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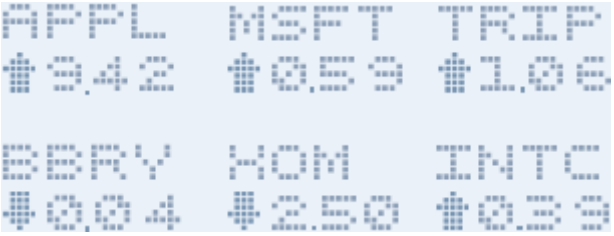
Empowering value investors with stock valuation tools, tutorials and resources



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15 Point Common Stock Checklist by the Father of

Growth Investing

October 6, 2014

Previously I had written about **a list of Don’ts (http://www.oldschoolvalue.com/blog/investing-strategy/five-donts-five-more-donts/)** that was listed in **Common Stocks and Uncommon Profits**

Twitter (https://twitter.com/#!/Jae_Jun)

Boost Returns by Easily Recognizing What's Beneath the Surface of a Stock

If you recall, Buffett said that he is was “85% Graham and 15% Fisher”.

But Buffett today is much more Fisher than Graham now.

How much?

Take a look at Fisher’s style of investing until his death in 2004.

- Purchase and hold for the long term
- Hold a concentrated portfolio
- Buy outstanding companies with compelling growth prospects
- Buy companies that you understand very well

Fisher is actually labeled the father of growth investing and he certainly wasn’t keen on statistical bargains like Graham did.

The fact that accounting can’t easily identify business headwinds was a reason he didn’t like the idea of cheap stocks. He also found that one good growth stock will outperform a bargain stock because the intrinsic value will increase compared to a cheap stock where it’s intrinsic value can easily decrease.

So you can see what type of effect Fisher had on Buffett.

And if Buffett says that Philip Fisher is a man worth learning from, then that applies to us too.

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Great Quotes by Phil Fisher

Here are some awesome quotes by Phil Fisher to get started.

“The stock market is filled with individuals who know the price of everything, but the value of nothing.”

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“what really counts is a management having both a determination to attain further growth and an ability to bring its plans to completion.”

“it is often easier to tell what will happen to the price of a stock than how much time will elapse before it happens.”

“Doing what everybody else is doing at the moment, and therefore what you have an almost irresistible urge to do, is often the wrong thing to do at all.”

“Even in those earlier times, finding the really outstanding companies and staying with them through all the fluctuations of a gyrating market proved far more profitable to far more people than did the more colorful practice of trying to buy them cheap and sell them dear.”

The Invention of Scuttlebutt

Scuttlebutt, a **verb** created by Fisher where the investor scrabbles information from all sources to obtain a complete view of the company business, prospects, management and competitors.

> *I am aware that most investors are not in a position to do for themselves much of what is needed to get the most from their investment funds. – Fisher*

This is still true today.

Time has to be invested to become better and to find what suits you.

Not all people find the time to research companies, but there are many shortcuts and methods of finding information.

Some of those methods are towards the end.

Fisher didn't have the internet to make his work easier, but even if he lived today, I doubt he would be sitting behind his computer reading news and articles solely as his main source of information.

He'd he out on the streets visiting companies, making calls, talking with management and reading books or textbooks on industries he is interested in.

After all, Fisher held Motorola from 1955 to 2004.

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But thanks to Fisher's work, he left you with a very useful scuttlebutt common stock checklist.

15 Points in a Common Stock Checklist

- Bold text are the checklist points
- Quotes are from the book to emphasize the point
- Additional commentary added by me

1. Does the company have the products or services with sufficient market potential to make possible a sizable increase in sales for at least several years?

Remember Heely's (HLYS)?

Those kids shoes with a built in wheel?

