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# Evaluating Company Management

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Presented by:  
Ty Hughes  
NAIC DC Chapter

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# Measuring Managerial Ability

Objective tests of managerial ability are few and rather unscientific. ... The most convincing proof of capable management lies in a superior comparative record over a period of time....

– Graham and Dodd

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# What To Look For in Management

- A management that has been tested by competition in both good and bad times
- A management whose sales and profits are expanding at a geometric rate
- A management that will have stronger and bigger businesses in five years
- Beware of management that is riding an industry wave or product cycle

– George Nicholson

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# Management Report Card

- SSG serves as a tool to review skills and quality of company management
- How is the management performing?
- Section 2 of the SSG offers important insights:
  - Pretax profits margins
  - Return on equity
  - Percent debt to equity (Toolkit and Stock Analyst)

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# Evaluating Management with the SSG

- Consistent and increasing growth in revenues
  - Section 1 of the SSG (Visual Analysis)
- Consistent and increasing growth in earnings
  - Section 1 of the SSG (Visual Analysis)
- Consistent or increasing pre-tax profit margin
  - Section 2a of the SSG
- Consistent or increasing return on equity
  - Section 2b of the SSG

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# Pre-Tax Profits

- Line 2a of the SSG
- Pre-Tax Profits =
  - Revenues - Expenses
  - Revenues - Cost of goods Sold - Overhead
- Are they stable, rising or falling?
- How do they compare to competitors or industry average?
- What is the future PTP trend likely to be?

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# Factors that Reduce Profits

- Increasing expenses:
  - Rising raw material costs
  - Rising labor costs
  - Rising marketing expenses
- Lower demand for products or services
- Pricing pressure from competitors
- Products going off patent

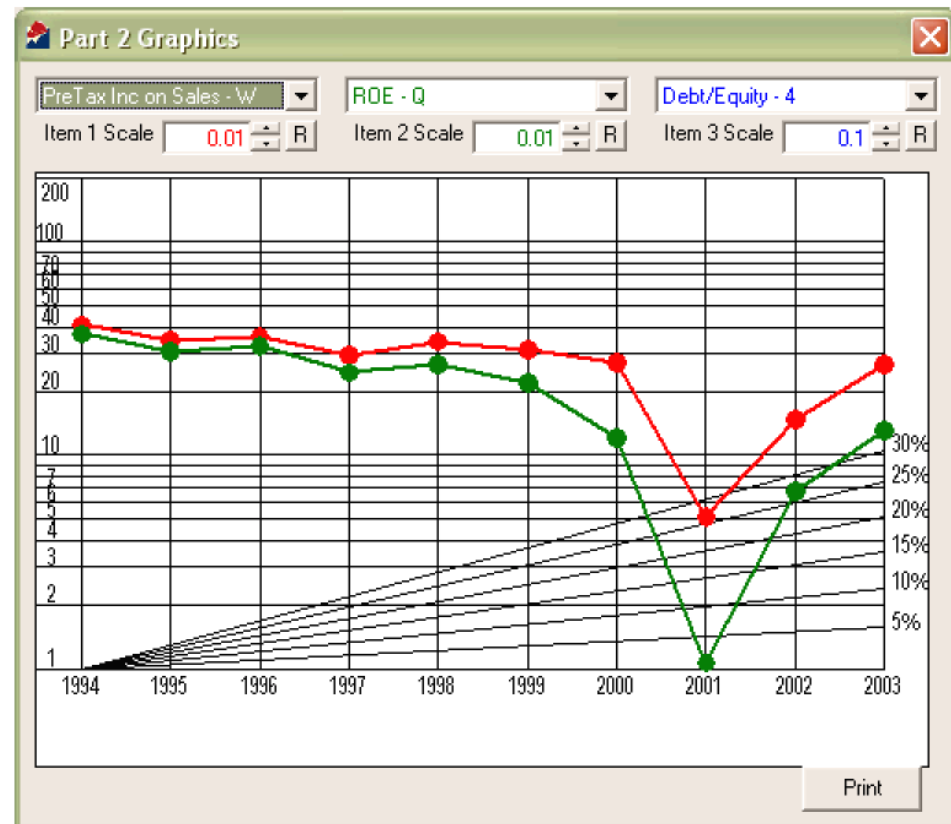
## 2 EVALUATING MANAGEMENT

CISCO SYSTEMS INC

Apr 26, 2004

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG	TREND
<b>A</b> % Pre-tax Profit on Sales (Net before Taxes / Sales)	41.0	34.3	35.8	29.3	34.2	31.3	27.4	5.2	14.7	26.8	19.6%	VARYING
<b>B</b> % Earned on Equity (EPS / Book Value)	36.1	29.9	31.5	23.6	25.8	21.0	11.6	1.1	6.6	12.7	9.2%	VARYING

Demand for Cisco products falls off sharply





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# Pre-Tax Profit Margin

- Represents how much of each sales dollar a company keeps before taxes
- SSG focuses on pre-tax profit margin rather than net profit margin.
  - Tax rates change from time to time

$$\text{PPM} = \frac{\text{Sales} - \text{Cost of Goods Sold} - \text{Overhead}}{\text{Sales}}$$

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# Using Value Line

- Value Line provides net profit margin (after tax) rather than pretax profit margin
- With net profit margin and tax rate, we can calculate the pre-tax profit margin

$$\text{Pre - Tax Profit Margin} = \frac{\text{Net Profit}}{(1 - \text{Tax Rate})}$$

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# Looking for Consistency

- Look for a steady upward trend that is above average for the industry
- Be skeptical of above average profit margins that make a big jump
- Consistent numbers year after year might mean either peak efficiency or stagnation
- Look for correlation with consistent and increasing revenues and earnings

# Examples

## #1 – Lowe's Companies:

<b>2 EVALUATING MANAGEMENT</b>		Company <b>LOWE'S COMPANIES INC.</b> ( <b>LOW</b> )										<b>10/27/04</b>		
		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
		UP	DOWN											
<b>A</b>	% Pre-tax Profit/Sales (Net Before Taxes + Sales)	5.6	5.0	5.3	5.5	6.2	6.8	6.8	7.3	8.9	9.7	7.9	UP	
<b>B</b>	% Earned on Equity (ES + Book Value)	15.6	13.2	13.4	13.8	15.3	14.6	14.7	15.1	17.4	17.7	15.9	UP	

## #2 – Orthodontic Centers of America:

<b>1 EVALUATING MANAGEMENT</b>		Company <b>ORTHODONTIC CENTERS OF AM</b> ( <b>OCA</b> )										<b>10/27/04</b>		
		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
		UP	DOWN											
<b>A</b>	% Pre-tax Profit/Sales (Net Before Taxes + Sales)	18.7	34.2	33.1	31.6	31.9	33.0	28.4	28.0	24.8	21.8	27.2		DOWN
<b>B</b>	% Earned on Equity (ES + Book Value)	10.3	12.4	12.6	12.4	14.5	16.6	16.2	15.8	15.0	10.7	14.9		DOWN

# Profit Margin Ratios FOR

LOW.N



Symbol Lookup

[Printable version](#)

## LOWE'S COMPANIES INC (NYS)

LAST [4:01 PM ET]

CHANGE

Risk Alert for LOW.N

56.56 USD

▲ 0.39 (0.69%)



Medium

sponsored by

SECTOR: [Services](#) | INDUSTRY: [Retail \(Home Improvement\)](#)

▶ Top 7 Stocks for October

Profitability Ratios (%)	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	32.51	33.04	43.67	47.88
Gross Margin - 5 Yr. Avg.	29.25	30.69	42.54	46.48
EBITD Margin (TTM)	12.54	12.52	22.24	21.15
EBITD - 5 Yr. Avg.	10.94	11.08	21.34	20.48
Operating Margin (TTM)	9.59	10.36	13.41	21.31
Operating Margin - 5 Yr. Avg.	7.92	9.04	11.59	18.04
Pre-Tax Margin (TTM)	9.59	10.37	10.71	17.25
Pre-Tax Margin - 5 Yr. Avg.	7.91	9.06	11.84	17.07
Net Profit Margin (TTM)	5.92	6.56	8.27	13.71
Net Profit Margin - 5 Yr. Avg.	4.96	5.61	7.85	11.29
Effective Tax Rate (TTM)	38.25	37.37	31.57	30.18
Effective Tax Rate - 5 Yr. Avg.	37.21	38.31	35.30	34.25

advertisement

**Note Increasing Pre-Tax Margin**

# Profit Margin Ratios FOR [Symbol Lookup](#)

[Printable version](#)

## OCA INC (NYS)

LAST [4:03 PM ET] CHANGE  
**4.16 USD** ▲ 0.16 (4.00%)

Risk Alert for OCA.N



**Low**

sponsored by

SECTOR: [Healthcare](#) | INDUSTRY: [Healthcare Facilities](#)

▶ Top 7 Stocks for October

Profitability Ratios (%)	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	75.12	51.05	68.55	47.88
Gross Margin - 5 Yr. Avg.	91.39	50.60	68.56	46.48
EBITD Margin (TTM)	18.22	15.87	22.48	21.15
EBITD - 5 Yr. Avg.	33.24	14.93	22.61	20.48
Operating Margin (TTM)	12.91	11.66	18.36	21.31
Operating Margin - 5 Yr. Avg.	27.53	9.42	17.63	18.04
Pre-Tax Margin (TTM)	11.71	10.03	20.66	17.25
Pre-Tax Margin - 5 Yr. Avg.	26.18	7.68	18.29	17.07
Net Profit Margin (TTM)	7.77	6.23	13.09	13.71
Net Profit Margin - 5 Yr. Avg.	16.41	4.48	11.77	11.29
Effective Tax Rate (TTM)	33.61	37.99	27.61	30.18
Effective Tax Rate - 5 Yr. Avg.	37.24	41.68	30.50	34.25

advertisement

**Note Decreasing Pre-Tax Margin**

# More Examples

## #3 – Qwest Communications:

**2 EVALUATING MANAGEMENT** Company **QWEST COMMUNICATION INTL INC** (Q) 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes + Sales)	19.6	19.3	19.5	18.0	20.6	19.8	14.9	3.6	-11.1	-7.2	4.0		<b>DOWN</b>
<b>B</b> % Earned on Equity (ES + Book Value)	37.4	34.3	31.3	27.9	212.5	130.3	4.5	0.2	94.8	81.9	62.3	<b>UP</b>	

## #4 – General Motors:

**2 EVALUATING MANAGEMENT** Company **GENERAL MOTORS CORP** (GM) 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes + Sales)	4.4	5.6	4.1	4.5	2.8	5.1	3.4	0.8	1.2	2.0	2.5		<b>DOWN</b>
<b>B</b> % Earned on Equity (ES + Book Value)	51.1	26.3	21.9	39.8	37.2	26.1	15.6	9.4	63.7	12.5	25.5		<b>DOWN</b>

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# What Profit Margins Tell Us

- Efficiency of management in earning money for each dollar of sales
- Comparing profit margins within an industry helps find the best company
- Reduced profit margins may suggest additional competition or increased costs
- Declining profit margins can provide an early warning indicator of declining earnings



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# Understanding Profit Margins

- Pre-tax profit margins varies with industry
  - Supermarkets – 3.5%
  - Retail Specialty – 9%
  - Insurance (Property & Casualty) – 14%
  - **S&P 500 – 17%**
  - Major Drugs – 24%
  - Software & Programming – 27%
- Always compare a company's profit margins with its industry peers and competitors

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# What ROE Means

- A measure of how well a company has used reinvested earnings to generate additional earnings
- ROE is the key financial factor in defining the growth potential of the company from internal sources

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# Return on Equity

- Line 2b of the SSG
- Measures management's skill in profitability, asset management, and financial leverage
  - Profitability is major driver, so usually tracks PTP
- Is ROE stable, rising or falling?
- How does company compare to competitors, industry average or market in general?
- Average for S&P 500 is around 15%
- Generally, anything above 10% is good

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# Calculating ROE

- Two ways of calculating ROE:
  - $\text{EPS} \div \text{Book Value}$
  - $\text{Net Income} \div \text{Equity}$
- Two variations of equity/book value
  - Use end of year book value
  - Use start of year book value
- NAIC Stock Analyst & Investor's Toolkit support both options

