

Tonight's club educational topic is about one of the business fundamentals you should keep an eye on when you own stock in a company,

its sales growth



As we discussed last month, once we own a stock, we want to track it's

business results from quarter to quarter. If we see big changes or management starts to warn us of difficulties ahead, we need to decide whether we want to stay an owner of the company.



If you recall, tonight's topic, sales growth, is one of the judgments we use to

predict future earnings. If you'll also recall,



That's important because earnings drives the stock price.

Math Model

Current Sales x Sales Growth = Future sales
 Future Sales x Net Profit Margin = Future earnings
 Future Earnings x Average Future P/E = Future stock price

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We use a simple math model and judgments about three factors to predict a stocks price in the future. Math model is just an fancy name for three simple calculations.

First we multiply Current sales times the sales growth rate to get

future sales

Then we multiply future sales by net profit margin to get a prediction of

future earnings

Finally, future earnings times future average P/E will equal

future stock price

The judgment items are Sales growth, Net profit margin in the future and Average future P/E or price to earnings ratio.

	A	B	C
3			
4	Quarterly Sales-4th Quarter 2020	20343	
5	1. Enter your Projection for the Percentage Growth in Q4 2020/21 Enter	10%	
6	4. Sales Growth Projection (Percentage)		
7			
8	2.0. Enter Your Projection for the Net Margin for the First Quarter	19.04%	
9	Net Margin projection (percentage)		
10			
11	Your Prediction of Earnings	\$ 4,444.93	
12	(Press F9 to calculate after you enter the two judgments above)		
13			
14	3.0. Enter Your Projection for Average Number of Shares Outstanding at the End of the First Quarter	300	
15	13. Projection of Number of Diluted Shares Outstanding		
16			
17	Your Prediction of Earnings Per Share	\$ 4.79	
18	(Press F9 to calculate after you enter the three judgments above)		
19			
20	4.0 P/E Projection	14	(P/E for Nov 2020)
21	(Press F9 to calculate)		
22	Your Prediction of the Stock Price	\$ 357.71	
23			

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We use a spreadsheet like this to make these calculations. All we need to do is input our judgments and a little bit of historical data that is very easy to find in many places on the internet. Today, we are talking about just the first judgment we input in the spreadsheet

The projected annual sales growth

	Three months ended December 31	
	2020	2019
Revenue	\$ 14,212	\$ 13,720
Recurrent operating costs (exclusive of depreciation and amortization shown separately below):		
Facility lease and parking	147,000	139,473
Labor	112,224	98,619
Occupancy	22,590	28,871
Other operating costs	71,877	44,518
General and administrative expenses	24,532	24,250
Depreciation and amortization	17,438	13,471
Provision for credit losses	1,843	2,283
Loss on disposal of assets	1,112	7,542
Total operating expenses	398,526	357,127
Revenue less operating expenses	77,334	74,809
Interest and other income	491	132
Interest and other expense	(145)	(170)
Income before income taxes	77,680	74,771
Provision for income taxes	(24,171)	(20,473)
Net income	\$ 53,509	\$ 54,298
Weighted average common shares outstanding:		
Basic	\$ 1.12	\$ 1.19
Diluted	\$ 1.02	\$ 1.08
Weighted average common shares outstanding:		
Basic	47,813	45,613
Diluted	52,429	51,249

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I'll be using the terms Sales and revenue interchangeably today.

Sales or revenue is the top line on a company income statement. If it's not increasing,

it's pretty hard to increase earnings, also referred to as the bottom line. Earnings are what's left after you subtract all the expenses from the sales. The company can keep them to reinvest in the business or distribute some of them to you as dividends.

Do you know what your company sells to make money?

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The first thing to think about when considering sales growth in the future is this.

Do you know what your company sells to make money?

Sounds like a simple question but if you really start to pay attention to this, you will realize that you are much more comfortable assessing certain companies than others. This is why you often hear to buy what you know. If you don't understand how a company makes money, how will you be able to understand if it is doing well now and might do well in the future?

Where Do Sales Come From?

