

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

Brian Altschul  
Director, NJ Chapter



**March 31, 2021**

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**Identifying Red Flags**

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

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### Identifying Red Flags

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

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### Identifying Red Flags

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

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### Software Used



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### Debt

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

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## Debt

- Debt to Capital Ratio  

$$\frac{\text{Debt}}{\text{Debt} + \text{Shareholders' Equity}}$$
- Debt to Equity Ratio  

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

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## Debt - Examples

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

**CAPITAL STRUCTURE as of 9/30/20**  
 Total Debt \$13902 mill. Due in 5 Yrs. \$2482 mill.  
 LT Debt \$13902 mill. LT Interest \$100 mill.  
 (6% of Cap'l)

Leases, Uncapitalized: Annual rentals \$1757 mill.

No Defined Benefit Pension Plan  
 Pfd Stock None

Common Stock 676,426,200 shares (300,643,829 Class A shares, 45,915,231 Class B shares, and 329,867,212 Class C shares) c d

MARKET CAP: \$1.28 trillion (Large Cap)

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## Debt - Examples

- Alphabet Inc. (Nasdaq: GOOG)

Evaluate Management	2016	2017	2018	2019	2020	5 Yr Avg	Trend
% 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!

**CAPITAL STRUCTURE as of 12/31/20**  
 Total Debt \$10331 mill. Due in 5 Yrs \$6000 mill.  
 LT Debt \$10111 mill. LT Interest \$430.0 mill.  
 (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)

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

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## Debt - Examples

- Home Depot Inc. (NYSE: HD)

Evaluate Management	2016	2017	2018	2019	2020 (p)	5 Yr Avg	Trend
% 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!

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## 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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## 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
	307.1	235.7
	26.6	21.1
	26.3	22.2
	28.6	19.8
	25.7	19.8

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## Price Earnings Ratio

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

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## PE Ratio - Examples

- Home Depot (NYSE: HD)

– PE Ratio steady?

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## PE Ratio - Examples

- Home Depot (NYSE: HD)

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

– Fairly steady over time

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**PE Ratio - Examples**

- Costco Wholesale (Nasdaq: COST)

– PE Ratio rising?

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**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
34.0	24.8

– Increasing over time

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**PE Ratio - Examples**

- Johnson & Johnson (NYSE: JNJ)

– Flat earnings, rising PEs

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**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
28.7	19.8

– Rising PEs!

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## 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%	
Historical EPS (\$)	3.49	3.86	5.61	5.63	5.51	4.6%	
Pre-Tax Profit (\$M)	12,361	13,775	17,999	17,328	16,497	2.8%	

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## Growth Rates

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

Historical Data	
Year	Sales
2011	65,030
2012	67,224
2013	71,312
2014	74,331
2015	70,074
2016	71,890
2017	76,450
2018	81,581
2019	82,059
2020	82,584

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## Growth Rates

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

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## Growth Rates - Examples

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

Range (yrs)	Growth
2011-20 (9)	11.0%
2012-20 (8)	10.6%
2013-20 (7)	10.7%
2014-20 (6)	11.8%
2015-20 (5)	12.3%
2016-20 (4)	14.6%
2017-20 (3)	14.3%
2018-20 (2)	12.8%
2019-20 (1)	9.2%

