

Evaluating Company Management

Presented by:
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NAIC DC Chapter

07 May 2005

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What is NAIC?

- National Association of Investors Corporation
- NAIC teaches individuals how to become successful strategic long-term investors
- NAIC investors use fundamental analysis to study common stocks
- Websites:
 - www.better-investing.org
 - www.naicdc.org

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NAIC Principles

- Invest a fixed amount regularly for the long term
- Reinvest all of your earnings
- Invest only in good quality growth companies
- Diversify (by company size and by industries)

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

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

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)

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 YR AVE	TREND
A % 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 % Earned on Equity (EPS / Book Value)	36.1	29.9	31.5	23.6	25.8	21.0	11.0	1.1	6.6	12.7	9.2%	VARYING

Demand for Cisco products falls off sharply



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:

2 EVALUATING MANAGEMENT Company **LOWE'S COMPANIES INC.** (LOW) 04/29/05

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND
A % Pre-tax Profit on Sales (Net Before Taxes - Sales)	5.0	5.3	5.5	6.2	6.8	6.8	7.3	8.9	9.7	9.7	8.5	UP
B % Earned on Equity (EIS - Book Value)	13.2	13.4	13.8	15.3	14.6	14.7	15.1	17.4	17.7	18.2	16.6	UP

#2 – Orthodontic Centers of America:

2 EVALUATING MANAGEMENT Company **ORTHODONTIC CENTERS OF AM** (OCA) 05/02/05

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG	TREND
A % Pre-tax Profit on 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 % Earned on Equity (EIS - 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

Examples

#3 – Wal-Mart Stores:

2 EVALUATING MANAGEMENT		Company WAL-MART STORES (WMT)										05/03/05	
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	4.6	4.6	4.8	5.2	5.5	5.3	4.9	5.2	5.5	5.6	5.3	EVEN
B	% Change in Equity (EPS + Book Value)	18.5	17.7	18.9	20.9	22.1	20.0	18.9	20.2	20.1	20.7	20.0	UP

#4 – Lucent Technologies:

2 EVALUATING MANAGEMENT		Company LUCENT TECHNOLOGIES INC. (LU)										05/02/05	
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	-5.3	2.2	5.4	11.6	14.9	11.6	-39.3	-42.5	-8.2	11.5	-13.4	UP
B	% Change in Equity (EPS + Book Value)	0.0	9.0	15.9	39.7	26.9	10.1	-61.3	107.7	23.6	N/A	20.0	DOWN

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

LOWE'S COMPANIES INC (NYS)		Risk Alert for LOW.N	
LAST [4:01 PM ET]	CHANGE		
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

Note Increasing Pre-Tax Margin

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

OCA INC (NYS)

LAST [4:03 PM ET] CHANGE **▲ 0.16 (4.00%)** Risk Alert for OCA.II **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

07 May 2005 **Note Decreasing Pre-Tax Margin** NAIC DC Chapter 17

A few More Examples

#5 – Qwest Communications:

2 EVALUATING MANAGEMENT Company **QWEST COMMUNICATION INTL INC** (Q) 05/02/05

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND
A % Pre-tax Profit on Sales (Net Before Taxes + Sales)	19.3	19.5	18.0	20.6	19.8	14.9	3.6	-11.1	-7.2	-7.2	-1.4	DOWN
B % Earned on Equity (E.S. + Book Value)	34.3	31.3	27.9	212.5	130.3	4.5	0.2	94.8	81.9	36.2	43.5	DOWN

#6 – General Motors:

2 EVALUATING MANAGEMENT Company **GENERAL MOTORS CORP** (GM) 05/05/05

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND
A % Pre-tax Profit on Sales (Net Before Taxes + Sales)	5.6	4.1	4.5	2.8	5.1	3.4	0.8	1.2	2.4	1.8	1.9	EVEN
B % Earned on Equity (E.S. + Book Value)	26.3	21.9	39.8	37.2	26.1	15.6	9.4	63.7	12.5	13.0	22.8	DOWN

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
 - Grocery – 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 ROE 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

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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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Quarterly PERT for RPM

