

Research Guidelines

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The following information is meant to be a guideline for researching a company. It assumes that you have already found a company that interests you.

STEP 1:	Complete Preliminary SSG <i>Make sure the quality criteria are met</i>
STEP 2:	Cursory Review of Company <i>Use one of the financial websites to take a quick tour.</i> <ul style="list-style-type: none">◆ <i>What does the company do?</i>◆ <i>How do they make money?</i>◆ <i>How do they compare to their industry?</i>◆ <i>Any recent negative news?</i>◆ <i>Do analyst projections meet your goals?</i>◆ <i>What do S&P and Value Line analysts think of the company's prospects?</i>◆ <i>If all is well, move on...</i>
STEP 3:	Order Investor's Packet <i>Email Investor Relations through their corporate website</i>
STEP 4:	Company Review <ul style="list-style-type: none">◆ <i>Read the 10K Business, Legal & Management sections</i>◆ <i>Read the Annual Report and Proxy Statement</i>◆ <i>Read the Management section of all 10Qs since the last 10k</i>◆ <i>Be prepared to provide a review of the company's overall business</i>
STEP 5:	Business Outlook <i>Look at the competitive landscape. What are the primary drivers of growth for the company and its industry? What are the positive and negative influences that could affect future growth?</i>
STEP 6:	Ratio Analysis – Competitors <ul style="list-style-type: none">◆ <i>Who are the company's primary competitors?</i>◆ <i>Where does the company rank among them?</i>◆ <i>How does the company compare on Debt, Pre-Tax Profits, Return on Equity, P/E, etc.</i>
STEP 7:	Relevant News and Articles <i>Search news sites, online financial magazine archives, the company's hometown newspaper, and message boards to find any articles that may provide helpful insight.</i>
STEP 8:	Back to the SSG <i>Now that you are better informed, reconsider your original SSG judgments.</i>

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STEP 1: COMPLETE PRELIMINARY SSG

After finding an interesting company, complete a preliminary SSG. There's no sense in performing an in-depth study on a stock that doesn't meet our basic quality criteria, such as:

- ◆ Is the company's debt/capital reasonable? (preferably 33% or less)
- ◆ Is insider ownership excessively high? Will their decisions be aligned with the shareholders?
- ◆ Section 1 - Did the company grow in double digits in the quarter-over-quarter box?
- ◆ Section 1 - Are the visual lines smooth and growing upward?
- ◆ Section 1 - Does the company's 10-year history show it has grown sales & earnings in double digits?
- ◆ Section 2 - Is pre-tax profit stable or trending up?

STEP 2: CURSORY REVIEW OF COMPANY

If the SSG looks good, we will want to do a cursory check of the company to make sure it's worthy of an in-depth study. Most of this can be done on any or all of the following websites:

- ◆ Multex Investor <http://www.multexinvestor.com/>
- ◆ Wall Street Research Net <http://www.wsrn.com/>
- ◆ Quicken <http://www.quicken.com/>
- ◆ MSN Money Central www.moneycentral.msn.com/investor/
- ◆ Wright Services <http://www.wisi.com/>
- ◆ Plus, Value Line Investment Survey
- ◆ Plus, S&P Stock Report

Using Multex Investor as our default checkpoint, try to gain some quick insights by entering your ticker symbol and moving through their entire list of company tabs. Here are some things to look for:

- ◆ **Company Overview and Business Description** - Between these two tabs, you will find a good description of the company's business, their sector and industry, and links to their website, investor relations department, financials, history/profile, and products and services.
- ◆ **Officers & Directors** - This tab will give you a biography of the people who run the company. Look to see if several board members share the same last name, the ages of the members and whether the board is well diversified with members from other business sectors.
- ◆ **Highlights Report** - This screen first shows historical sales and EPS highlights, but the real value comes at the bottom. Under "Equity" and "Footnotes", you will find information on insider ownership, majority stockholders, shares outstanding, including preferred stock, and stock-split dates.
- ◆ **Earnings Estimates** - In the first box, look for LT (long-term) growth estimates. The mean is the average of all analysts following the stock.