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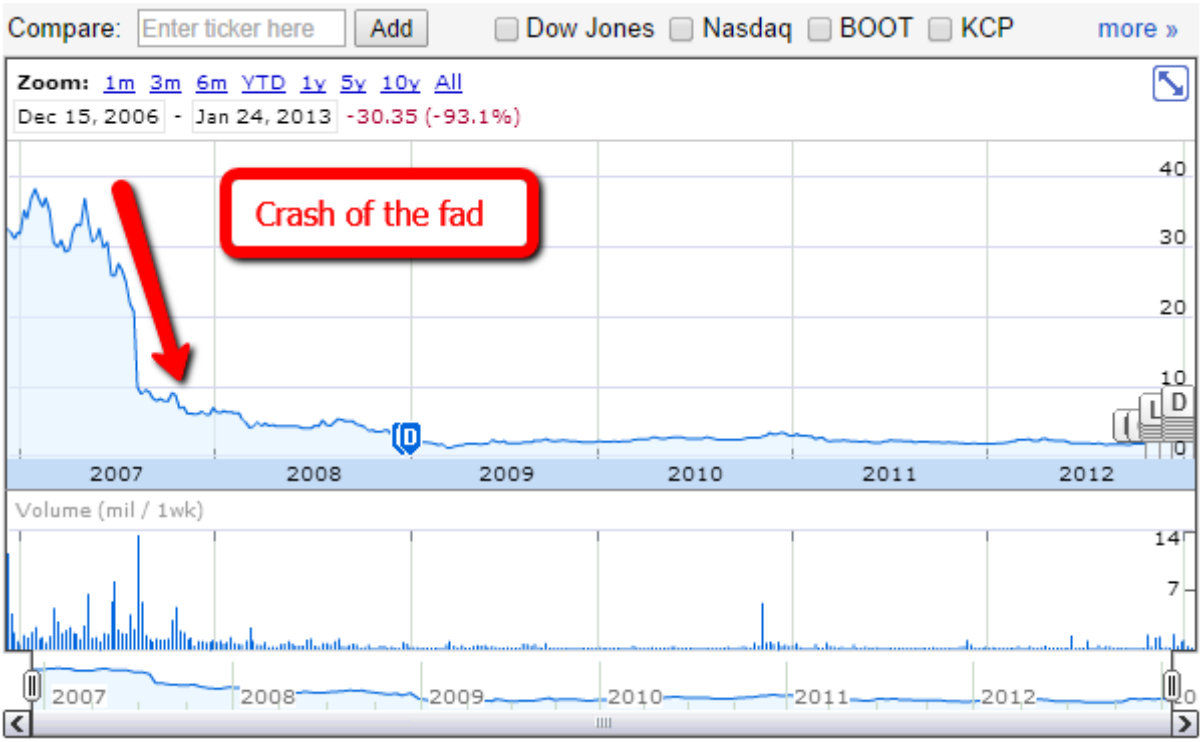
Heely's Fad

Here's what happened to the company.



(http://cdn6.oldschoolvalue.com/blog/wp-content/uploads/HLYS-chart.png)

Heely's Chart Before Being Bought Out

Avoid fads and one hit wonders. Crocs (CROX) also went through the same issue and I showed the history of the company based on its cash conversion cycle (http://www.oldschoolvalue.com/blog/accounting/the-cash-conversion-cycle-to-help-you-pick-winners-and-losers/). But they've reinvented themselves into a real shoe company.

Find a company with a competitive edge offering products and services that help businesses make money.

If a business is able to help other businesses make money, there is something good going on.

2. Does the management have a determination to continue to develop products or processes that will still further increase total sales potentials when the growth potentials of currently attractive product lines have largely been exploited?

Is management exploring ways to create further business opportunities?

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An example I used years ago was Motorola and their super phone the razr.

The problem was that Motorola got too comfortable and big headed about its success and didn't bother to come up with new products.

Then Apple and Samsung came along, and it was too late.

Another example is Xerox.

You know them for their copying machines, but did you know that 55% of revenues now come from their services business?

They were supposed to have been dead, but their expansion into cloud and B2B services have pushed them into strong contention.

Stock price obviously followed the positive changes and results.

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(http://cdn5.oldschoolvalue.com/blog/wp-content/uploads/xrx-stock-chart.png)

XRX Being Rewarded for the Turnaround

3. How effective are the company's research and development efforts in relation to its size?

Pretty simple as it is. Is the company over spending or under spending?