PERIOD	EPS		PRE-TAX PROFIT			SALES		INCOME TAX RATE
	\$	% CHANGE	\$ MIL	% SALES	% CHANGE	\$ MIL	% CHANGE	
11/96	0.18	5.9	32.20	10.2	15.0	316.10	12.3	42.5
02/97	0.08	-11.1	13.10	4.4	-5.8	297.20	16.5	42.7
05/97	0.27	17.4	48.80	12.0	12.7	408.10	28.8	42.0
08/97	0.27	17.4	49.00	11.8	17.5	415.10	26.1	42.4
11/97	0.21	16.7	37.30	9.4	15.8	397.80	25.8	42.6
02/98	0.06	-25.0	9.60	2.7	-26.7	350.50	17.9	42.7
05/98	0.30	11.1	53.60	11.9	9.8	452.00	10.8	39.2
08/98	0.29	7.4	53.40	11.9	9.0	448.10	7.9	41.6
11/98	0.20	-4.8	36.20	8.7	-2.9	415.70	4.5	40.1
02/99	0.06	0.0	10.40	2.8	8.3	373.00	6.4	41.3
05/99	0.32	6.7	59.60	12.5	11.2	475.30	5.2	40.6
08/99	0.07	-75.9	12.30	2.5	-77.0	495.50	10.6	40.7
11/99	0.19	-5.0	34.50	6.9	-4.7	500.40	20.4	41.2
02/00	0.04	-33.3	6.32	1.5	-39.2	411.40	10.3	32.6
05/00	0.20	-37.5	25.58	4.7	-57.1	546.77	15.0	18.0
08/00	0.28	300.0	46.53	8.4	278.3	554.92	12.0	38.4
11/00	0.17	-10.5	27.21	5.4	-21.1	499.90	-0.1	36.2
02/01	-0.07	-275.0	-11.32	-2.8	-279.0	405.40	-1.5	36.8
05/01	0.24	20.0	39.07	7.1	52.7	547.54	0.1	37.2
08/01	0.36	28.6	55.99	10.5	20.3	533.28	-3.9	34.3
11/01	0.24	41.2	36.53	7.5	34.3	487.89	-2.4	32.4
02/02	0.03	NMFI	4.95	1.2	NMFI	407.54	0.5	37.2
05/02	0.33	37.5	56.65	10.2	45.0	557.43	1.8	34.7
08/02	0.38	5.6	67.89	12.5	21.3	542.41	1.7	35.2
11/02	0.26	8.3	45.67	8.8	25.0	517.97	6.2	33.8
02/03	0.04	33.3	7.51	1.7	51.7	433.56	6.4	38.2
05/03	0.38	15.2	66.78	11.3	17.9	589.55	5.8	34.0

Warning



Improvement



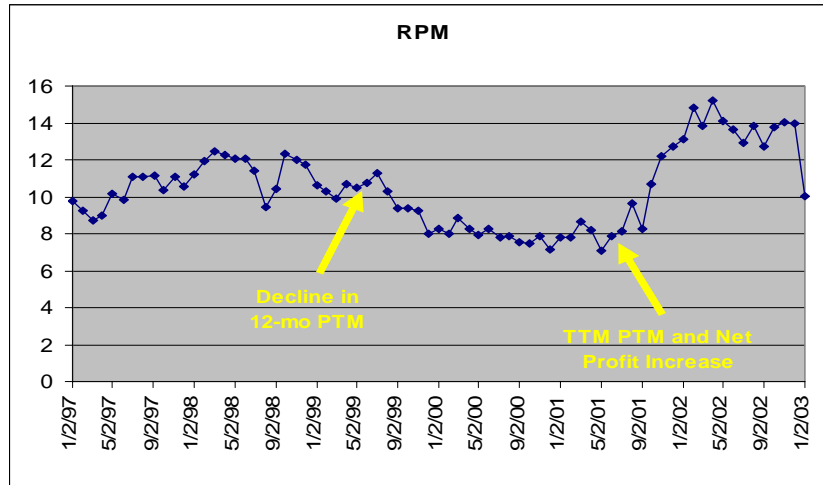
Trailing 12 mos PERT for RPM

EPS \$	PRE-TAX PROFIT		SALES MIL	INCOME TAX		% CHANGE		
	\$ MIL	% SALES		\$ MIL	% RATE	EPS	PRE-TAX PROFIT	SALES
0.73	131.10	10.8	1,217.4	55.8	42.6			
0.72	130.30	10.3	1,259.4	55.6	42.7			
0.76	135.80	10.1	1,350.6	57.6	42.4	10.1	13.3	18.8
0.80	143.10	10.0	1,436.5	60.7	42.4	11.1	12.8	21.5
0.83	148.20	9.8	1,518.2	62.9	42.4	13.7	13.0	24.7
0.81	144.70	9.2	1,571.5	61.4	42.4	12.5	11.1	24.8
0.84	149.50	9.3	1,615.4	62.4	41.7	10.5	10.1	19.8
0.86	153.90	9.3	1,648.4	63.9	41.5	7.5	7.5	14.8
0.85	152.80	9.2	1,666.3	62.5	40.9	2.4	3.1	9.8
0.85	153.60	9.1	1,688.8	62.3	40.6	4.9	2.2	7.5
0.87	159.60	9.3	1,712.1	65.3	40.9	3.6	6.8	6.0
0.65	118.50	6.7	1,759.5	48.2	40.7	-24.4	-23.0	6.7
0.64	116.80	6.3	1,844.2	47.8	41.0	-24.7	-23.6	10.7
0.62	112.72	6.0	1,882.6	43.7	39.8	-27.1	-26.6	11.5
0.50	78.70	4.0	1,954.1	26.1	33.1	-42.5	-50.7	14.1
0.71	112.94	5.6	2,013.5	36.8	32.6	9.2	-4.7	14.4
0.69	105.64	5.2	2,013.0	33.1	31.3	7.8	-9.6	9.2
0.58	88.00	4.4	2,007.0	28.5	32.4	-6.5	-21.9	6.6
0.62	101.43	5.1	2,007.8	37.7	37.2	24.0	28.9	2.7
0.70	110.95	5.6	1,986.1	40.1	36.1	-1.4	8.8	-1.4
0.77	120.27	6.1	1,974.1	42.3	35.2	11.6	13.8	-2.1
0.87	136.54	6.9	1,976.2	48.2	35.3	50.0	55.2	-1.5
0.96	154.12	7.8	1,986.1	53.4	34.7	54.8	51.9	-1.1
0.98	166.03	8.3	1,995.3	57.9	34.9	40.0	49.6	0.5
1.00	175.16	8.6	2,025.4	61.7	35.2	29.9	45.6	2.6
1.01	177.72	8.7	2,051.4	63.1	35.5	16.1	30.2	3.8
1.06	187.85	9.0	2,083.5	66.3	35.3	10.4	21.9	4.9

