<u>Some Fine Points of Tool Kit 5</u>

As Demonstrated with HD and LOW SSG's

HD Visual Analysis

1. After downloading HD data into the SSG, note HD sales during the past five years are rising slower than they did 5-10 years ago. This results in the solid red line that runs near the data points for sales (a statistically calculated best fit line using all the data from the past ten years) lying above the data points for the past few years. That should be a red flag that sales growth rates have slowed and the curve needs adjustment. To adjust the curve, left click on any part of the graph of the SSG. A new screen will appear showing the SSG in a form you can edit directly. You can remove the data points for any given year by simply clicking on the vertical line that defines the end of that year. For HD, remove the oldest five data points, noting as you do, that the growth rates of sales and earnings changes each time you click away a year. And the solid red line also moves. Certainly the most recent five years represents a more conservative and probably more accurate estimate of what the upcoming five years will be than does the data from five and ten years ago. Earnings may continue to slow from the present going forward, so to be conservative, be sure your judgment of earnings projects from the last year at a slower rate than the previous five years. And since sales drive earnings, never estimate earnings to grow faster than sales. The only exception would be if you have solid knowledge that the margins of the business will be improving over time because of a fundamental change in their business model.
2. Note how earnings are growing faster than sales. This means margins at HD have improved. This is good news. HD is becoming more efficient. But, while it is reasonable HD may be able to maintain the margins they now enjoy this is a one time event and should not be expected over a long period. Use sales to gauge long term earnings growth.
3. Note how price has remained flat for the past five or more years as earnings have risen. What's the reason for this and why would you expect price to double in the next five years.
    a. Was HD overpriced?
    b. Have investors moved to LOW?
    c. Has the collapse of the internet bubble been a part of the flattening of price?

Some Alt Commands.

1. **Alt b**. After you've filled in all the "judgments" on both sides of the SSG, place the cursor in the purple box that covers "zoning" in Section 4c and 4d of the SSG. Hold down the alt key and depress the letter b. The result will be a display that shows what price the stock will need to reach for you to have an upside-downside ratio of 3.0 and return 15% compounded for five years (double in price in five years).

2. **Alt m.** Click on the "Estimated High P/E" box in Section 4A. A dialog box will appear that displays the high and low P/E's for the past ten years. Since for many companies, stock prices became inflated during the blowing of the internet bubble, using the average of these P/E's can be very aggressive. To eliminate the highest five high P/E's and the highest five low P/E's, hold down the alt key and touch the m key.
3. **Alt q**. Often times using the latest annual data to estimate the next five years EPS is too conservative. For example, if a company has just reported third quarter earnings, the latest annual data is now about ten months old. A better choice for estimating low earnings (Section 4C of the SSG) might be the last four quarters eps. To load the last four quarters earnings into the "estimated low earnings" box, hold down the alt key and depress the letter q.
4. To display quarterly data for the past year in the Visual Analysis section of the SSG, hold down the Alt and Shift keys and depress the Y key.

These are often crucial steps in filling out the SSG that may help you to properly value the stock you are studying.

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