	QTR	TTM
Current	1.9%	14.8%

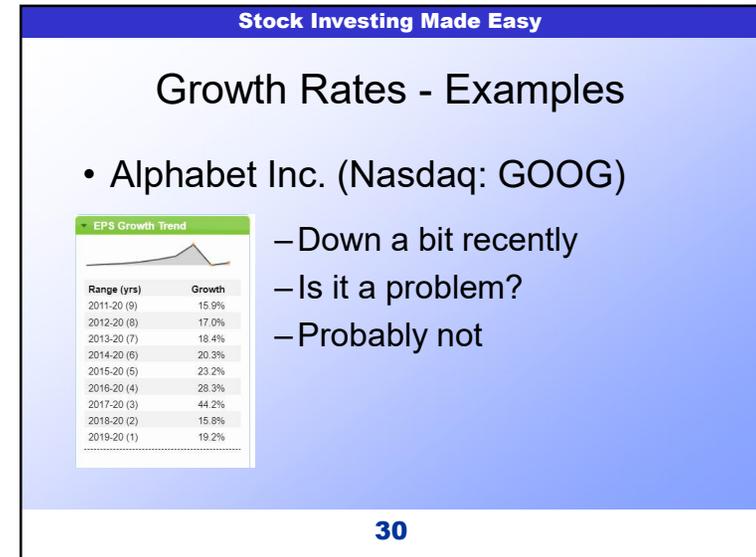
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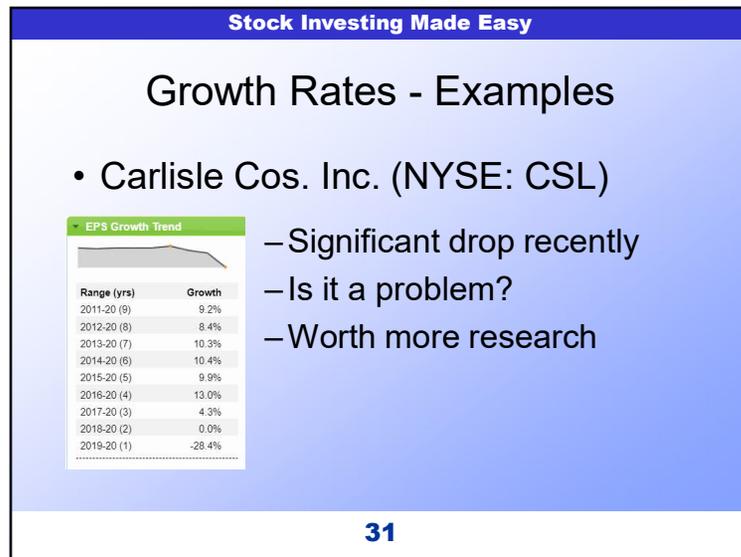
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## Growth Rates - Examples

- Starbucks Corp. (Nasdaq: SBUX)
  - Not so good
  - Consistently going down
  - Definitely a Red Flag!

Range (yrs)	Growth
2011-20 (9)	28.7%
2012-20 (8)	40.6%
2013-20 (7)	63.0%
2014-20 (6)	-0.5%
2015-20 (5)	-6.6%
2016-20 (4)	-12.7%
2017-20 (3)	-24.8%
2018-20 (2)	-50.6%
2019-20 (1)	-72.9%

	QTR	TTM
Current	-28.4%	-51.7%



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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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## 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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## Profit Margin

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

Year	Sales
2011	66,030
2012	67,224
2013	71,312
2014	74,331
2015	70,074
2016	71,990
2017	76,450
2018	81,581
2019	82,059
2020	82,584



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## 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



Year	Pre-Tax Profit Margin
2011	1.9%
2012	0.9%
2013	0.7%
2014	-0.1%
2015	1.5%
2016	2.9%
2017	2.1%
2018	4.8%
2019	5.0%
2020	6.3%

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## 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?

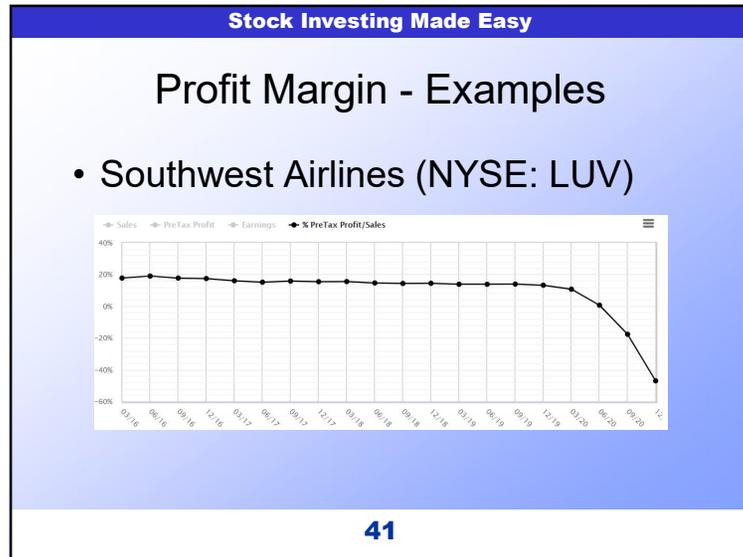


Year	Pre-Tax Profit Margin
2011	2.1%
2012	4.0%
2013	6.8%
2014	9.8%
2015	17.6%
2016	17.4%
2017	15.4%
2018	14.4%
2019	13.2%
2020	-47.0%