Note drop in 12-mo EPS and PTP

Starting to turn the corner

Pretax Margins as Early Warning

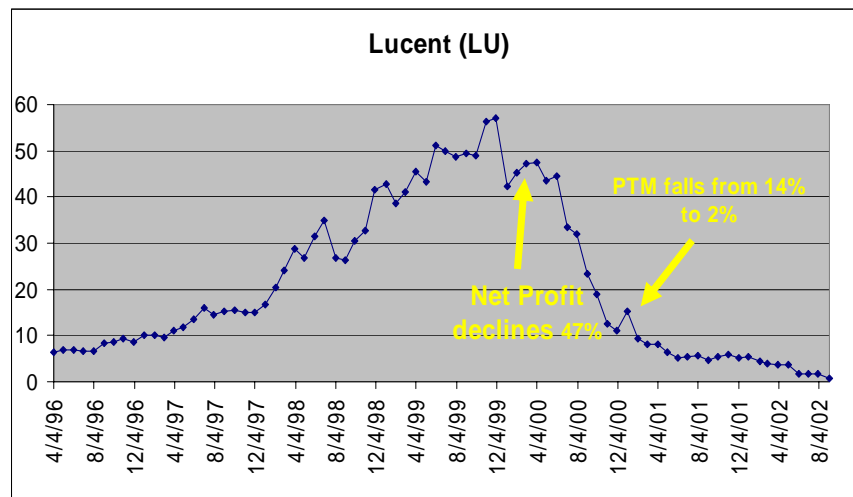


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Changes in Net Profit and PTM

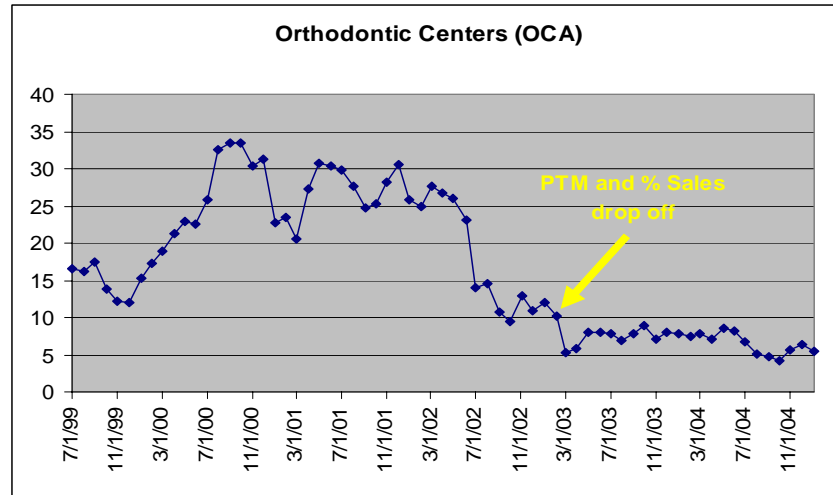


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Sometimes the signals are too late



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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

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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
A % Pre-tax Profit to 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 % Earnings 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		B	C	Earnings Per Share	D	E	F	G	H	I	
		HIGH	LOW									% High Yield	F + B X 100
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			101.0			
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
 $= 26.5\% \times (1 - .362)$
 $= 16.9\%$

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
A % Pre-Or Post-Or Cash (Net-Or Tax + Cash)	10.5	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	19.4	UP
B % Booked EBIT (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 GO Symbol Lookup Printable version

HARLEY-DAVIDSON INC (NYS)
 LAST [4:01 PM ET] CHANGE **▼ -0.75 (-1.29%)** Risk Alert for HDI
 57.57 USD **Low** sponsored by

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
A % Pre-Or Post-Or Cash (Net-Or Tax + Cash)	11.6	11.1	11.1	11.4	11.6	11.5	11.8	12.2	13.4	14.5	12.7	UP
B % Booked EBIT (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 FOR BBBY GO Symbol Lookup Printable version

BED BATH & BEYOND INC (UTC)
 LAST [4:00 PM ET] CHANGE **▼ -0.02 (-0.05%)** Risk Alert for BBBY.O
 40.79 USD **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	10.79
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

Even to Slightly Down

Exceeds Industry Average

ROE Example - PSFT

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

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG	TREND
A % Pre-Tax Profit to Sales (Net Income / Total 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 % Earnings ERM (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 PSFT.O Symbol Lookup

PEOPLESFT 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
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	9.49	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