# Components of ROE

- Asset turnover (efficiency)
- Profit margin (profitability)
- Financial leverage (leverage)
- Tax Retention Rate (100% - tax rate)

$$\text{ROE} = \frac{\text{Net Income}}{\text{Equity}}$$

$$\text{ROE} = \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Pretax Income}}{\text{Sales}} \times \frac{\text{Assets}}{\text{Equity}} \times \frac{\text{Net Income}}{\text{Pretax Income}}$$

$$\text{ROE} = \text{Turnover} \times \text{Pretax Profit Margin} \times \text{Leverage} \times \text{Tax Retention Rate}$$

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# ROE and Potential Internal Growth

- Average rate of return earned on earnings reinvested in the business
- Theoretical limit on growth without financing
- Also called the “Implied” or “Sustainable Growth Rate” of a company
- ROE can be used to determine potential earnings growth of company without borrowing
  - Return on Equity x Earnings Retention Rate
  - Generally, use 5-year average for ROE

# Sustainable or Implied Growth Rate

## 2 EVALUATING MANAGEMENT

Company **JOHNSON & JOHNSON** (JNJ)

10/28/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes + Sales)	17.0	17.6	18.7	20.2	21.3	20.9	22.8	24.7	26.8	26.3	24.3	UP	
<b>B</b> % Earned on Equity (ES + Book Value)	27.8	26.1	26.1	26.2	26.4	25.5	25.3	24.0	29.7	28.1	26.5	UP	

## 3 PRICE-EARNINGS HISTORY as an indicator of the future

*This shows how stock prices have fluctuated with earnings and dividends. It is a building block for translating earnings into future stock prices.*

PRESENT PRICE 57.770 HIGH THIS YEAR 58.800 LOW THIS YEAR 48.050

Year	A PRICE		C Earnings Per Share	D	E	F	G	H % High Yield F ÷ B × 100
	HIGH	LOW						
1 1999	53.4	38.5	1.49					1.4
2 2000	53.0	33.1	1.71					1.9
3 2001	61.0	40.3	1.91	31.9	21.1	0.700	36.6	1.7
4 2002	65.9	41.4	2.27	29.0	18.2	0.795	35.0	1.9
5 2003	59.1	48.1	2.54	23.3	18.9	0.925	36.4	1.9
6 TOTAL		201.3		115.2	77.5		181.0	
7 AVERAGE		40.3		28.8	19.4		36.2	
8 AVERAGE PRICE EARNINGS RATIO			24.1	9	CURRENT PRICE EARNINGS RATIO		19.3	

**Implied Growth Rate**  
 $= 26.5\% \times (1 - .362)$   
 $= 16.9\%$

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# How to Assess ROE

- Return on Equity is a measure of management's efficiency in earning profits on shareholder investment and reinvestment
- Higher is better, all other things equal
- An upward trend over time is positive
- Stability at 15% or higher is acceptable
- Recent downtrends of two or more years are a serious “red flag”



# ROE Example - HDI

2 EVALUATING MANAGEMENT Company HARLEY-DAVIDSON, INC. (HDI) 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
A % Pre-tax Profit/Sales (Net Before Taxes + Sales)	10.5	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	19.4	UP	
B % Earned on Equity (ES + Book Value)	24.2	22.1	21.4	20.8	20.3	22.5	23.9	24.7	25.8	25.5	24.5	UP	

Mgt Effectiveness Ratios FOR HDI.N  [Symbol Lookup](#) [Printable version](#)

## HARLEY-DAVIDSON INC (NYS)

LAST [4:01 PM ET] CHANGE

57.57 USD ▼ -0.75 (-1.29%)

Risk Alert for HDI.N



SECTOR: Consumer Cyclical | INDUSTRY: Recreational Products

▶ Top 7 Stocks for October

Management Effectiveness (%)	Company	Industry	Sector	S&P 500
Return On Assets (TTM)	18.16	12.65	6.71	7.15
Return On Assets - 5 Yr. Avg.	15.65	10.28	6.10	6.64
Return On Investment (TTM)	22.33	17.30	9.15	10.90
Return On Investment - 5 Yr. Avg.	20.33	14.68	8.77	10.79
Return On Equity (TTM)	29.77	23.07	16.96	19.50
Return On Equity - 5 Yr. Avg.	27.52	18.01	14.53	19.01

Trend up

Exceeds Industry Average

# ROE Example - BBBY

**2 EVALUATING MANAGEMENT** Company **BED BATH & BEYOND INC (BBBY)** 10/28/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes + Sales)	11.6	11.1	11.1	11.4	11.6	11.5	11.8	12.2	13.4	14.5	12.7	UP	
<b>B</b> % Earned on Equity (ES + Book Value)	27.1	25.5	25.0	24.1	23.1	22.9	20.8	19.7	20.3	19.8	20.7		DOWN

Mgt Effectiveness Ratios   [Symbol Lookup](#) [Printable version](#)

BED BATH & BEYOND INC (UTC)		
LAST [4:00 PM ET]	CHANGE	Risk Alert for BBBY.O
40.79 USD	▼ -0.02 (-0.05%)	No Alert sponsored by
SECTOR: Services   INDUSTRY: Retail (Specialty)		

Top 7 Stocks for October

Management Effectiveness (%)	Company	Industry	Sector	S&P 500
Return On Assets (TTM)	15.70	10.09	6.12	7.15
Return On Assets - 5 Yr. Avg.	16.24	5.05	5.40	6.64
Return On Investment (TTM)	21.88	14.38	8.50	10.90
Return On Investment - 5 Yr. Avg.	23.50	6.68	7.55	10.70
Return On Equity (TTM)	22.98	14.60	12.57	19.50
Return On Equity - 5 Yr. Avg.	24.39	14.49	12.80	19.01

[Learn about Management Effectiveness](#)

Even to Slightly Down

Exceeds Industry Average

# ROE Example - PSFT

**2 EVALUATING MANAGEMENT** Company **PEOPLESOFT INC (PSFT)** 10/28/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit/Sales (Net Before Taxes + Sales)	21.1	21.5	13.7	21.6	20.1	5.8	8.1	14.0	15.1	8.2	10.2		DOWN
<b>B</b> % Earned on Equity (ES + Book Value)	14.4	17.0	12.7	23.6	21.5	2.8	7.6	11.5	9.6	4.4	7.2		DOWN

Mgt Effectiveness Ratios FOR   [Symbol Lookup](#) [Printable version](#)

**PEOPLESOFT INC (UTC)**

LAST [4:00 PM ET] CHANGE **▲ 0.17 (0.83%)** Risk Alert for PSFT.O

20.77 USD  **Medium** sponsored by

SECTOR: [Technology](#) | INDUSTRY: [Software & Programming](#)

Top 7 Stocks for October

Management Effectiveness (%)	Company	Industry	Sector	S&P 500	advertisement
Return On Assets (TTM)	1.77	9.81	8.88	7.15	
Return On Assets - 5 Yr. Avg.	2.94	9.55	5.74	6.64	
Return On Investment (TTM)	2.42	13.09	12.27	10.90	
Return On Investment - 5 Yr. Avg.	4.09	14.23	9.19	10.70	
Return On Equity (TTM)	2.55	14.17	15.86	19.50	
Return On Equity - 5 Yr. Avg.	4.20	15.51	12.99	19.01	

[Learn about Management Effectiveness](#)

Down

Below Industry Average

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# Review

- Use Section 1 to assess revenue and earnings growth for consistency and growth
- Use Section 2 to assess pretax profit margins and ROE (consistent or growing)
- Look at with industry peers
- Cross check quality
  - Value Line Financial Strength (B+ or better) and Earnings predictability (85 or better)
  - S&P “Investability Quotient” Rating (85 or better)

# Use S&P to Confirm Quality

STANDARD  
& POOR'S

## Harley-Davidson

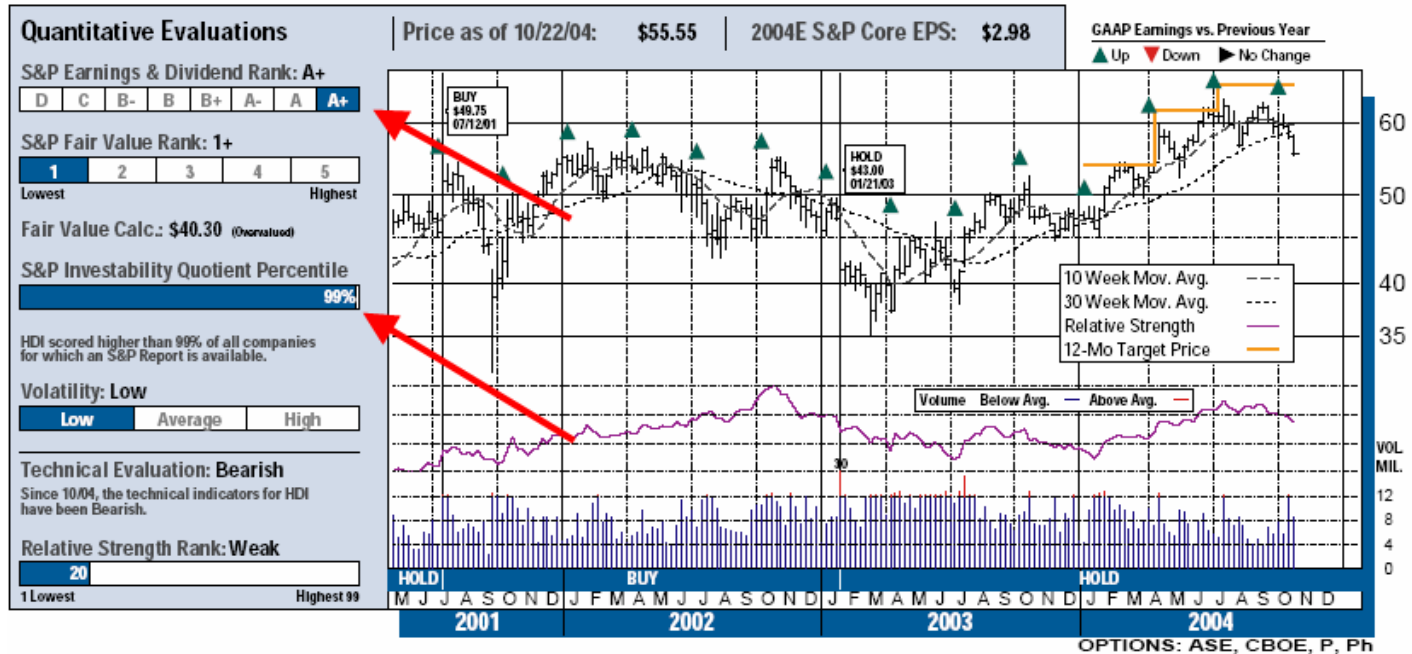
Stock Report  
October 23, 2004  
NYSE Symbol: HDI

Recommendation: **HOLD** ★ ★ ★ ★ ★  
12-Month Target Price: **\$66.00**  
(as of July 14, 2004)

Sector: Consumer Discretionary  
Sub-Industry: Motorcycle Manufacturers  
Peer Group: Motorcycles

Summary: This leading maker of heavyweight motorcycles also produces a line of motorcycle parts and accessories.

