

6A When Earnings Grow Faster Than Sales
Mary Enright

When Earnings Grow Faster than Sales



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 **BETTERINVESTING**
The Leader in Investment Education

Classes-To-Go! 6A

BETTERINVESTING NATIONAL CONVENTION

Disclaimer

- The information in this presentation is for educational purposes only and is not intended to be a recommendation to purchase or sell any of the stocks, mutual funds, or other securities that may be referenced.



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Information For Evaluating Growth

- Value Line Investment Survey
- Annual Report
- 10K

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Sales And Earnings Growing At Different Rates

- Any difference can't last forever
- They must settle into a state of equilibrium

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Getting From Sales To EPS

(1) Sales or Revenues
- Costs or Expenses

= Pre-tax Profit (PTP)

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Getting From Sales To EPS

(2) Pre-tax Profit (PTP)
- Taxes Paid

= Earnings or Net Income

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Getting From Sales To EPS

(3) $\frac{\text{Earnings}}{\div \text{Shares Outstanding}}$
= Earnings Per Share (EPS)

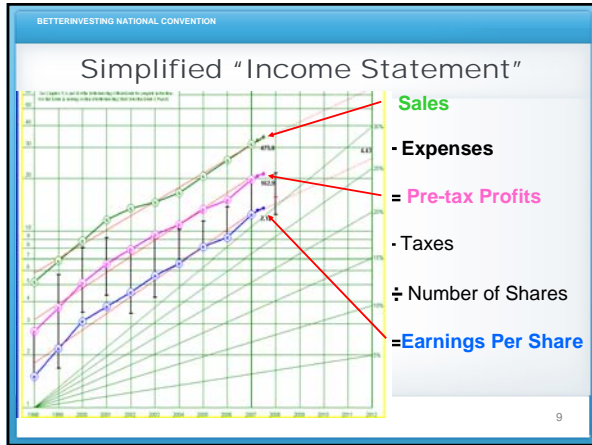
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Getting From Sales To EPS

Sales or Revenues
- Costs or Expenses
= Pre-tax Profit (PTP)
- Taxes Paid
= Earnings or Net Income
 \div Shares Outstanding
= Earnings Per Share (EPS)

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Explaining The Difference In Growth Rates

Three Primary Causes:

- Change in the expenses per dollar of sales
- Change in tax rates
- Change in shares outstanding

We will look at each of these

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Explaining The Difference In Growth Rates

- Change in the expenses per dollar of sales
- Have profit margins changed?
- Are expenses going up faster or slower than sales?

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Explaining The Difference In Growth Rates

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	® VALUE LINE PUBL.
1.82	2.19	2.73	3.53	4.06	4.40	5.39	6.47	7.92	9.84	11.90	13.90	Revenues per sh ^A
.44	.60	.76	1.00	1.19	1.34	1.55	1.82	2.12	2.86	3.25	3.80	"Cash Flow" per sh
.26	.37	.50	.64	.77	.96	1.15	1.39	1.57	2.14	2.50	2.90	Earnings per sh ^B
---	.07	.08	.09	.11	.15	.17	.19	.21	.30	.48	.52	Div'ds Decl'd per sh ^C
.28	.35	.23	.60	.20	.17	.81	.45	.48	.81	.86	.95	Cap'l Spending per sh
1.18	1.64	2.09	2.76	3.49	4.20	3.52	5.55	7.34	8.47	10.10	12.10	Book Value per sh ^E
43.24	47.31	49.23	50.03	50.68	50.49	46.75	48.34	48.89	48.35	48.00	47.50	Common Shs Outst'g
27.0	35.2	40.7	36.1	26.7	22.8	24.6	24.0	26.0	27.4	26.0	27.4	Book Value per sh ^F
1.40	2.01	2.65	1.85	1.46	1.30	1.30	1.28	1.40	1.44	1.44	1.44	Value Line est. (millions)
---	5%	4%	4%	5%	7%	6%	6%	5%	5%	5%	5%	Avg Ann'l P/E Ratio
78.9	103.8	134.2	176.7	205.9	222.3	251.9	312.6	387.4	475.8	570	660	Revenues (\$mill) ^A
38.7%	37.0%	38.0%	38.2%	38.0%	42.4%	40.6%	40.1%	36.1%	38.6%	37.5%	37.5%	Operating Margin
6.6	9.8	11.9	16.5	18.3	17.5	14.7	16.3	24.3	28.6	30.0	35.0	Depreciation (\$mill)
12.6	18.6	25.6	33.4	40.5	50.1	58.0	69.8	79.5	109.6	126	145	Net Profit (\$mill)
43.8%	39.4%	39.5%	38.4%	37.7%	36.5%	35.1%	35.5%	33.0%	32.7%	34.0%	34.0%	Income Tax Rate
16.0%	17.9%	19.1%	18.9%	19.7%	22.6%	23.0%	22.3%	20.5%	23.0%	22.1%	22.0%	Net Profit Margin

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Explaining The Difference In Growth Rates

- Change in the tax rate
- Have tax rates changed?
 - These are also expenses, but not necessarily under management's control

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Explaining The Difference In Growth Rates

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Explaining The Difference In Growth Rates

- Change in shares outstanding
- Have shares outstanding changed?
 - Are company earnings spread over more or fewer shares?

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Explaining The Difference In Growth Rates

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Explaining The Difference in Growth Rates

- Improving Profit Margin will contribute to Earnings Per Share growing faster than Sales.
- Tax rate decline also contributed to Earnings Per Share growing faster than Sales.

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Explaining The Difference in Growth Rates

- Be sure to check shares outstanding
- A sharp decline in shares outstanding in 2004 is followed by an increase in 2005 and then remaining level

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Difference In Growth Rates

- EPS growing faster than sales
 - Check if profit margins are increasing
 - Check if tax rates are decreasing
 - Check if shares outstanding are decreasing

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Difference In Growth Rates

- EPS growing faster than sales
 - Cutting costs
 - Can this go on forever?
 - There is a limit to how much you can cut costs
 - Buying back Shares
 - Can this go on forever?

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Questions?

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