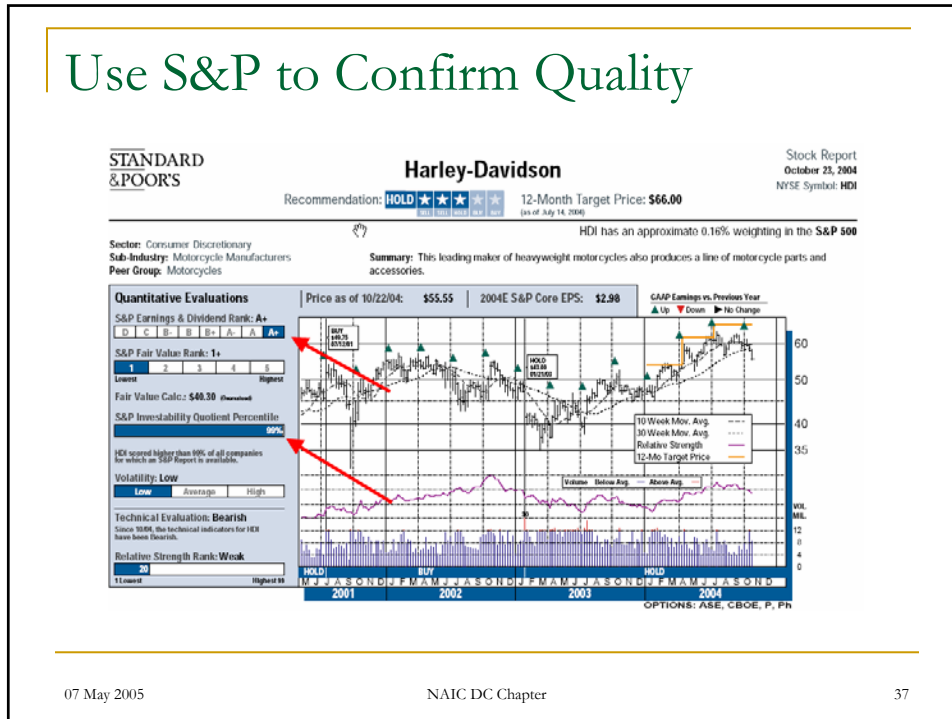
↓
Down

↖
Below Industry Average

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)

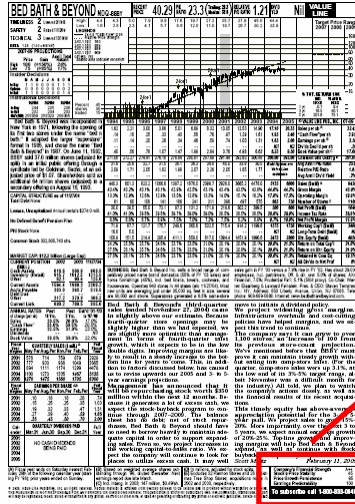
Use S&P to Confirm Quality



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	A++
Stock's Price Stability	45
Price Growth Persistence	95
Earnings Predictability	100

Robertson Quality Rating (RQR)

Financial

- Financial Strength
 - A++ = 25 ... C = 0
 - Up to 25 points
- EPS Predictability
 - VL score (100 max) divided by 4. e.g., 90 yields 90/4 = 22.5 points

Future Performance

- Sales Growth
 - $25/2 * (Co\ Grw / Ind\ Grw)$
e.g., co = 15, ind = 10,
= $25/2 * 15/10 = 18.75$
- Relative Profitability
 - $25/2 * (Co\ NM / Ind\ NM)$
 - e.g., co = 18, ind = 14,
= $25/2 * 18/14 = 16$

RQR for BBY

Financial

- Financial Strength
 - A++ = 25
- EPS Predictability
 - 100 = 25

Future Performance

- Sales Growth
 - Retail (special lines)
 - $(17 / 10.3)^* (25/2)$
 - 20.6
- Relative Profitability
 - $(11 / 6.2)^* (25/2)$
 - 22.2

$$25+25+20.6+22.2 = 92.8$$

RQR for WMT

Financial

- Financial Strength
 - A++ = 25
- EPS Predictability
 - 100 = 25

Future Performance

- Sales Growth
 - Retail Store
 - $(13 / 8.8)^* (25/2)$
 - 18.4
- Relative Profitability
 - $(3.7 / 4)^* (25/2)$
 - 11.6

$$25+25+18.4+11.6 = 80$$

RQR for INTC

Financial

- Financial Strength
 - A++ = 25
- EPS Predictability
 - $50 = 12.5$

Future Performance

- Sales Growth
 - Semiconductor
 - $(10.5 / 12.6) * (25/2)$
 - 10.4
- Relative Profitability
 - $(24 / 18) * (25/2)$
 - 16.7

$$25+12.5+10.4+16.7 = 64.6$$

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RQR for GM

Financial

- Financial Strength
 - $B = .25 * 30 = 7.5$
- EPS Predictability
 - $35 = .25 * 35 = 12.5$

Future Performance

- Sales Growth
 - Semiconductor
 - $(1.5 / 3.7) * (25/2)$
 - 5.1
- Relative Profitability
 - $(2.0 / 4.9) * (25/2)$
 - 5.1