HDI has an approximate 0.16% weighting in the **S&P 500**

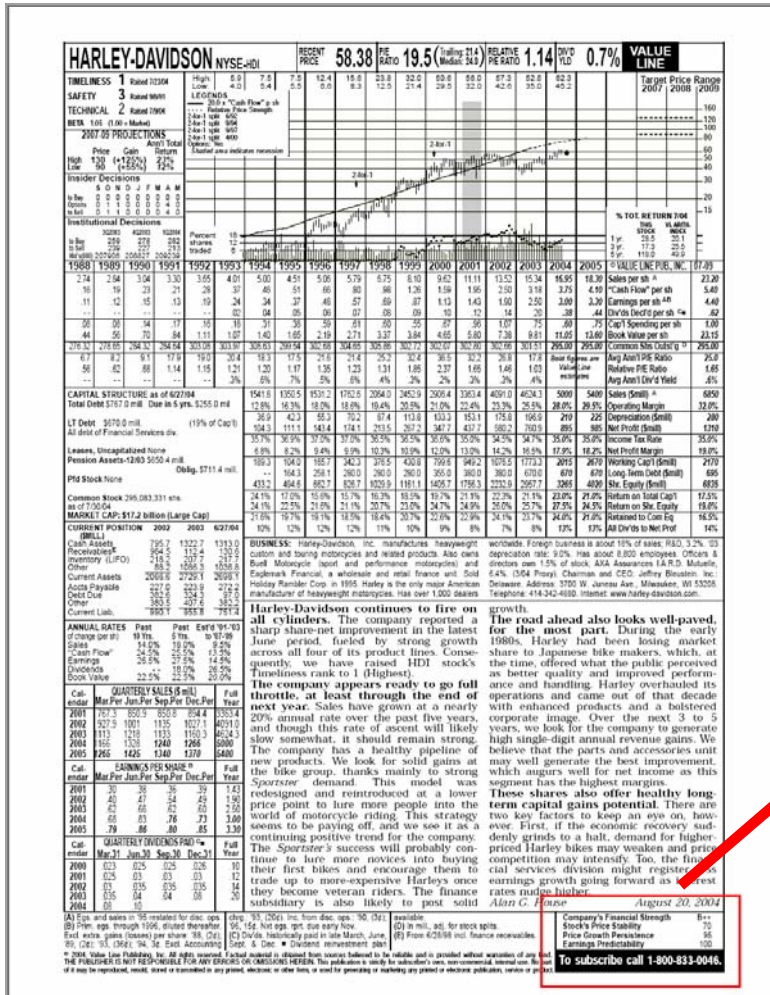


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# Value Line Quality Indicators

- ***Earnings Predictability***—a measure of the reliability of an earnings forecast. The most reliable forecasts tend to be those with the highest rating (100); the least reliable (5).
- ***Financial Strength Rating***—a relative measure of financial strength of the companies reviewed by Value Line. The relative ratings range from A++ (strongest) down to C (weakest), in nine steps.

# Value Line Quality Indicators



- Financial Strength (B+ or better)
- Earnings Predictability (85 or better)

**Company's Financial Strength** B++  
**Stock's Price Stability** 70  
**Price Growth Persistence** 95  
**Earnings Predictability** 100

# Looking at the Data – LTR

Company's Financial Strength	B++
Stock's Price Stability	80
Price Growth Persistence	55
Earnings Predictability	45

**Quantitative Evaluations**

S&P Earnings & Dividend Rank: B-

D	C	<b>B-</b>	B	B+	A-	A	A+
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S&P Fair Value Rank: NR

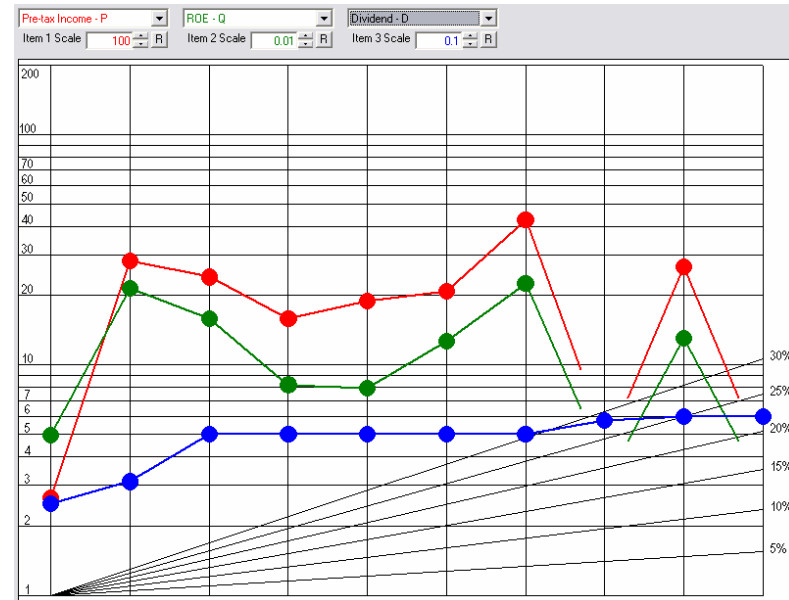
1	2	3	4	5	
Lowest					Highest

Fair Value Calc.: NA

S&P Investability Quotient Percentile

	83%
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LTR scored higher than 83% of all companies for which an S&P Report is available.



## 2 EVALUATING MANAGEMENT

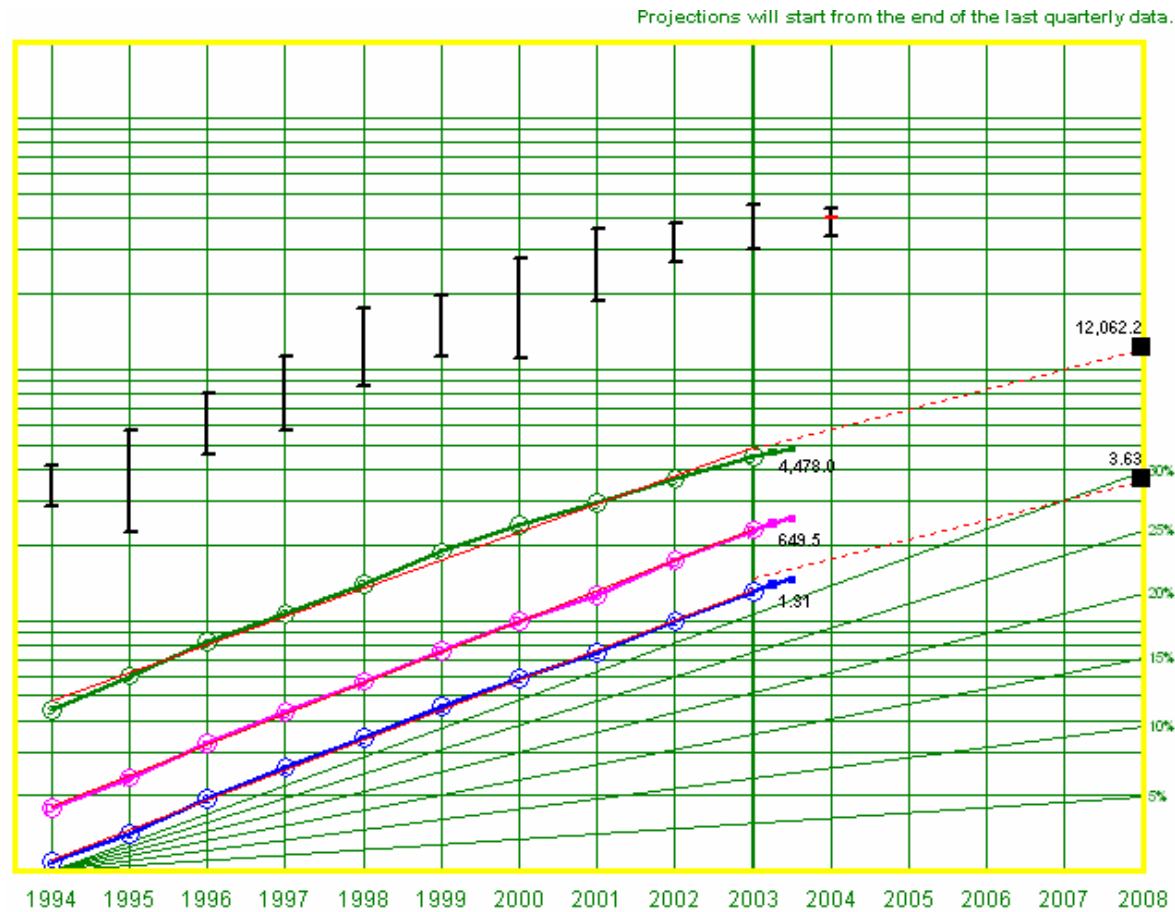
Company **LOEWS CORP** (LTR)

10/28/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes + Sales)	2.0	15.4	10.3	5.9	9.2	10.0	20.7	-3.0	15.9	-8.6	7.0		DOWN
<b>B</b> % Earned on Equity (EG + Book Value)	2.4	21.4	15.7	8.2	7.8	12.2	22.3	-3.8	12.9	-6.9	7.4		DOWN



# Example of Solid Management



# Look at the Data – BBBY

Company's Financial Strength	A++
Stock's Price Stability	45
Price Growth Persistence	100
Earnings Predictability	100

**Quantitative Evaluations**

S&P Earnings & Dividend Rank: **A-**

D	C	B-	B	B+	<b>A-</b>	A	A+
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S&P Fair Value Rank: **2-**

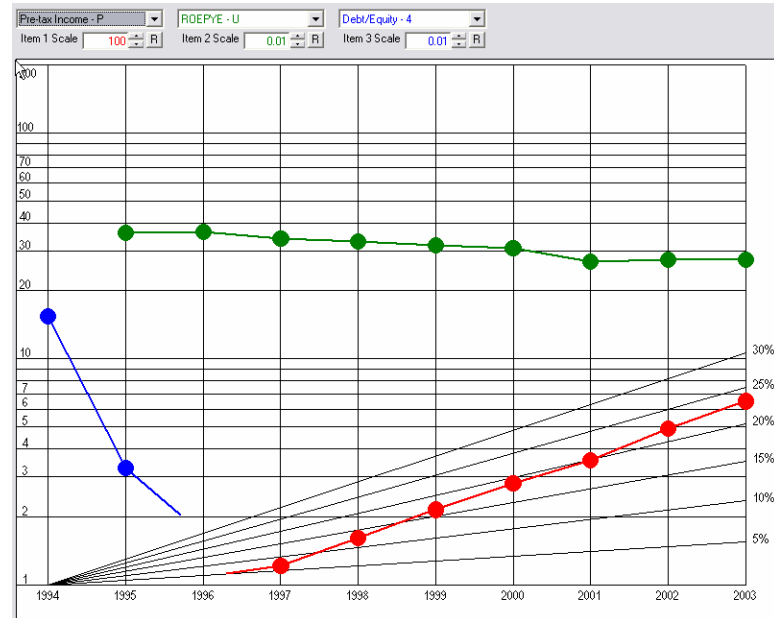
1	<b>2</b>	3	4	5
Lowest		Highest		

Fair Value Calc.: **\$35.60** (Slightly Overvalued)

S&P Investability Quotient Percentile

	<b>99%</b>
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BBBY scored higher than 99% of all companies for which an S&P Report is available.