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- ◆ **Ratio Comparison** - It's important to make a rough determination of where the company ranks in its industry. This tab will provide that information. We are looking for companies who have equal or better numbers as compared to their peers. Skim all the ratios to see where the company stands, but make a special note of the following:
 - P/E ratios - is the stock more or less expensive?
 - Beta - Is the stock volatile? 1.00 means it moves with the whole industry
 - Sales & Earnings - Are they ahead of the pack?
 - All Financial Ratios - Is their debt more or less than the industry average?
 - Pre-Tax Profit Margins - Are they making money from their products compared to the others?
 - Net Profit Margins - Is there anything left for shareholders at the end of the day?
 - All Management Effectiveness Ratios - Are they better managed than their peers?
 - Efficiency - Are they doing a better job of turning over their products or services?
- ◆ **News & Significant Developments** - These two tabs will alert you to any recent news that may change your mind about whether or not you wish to pursue your study.
- ◆ **Insider Trading (Advanced)** - Skim recent trading by officers and directors. Check for any trades that are out of the ordinary.
- ◆ **Cash Flow (Advanced)** - Check the Cash from Operations (first sub-total). We want positive cash flow!
- ◆ **Check for Problems with Inventory (Advanced)** - Inventory shouldn't be growing faster than sales. It's a sign that the company has gotten sloppy with its product delivery. To determine the growth of inventory, divide the current year's inventory figure (balance sheet) by last year's inventory figure and subtract 1.00. Compare it to the % of sales growth for the same period of time (do the same calculation for sales). It should be growing slower. These figures can easily be found on the Value Line, too.
- ◆ **Check for Problems with Accounts Receivable (Advanced)** - A/R should not be outpacing sales. If so, it's a sign that the company's customers are not paying their bills. A/R is found on the balance sheet. It's also located in the Current Position Box on Value Line. Calculate it the same as you did with inventory.

STEP 3: ORDER INVESTOR'S PACKET

This is pretty easy! Most of the websites' Profile tabs will have a link to the company's website. Once there, you will be looking for their Investor's Relations link, or their Contact Us link. Most companies actually have a form you can fill out to request materials. You can also make your request by phone. The number can be found at the end of the Value Line Business Section. Investor Packets should arrive in 3-7 days. Make sure you request an Annual Report, 10k, the latest 10Q, the Proxy Statement and any analyst reports available. A packet that arrives late, or that never arrives at all, is a sign of the company's commitment to shareholders. Make note of it.

STEP 4: COMPANY REVIEW

The following questions are not to be answered individually. They are meant to give you an idea of what you should be paying attention to while reading through the company and SEC documents. Use a highlighter as you read, highlighting anything you think is important for your

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presentation. You can condense it later into a much smaller and more defined set of paragraphs. Consider the following:

- ◆ Who are they? What do they do?
- ◆ Exactly how do they make money? Explain their business model.
- ◆ Is the company's history interesting and/or relevant?
- ◆ Describe their products and/or services?
- ◆ Do they dominate in certain markets? Do they plan to?
- ◆ Do they have an international presence? What percentage? Is it growing?
- ◆ Do they have a wide range of products? Or only a small handful?
- ◆ Do they sell their products to a vast number of customers? Or only a select few?
- ◆ Do their products or services have high visibility to the public?
- ◆ Does the company produce a high ratio of repeat business?
- ◆ Does the company have promising new products in development?
- ◆ Are new products successful in garnering market share?
- ◆ What is the spending on Research & Development? (7% - 9% of sales is good)
- ◆ Who is managing the company? What do we know about them?
- ◆ How is management keeping up with the changes in markets, technology and global markets?
- ◆ Has management accomplished what it set out to do over the last few years? (Read the last 3-4 Annual Report Letters to the Shareholders or past 10Ks for the truth on management's performance.)
- ◆ Is the company buying new businesses, or selling existing ones, in keeping with their overall strategic plan?
- ◆ How is the company increasing overall productivity and efficiency?
- ◆ Is this company capital-intensive? Are they required to continually retool or upgrade plant equipment?

After reading the annual report and 10K, it would be wise to read the Management's Discussion section of every 10Q (quarterly SEC filing) since the last 10K (Don't worry! The 10Q is much shorter!). This will alert you to any new developments that may cause you to abort the study.