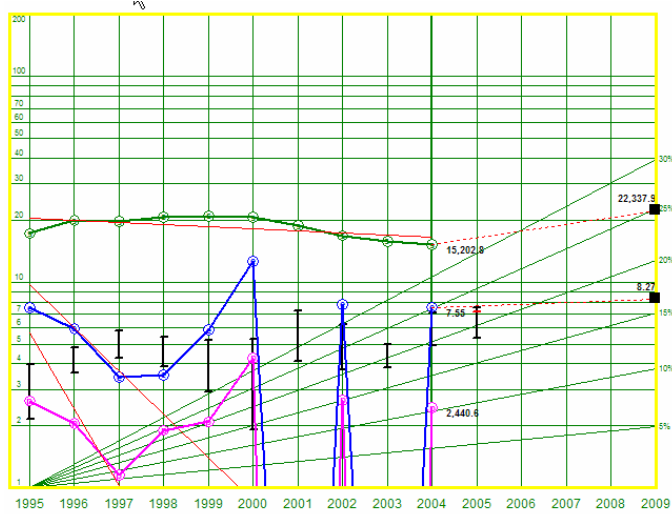
$$7.5+12.5+5.1+5.1 = 30.2$$

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Example of Weak Management



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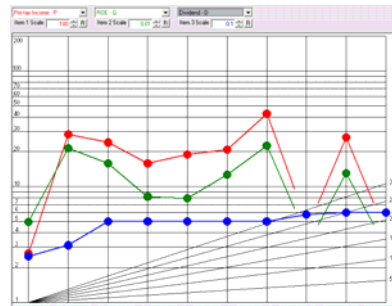
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Looking at the Data – LTR

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+	A-	A	A+
S&P Fair Value Rank: NR							
1	2	3	4	5			
Lowest			Highest				
Fair Value Calc: NA							
S&P Investability Quotient Percentile							
83%							
LTR scored higher than 83% of all companies for which an S&P Report is available.							



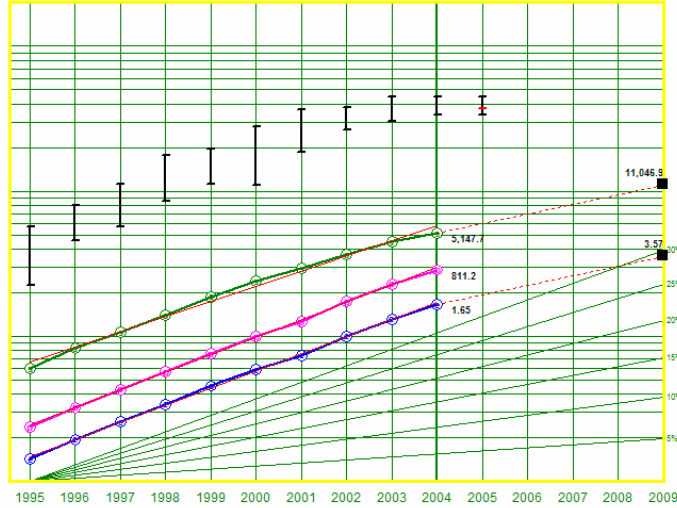
2 EVALUATING MANAGEMENT		Company	LOEWS CORP								(LTR)	10/28/04		
		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	LAST 5 YEAR AVG.	TREND	
A	% Pre-Tax Profit on Sales (Net Interest Taxes = Cash)	2.0	15.4	10.3	5.9	9.2	10.0	20.7	-3.0	15.9	-8.6	7.0	DOWN	
B	% Earnings to Equity (ES = Book Value)	2.4	21.4	15.7	8.2	7.8	12.2	22.3	-3.8	12.9	-6.9	7.4	DOWN	

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Example of Solid Management



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Look at the Data – BBBY

Company's Financial Strength	A++
Stock's Price Stability	45
Price Growth Persistence	95
Earnings Predictability	100

Quantitative Evaluations

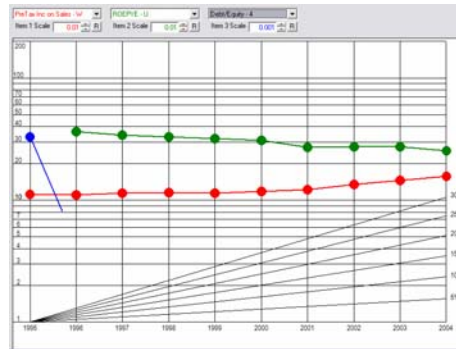
S&P Earnings & Dividend Rank: **A-**

S&P Fair Value Rank: **5**

Fair Value Calc.: **\$50.30** (Abnormal)

S&P Investability Quotient Percentile: **100%**

BBBY scored higher than 100% of all companies for which an S&P Report is available.



2 EVALUATING MANAGEMENT

		Company: BED BATH & BEYOND INC (BBBY)										04/29/05		
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND	
													UP	DOWN
A	% Pre-tax Profit on Sales (Net Before Taxes + Sales)	11.1	11.1	11.4	11.6	11.5	11.8	12.2	13.4	14.5	15.8	13.5	UP	
B	% Earned on Equity (ES + Book Value)	25.5	25.0	24.1	23.1	22.9	20.8	19.7	20.3	19.8		20.1		NMF

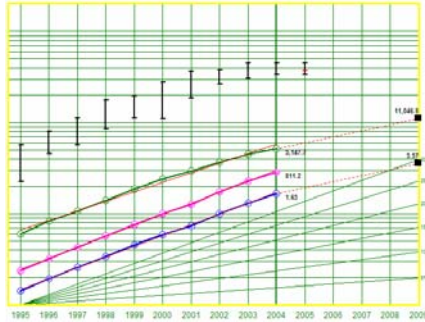
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Good Management = Quality