One easy method you can use is to compare the R&D expense in relation to competitors.

A company with a bigger moat can spend less on R&D and still have the same effectiveness. Whereas, a weaker competitor will have to outspend the #1 competitor to try and develop something better.

A Warren Buffett's way of looking at R&D (http://www.oldschoolvalue.com/blog/tutorial/this-is-how-buffett-interprets-financial-statements/) is that a high R&D usually dictates high SG&A which threatens the competitive advantage.

Look at the difference between Intel and AMD.

Intel Corporation

(INTC)

October 5, 2014

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Figures in Millions except p

Operating Expenses						
Selling, General & Admin. Expenses	$ 7,931.0	$ 6,309.0	$ 7,670.0	$ 8,057.0	$ 8,088.0	$ 8,084.0
SG&A (%)	*22.6%*	*14.5%*	*14.2%*	*15.1%*	*15.3%*	*15.0%*
Research & Development	$ 5,653.0	$ 6,576.0	$ 8,350.0	$ 10,148.0	$ 10,611.0	$ 11,273.0
R&D (%)	*16.1%*	*15.1%*	*15.5%*	*19.0%*	*20.1%*	*20.9%*

(http://cdn7.oldschoolvalue.com/blog/wp-content/uploads/INTC-RnD-Expense.png)

INTC R&D Expense

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Advanced Micro Devices, Inc.

(AMD)

October 5, 2014

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Figures in Millions except p

Operating Expenses							
Selling, General & Admin. Expenses	$ 1,304.0	$ 994.0	$ 651.0	$ 992.0	$ 823.0	$ 674.0	$ 478.0
SG&A (%)	*22.5%*	*18.4%*	*10.0%*	*15.1%*	*15.2%*	*12.7%*	*10.6%*
Research & Development	$ 1,848.0	$ 1,721.0	$ 1,405.0	$ 1,453.0	$ 1,354.0	$ 1,201.0	$ 858.0
R&D (%)	*31.8%*	*31.9%*	*21.6%*	*22.1%*	*25.0%*	*22.7%*	*19.1%*

(http://cdn7.oldschoolvalue.com/blog/wp-content/uploads/AMD-RnD-Expense.png)

AMD R&D Expense

Intel was always dominant in the PC industry, but their R&D expense has increased due to the work they need to do for mobiles.

On the other hand, AMD's R&D expense during 2008, 2009 was in the 30% range. In absolute dollars, it is much less than INTC, but that's what a moat can do to weaker competitors.

In relation to its size, AMD was spending a huge amount and has dramatically dropped off which is not a good sign.

4. Does the company have an above average sales organization?

No matter how good a product is, it is useless if it can't be sold. Many investors don't pay as much attention to the efficiency of a company's sales, advertising, and distribution.

> *It is the making of repeat sales to satisfied customers that is the first benchmark of success – Fisher*

Go to Google and search "Anti (company name)" and you will get a whole list of hate sites. Here you can get a good idea of why customers are not satisfied.

People outside the company are seldom hesitant in expressing their views.

Another method to determine the sales quality of a company is to use glassdoo (http://www.glassdoor.com/)r to view the salary ranges.

Here's a look at IBM's sales reps salary and other compensation.

Salaries in USD	Average	$10k $50k $90k
Total Pay — Salary / Bonus / Other (9)	$69,333	$44k $103k
Bonuses (5)	$14,500	$3,000 $25k
Cash Bonus (4)	$17,375	$4,500 $25k
Stock Bonus (0)	n/a	No Reports
Profit Sharing (1)	n/a	$3,000 $3,000
Other Pay (5)	$20,500	$5,000 $38k
Commissions on Sales (5)	$20,500	$5,000 $38k
Tips (0)	n/a	No Reports
Salaries in USD		$10k $50k $90k

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(http://cdn4.oldschoolvalue.com/blog/wp-content/uploads/IBM-sales-salary.png)

IBM Sales Rep Salary and Bonuses | Glassdoor

Obviously, when the pay is higher, there is more motivation to do well and the reviews from Glassdoor help in figuring out how people really view the company.