## 2 EVALUATING MANAGEMENT

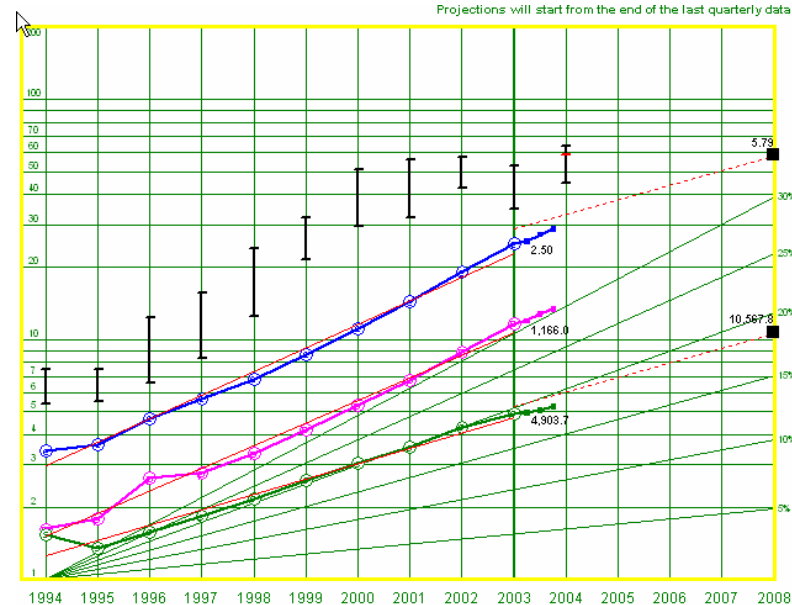
Company **BED BATH & BEYOND INC (BBBY)**

**10/27/04**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes ÷ Sales)	11.6	11.1	11.1	11.4	11.6	11.5	11.8	12.2	13.4	14.5	12.7	UP	
<b>B</b> % Earned on Equity (ES ÷ Book Value)	27.1	25.5	25.0	24.1	23.1	22.9	20.8	19.7	20.3	19.8	20.7		DOWN

# Good Management = Quality

- Note the correlation with quality factors
  - Consistent growth in sales and earnings
  - Increasing profit margin
  - Increasing ROE



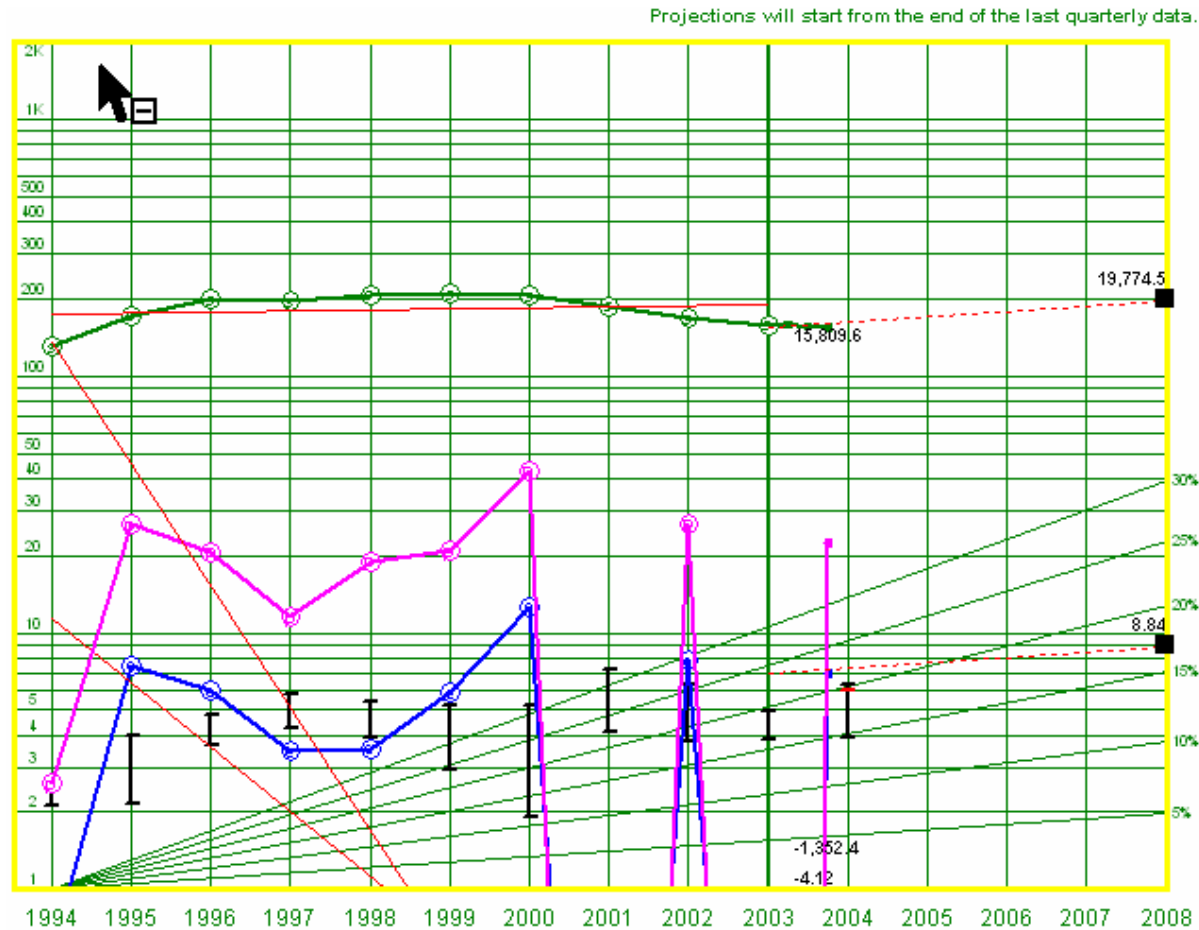
## 2 EVALUATING MANAGEMENT

Company **HARLEY-DAVIDSON, INC.** (HDI)

10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit on Sales (Net Before Taxes ÷ Sales)	10.5	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	19.4	UP	
<b>B</b> % Earned on Equity (ES ÷ Book Value)	24.2	22.1	21.4	20.8	20.3	22.5	23.9	24.7	25.8	25.5	24.5	UP	

# Example of Weak Management



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# Finding Quality Management

- Software Programs
  - NAIC Prospector
  - AAll Stock Investor Pro
  - Microsoft Money Website
- Screening is just that – a screen
- Further research and analysis is always required

---

# Screening for Quality

- ROE > Industry ROE
- ROE > 10%
- EPS Growth > Industry EPS Growth
- Sales Growth > Industry Sales Growth
- Historical EPS and Rev Growth > 10%
- Consistent EPS Growth or ( $R^2 > 0.9$ )
- Revenues > \$100 million
- At least five years of public data

# Translating to Prospector

**Define screening criteria**

Available criteria  Pro mode  Display running totals

Available criteria	Buttons	And/Or	(	Report item	Criteria	)	Records selected
<b>PDC</b> Growth companies	Add >	AND	(	Sales	> 100	)	
<b>PDC</b> NAIC 1	< Delete row	AND	(	Avg 5Yr ROE	> [Industry Average - Avg 5Yr ROE]	)	
<b>PDC</b> NAIC 2	Delete group	AND	(	Hist 5Yr EPS Gr	> [Industry Average - Hist 5Yr EPS Gr]	)	
<b>PDC</b> Quality companies	Clear list	AND	(	Hist 5Yr Rev Gr	> [Industry Average - Hist 5Yr Rev Gr]	)	
<b>PDC</b> Safety companies		AND	(	Hist 5Yr Rev Gr	>=.10	)	
<b>PDC</b> Value companies		AND	(	Hist 5Yr EPS Gr	>=.10	)	
<b>UC</b> DEMO		AND	(	Proj 5Yr EPS Gr	>=.10	)	
<b>UC</b> Dow Jones		AND	(	EPS R2 10yr	>.92	)	
<b>UC</b> Good Growth Companies		AND NOT	(	Industry	= 'regional banks'	)	
<b>UC</b> Growth		AND NOT	(	Industry	= 'thrifts & mortgage financ'	)	
<b>UC</b> Industry		AND	(	Num Yrs of Data	>= 5	)	
<b>UC</b> Large Growth Companies							
<b>UC</b> Medium Growth Companies							
<b>UC</b> NAIC 01							
<b>UC</b> Small Growth Companies							

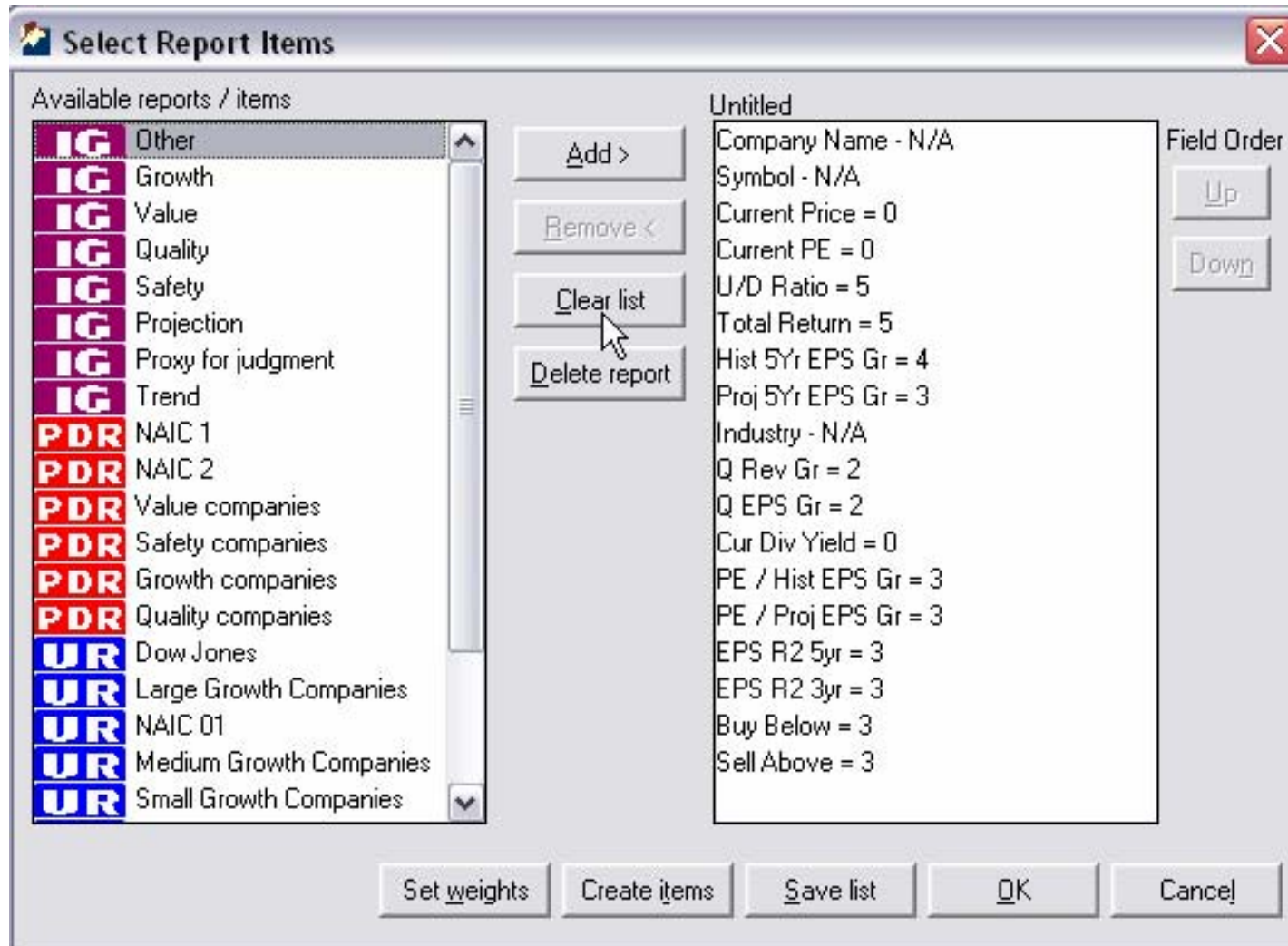
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# Prospector Results