- 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) 04/29/05

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG.	TREND	
												UP	DOWN
A % Pre-tax Profit on Sales (Net Before Taxes - Sales)	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	25.9	21.3	UP	
B % Earnings on Equity (EIS - Book Value)	22.1	21.4	20.8	20.3	22.5	23.9	24.7	25.8	25.5	27.4	25.4	UP	

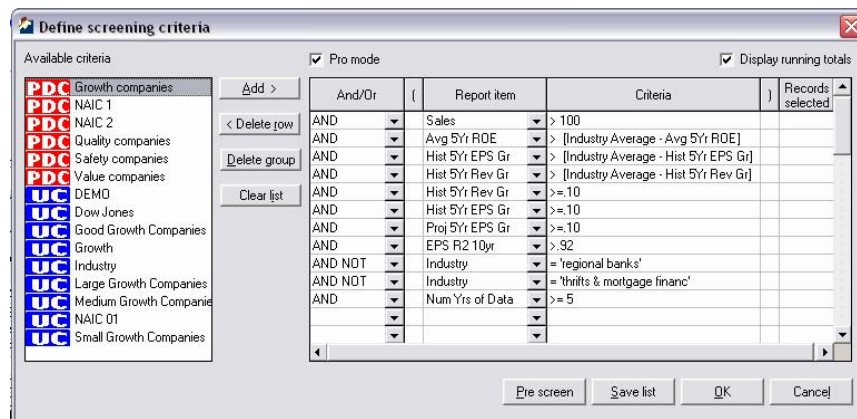
Finding Quality Management

- 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



Prospector Results

Weighted ranking	Company Name	Symbol	Exchange	Industry	Date Info	Current Price (\$)	Hist 10Yr Rev Gr (%)	Hist 10Yr EPS Gr (%)	Div Gr (%)	Rel Value
1.6 Minimum values						14,210	0.0	0.0	0.0	0.59
3.5 Average values						38,184	18.0	21.0	7.1	1.14
5.3 Maximum values						107,280	50.4	54.1	43.3	2.05
1	5.3 HARLEY-DAVIDSON INC	HDI	NYSE	MOTORCYCLE MANUFACTURERS	04/29/2005	47.020	17.2	26.8	22.4	0.59
2	5.0 BED BATH & BEYOND INC	BBBY	NASDAQ	SPECIALTY STORES	04/29/2005	37.210	27.3	31.2	0.0	0.73
3	4.9 D R HORTON INC	DHI	NYSE	HOMEBUILDING	04/29/2005	30.500	44.7	35.8	43.3	1.33
4	4.5 SCP POOL CORP	POOL	NASDAQ	LEISURE PRODUCTS	04/29/2005	32.580	25.5	35.2	0.0	1.48
5	4.4 BLOCK H & R INC	HRB	NYSE	DIVERSIFIED COMMERCIAL &	04/29/2005	49.810	13.9	28.1	3.2	1.09
6	4.3 STARBUCKS CORP	SBUX	NASDAQ	RESTAURANTS	04/29/2005	49.520	29.6	28.3	0.0	1.12
7	4.3 DOLLAR GENERAL CORP	DG	NYSE	GENERAL MERCHANDISE STORE	04/29/2005	20.350	18.0	14.6	16.0	0.83
8	4.2 BEST BUY CO INC	BBY	NYSE	COMPUTER & ELECTRONICS RE	04/29/2005	50.340	18.7	54.1	0.0	0.71
9	4.2 LENNAR CORP	LEN.B	NYSE	HOMEBUILDING	04/29/2005	47.910	34.6	25.1	16.7	1.02
10	4.0 LENNAR CORP	LEN	NYSE	HOMEBUILDING	04/29/2005	51.470	34.6	25.1	16.7	1.16
11	3.9 ORLEANS HOMEBUILDERS INC	OHB	AMEX	HOMEBUILDING	04/29/2005	17.340	22.8	46.2	0.0	1.39
12	3.7 STANTEC INC	STN.	TORONTO	CONSTRUCTION & ENGINEERIN	04/29/2005	28.700	22.2	21.5	0.0	1.37
13	3.7 BROWN & BROWN INC	BRD	NYSE	INSURANCE BROKERS	04/29/2005	43.750	24.6	24.7	16.2	0.98
14	3.7 INTL GAME TECHNOLOGY	IGT	NYSE	CASINOS & GAMING	04/29/2005	26.890	16.8	25.4	11.9	1.01
15	3.6 BRINKER INTL INC	EAT	NYSE	RESTAURANTS	04/29/2005	33.800	15.7	21.2	0.0	0.89
16	3.5 SCANSOURCE INC	SCSC	NASDAQ	TECHNOLOGY DISTRIBUTORS	04/29/2005	46.250	50.4	31.3	0.0	1.01
17	3.5 WILLIAMS-SONOMA INC	WSM	NYSE	SPECIALTY STORES	04/29/2005	33.490	19.7	40.4	0.0	2.05
18	3.4 ITT EDUCATIONAL SVCS INC	ESI	NYSE	DIVERSIFIED COMMERCIAL &	04/29/2005	45.980	12.7	25.3	0.0	0.97
19	3.3 AMERICAN VANGUARD CORP	AVD	AMEX	FERTILIZERS & AGRICULTURA	04/29/2005	17.650	11.9	24.8	40.2	1.89
20	3.2 CORINTHIAN COLLEGES INC	COCO	NASDAQ	DIVERSIFIED COMMERCIAL &	04/29/2005	14.210	0.0	0.0	0.0	0.64
21	3.1 HOVNANIAN ENTRPRIS INC - CL A	HOV	NYSE	HOMEBUILDING	04/29/2005	50.770	21.9	0.0	0.0	1.47
22	3.1 SIMPSON MANUFACTURING INC	SSD	NYSE	BUILDING PRODUCTS	04/29/2005	27.000	15.9	17.6	0.0	1.03
23	3.0 SONIC CORP	SONC	NASDAQ	RESTAURANTS	04/29/2005	32.040	17.1	22.2	0.0	1.50
24	2.9 YANKEE CANDLE CO INC	YCC	NYSE	HOUSEWARES & SPECIALTIES	04/29/2005	27.790	0.0	0.0	0.0	0.86
25	2.9 APPLEBEES INTL INC	APFB	NASDAQ	RESTAURANTS	04/29/2005	24.780	12.5	18.5	12.9	1.13