STEP 5: BUSINESS OUTLOOK

After reading the annual report, 10K and 10Qs, you probably highlighted some information that would shed some light on the industry and what drives the companies in it. Try to list any opportunities or threats that would affect the SSG judgments and, ultimately, your decision to buy. Consider these items:

Industry:

- ◆ What do we know about the industry?
- ◆ Is it fragmented? Is it consolidating?
- ◆ Is price competition within the industry intense, moderate or minor?
- ◆ What are the positive and negative aspects of the industry?
- ◆ What is the outlook for this industry?
- ◆ What is the industry's future growth rate?

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Finding Industry Information: Be sure to read the Value Line Company Report, the Value Line Industry Page, and the S&P Report, along with the Annual Report, to gain some insights into the company's industry. Also check out industry-related sites such as <http://finance.yahoo.com/>. They have an Industry News section. You might find news on a competitor that could cause some temporary problems for the whole industry. This could create a buying opportunity.

Positive and Negative Influences on the Company:

- ◆ What are the positive aspects of the company?
- ◆ Are they buying back shares on a regular basis?
- ◆ Have they implemented a cost-reduction program?
- ◆ Do they have strong brand-name recognition? Low debt? A broad client base?
- ◆ Does their manufacturing process have large barriers to entry?
- ◆ Are their products in demand?
- ◆ What are the negative aspects of the company?
- ◆ Do they have pending lawsuits that could materially impact future cash flow?
- ◆ Do they have environmental problems? Are they involved in a Super Fund site?
- ◆ Are they heavily regulated by the government?
- ◆ Is their business adversely affected by the whims of the economy? By other industries?
- ◆ Do the company's products have a high rate of defect, returns, or recalls?
- ◆ Do foreign exchange rates substantially affect earnings?
- ◆ Do they have large customers that account for a significant percentage of sales? Or too few Customers?

All this information can be gleaned from the company and SEC documents, which you've already read, and from online news and magazine articles (see Step 8).

Primary Drivers of Future Growth:

- ◆ How will the company make money in the future?
- ◆ New products? New markets? More market share? Acquisitions? New store openings?
- ◆ Will it grow through expanding margins? Price increases?
- ◆ Is international expansion believable for its products or services?
- ◆ What is the estimated sales and earnings growth for the company? Double digit?

These details have to be mined from the Letter to the Shareholders (annual report), the 10K, 10Q, conference calls with the CEO and CFO, press releases from the company website, and newspaper or magazine articles. Conference calls are a simple way to gain information. You can find them on the company's website or at <http://www.vcalls.com/>. Value Line and S&P reports are great sources for long-term growth rates, as are the financial websites in Step 2.

Combine the above information into a paragraph or two that clearly states where the company is going, how it's going to get there, and what stumbling blocks may get in the way.

STEP 6: RATIO ANALYSIS – COMPETITORS

- ◆ Is the company a predominant player in its industry?
- ◆ Who are the primary competitors and where does the company rank among them?
- ◆ Make sure to provide a ratio comparison on pertinent items like Debt, Pre-Tax Profit, ROE, P/E, etc.

Find competitors: Check out Hoover's Snapshot of your company (<http://www.hoovers.com/>). Or Value Line. Any of the financial websites listed in Step 2 will also provide a list of competitors.

Find Ratio Comparisons: Wright Services (<http://www.wisi.com/>) has a nice comparison in their Report format, as does Quicken (<http://www.quicken.com/>) in their Evaluator section. Other good sites include MSN (<http://www.moneycentral.com/>), and Multex Investor (<http://www.multexinvestor.com/>).

STEP 7: RELEVANT NEWS AND ARTICLES

There are literally 100s of websites that report financial news off the news wires. MSN, Quicken, Yahoo, Motley Fool, and Multex Investor are just a small handful. And most financial magazines have an online presence, such as Individual Investor, Money, Smart Money, Forbes, Fortune...the list goes on and on. Message boards are also an interesting place to gather information or ask questions of investor's who already follow the stock. Just remember to take the boards with a grain of salt, and always try to verify that information. In our Quality Stocks Handout (November, 2001) you will find that many of these websites are already listed. Go to www.bivio.com/crowriver, click on Education - Assignments and Downloads.

STEP 8: BACK TO THE SSG

By now, we will have a much better understanding of the company and its future prospects. Now is the time to revisit the SSG. Does our new-found knowledge change our original judgments?