5. Does the company have a worthwhile profit margin?

During a good year, even bad company's will increase their profit margin by a considerable amount.

Why?

Percentage wise, if a company has small margins to begin with, any additional increase or decrease makes a big difference in the percentages.

SUPERVALU Inc.
(SVU)
10/5/2014

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	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	TTM
Net Income From Continuing Operations	2.0%	1.0%	1.2%	1.3%	-6.4%	1.0%	-1.2%	-0.6%	-1.5%	0.0%	0.9%
Net Income From Discontinued Operations	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-7.5%	-5.4%	-7.0%	1.0%	0.0%
Net Income From Total Operations	2.0%	1.0%	1.2%	1.3%	-6.4%	1.0%	-8.7%	-6.0%	-8.6%	1.1%	0.8%

(http://cdn7.oldschoolvalue.com/blog/wp-content/uploads/SVU-razor-margins.png)

SUPERVALU and their Horrific Margins | old school value

Conversely, a company with broad margins may not have a great percentage increase as the

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So don't be fooled by Wall Streets claims of "huge % increase". Look at the real numbers too to see whether it's a sign of exaggeration or whether profits can be sustained.

6. What is the company doing to maintain or improve profit margins?

> *The success of a stock purchase does not depend on what is generally known about a company at the time the purchase is made. Rather, it depends upon what gets to be known about it after the stock has been bought – Fisher*

7. Does the company have outstanding labor and personnel relations?

By labor relations, Fisher refers to employees and also union workers.

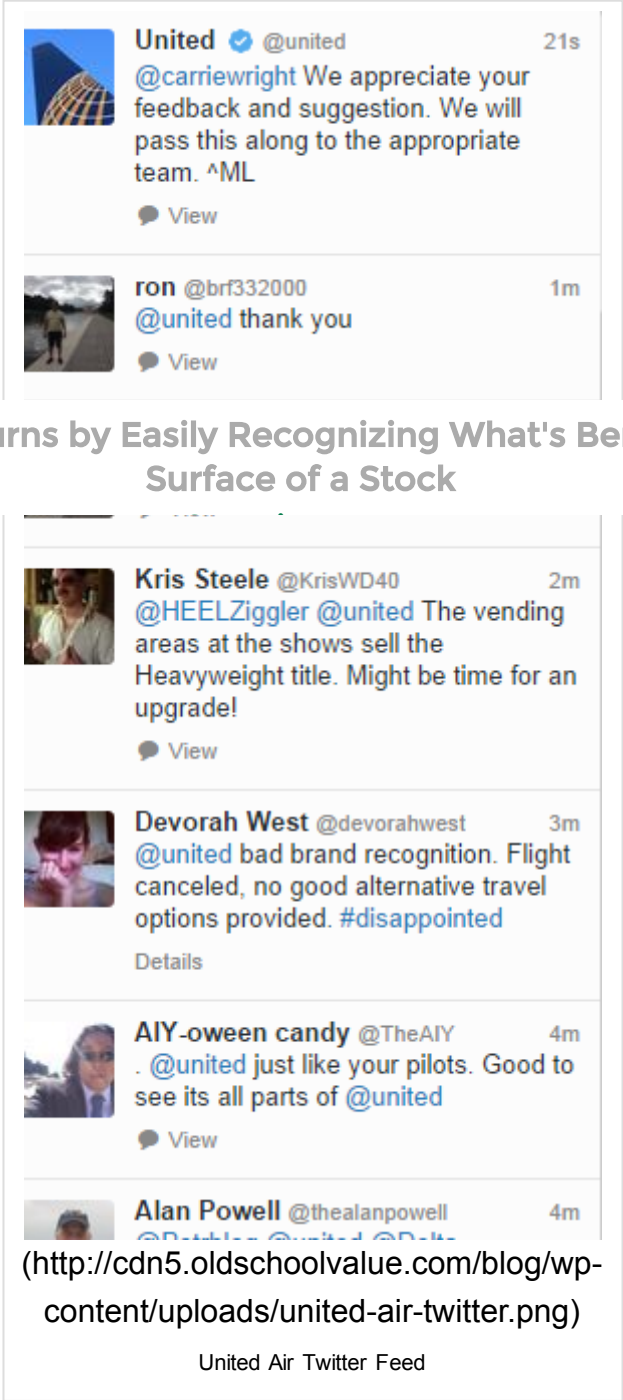
> *Why do workers feel unusually loyal to one employer and resentful of another? – Fisher*