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Prospector Report Weighting

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Top Four from the Quality Screen

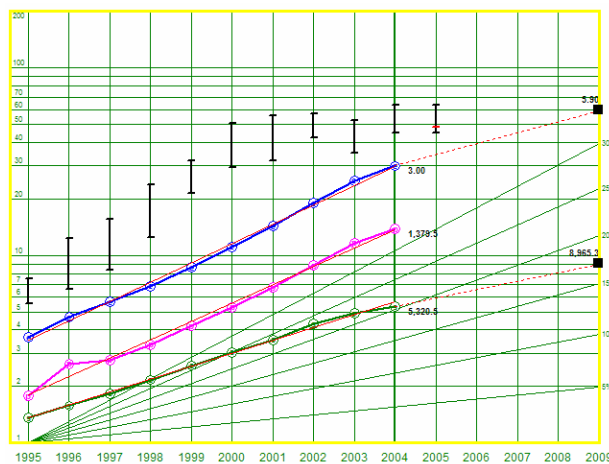
- Harley Davidson (HDI)
 - RQR = 80.1, PAR = 13.9
- Bed, Bath and Beyond (BBBY)
 - RQR = 92.6, PAR = 23.0
- D.H. Horton (DHI)
 - RQR = 64.5, PAR = 10.6
- SCP Pool Corp. (POOL)

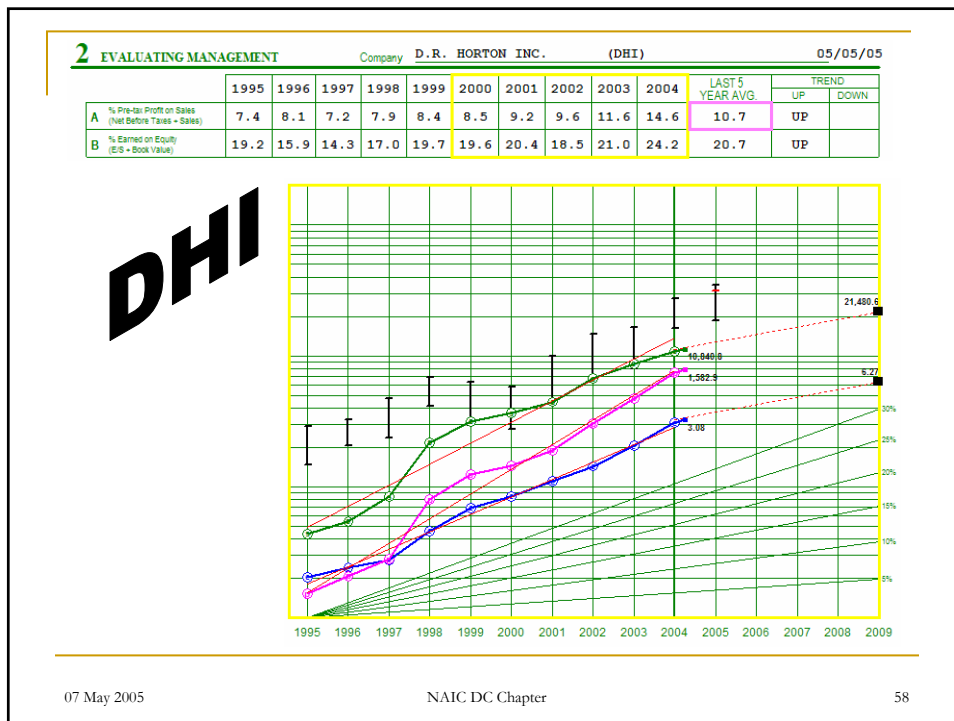
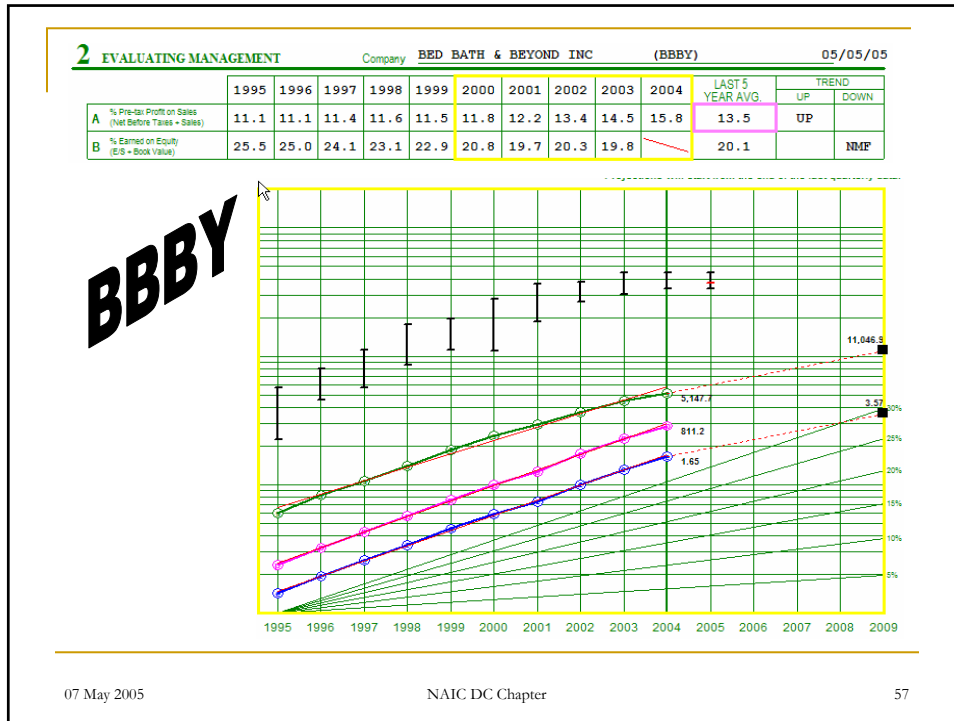
2 EVALUATING MANAGEMENT