	Weighted ranking	Company Name	Symbol	Current Price (\$)	Current PE	U/D Ratio	Total Return	Hist 5Yr EPS Gr (%)	Proj 5Yr EPS Gr	Industry
	<b>1.8</b>	<b>Minimum values</b>		<b>18.710</b>	<b>7.6</b>	<b>1.0</b>	<b>10.6</b>	<b>11.2</b>	<b>10.0</b>	
	<b>5.0</b>	<b>Average values</b>		<b>37.679</b>	<b>18.5</b>	<b>3.0</b>	<b>21.4</b>	<b>24.1</b>	<b>14.9</b>	
	<b>7.1</b>	<b>Maximum values</b>		<b>74.380</b>	<b>28.3</b>	<b>6.4</b>	<b>37.6</b>	<b>47.8</b>	<b>20.0</b>	
<b>1</b>	7.1	CARDINAL HEALTH INC	CAH	38.490	11.1	6.1	37.6	23.6	15.0	HEALTH CARE DISTRIBUTORS
<b>2</b>	7.0	BED BATH & BEYOND INC	BBBY	39.040	26.7	4.4	29.2	30.2	20.0	SPECIALTY STORES
<b>3</b>	6.9	HARLEY-DAVIDSON INC	HDI	55.550	19.3	3.4	26.4	30.5	15.0	MOTORCYCLE MANUFACTURERS
<b>4</b>	6.7	ORLEANS HOMEBUILDERS INC	OHB	19.260	8.9	3.9	17.4	47.8	15.0	HOMEBUILDING
<b>5</b>	6.5	D R HORTON INC	DHI	27.610	7.6	2.3	16.8	31.3	15.0	HOMEBUILDING
<b>6</b>	5.8	HOME DEPOT INC	HD	39.170	18.6	6.4	33.5	17.5	13.0	HOME IMPROVEMENT RETAIL
<b>7</b>	5.7	LOWES COS	LOW	55.240	21.9	3.4	24.2	28.0	17.5	HOME IMPROVEMENT RETAIL
<b>8</b>	5.5	THOR INDUSTRIES INC	THO	25.660	13.6	1.7	13.3	32.2	15.0	AUTOMOBILE MANUFACTURERS
<b>9</b>	5.4	KOHL'S CORP	KSS	52.290	28.3	5.3	32.3	23.8	19.0	DEPARTMENT STORES
<b>10</b>	5.1	WALGREEN CO	WAG	35.500	27.1	3.6	28.1	15.8	15.0	DRUG RETAIL
<b>11</b>	5.1	ARTHUR J GALLAGHER & CO	AJG	29.930	15.3	3.0	23.8	19.5	12.0	INSURANCE BROKERS
<b>12</b>	5.1	RENT-A-CENTER INC	RCII	23.460	9.6	3.6	21.2	35.1	13.0	SPECIALTY STORES
<b>13</b>	5.0	BROWN & BROWN INC	BRO	41.500	23.2	1.8	16.8	36.2	15.0	INSURANCE BROKERS
<b>14</b>	4.8	DANAHER CORP	DHR	53.680	25.4	1.9	17.4	14.4	15.0	INDUSTRIAL MACHINERY
<b>15</b>	4.3	WEYCO GROUP INC	WEYS	37.570	12.3	1.5	17.2	15.7	19.8	FOOTWEAR
<b>16</b>	4.1	SONIC CORP	SONC	26.660	26.1	1.1	10.6	19.9	17.5	RESTAURANTS
<b>17</b>	4.0	AMBAC FINANCIAL GP	ABK	74.380	11.7	1.8	16.7	16.6	14.5	PROPERTY & CASUALTY INSUR
<b>18</b>	2.6	U S BANCORP	USB	27.860	13.9	1.9	19.4	11.2	10.0	DIVERSIFIED BANKS
<b>19</b>	2.1	LUXOTTICA GROUP SPA	LUX	18.710	22.3	1.4	12.9	21.2	10.0	APPAREL, ACCESSORIES & LU
<b>20</b>	1.8	ECOLAB INC	ECL	32.020	27.1	1.0	12.8	12.2	12.0	SPECIALTY CHEMICALS



# Prospector Report Weighting



# Top Four from the Quality Screen

## 2 EVALUATING MANAGEMENT Company **CARDINAL HEALTH INC (CAH)** 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit to Sales (Net Before Taxes + Sales)	1.2	1.9	2.3	2.8	2.5	3.6	3.8	3.0	3.6	3.8	3.6	EVEN	
<b>B</b> % Earned to Equity (ES + Book Value)	8.9	15.4	11.9	13.8	15.1	16.3	17.8	17.1	18.5	18.4	17.6	UP	

## 2 EVALUATING MANAGEMENT Company **BED BATH & BEYOND INC (BBBY)** 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit to Sales (Net Before Taxes + Sales)	11.6	11.1	11.1	11.4	11.6	11.5	11.8	12.2	13.4	14.5	12.7	UP	
<b>B</b> % Earned to Equity (ES + Book Value)	27.1	25.5	25.0	24.1	23.1	22.9	20.8	19.7	20.3	19.8	20.7		DOWN

## 2 EVALUATING MANAGEMENT Company **HARLEY-DAVIDSON, INC. (HDI)** 10/27/04

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit to Sales (Net Before Taxes + Sales)	10.5	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	19.4	UP	
<b>B</b> % Earned to Equity (ES + Book Value)	24.2	22.1	21.4	20.8	20.3	22.5	23.9	24.7	25.8	25.5	24.5	UP	

## 2 EVALUATING MANAGEMENT Company **ORLEANS HOMEBUILDERS INC (OHB)** 10/28/04

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
<b>A</b> % Pre-tax Profit to Sales (Net Before Taxes + Sales)	1.3	1.4	2.8	2.5	5.7	6.8	6.1	8.1	11.6	11.5	8.8	UP	
<b>B</b> % Earned to Equity (ES + Book Value)	9.6	8.3	9.9	9.0	17.8	18.4	18.6	22.1	24.1	22.0	21.0	UP	

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# On-line Resources

- NAIC – OPS Data for SSGs
  - Available with NAIC membership
- Reuters – [www.investor.reuters.com](http://www.investor.reuters.com)
- Value Line – [www.valueline.com](http://www.valueline.com)
- S&P Reports – Most on-line brokers provide

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# Recommended Reading

- Evaluating Management  
*by Amy Rauch-Neilson*
  - [www.better-investing.org/articles/bi/120/1000](http://www.better-investing.org/articles/bi/120/1000)
- Determining the Quality of Management  
*by Nancy Isaacs*
  - [www.better-investing.org/articles/bi/11/108](http://www.better-investing.org/articles/bi/11/108)
- Quality: A Measure of Excellence  
*by Mark Robertson*
  - [www.better-investing.org/articles/web/4654](http://www.better-investing.org/articles/web/4654)

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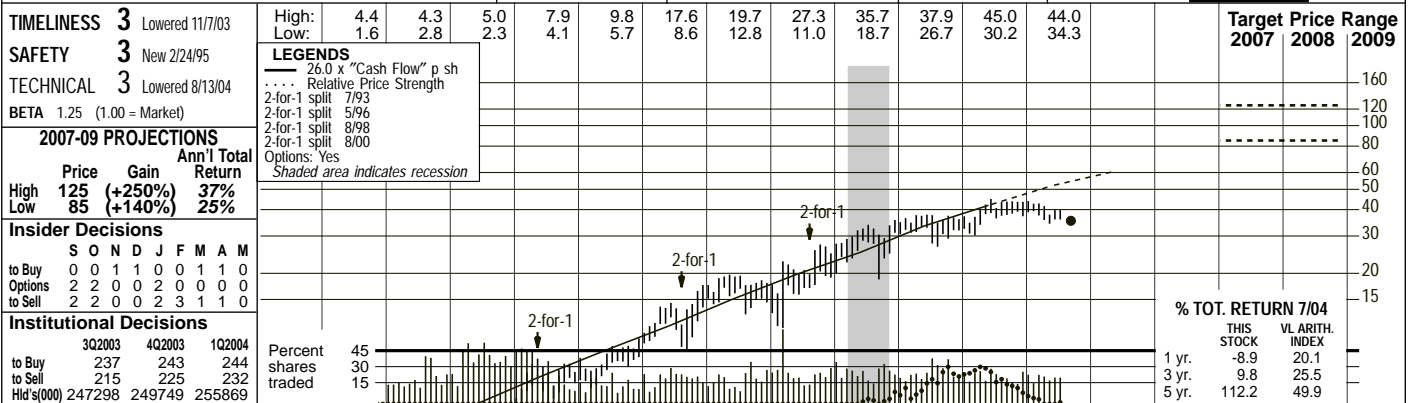
# Conclusion

- Any final questions?
- You can contact me at:  
Ty Hughes – [tyhughes@gmail.com](mailto:tyhughes@gmail.com)
- Better Investing!

# BED BATH & BEYOND NDQ-BBBY

RECENT PRICE **35.47** P/E RATIO **23.0** (Trailing: 25.5 Median: 33.0) RELATIVE P/E RATIO **1.32** DIV'D YLD **Nil**

**VALUE LINE**



Bed Bath & Beyond was incorporated in New York in 1971, following the opening of its first two stores under the name "bed n bath." It adopted the larger "superstore" format in 1985, and chose the name "Bed Bath & Beyond" in 1987. On June 11, 1992, BBBY sold 37.0 mill. shares (adjusted) to the public in an initial public offering through a syndicate led by Goldman, Sachs, at a split-adjusted price of \$1.07. Shareholders sold an additional 64 mill. shares in a secondary offering on August 16, 1993.

**CAPITAL STRUCTURE as of 5/29/04**  
**Total Debt** None  
**Leases, Uncapitalized** Annual rentals \$274.0 mill.  
**No Defined Benefit Pension Plan**  
**Pfd Stock** None  
**Common Stock** 300,573,279 shs.  
**MARKET CAP: \$10.7 billion (Large Cap)**

CURRENT POSITION	2002	2003	5/29/04
<b>(SMILL)</b>			
Cash Assets	616.6	866.6	814.8
Inventory (Retail)	915.7	1012.3	1065.5
Other	62.1	90.4	106.5
Current Assets	1594.4	1969.3	1986.8
Accts Payable	363.0	398.7	428.3
Debt Due	--	--	--
Other	317.2	370.8	356.5
Current Liab.	680.2	769.5	784.8

ANNUAL RATES	Past 10 Yrs.	Past 5 Yrs.	Est'd '01-'03 to '07-'09
of change (per sh)			
Sales	30.5%	26.0%	18.5%
"Cash Flow"	33.0%	30.5%	20.5%
Earnings	32.5%	31.0%	23.0%
Dividends	--	--	Nil
Book Value	38.0%	36.0%	24.5%

Fiscal Year Begins	QUARTERLY SALES (\$ mill.) <sup>A</sup>				Full Fiscal Year
	May	Per Aug.	Per Nov.	Per Feb.	Per
2001	575.8	713.6	759.5	879.1	2928.0
2002	776.8	903.0	936.0	1049	3665.2
2003	893.9	1111	1174	1298	4478.0
2004	1100	1320	1385	1544.1	5350
2005	1290	1565	1650	1855	6360

Fiscal Year Begins	EARNINGS PER SHARE <sup>AB</sup>				Full Fiscal Year
	May	Per Aug.	Per Nov.	Per Feb.	Per
2001	.10	.18	.18	.28	.74
2002	.15	.25	.25	.35	1.00
2003	.19	.32	.33	.47	1.31
2004	.27	.40	.40	.58	1.65
2005	.34	.48	.48	.70	2.00

Calendar	QUARTERLY DIVIDENDS PAID				Full Year
	Mar.31	Jun.30	Sep.30	Dec.31	
2000					
2001					
2002					
2003					
2004					

NO CASH DIVIDENDS BEING PAID

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	© VALUE LINE PUB, INC.	07-09
1.62	2.21	3.00	3.86	5.01	6.69	8.32	10.05	12.53	14.90	17.90	21.15	23.35	Sales per sh <sup>A</sup>	34.65
.14	.18	.25	.33	.43	.58	.76	.97	1.29	1.61	2.00	2.35	2.00	"Cash Flow"/per sh	3.90
.11	.14	.20	.26	.34	.46	.59	.74	1.00	1.31	1.65	2.00	2.00	Earnings per sh <sup>B</sup>	3.50
--	--	--	--	--	--	--	--	--	--	Nil	Nil	Nil	Div'ds Decl'd per sh	Nil
.40	.56	.78	1.07	1.47	1.99	2.84	3.76	4.96	6.63	8.30	10.30	10.30	Book Value per sh	19.00
271.08	272.27	274.41	276.18	278.84	280.81	287.89	291.44	292.60	300.48	300.50	301.00	301.00	Common Shs Outst'g <sup>C</sup>	303.00
31.8	25.6	32.7	31.5	38.1	36.3	34.8	40.0	33.8	30.5	Bold figures are Value Line estimates			Avg Ann'l P/E Ratio	30.0
2.09	1.71	2.05	1.82	1.98	2.07	2.26	2.05	1.85	1.77				Relative P/E Ratio	2.00
--	--	--	--	--	--	--	--	--	--				Avg Ann'l Div'd Yield	Nil
440.3	601.3	823.2	1066.6	1397.2	1878.0	2396.7	2928.0	3665.2	4478.0	5350	6360	6360	Sales (\$mill) <sup>A</sup>	10500
43.4%	43.2%	43.1%	43.1%	42.9%	42.5%	43.1%	43.4%	43.5%	43.8%	43.8%	44.0%	44.0%	Gross Margin	44.5%
13.3%	12.9%	12.6%	12.9%	13.0%	12.8%	13.3%	14.0%	15.1%	16.2%	17.0%	17.2%	17.2%	Operating Margin	17.5%
61	80	108	141	186	241	316	396	497	575	660	745	745	Number of Stores <sup>D</sup>	1000
30.0	39.5	55.0	73.1	97.3	131.2	171.9	219.6	302.2	399.5	505	610	610	Net Profit (\$mill)	1050
41.0%	41.0%	39.8%	39.8%	39.7%	39.0%	38.5%	38.5%	38.5%	38.5%	38.5%	38.5%	38.5%	Income Tax Rate	38.5%
6.8%	6.6%	6.7%	6.9%	7.0%	7.0%	7.2%	7.5%	8.2%	8.9%	9.4%	9.6%	9.6%	Net Profit Margin	10.0%
71.9	87.7	121.7	175.7	249.6	360.6	532.5	715.4	914.2	1199.8	1495	1980	1980	Working Cap'l (\$mill)	4330
16.8	5.0	--	--	--	--	--	--	--	--	Nil	Nil	Nil	Long-Term Debt (\$mill)	Nil
108.9	151.5	214.4	295.4	411.1	559.0	817.0	1094.4	1451.9	1990.8	2495	3100	3100	Shr. Equity (\$mill)	5780
24.2%	25.5%	25.7%	24.8%	23.7%	23.5%	21.0%	20.1%	20.8%	20.1%	20.0%	19.5%	19.5%	Return on Total Cap'l	18.5%
27.5%	26.1%	25.7%	24.8%	23.7%	23.5%	21.0%	20.1%	20.8%	20.1%	20.0%	19.5%	19.5%	Return on Shr. Equity	18.5%
27.5%	26.1%	25.7%	24.8%	23.7%	23.5%	21.0%	20.1%	20.8%	20.1%	20.0%	19.5%	19.5%	Retained to Com Eq	18.5%
--	--	--	--	--	--	--	--	--	--	Nil	Nil	Nil	All Div'ds to Net Prof	Nil