> *Companies with good labor relations usually are the ones making every effort to settle grievances quickly… The investor who buys into a situation in which a significant part of earnings comes from paying below standard wages for the area involved may in time have serious trouble on his hands – Fisher*

With social media and sites like glassdoor, it's so easy to find real experiences of a company.

Go to twitter, search for the company and see whether they are getting showered with complaints or love.

Here's an example with United Air.



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(http://cdn5.oldschoolvalue.com/blog/wp-content/uploads/united-air-twitter.png)

United Air Twitter Feed

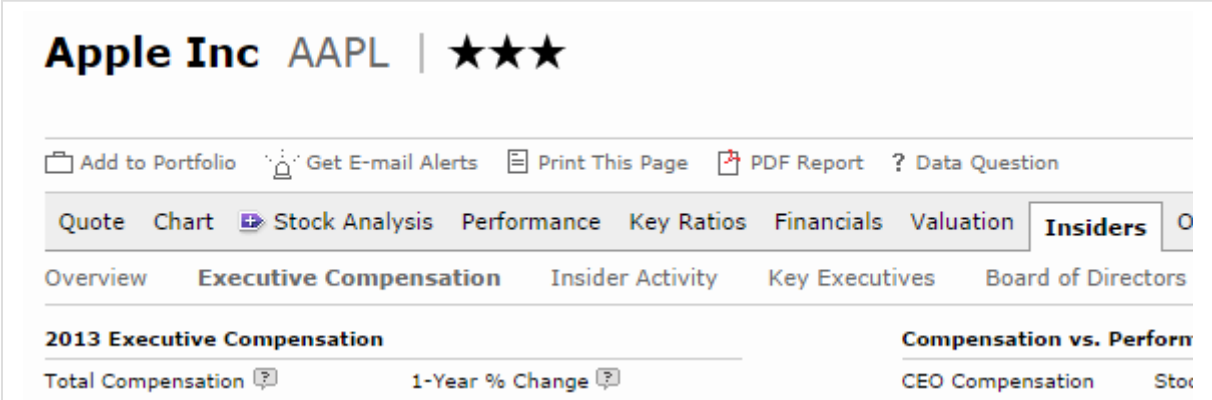
8. Does the company have outstanding executive relations?

It's not just people being transparent on the internet. Companies are more transparent too with the reporting being mandated by the SEC.

Fisher makes a point that companies should put a focus on the performance and ability instead of promoting family members just because they have control.

Another check is to make sure that executive salaries is in line with industry standards and not excessive.

I like to use the insider section at Morningstar to view this data.



