</b> | <b>28.6%</b> |              |
| <b>AVERAGE PRICE EARNINGS RATIO: 29.4</b> |       |              |             | <b>CURRENT PRICE EARNINGS RATIO: 32.4</b> |             |             |              |              |

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## Stock Investing Made Easy

# Reality Checks - Examples

- High Price

CLOSING PRICE (03/05/21): 317.32

HIGH THIS YEAR: 393.15

LOW THIS YEAR: 276.34

**X 2 ≈ 800**

### A. HIGH PRICE - NEXT 5 YEARS

Avg. High P/E: 34.0 X Estimate High Earnings / Share: 24.34 = Forecasted High Price:

– Seems okay?

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## Stock Investing Made Easy

# Reality Checks - Examples

- Low Price

**CLOSING PRICE (03/05/21):** 317.32

**HIGH THIS YEAR:** 393.15

**LOW THIS YEAR:** 276.34

### B. LOW PRICE - NEXT 5 YEARS

(a) Avg. Low P/E: 20.1 X Estimate Low Earnings/Share 9.78 = Forecasted Low Price: 196.6

– Perhaps a little low?

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## Stock Investing Made Easy

# Price Ranges

- Near the top of the buy range?
- High is OFTEN twice the low
- Will you get a better opportunity?

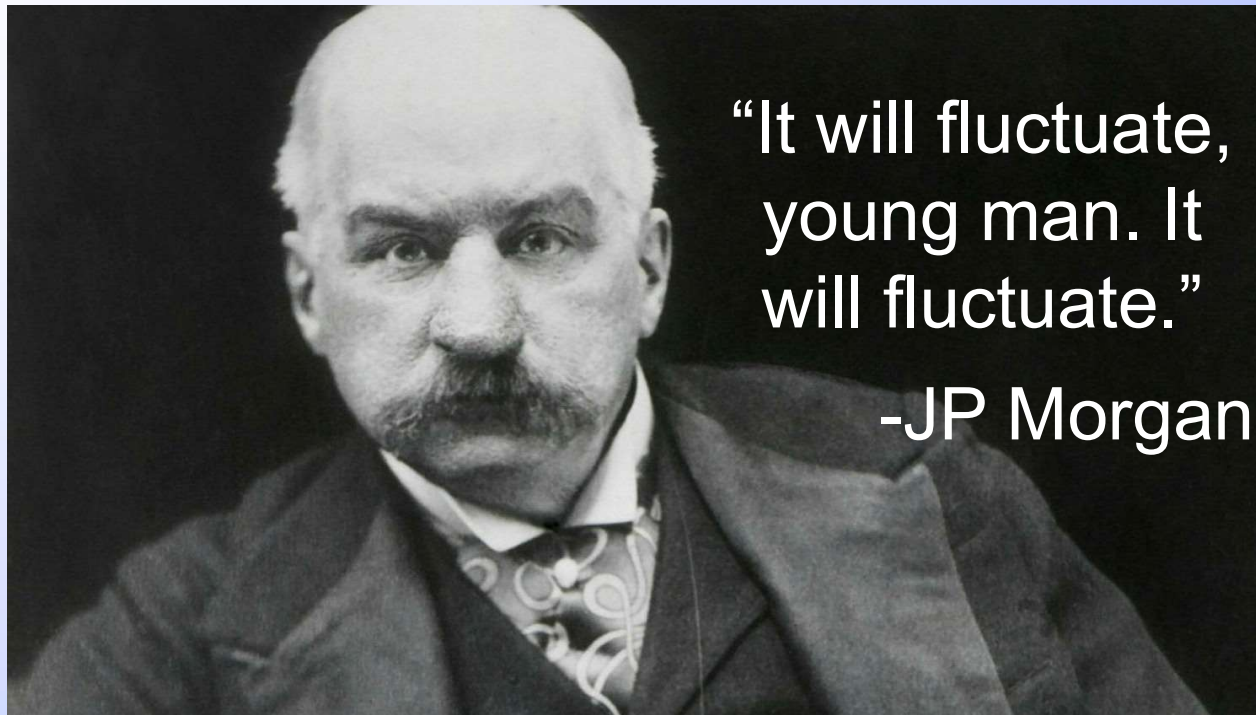
**YES!**

– Okay, maybe

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## Stock Investing Made Easy