**BUSINESS:** Bed Bath & Beyond Inc. sells a broad range of competitively priced name brand domestics (55% of FY '03 sales) and home furnishings (45%), incl. bed linens, towels, cookware, and housewares. Operated 592 stores in 44 states (a/o 5/29/04). Most new units are averaging just under 30,000 sq. feet in size; several are 80,000 and above. Superstores generated a 6.3% same-store

**Earnings at Bed Bath & Beyond are likely to continue their rapid ascent.** With a 5% contribution from comparable-store sales increases, and about a 15% rise in store count, sales growth in fiscal 2004 (ends February 26, 2005) should approximate 20%. We think this will carry share net to \$1.65, or 25% more than fiscal 2003's level.

**Fiscal 2005 should reveal similar growth.** Same-store sales are likely to continue along their present path, hovering in the mid-single-digits, while store expansion should remain the primary driver of growth, as new locations often perform above management expectations on both a sales and profitability basis. All told, earnings should rise 21% from our 2004 target, to \$2.00 per share.

**The long-term trends for the home goods retailer appear strong.** BBBY still owns only a sliver of the national home goods market, meaning that additional store expansion should prove fruitful. Indeed, we look for store openings in the range of 80-90 annually over the 3- to 5-year period, which will likely account for a large portion of the sales gains that we

foresee. The balance sheet is still a source of opportunity. With cash and investment securities surging beyond the \$1 billion mark, the company has a number of options. With its financial flexibility, it may well initiate a recurring dividend, announce a one-time special dividend, buy back a large amount of stock, or make further acquisitions. For the moment, however, management is not tipping its hand, and even seems content to let the cash sit on the balance sheet.

**Bed Bath & Beyond shares have been under pressure in recent months.** Indeed, the stock has fallen almost 15% since our February report. For the year ahead, the equity is only expected to mirror the broader market averages. Nonetheless, the retailer appears to be positioned for better-than-20% earnings growth over the 3- to 5-year period. This, coupled with the fact that the issue is trading at a discount to our projected earnings multiple, results in alluring capital appreciation prospects out to 2007-2009. The stock is ranked 3 (Average) for Timeliness.

*Michael P. Gorman*  
 August 13, 2004

(A) Fiscal year ends on Saturday nearest February 28th of the following calendar year (starting FY '96); prior years ended on Sunday.  
 (B) Based on weighted average shares outstanding through '96, diluted thereafter. Next earnings report due late Sept.  
 (C) In millions, adjusted for stock splits.  
 (D) Excludes 29 Harmon Stores; health & beauty aids chain acquired March 5, 2002.  
 (E) Sales don't total due to rounding.

**To subscribe call 1-800-833-0046.**



**INDUSTRY TIMELINESS: 64 (of 98)**

The Retail (Special Lines) Industry has fallen from grace in our Timeliness system, dropping into the bottom half of all sectors in the *Value Line* universe. Moreover, after a strong run, most of the stocks within the retail subsector have come under pressure since our May report, with nearly 75% turning in a negative performance. In fact, the average decline for the specialty retailer stocks was slightly greater than 7%. Nearly two-thirds of the companies in the following pages underperformed the S&P Retail Index, and even more lagged the broader market averages.

The weakness in the Retail (Special Lines) performance likely stemmed from a slowing in the economic environment in the second quarter, as well as the spectre of rising interest rates and higher energy prices finally dawning on the mind of the American consumer. Where the economy heads in the next couple of months should have major implications for retail stocks.

The Specialty Retail universe is made up of an assorted group of subsectors with diverse businesses. Each of these different niches displays its own strengths and weaknesses against the economic tides. As such, we strongly suggest that investors closely examine each report before taking any positions.

### A Soft Spot

After continuing to advance smartly in the first quarter, the economy took a breather in the second interim, with gross domestic product (GDP) rising at a weaker-than-expected 3.0%. With growth running at that level, any substantial improvement in the jobs picture would seem unlikely, which would probably put a dent in consumer confidence. However, despite the slowdown, interest rates are likely to continue rising, spurred on by the Federal Reserve, which would put a squeeze onto disposable income.

Most importantly, consumer spending in the month of June (the most recent data available) fell 0.7%. This was not wholly unexpected, as the euphoria over refinancing and tax returns finally began to fade, leaving consumers with a more normalized sense of spending power. Furthermore, income growth continues to be nearly non-existent, rising only 0.2%. With inflation also rising 0.2% during the period, real income growth was flat. We continue to believe that for any real, sustained expansion

in consumer spending to take place, incomes *must* begin to rise more substantially. Otherwise, we will be left with stimulus induced bursts of spending, followed by periods of weak consumption.

### Indirect Taxation

Energy prices have remained stubbornly high over the past year. In recent weeks, prices have jumped to near record levels. This is especially true of oil, which has traded around \$44 per barrel. This, coupled with high gasoline prices, is diverting consumer spending away from retailers. If energy supplies remain this tight and prices this high heading into the winter heating season, results could well weaken as retailers are compete for consumers' paychecks.

### Back To School

The back-to-school season is upon us, and that has historically been a fairly strong time for some retailers. Specifically, stores that focus primarily on clothing for teenagers and "tweens" are likely to see the largest boost, although they are not without risk. It is important that the retailers judge correctly when merchandising their stores, otherwise fashion trends would likely leave them behind, with bloated inventories that must be marked down. Chains to keep an eye on during this period include *Too*, *Aeropostale*, and *American Eagle*, as well as others. We recommend that readers take a close look at the reports for these firms, as some have already begun raising guidance in anticipation of a strong selling season.

### Investment Advice

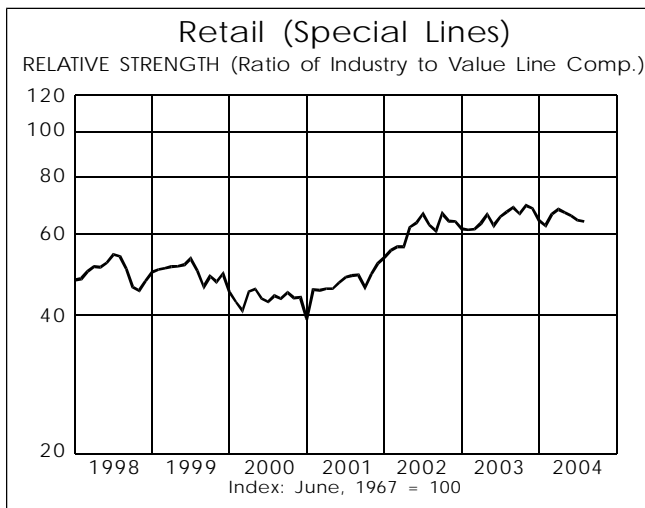
The stocks in the Retail (Special Lines) Industry have faced increased downward pressure of late, and we expect that the trend might well continue over the short term. Indeed, the earnings season that begins for many of the companies shortly after this publication will likely be a crucial one, with those retailers that do not deliver results being punished rather harshly. In the pages that follow, subscribers should be able to find timely selections, as well as attractive long-term opportunities, since recent declines have opened up some alluring entry points for those willing to be patient. As always, readers are advised to examine each report closely.

Michael P. Gorman

Composite Statistics: Retail (Special Lines) Industry

2000	2001	2002	2003	2004	2005		07-09
152849	162681	173170	186683	<b>230500</b>	<b>247000</b>	Sales (\$mill)	<b>262500</b>
34.9%	34.7%	35.6%	36.2%	<b>36.3%</b>	<b>36.5%</b>	Gross Margin	<b>37.0%</b>
10.1%	9.4%	10.3%	10.8%	<b>11.0%</b>	<b>11.2%</b>	Operating Margin	<b>11.5%</b>
59034	62355	64769	65565	<b>73000</b>	<b>76000</b>	Number of Stores	<b>82000</b>
5793.9	5022.2	6839.3	8212.1	<b>8500</b>	<b>9615</b>	Net Profit (\$mill)	<b>11500</b>
39.7%	41.4%	38.4%	38.2%	<b>38.0%</b>	<b>38.0%</b>	Income Tax Rate	<b>38.0%</b>
3.8%	3.1%	3.9%	4.4%	<b>3.7%</b>	<b>3.9%</b>	Net Profit Margin	<b>4.5%</b>
14832	18752	25041	30799	<b>32500</b>	<b>34000</b>	Working Cap'l (\$mill)	<b>36000</b>
9000.8	11429	12449	12156	<b>13000</b>	<b>13250</b>	Long-Term Debt (\$mill)	<b>13750</b>
40491	44247	49504	54976	<b>57500</b>	<b>60000</b>	Shr. Equity (\$mill)	<b>72000</b>
12.4%	9.7%	11.7%	12.8%	<b>13.5%</b>	<b>13.5%</b>	Return on Total Cap'l	<b>15.0%</b>
14.3%	11.4%	13.8%	14.9%	<b>14.5%</b>	<b>16.0%</b>	Return on Shr. Equity	<b>16.0%</b>
13.3%	10.4%	12.9%	13.6%	<b>13.5%</b>	<b>13.5%</b>	Retained to Com Eq	<b>15.0%</b>
7%	8%	7%	9%	<b>7%</b>	<b>7%</b>	All Div'ds to Net Prof	<b>6%</b>
21.0	23.1	18.7	18.7			Avg Ann'l P/E Ratio	<b>19.0</b>
1.37	1.25	1.02	1.02			Relative P/E Ratio	<b>1.25</b>
.3%	.3%	.4%	.4%			Avg Ann'l Div'd Yield	<b>.3%</b>

*Bold figures are Value Line estimates*



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## Ratios

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### BED BATH & BEYOND INC (UTC)

LAST [4:00 PM ET] CHANGE

40.79 USD

▼ -0.02 (-0.05%)


Risk Alert for BBBY.O

No Alert

SECTOR: [Services](#) | INDUSTRY: [Retail \(Specialty\)](#)

### Profit Margin Ratios

Profitability Ratios (%)	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	42.04	45.51	43.67	47.88
Gross Margin - 5 Yr. Avg.	41.41	44.28	42.54	46.48
EBITD Margin (TTM)	16.53	16.69	22.24	21.15
EBITD - 5 Yr. Avg.	14.31	10.07	21.34	20.48
Operating Margin (TTM)	14.66	14.98	13.41	21.31
Operating Margin - 5 Yr. Avg.	12.37	7.89	11.59	18.04
Pre-Tax Margin (TTM)	14.91	15.03	10.71	17.25
Pre-Tax Margin - 5 Yr. Avg.	12.69	8.96	11.84	17.07
Net Profit Margin (TTM)	9.22	12.44	8.27	13.71
Net Profit Margin - 5 Yr. Avg.	7.78	4.96	7.85	11.29
Effective Tax Rate (TTM)	38.16	32.37	31.57	30.18
Effective Tax Rate - 5 Yr. Avg.	38.70	36.27	35.30	34.25