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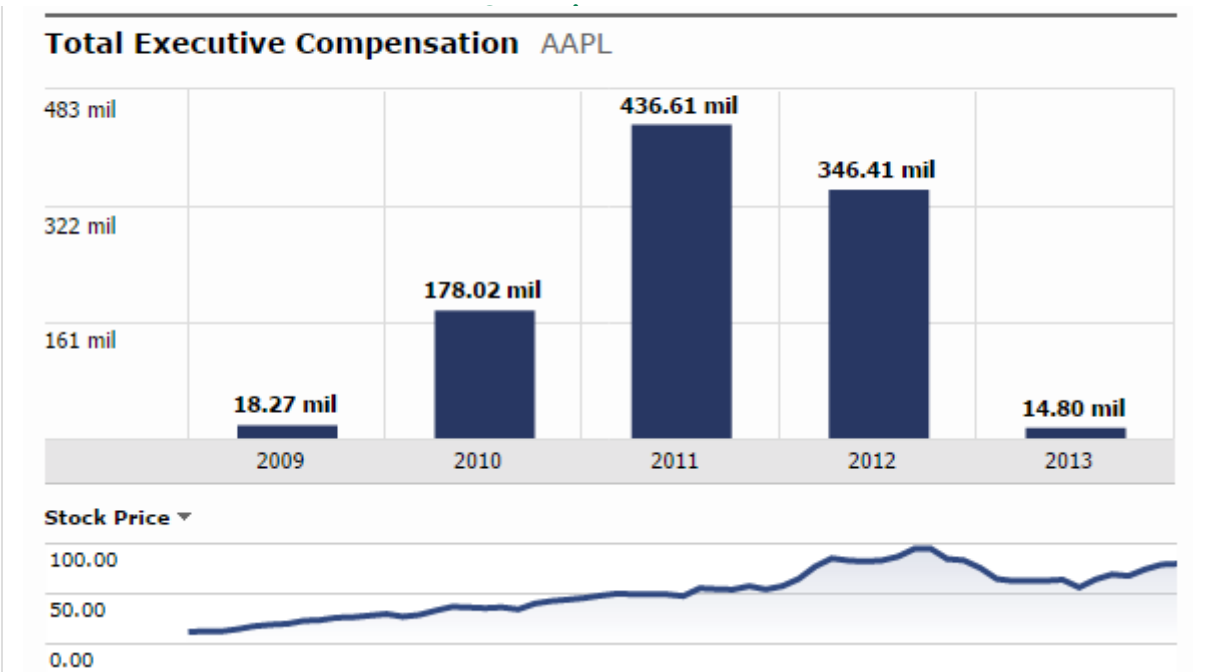

(http://cdn4.oldschoolvalue.com/blog/wp-content/uploads/AAPL-executive-compensation.png)

AAPL Executive Compensation

9. Does the company have depth to its management?

> *the investor should have some idea of what can be done to prevent corporate disaster if the key man should no longer be available. – Fisher*

A company needs to be able to survive on it's own without relying solely on one brilliant manager.

Elon Musk is an example with Tesla.

Once Musk is gone, will Tesla continue to grow and continually come up with mind blowing and ambitious plans to change the world?

Fisher wants companies where management delegates to lower level managers.

> *I try to buy stock in businesses that are so wonderful that an idiot can run them. Because sooner or later, one will. – Buffett*

10. How good are the company's cost analysis and accounting controls?

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of the CFO and check their record.

Did they come from a company like Enron?

Or any other company that were cooking the books?

The main thing here is to make sure that there are no red flags.

You can do deep **financial statement analysis (http://www.oldschoolvalue.com/blog/financial-statement-analysis/)** and make use of **important investing ratios (http://www.oldschoolvalue.com/blog/valuation-methods/5-rockin-investing-ratios-and-why-i-like-it/)** to determine the cost and valuation of the business.

11. Are there other aspects of the business, somewhat peculiar to the industry involved, which will give the investor important clues as to how outstanding the

company may be in relation to its competition?

> *in most important operations involving retailing, the degree of skill a company has in handling real estate matters – the quality of its leases, for instance – is of great significance. – Fisher*

You can see that as you work down this checklist, the items to go through become much broader and open to interpretation.

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Annual reports do a good job of giving a high level overview of what the business does, but unless you start looking up youtube videos, looking up books, trade magazines or reading specialty blogs, there is a lot of information that you miss out on.

12. Does the company have a short range or long range outlook in regards to profits?

Any company that is prepared to sacrifice short term profits in order to produce maximum long term growth and profit is an admirable company and one worthy of investigating.

Now Amazon is a prime example of a very gutsy and visionary company.

Throw Tesla into the mix too (http://www.oldschoolvalue.com/blog/stock-analysis/the-story-of-tesla/).

It's just the valuation that I don't agree with, but the way Amazon and Tesla focuses on the long term and doesn't care what Wall Street thinks is something that investors should be looking for.

I'm a fan of companies that do not hold earnings calls or provide guidance.

These are a rare breed and most are found on the OTC exchange, but when you come across a management team that doesn't care what Wall Street thinks, it's definitely worth digging into.