# What will the market do?



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## Stock Investing Made Easy

# Price Ranges – Examples

- Amazon.com, Inc. (Nasdaq: AMZN)

|      | A       | B       |
|------|---------|---------|
| Year | Price   |         |
|      | High    | Low     |
| 2016 | 847.2   | 474.0   |
| 2017 | 1,213.4 | 747.7   |
| 2018 | 2,050.5 | 1,170.5 |
| 2019 | 2,035.8 | 1,460.9 |
| 2020 | 3,552.3 | 1,626.0 |

– Highs right around double the lows

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## Stock Investing Made Easy

# Price Ranges – Examples

- Starbucks Corp. (Nasdaq: SBUX)

|      | A     | B    |
|------|-------|------|
| Year | Price |      |
|      | High  | Low  |
| 2016 | 64.0  | 52.6 |
| 2017 | 64.9  | 50.8 |
| 2018 | 61.9  | 47.4 |
| 2019 | 99.7  | 54.7 |
| 2020 | 94.1  | 50.0 |

– True the last couple of years

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## Stock Investing Made Easy

# Price Ranges – Examples

- Costco Wholesale (Nasdaq: COST)

|      | A     | B     |
|------|-------|-------|
| Year | Price |       |
|      | High  | Low   |
| 2016 | 169.7 | 138.2 |
| 2017 | 183.2 | 142.1 |
| 2018 | 233.5 | 154.1 |
| 2019 | 299.9 | 189.5 |
| 2020 | 349.1 | 271.3 |

- Not always the case
- Still around 3:2 ratio

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## Stock Investing Made Easy

# Share Buybacks

- The Good:
  - The company is showing they have faith in themselves
  - Increases your shareholder equity

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## Stock Investing Made Easy

# Share Buybacks

- The Bad:
  - Possible manipulation of financial ratios:
    - Earnings Per Share
    - Return on Equity

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## Stock Investing Made Easy

# Manipulation of Ratios

- Earnings Per Share
  - Decreases the number of shares
  - Increases the EPS
  - Shares are the denominator

**Earnings**  

---

**Shares**



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## Stock Investing Made Easy

# Manipulation of Ratios

- Return on Equity
  - When a company takes on debt:
    - Increases liabilities
    - Decreases shareholders' equity

**Net Income**

**Shareholders' Equity**

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## Stock Investing Made Easy

# Manipulation of Ratios

- Return on Equity
  - When a company takes on debt:
    - Increases liabilities
    - Decreases shareholders' equity

**Net Income**

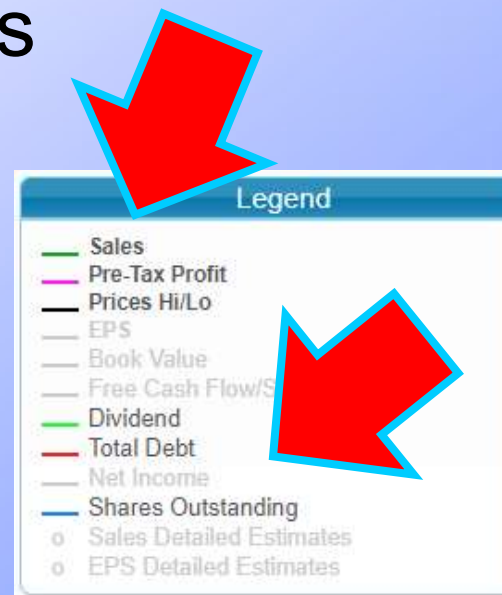
**Assets - Liabilities**

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## Stock Investing Made Easy

# Share Buybacks

- How can we use the SSG to investigate this activity?
  - Use the LEGEND box
  - Remove Sales, PTP, Prices Hi/Lo
  - Add Dividend, Debt, Shares Outstanding