 [Learn about Profit Margin Ratios](#)

### Management Effectiveness

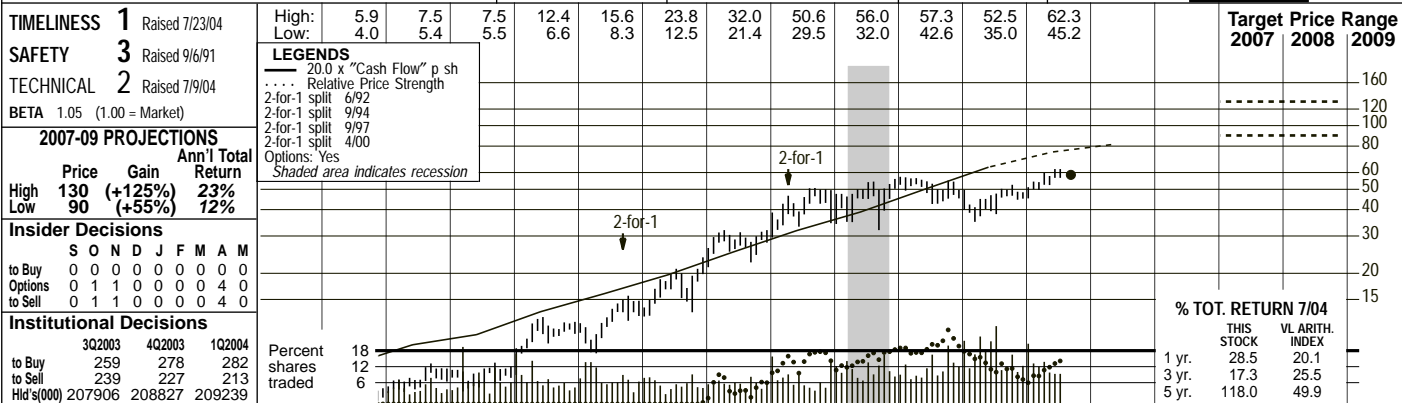
Management Effectiveness (%)	Company	Industry	Sector	S&P 500
Return On Assets (TTM)	15.70	10.09	6.12	7.15
Return On Assets - 5 Yr. Avg.	16.24	5.05	5.40	6.64
Return On Investment (TTM)	21.88	14.38	8.50	10.90
Return On Investment - 5 Yr. Avg.	23.50	6.68	7.55	10.70
Return On Equity (TTM)	22.98	14.60	12.57	19.50
Return On Equity - 5 Yr. Avg.	24.39	14.49	12.80	19.01

 [Learn about Management Effectiveness](#)



# HARLEY-DAVIDSON NYSE-HDI

RECENT PRICE **58.38** P/E RATIO **19.5** (Trailing: 21.4 Median: 24.0) RELATIVE P/E RATIO **1.14** DIV'D YLD **0.7%** **VALUE LINE**



1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	© VALUE LINE PUB, INC.	07-09
2.74	2.84	3.04	3.30	3.65	4.01	5.00	4.51	5.06	5.79	6.75	8.10	9.62	11.11	13.52	15.34	16.95	18.30	Sales per sh <sup>A</sup>	23.20
.16	.19	.23	.21	.28	.37	.46	.51	.66	.80	.98	1.26	1.59	1.95	2.50	3.18	3.75	4.10	"Cash Flow" per sh	5.40
.11	.12	.15	.13	.19	.24	.34	.37	.48	.57	.69	.87	1.13	1.43	1.90	2.50	3.00	3.30	Earnings per sh <sup>AB</sup>	4.40
--	--	--	--	--	.02	.04	.05	.06	.07	.08	.09	.10	.12	.14	.20	.38	.44	Div'ds Decl'd per sh <sup>C</sup>	.62
.08	.08	.14	.17	.16	.18	.31	.38	.59	.61	.60	.55	.67	.96	1.07	.75	.60	.75	Cap'l Spending per sh	1.00
44	56	70	84	1.11	1.07	1.40	1.65	2.19	2.71	3.37	3.84	4.65	5.80	7.38	9.81	11.05	13.60	Book Value per sh	23.15
276.32	278.65	284.32	284.64	303.08	303.97	308.63	299.54	302.68	304.65	305.86	302.72	302.07	302.80	302.66	301.51	295.00	295.00	Common Shs Outst'g <sup>D</sup>	295.00
6.7	8.2	9.1	17.9	19.0	20.4	18.3	17.5	21.6	21.4	25.2	32.4	36.5	32.2	26.8	17.8	Bold figures are Value Line estimates		Avg Ann'l P/E Ratio	25.0
.56	.62	.68	1.14	1.15	1.21	1.20	1.17	1.35	1.23	1.31	1.85	2.37	1.65	1.46	1.03			Relative P/E Ratio	1.65
--	--	--	--	--	.3%	.6%	.7%	.5%	.6%	.4%	.3%	.2%	.3%	.4%			Avg Ann'l Div'd Yield		.6%

CAPITAL STRUCTURE as of 6/27/04				1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	© VALUE LINE PUB, INC.	
Total Debt \$767.0 mill. Due in 5 yrs. \$255.0 mill				1541.8	1350.5	1531.2	1762.6	2064.0	2452.9	2906.4	3363.4	4091.0	4624.3	5000	5400	Sales (\$mill) <sup>A</sup>	6850						
LT Debt \$670.0 mill. (19% of Cap'l)				12.8%	16.3%	18.0%	18.6%	19.4%	20.5%	21.0%	22.4%	23.3%	25.5%	28.0%	29.5%	Operating Margin	32.0%						
All debt of Financial Services div.				36.9	42.3	55.3	70.2	87.4	113.8	133.3	153.1	175.8	196.9	210	225	Depreciation (\$mill)	280						
Leases, Uncapitalized None				104.3	111.1	143.4	174.1	213.5	267.2	347.7	437.7	580.2	760.9	895	985	Net Profit (\$mill)	1310						
Pension Assets-12/03 \$650.4 mill.				35.7%	36.9%	37.0%	37.0%	36.5%	36.5%	36.6%	35.0%	34.5%	34.7%	35.0%	35.0%	Income Tax Rate	35.0%						
Oblig. \$711.4 mill.				6.8%	8.2%	9.4%	9.9%	10.3%	10.9%	12.0%	13.0%	14.2%	16.5%	17.9%	18.2%	Net Profit Margin	19.0%						
Pfd Stock None				189.3	104.0	165.7	342.3	376.5	430.8	799.6	949.2	1076.5	1773.3	2015	2670	Working Cap'l (\$mill)	2170						
Common Stock 295,083,331 shs. as of 7/30/04				--	164.3	258.1	280.0	280.0	280.0	355.0	380.0	380.0	670.0	670	670	Long-Term Debt (\$mill)	695						
MARKET CAP: \$17.2 billion (Large Cap)				433.2	494.6	662.7	826.7	1029.9	1161.1	1405.7	1756.3	2232.9	2957.7	3265	4020	Shr. Equity (\$mill)	6835						
CURRENT POSITION				24.1%	17.0%	15.6%	15.7%	16.3%	18.5%	19.7%	21.1%	22.3%	21.1%	23.0%	21.0%	Return on Total Cap'l	17.5%						
CASH (\$MILL.)				24.1%	22.5%	21.6%	21.1%	20.7%	23.0%	24.7%	24.9%	26.0%	25.7%	27.5%	24.5%	Return on Shr. Equity	19.0%						
Cash Assets				21.6%	19.7%	19.1%	18.5%	18.4%	20.7%	22.6%	22.9%	24.1%	23.7%	24.0%	21.0%	Retained to Com Eq	16.5%						
Receivables <sup>E</sup>				10%	12%	12%	12%	11%	10%	9%	8%	7%	8%	13%	13%	All Div'ds to Net Prof	14%						
Inventory (LIFO)				<b>BUSINESS:</b> Harley-Davidson, Inc. manufactures heavyweight custom and touring motorcycles and related products. Also owns Buell Motorcycle (sport and performance motorcycles) and Eaglemark Financial, a wholesale and retail finance unit. Sold Holiday Rambler Corp. in 1995. Harley is the only major American manufacturer of heavyweight motorcycles. Has over 1,000 dealers worldwide. Foreign business is about 18% of sales; R&D, 3.2%. '03 depreciation rate: 9.0%. Has about 8,800 employees. Officers & directors own 1.5% of stock; AXA Assurances I.A.R.D. Mutuelle, 6.4%. (3/04 Proxy). Chairman and CEO: Jeffrey Bleustein, Inc.: Delaware. Address: 3700 W. Juneau Ave., Milwaukee, WI 53208. Telephone: 414-342-4680. Internet: www.harley-davidson.com.																			
Other				<b>Harley-Davidson continues to fire on all cylinders.</b> The company reported a sharp share-net improvement in the latest June period, fueled by strong growth across all four of its product lines. Consequently, we have raised HDI stock's Timeliness rank to 1 (Highest).																			
Current Assets				<b>The company appears ready to go full throttle, at least through the end of next year.</b> Sales have grown at a nearly 20% annual rate over the past five years, and though this rate of ascent will likely slow somewhat, it should remain strong. The company has a healthy pipeline of new products. We look for solid gains at the bike group, thanks mainly to strong <i>Sportster</i> demand. This model was redesigned and reintroduced at a lower price point to lure more people into the world of motorcycle riding. This strategy seems to be paying off, and we see it as a continuing positive trend for the company. The <i>Sportster's</i> success will probably continue to lure more novices into buying their first bikes and encourage them to trade up to more-expensive Harleys once they become veteran riders. The finance subsidiary is also likely to post solid growth.																			
Accts Payable				<b>The road ahead also looks well-paved, for the most part.</b> During the early 1980s, Harley had been losing market share to Japanese bike makers, which, at the time, offered what the public perceived as better quality and improved performance and handling. Harley overhauled its operations and came out of that decade with enhanced products and a bolstered corporate image. Over the next 3 to 5 years, we look for the company to generate high single-digit annual revenue gains. We believe that the parts and accessories unit may well generate the best improvement, which augurs well for net income as this segment has the highest margins.																			
Debt Due				<b>These shares also offer healthy long-term capital gains potential.</b> There are two key factors to keep an eye on, however. First, if the economic recovery suddenly grinds to a halt, demand for higher-priced Harley bikes may weaken and price competition may intensify. Too, the financial services division might register less earnings growth going forward as interest rates nudge higher.																			
Other				<i>Alan G. House</i> August 20, 2004																			
Current Liab.																							