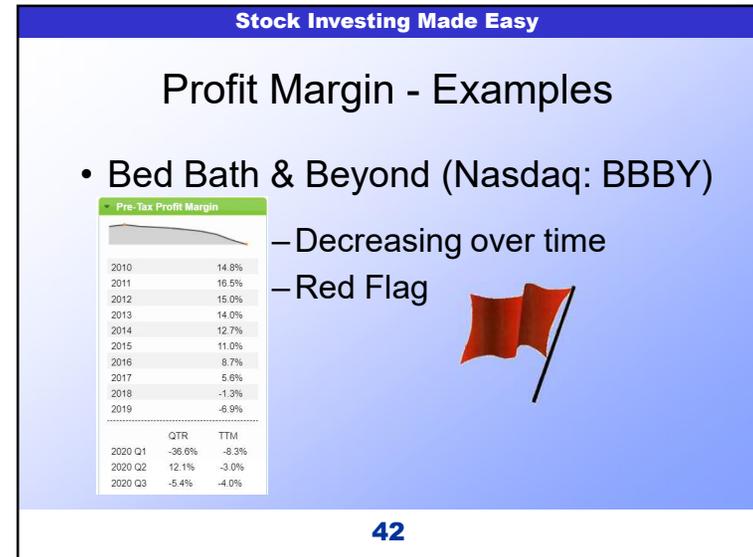
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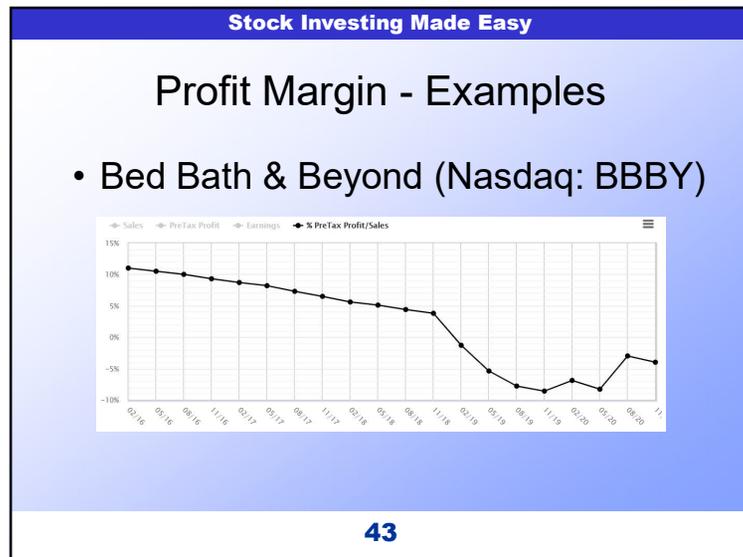
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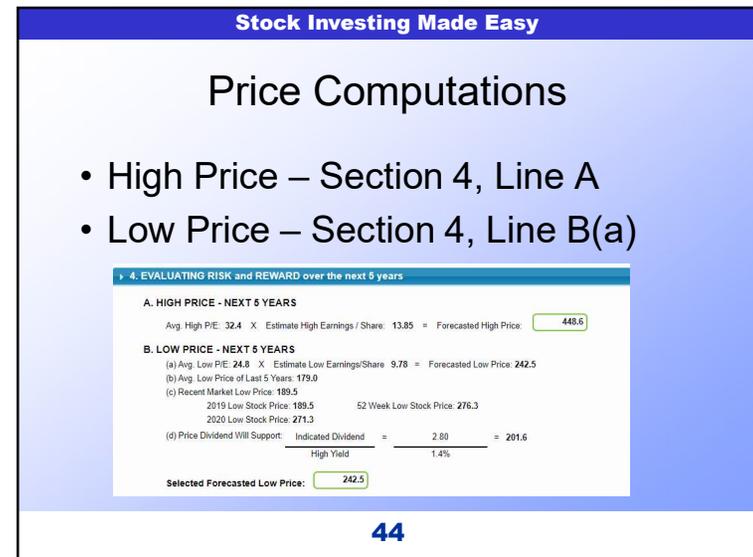
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## Price Computations