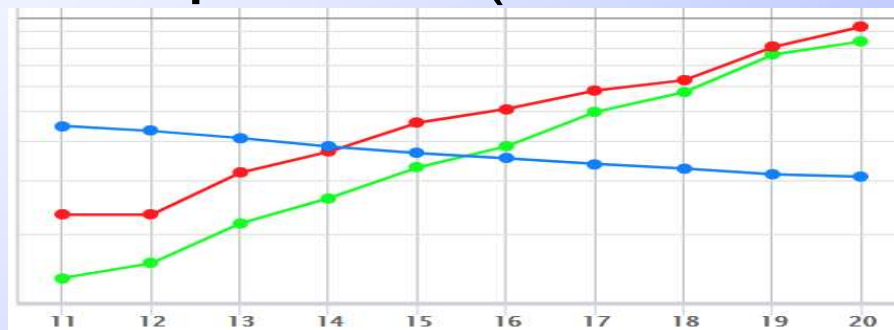


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## Stock Investing Made Easy

# Share Buybacks – Examples

- Home Depot Inc. (NYSE: HD)



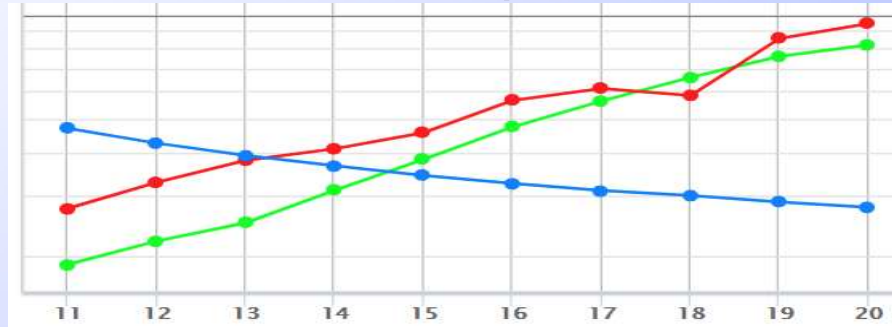
- Debt (**RED**) continues to increase
- Dividends (**GREEN**) increased yearly
- Shares (**BLUE**) reduced every year

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# Share Buybacks – Examples

- Lowe's Cos., Inc. (NYSE: LOW)



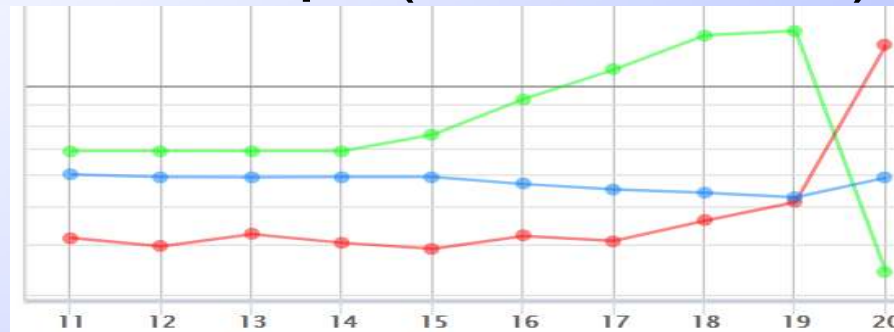
- Similar to Home Depot
- Share buybacks appear to be greater

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# Share Buybacks – Examples

- Carnival Corp. (NYSE: CCL)



- Reduced Dividend
- Increased debt and shares
- What situation caused this?

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# Share Buybacks

- Share Buybacks Funded by Debt

**My #1**   
**Red Flag!**

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## Stock Investing Made Easy

# Summary

In this session we've touched on:

- Debt
- Price Earnings Ratio
- Growth Rate
- Profit Margin

## Stock Investing Made Easy

# Summary

In this session we've touched on:

- Projected Price Computations
- Reality Checks
- Price Ranges
- Share Buybacks

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# Questions or Comments?

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*Director, NJ Chapter*



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