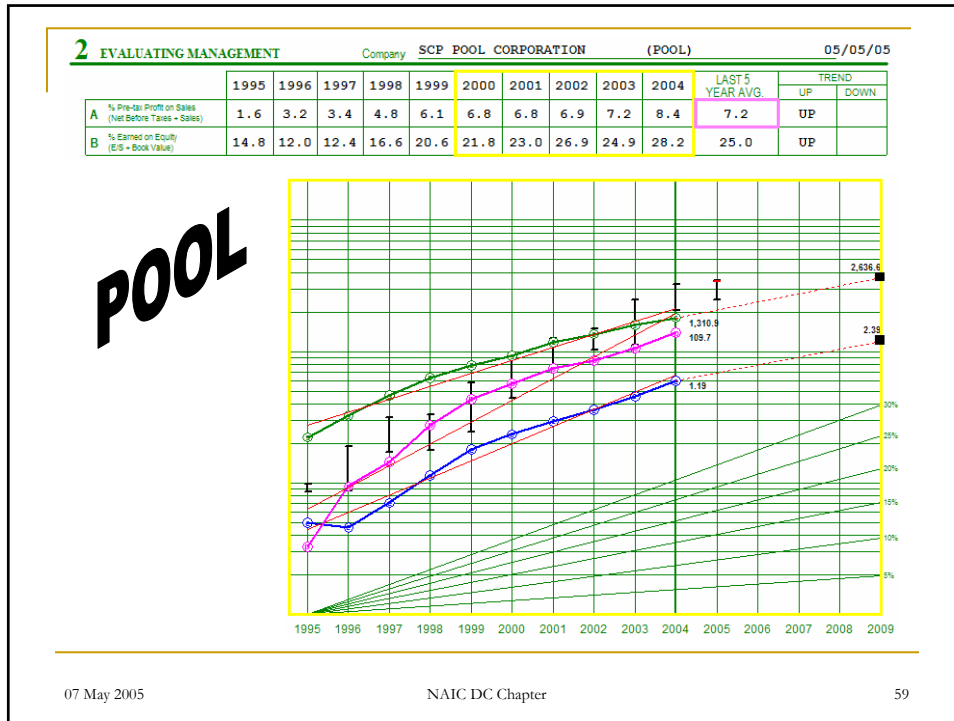
Company HARLEY-DAVIDSON, INC. (HDI) 05/05/05

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	LAST 5 YEAR AVG	TREND	
A % Pre-tax Profit on Sales (Net Before Taxes + Sales)	13.2	16.7	15.1	15.4	16.3	17.4	19.0	20.6	23.8	25.9	21.3	UP	
B % Earned on Equity (ES + Book Value)	22.1	21.4	20.8	20.3	22.5	23.9	24.7	25.8	25.5	27.4	25.4	UP	

HDI







On-line Resources

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

Recommended Reading

- Evaluating Management
by Amy Rauch-Neilson
 - www.better-investing.org/articles/bi/120/1000
- Determining the Quality of Management
by Nancy Isaacs
 - www.better-investing.org/articles/bi/11/108
- Quality: A Measure of Excellence
by Mark Robertson
 - 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
<http://tyhughes.net/moosepond>
- Better Investing!

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