13. In the foreseeable future, will the growth of the company require sufficient equity financing so that the larger number of shares then outstanding will largely cancel the existing stockholders' benefit from this anticipated growth?

> *what really matters is whether the company's cash plus further borrowing ability is sufficient to take care of the capital needed to exploit the prospects of the next several years. – Fisher*

No debt.

Strong balance sheet.

Two phrases that makes me warm, fuzzy and helps me sleep at night even if a company I own goes through a difficult patch.

On the other hand, after having invested in several junior miners, I know how true this number 13 is.

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Once it starts, it's too easy to dilute further.

Beware the dangers of share dilution (http://www.investopedia.com/articles/stocks/11/dangers-of-stock-dilution.asp).

14. Does the management talk freely to investors about its affairs when things are going well but "clam up" when troubles and disappointments occur?

Pretty self evident.

Does management speak openly about their issues, or do they gloss it up and try to make it sound rosy and like everything is ok?

Check out how ITT Educational Services (ESI) is handling their probe from the SEC.

It's not a pretty sight with very little communication from the CEO.

Guy Spier is against meeting with management (http://www.oldschoolvalue.com/blog/book-reviews/the-education-of-a-value-investor/) because the CEO is the salesmen of their company.

They are eloquent, charismatic and it's far too easy to start agreeing with whatever they say.

Steve Jobs.

Elon Musk.

Even Steve Ballmer, despite not having shown the results.

You find yourself nodding your head without realizing.

15. Does the company have a management of unquestionable integrity?

Do you want to invest in Enron, Lucent, Worldcom, South Sea Bubble or England's Enron (http://en.wikipedia.org/wiki/The_South_Sea_Company)?

This is NOT an Easy Common Stock Checklist

This is definitely not a stock checklist that you can complete in 10 minutes.

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Trying to find an answer to all those questions is a time staking and daunting task.

But keep in mind that you are free to modify and "update" this checklist.

Nothing is carved in stone.

When better ideas come across, it's important to throw away the old and update with the new and better.

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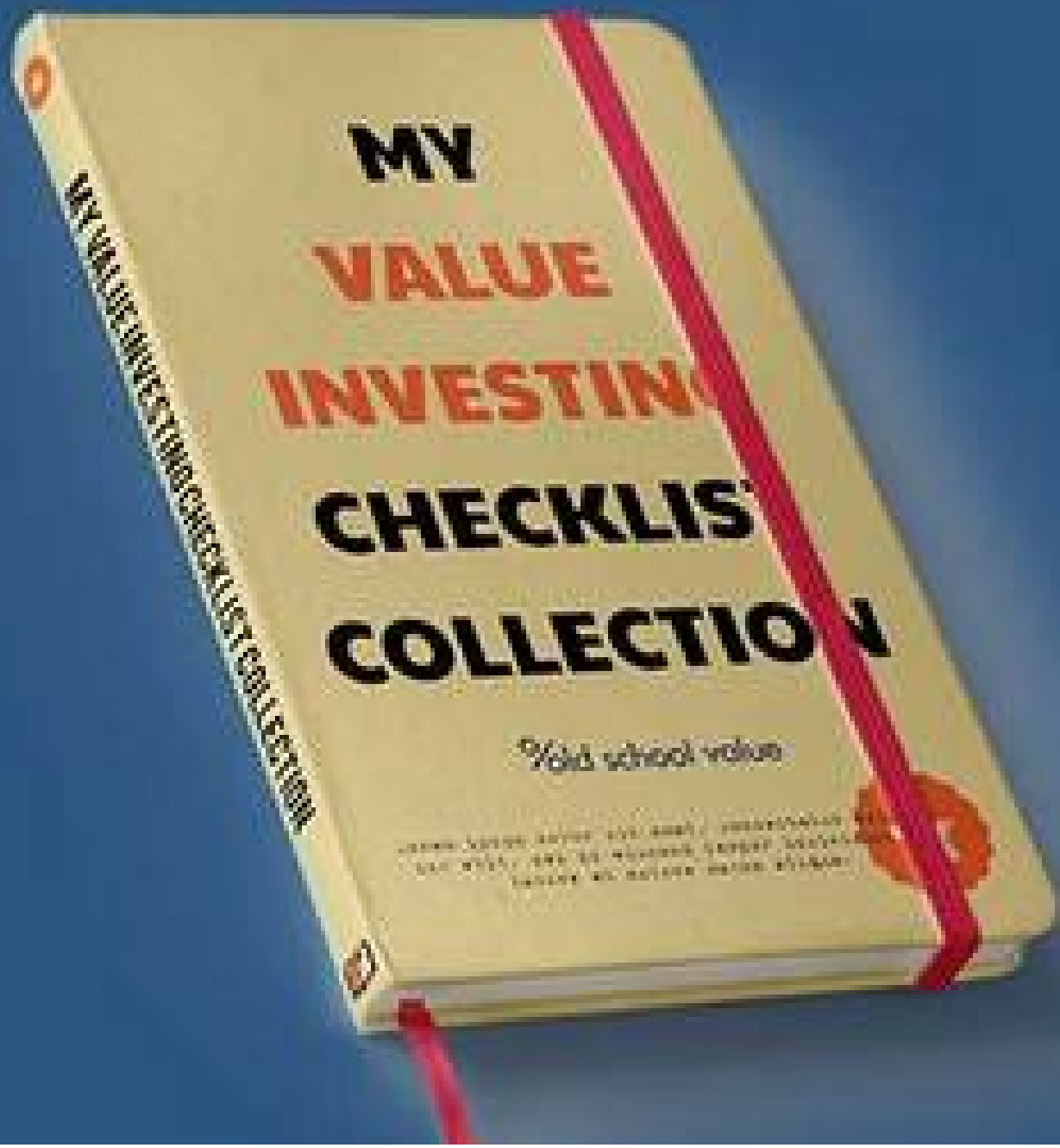

