THE INVESTORS PODCAST
WE STUDY BILLIONAIRES

Preston & Stig's

Stock Selecting Checklist

Step 1: Find stocks using Google Stock Screener

Below is a list of criteria that I typically start with. Depending on the current market conditions, you may get varying results. I would adjust the inputs until you get about 10-20 different companies. I typically keep the LT Debt, current ratio, and interest coverage intact and adjust the other variables if I need more or less results.

1) Market Cap > $500 Million
2) P/E Ratio < 15
3) Price to Book < 1.5
4) Current Ratio > 1.5
5) LT Debt/Equity (Recent Year.) < 0.5
6) Return on Equity (5 Year Average) (%) > 8
7) 5Y Net Income Growth Rate (%) > 5
8) 10Y Revenue Growth Rate (%) > 5
9) 10Y EPS Growth Rate (%) > 5
10) Interest Coverage > 6.0

Step 2: Investigate further on Morningstar.com

Once you find a company that interests you, you will want to conduct more thorough research. I like to start by identifying the highest risks for owning the company. Therefore I focus on the current debt and current interest coverage, and then I look at the historical performance over the past ten years. After mitigating the current risks of owning the company, I then focus on it's ability to earn profits into the future. You can use the following site to conduct that research. (www.nasdaq.com/symbol/YOURTICKERHERE/earnings-forecast) Note: for a company like RDS.A, YOURTICKERHERE = rds-a, in the web address listed above. For a company like CVX, simply substitute: YOURTICKERHERE = cvx

1) Plot the company's stability metrics at the following link (BuffettsBooks.com/stability)
2) Is the company performing better than its industry peers? (MorningStar, Valuation Tab)
3) Are gross, operating and income margins steady or increasing? How do they compare to other competitors? (MorningStar, Key Ratios)
4) Is the FCF tracking the EPS? If not, how much is the difference. Why is there a difference?

Step 3: Calculate the intrinsic value at BuffettsBooks.com

Compare the return (based on the current market price) to the return of your other options. (i.e. the ten year treasure note, or the inverse of the S&P 500 P/E ratio, or another stock that might have a better return for similar risk). Use the BuffettsBooks Intrinsic Value Calculator: (BuffettsBooks.com/intrinsicvalue)

Step 4: Locate a moat

What are the key aspects of the company that fend-off competitors in the long run?

1. Brand/Trade Marks
2. Proprietary Technology
3. Patents/Copyrights
4. Trade Secrets
5. Stickiness of product (think Microsoft Office)

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Additional Notes for using the checklist:

Step 1: I have recorded a video on how to use a stock screener. The video can be found here: http://BuffettsBooks.com/stockscreener

Step 2: When opening MorningStar.com, I typically use the "Key Ratios", "Financials", and "Valuation" tabs the most. I typically start at the top of each page and read down. Typically, a company that has great leadership also has great financials. This is where I spend most of my time trying to understand the decision making of the company leadership. By looking at the numbers, you can see how the company manages debt, how they employ retained earnings, and many other things. This is where you really need to operate and understand things.

a. If you're using the stability-grapher (http://BuffettsBooks.com/stability), you'll find the important information on the "Key Ratios" tab. If you see unwanted things in the stability of the company, understand why they exist.
b. For industry research, you'll find the "Valuation" tab helpful for a cursory look. You'll want to find the #1 competitor for your company of interest and analyze their entire financial statements if you want to conduct thorough research on industry peers.
c. The margins of the company are important because they demonstrate the company's current competitive environment. It also demonstrates how quickly they will be able to grow in the future. If margins are high, the company will likely face fierce competition in the future. This is where you'll want to look at Step 4 to help identify how you can mitigate/protect those margins.
d. The FCF is the magic number. If you see fluctuation here, it might not necessarily be a bad thing, it might just mean that the company had a substantial capital expenditure. These may come every 3-5 years. If this is the case, make sure you understand why and how it might impact things in the future. The FCF is the money that the company actual has to invest and grow the business. Think of it like this; when you get your paycheck every month, how much do you have left after all your normal monthly expenses are paid? – That's your FCF. This is the money you use to invest and grow your equity. Same thing for a business. If you're using MorningStar for research, you'll find some valuable information at the bottom of the "Key Ratios" tab. The subordinate tab is called "Cash Flow".

Step 3: Please refer to the videos on the site for this one.

Step 4: Buffett describes a "moat" as an item that protects the company from competitors. Think of Castles in the medieval times. The moat is what protected the citizens from invaders. The list of items in Step 4 are truly what keeps your company competitive. If you're investing in a company with very high margins (typically classified as a "growth pick"), you'll definitely want to ensure you've got a very wide moat. High margins attract competitors like meat wagons attract dogs. Here's a great article about this idea: http://bitsbusiness.com/investing-2/moats/

Which Broker I Recommend and Why:

So I actually use two different brokers because there are advantages and disadvantages for the way I have things set-up. To start, a broker is nothing more than a company that conducts trades on your behalf. I encourage people to separate their research tools from their broker(s). I personally find the recommendations from stockbrokers to be grossly plagued in self-interest. As you might suspect, a broker has an interest in selling you on their company's mutual funds or highest commission products. You'll want to avoid this trap. A knowledgeable investor needs to think for themselves and do their own homework. Since I don't need the broker's analytical tools, and subsequent high fees, I recommend the following.

> **My broker for personal use**. I strongly recommend TradeKing. The reason TradeKing works well for me is because I want my frictional costs (or transactional costs) to be an absolute minimum. Although I don't conduct a lot of trades a year (usually about 20 a year), those costs can really add up. Since most brokers charge about $10 a trade, that means I would spend $200 a year just on trading costs. Now, let's imagine you're like most investors and you trade a lot more than I do. For example, the typical day trader might buy and sell once a day during the 252 trading days in the year. That means they would conduct 504 trades in a year. Without much analysis, you can see that this behavior would cost the "investor" $5,040! That's a lot of money. It's very difficult to have any kind of returns when all the money is going to the broker. TradeKing's personal trading accounts have no set-up fees. No annual fees, and they only charge $4.95 per trade. They'll even refund you $150 for fees associated with switching-over to their service. So in short, I only spend about $99 a year conducting all of my trades. For the day trader, they would **save** about $2,545.20 a year with TradeKing if they were making 1 trade a day.
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> **My broker for corporate use.** I recommend Scottrade. So I have a second broker because I also have a trading account within my business, The Pylon Holding Company. I don't use TradeKing here because with corporate accounts, they charge a $200 annual fee and also a $250 start-up fee. It's important to note that TradeKing does not assess these fees for personal accounts; only corporate accounts. As a result, I have a corporate trading account with Scottrade because they have no initial sign-up fee and no annual fees. Now the slight downside is that their trading costs are slightly higher, at $7.00 a trade. Since I only do about 20 trades per year, Scottrade offers a better value for my corporate account. (Cost per year is approximately $140; whereas TradeKing would have been $340 with the fees for being a corporation).

Do Stig and Preston have other courses?

That is a good question, and something that I continuously found myself thinking of when I first started out. I chose to reverse the question and ask instead: "Who is the best stock investor in the world, and how do I learn to make the same decisions?"

If you play the video below you'll see where my journey took me.