- PE Ratio x Earnings = Price

~~Price~~ / ~~Earnings~~ = X ~~Earnings~~

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## 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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## Reality Checks

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

3. PRICE EARNINGS HISTORY as an indicator of the future

Year	A Price		C Earnings Per Share	D Price Earnings Ratio		F Dividend Per Share	G % Payout F / C * 100	H % High Yield F / B * 100
	High	Low		High A / C	Low B / C			
2016	169.7	138.2	5.33	31.8	26.9	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	188.5	8.26	36.3	22.9	2.44	29.5%	1.3%
2020	348.1	271.3	9.02	38.7	30.1	2.70	29.9%	1.0%
AVERAGE		179.0		34.0	24.8		30.6%	
CURRENT/TTM			9.78			2.80	28.6%	
AVERAGE PRICE EARNINGS RATIO: 29.4				CURRENT PRICE EARNINGS RATIO: 32.4				

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## Reality Checks - Examples

- High Price

CLOSING PRICE (03/05/21): 317.32  
 HIGH THIS YEAR: 393.15  
 LOW THIS YEAR: 276.34

$X 2 \approx 800$

A. HIGH PRICE - NEXT 5 YEARS

Avg. High P/E: 34.0 X Estimate High Earnings / Share: 24.34 = Forecasted High Price: 827.4

- Seems okay?

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## 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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## Price Ranges

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

**YES!**

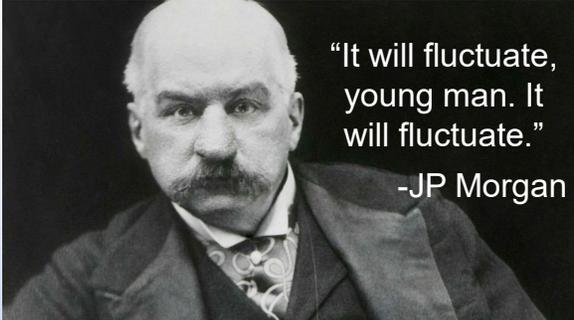
– Okay, maybe

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## What will the market do?



“It will fluctuate,  
young man. It  
will fluctuate.”

–JP Morgan

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## Price Ranges – Examples

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

Year	Price	
	A	B
	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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### Price Ranges – Examples

- Starbucks Corp. (Nasdaq: SBUX)

Year	Price	
	A	B
	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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### Price Ranges – Examples

- Costco Wholesale (Nasdaq: COST)

Year	Price	
	A	B
	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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### Share Buybacks

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

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### Share Buybacks

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

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### Manipulation of Ratios

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

$$\frac{\text{Earnings}}{\text{Shares}}$$


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### Manipulation of Ratios

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

$$\frac{\text{Net Income}}{\text{Shareholders' Equity}}$$

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### Manipulation of Ratios

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

$$\frac{\text{Net Income}}{\text{Assets} - \text{Liabilities}}$$

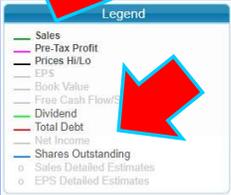
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### Share Buybacks

- 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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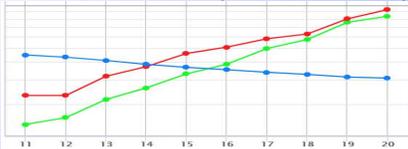
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### Share Buybacks – Examples

- Home Depot Inc. (NYSE: HD)



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

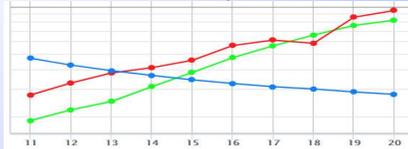
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### Share Buybacks – Examples

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



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

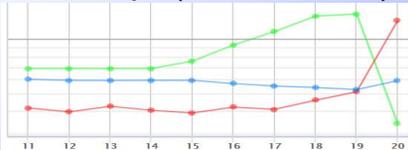
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### Share Buybacks – Examples

- 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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## Summary

In this session we've touched on:

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

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## Summary

In this session we've touched on:

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

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## Make A Difference In Someone's Life

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## Questions or Comments?

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**Brian Altschul**  
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