ANNUAL RATES	Past 10 Yrs.	Past 5 Yrs.	Est'd '01-'03	Full Year
of change (per sh)	10 Yrs.	5 Yrs.	to '07-'09	
Sales	14.0%	18.0%	9.5%	3363.4
"Cash Flow"	24.5%	25.5%	13.5%	4091.0
Earnings	26.5%	27.5%	14.5%	4624.3
Dividends	--	18.0%	26.5%	5000
Book Value	22.5%	22.5%	20.0%	5400

Cal-endar	QUARTERLY SALES (\$ mill.)				Full Year
	Mar.Per	Jun.Per	Sep.Per	Dec.Per	
2001	767.3	850.9	850.8	894.4	3363.4
2002	927.9	1001	1135	1027.1	4091.0
2003	1113	1218	1133	1160.3	4624.3
2004	1166	1328	1240	1266	5000
2005	1265	1425	1340	1370	5400

Cal-endar	EARNINGS PER SHARE <sup>B</sup>				Full Year
	Mar.Per	Jun.Per	Sep.Per	Dec.Per	
2001	.30	.38	.36	.39	1.43
2002	.40	.47	.54	.49	1.90
2003	.62	.66	.62	.60	2.50
2004	.68	.83	.76	.73	3.00
2005	.79	.86	.80	.85	3.30

Cal-endar	QUARTERLY DIVIDENDS PAID <sup>C</sup>				Full Year
	Mar.31	Jun.30	Sep.30	Dec.31	
2000	.023	.025	.025	.026	.10
2001	.025	.03	.03	.03	.12
2002	.03	.035	.035	.035	.14
2003	.035	.04	.04	.08	.20
2004	.08	.10			

(A) Egs. and sales in '95 restated for disc. ops. chrg.: '93, (20¢). Inc. from disc. ops.: '90, (3¢); '96, 15¢. Nxt egs. rpt. due early Nov. available. (D) In mill., adj. for stock splits. (E) From 6/28/98 incl. finance receivables. (B) Prim. egs. through 1996, diluted thereafter. (C) Div'ds. historically paid in late March, June, Sept. & Dec. ■ Dividend reinvestment plan

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The Recreation Industry is ranked in the bottom one-third of all sectors under *Value Line* coverage. This industry, of course, is highly dependent on the health of the domestic economy, as it relates to consumers' discretionary income levels. Although we look for GDP (Gross Domestic Product) growth of 3% to 4% over the next couple of quarters, there are some signs of trouble. First, the labor market has been in a state of uncertainty, and this was magnified by the recent report that fewer-than-expected jobs were added in July. This may well result in consumers opening their wallets less as they worry about possibly losing their jobs. Furthermore, record-high oil prices are cause for concern, as the cost of filling up the car becomes extra burdensome. Should prices of oil stay elevated, the cost of heating homes will be especially high this coming winter, reducing discretionary income. Finally, geopolitical factors, including presidential election uncertainty, the turmoil in Iraq, and global terrorism threats add to consumer concerns.

**The Rest Of This Year**

Despite the concerns mentioned above, we look for a year-over-year profit increase for the Recreation Industry as a whole. This primarily reflects seasonal factors, along with the ultraimportant holiday shopping season. Many companies will benefit from a cold winter season, most notably ski and snowboard manufacturers, while most, if not all, recreation-oriented companies will profit from the holidays. Our cautiously optimistic outlook, however, is dependent on a continued economic recovery, along with the absence of a significant terror-related attack.

**Favorably Positioned Companies**

There are many companies in the Recreation Industry that have favorable near-term prospects. Two that immediately come to mind are toy makers *Hasbro* and *Mattel*. Managements have done a good job of overhauling these two companies through extensive cost-cutting programs. Indeed, we believe that the two toy manufacturers are in a solid competitive position for their peak season. This is particularly the case this year, as global political and economic uncertainty makes these companies' relatively inexpensive items more practical at gift-

**INDUSTRY TIMELINESS: 76 (of 98)**

giving time. Another company that should do well over the next few quarters is *K2*. This primarily reflects the company's significant ski and snowboard exposure. The company has made a few acquisitions in this segment over the past couple of years to augment its presence. What's more, management noted that preseason orders of this equipment were quite robust. Of course, much of the success of this division is dependent on the amount of snowfall.

**Attractive Long-Term Plays**

One company that immediately comes to mind as a potentially lucrative 3- to 5-year holding is *Harley-Davidson*. This is largely due to the company's strong and loyal following in the motorcycle-riding community. Although we look for the company's outstanding revenue growth rate to slow somewhat, it should remain quite strong, nevertheless. Another stock that we favor for the long pull is *Brunswick*. This is due to the company's diversified nature. *Brunswick's* boat and marine segment should benefit from strong sales of outboard and sterndrive engines, coupled with healthy international demand. This segment, however, is correlated to the health of the broader economy, as boats are high-ticket items. Too, despite current high steel prices, we look for the company's exercise equipment segment to generate strong results out to 2007-2009, thanks to a more health-conscious society. Finally, *International Speedway* is likely to benefit from the increased popularity of NASCAR racing, which has led to more-profitable television contracts.

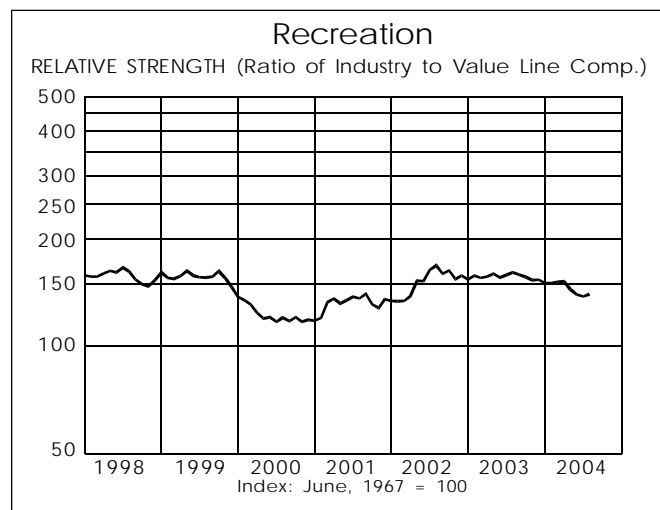
**Conclusion**

The Recreation Industry is comprised of companies that operate in very different segments, and thus, have different demand trends and target markets. Furthermore, most companies in this sector are susceptible not only to an economic downturn, but to changing consumer tastes and preferences. An item might be a fad one day, but an inventory burden a few weeks later. Thus, owing to the diverse nature of this industry, we recommend that investors read each company's full-page report before committing funds.

*Alan G. House*

Composite Statistics: RECREATION INDUSTRY									
2000	2001	2002	2003	2004	2005			07-09	
30936	31450	33515	36115	40000	43500	Revenues (\$mill)			55000
19.7%	20.2%	20.7%	21.3%	23.5%	24.5%	Operating Margin			26.0%
1935.1	2159.0	1980.6	2193.5	2350	2500	Depreciation (\$mill)			3000
2678.3	2510.8	3294.5	3749.8	4300	4600	Net Profit (\$mill)			6000
21.9%	21.9%	21.3%	23.0%	21.0%	21.0%	Income Tax Rate			21.0%
8.7%	8.0%	9.8%	10.4%	11.0%	11.0%	Net Profit Margin			11.0%
805.7	3783.1	3184.5	2870.5	3200	3400	Working Cap'l (\$mill)			4500
13597	16185	15239	19190	20000	22000	Long-Term Debt (\$mill)			25000
20003	22256	24339	31661	34000	37000	Shr. Equity (\$mill)			44000
9.3%	7.9%	9.5%	8.3%	8.0%	8.0%	Return on Total Cap'l			8.5%
13.4%	11.3%	13.5%	11.8%	12.5%	12.5%	Return on Shr. Equity			13.5%
9.6%	8.6%	11.0%	9.2%	9.5%	9.5%	Retained to Com Eq			10.5%
29%	25%	20%	23%	22%	22%	All Div'ds to Net Prof			22%
20.3	23.0	19.3	18.1			Avg Ann'l P/E Ratio			16.0
1.32	1.18	1.05	1.03			Relative P/E Ratio			1.05
1.4%	1.0%	1.0%	1.3%			Avg Ann'l Div'd Yield			1.2%

*Bold figures are Value Line estimates*



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### HARLEY-DAVIDSON INC (NYS)

LAST [4:01 PM ET] CHANGE

57.57 USD

▼ -0.75 (-1.29%)

Risk Alert for HDI.N



Low

SECTOR: [Consumer Cyclical](#) | INDUSTRY: [Recreational Products](#)

### Profit Margin Ratios

Profitability Ratios (%)	Company	Industry	Sector	S&P 500
Gross Margin (TTM)	35.05	38.71	29.36	47.88
Gross Margin - 5 Yr. Avg.	31.00	36.70	28.74	46.48
EBITD Margin (TTM)	29.23	19.65	11.86	21.15
EBITD - 5 Yr. Avg.	23.26	16.57	10.36	20.48
Operating Margin (TTM)	25.20	16.66	8.40	21.31
Operating Margin - 5 Yr. Avg.	19.04	12.76	7.22	18.04
Pre-Tax Margin (TTM)	25.47	16.32	8.28	17.25
Pre-Tax Margin - 5 Yr. Avg.	19.44	11.82	6.68	17.07
Net Profit Margin (TTM)	16.43	11.01	5.00	13.71
Net Profit Margin - 5 Yr. Avg.	12.56	7.63	4.18	11.29
Effective Tax Rate (TTM)	35.50	32.05	31.20	30.18
Effective Tax Rate - 5 Yr. Avg.	35.47	34.27	38.31	34.25

[Learn about Profit Margin Ratios](#)

### Management Effectiveness

Management Effectiveness (%)	Company	Industry	Sector	S&P 500
Return On Assets (TTM)	18.16	12.65	6.71	7.15
Return On Assets - 5 Yr. Avg.	15.65	10.28	6.10	6.64
Return On Investment (TTM)	22.33	17.30	9.15	13.90
Return On Investment - 5 Yr. Avg.	20.33	14.68	8.77	10.70
Return On Equity (TTM)	29.77	23.07	16.96	19.50
Return On Equity - 5 Yr. Avg.	27.52	18.01	14.53	19.01

[Learn about Management Effectiveness](#)

## Screening for Quality Management with Value Line

## Criteria:

Earnings Predictability &gt; 85

Financial Strength &gt; B+

5-yr Sales Growth &gt;= 12%

5-yr EPS Growth &gt;= 12%

Current ROE &gt;= 12%

Proj. Tot Return &gt; 10%

Company	Ticker	Financial Strength	Earnings Predict	Earnings Grw 5-Yr	Sales Grw 5-Yr	Proj EPS Growth	Current ROE	Proj Tot Ann Rtn
Cardinal Health	CAH	A	100	23.5	17	16.5	18.63	29
Dollar Tree Stores	DLTR	A+	85	20.5	22.5	16	17.5	28
Bed Bath & Beyond	BBBY	A++	100	31.5	28	23	20.07	27
Fiserv Inc.	FISV	B++	100	22	16	18	14.32	27
Lowe's Cos.	LOW	A+	100	27.5	18	19	18.06	24
Home Depot	HD	A++	90	23.5	17.5	14	19.21	24
Express Scripts 'A'	ESRX	A	90	36	43.5	18.5	20.99	23
SunGard Data Sys.	SDS	A	100	17.5	13	14	13.42	21
Wal-Mart Stores	WMT	A++	100	17	15.5	14.5	20.31	20
Paychex, Inc.	PAYX	A	85	22	17	15	25.25	19
Gentex Corp.	GNTX	A	85	20.5	16	16	15.39	18
Stryker Corp.	SYK	A	100	22.5	24.5	22	21.05	18
Harley-Davidson	HDI	B++	100	27.5	18	14.5	25.73	18
Affiliated Computer	ACS	A	85	27	17	18	13.87	17
Ross Stores	ROST	A	95	17	17	16	30.2	17
Walgreen Co.	WAG	A++	100	17.5	15.5	17	16.08	17
Family Dollar Stores	FDO	A	95	22	15.5	13	18.88	16
UnitedHealth Group	UNH	A+	95	24.5	25	20	35.59	16
Total System Svcs.	TSS	B++	100	20.5	19.5	14.5	19.25	16
Brinker Int'l	EAT	A	95	23	17.5	14	16.1	15
Pulte Homes	PHM	A	85	36	15	20	17.9	14
Outback Steakhouse	OSI	B++	95	13	15	12	16.92	14
Medtronic, Inc.	MDT	A+	100	17	16.5	15	22	13
TJX Companies	TJX	A+	85	19	15	12.5	42.41	13
Cheesecake Factory	CAKE	A	85	32	21.5	19	12.63	12
Kohl's Corp.	KSS	A	85	29.5	22	15.5	14.1	12
O'Reilly Automotive	ORLY	A	95	22	21	18	12.76	12
Engineered Support	EASI	B++	85	30.5	25	20.5	21.95	12
Apollo Group `A'	APOL	A	95	37	29	23	24.05	11
Lincare Holdings	LNCR	A	95	18	19.5	13.5	27.36	11
Strayer Education	STRA	B++	95	14	27.5	19.5	26.17	11
Patterson Cos.	PDCO	A	100	22.5	13.5	17	18.64	10
Cintas Corp.	CTAS	B++	100	13	13.5	12	14.42	10
DST Systems	DST	B++	90	23.5	24.5	13.5	31.89	10