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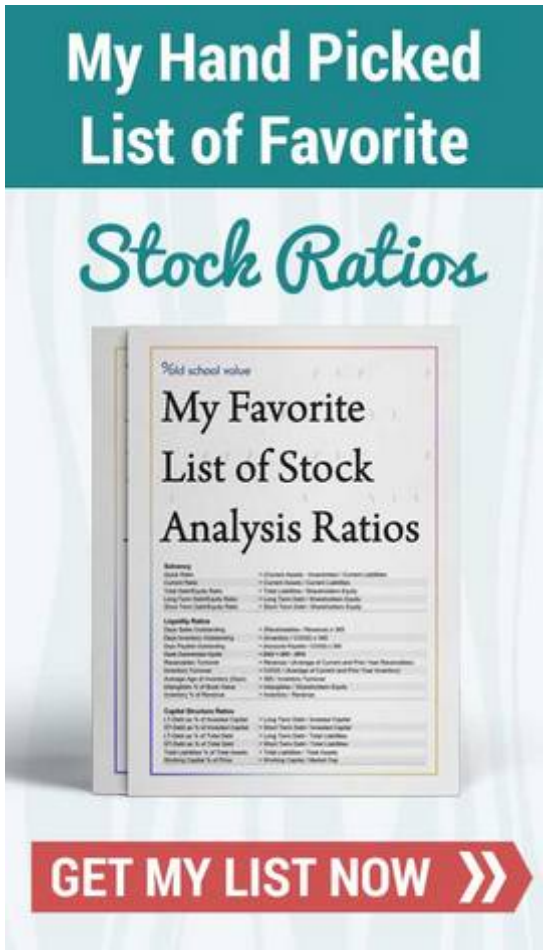

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Our Mission

(http://www.oldschoolvalue.com/about.php) My wife and I are Christians and our focus is to love God and love people. We are proud supporters of Compassion and are grateful to be sponsoring 8 children. We are just two ordinary people and understand that we cannot change the world. However, that doesn't mean we can't try. Call me crazy, but our dream is to one day sponsor 1,000 children around the world. Thank you for helping us achieve this one child at a time.

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