- Selling a product
- Selling a service
- Investing
- Collecting rents or fees
- Advertising
- Combination of the above

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Where might sales come from?

Some companies sell products, for example Apple, or Proctor and Gamble

Others sell services, for example, Paychex or Strayer Education

Some earn their revenue by investing, These include banks and insurance companies like Aflac

Some collect a regular stream of payments for something they rent or something you subscribe to, for example Netflix or ATT

Companies like Google and the Washington post earn much of their revenue from selling advertising.

Of course some companies receive revenue from a combination of the sources mentioned. For example Microsoft sells products such as Xbox, Windows 7 and Office 2010 but it also makes money by providing service contracts to businesses. The larger the company, the more types of business activities it may be involved in and the more you may need to understand to follow the company.

Purchase
Sales Growth Expectations

% Growth/Time period
Ex.
20% per year



If you look at the stocks in your portfolio, part of the reason you purchased them and part of the reason you continue to hold them is an expectation that their sales will continue to grow. In order to be able to project earnings and possible return for your investment you need to quantify by how much.

Usually it is quantified by an expected growth rate for an expected period of time.

For example, you might say, “We expect this company to grow its sales by 20% each year”

Ownership

Are we meeting sales
growth expectations?




Once you own a stock, you want to watch each quarters financial results and make sure it keeps meeting your expectations.

How do we do that?



What Causes Sales to Increase?

- Selling more product-
– more popular, same store sales increasing, larger sales per customer
- Selling in more places-
– more stores, more restaurants, more countries
- Increase in product pricing
- Purchase of other companies
- New sales initiatives
- Economy



First of all, it helps to know what you are looking for.

What causes sales to increase? It will be different things for different types of businesses. The things we like to see are things like these.

Management Discussion and Analysis

- Net sales during 2010 increased \$22.3 billion or 52% compared to 2009. Several factors contributed positively to these increases, including the following:
 - Net sales of iPhone and related products and services were \$25.2 billion in 2010 representing an increase of \$12.1 billion or 93% compared to 2009.
 - Net sales of iPhone and related products and services accounted for 39% of the Company's total net sales for the year
 - As of September 25, 2010, the Company distributed iPhone in 89 countries through 166 carriers.



Underneath the table I just showed you is managements written description of the results shown. It's not hard to read and includes information like:

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- Net sales of iPhone and related products and services were \$25.2 billion in 2010 representing an increase of \$12.1 billion or 93% compared to 2009.

Net sales of iPhone and related products and services accounted for 39% of the Company's total net sales for the year.....

As of September 25, 2010, the Company distributed iPhone in 89 countries through 166 carriers.

Some very specific values for sales growth that you can compare to what your projections were.

Management Discussion and Analysis

iPhone year-over-year growth was attributable primarily to continued growth from existing carriers, expanded distribution with new international carriers and resellers, and strong demand for iPhone 4, which was released in the U.S. in June 2010 and in many other countries over the remainder of 2010



They go on to give reasons for the great growth.

There is a similar description of the revenue and reasons for it for each product that they sell.

Management Discussion and Analysis

Historically the Company has opened between 25 and 50 new retail stores per year. During 2011, the Company expects to open 40 to 50 new stores, over half of which are expected to be located outside of the U.S.



You will also find reference to future plans which will affect their sales. In this note, Apple tells you they are increasing their revenue by opening new stores and they intend to open at least as many this year as they have historically. This is also something that might encourage you that future sales growth might be similar to that achieved in the past.

Where Do you Find Information?

Earnings conference calls




A second excellent source of information about sales growth and projected sales growth are the

quarterly earnings conference calls.

You can listen to these live when they happen or listen to recordings posted on company websites.

Earnings Conference Calls

- Seeking Alpha
- <http://seekingalpha.com/tag/transcripts>





Seeking Alpha also seems to be regularly transcribing them.

You can search for transcripts here.

Click

Earnings Conference Calls
Strayer 4th Quarter

- Our revenue comes from tuition payments and associated fees. Approximately 70% of that revenue comes to us from federally insured Title 4 loans issued to our students.
- Revenues for the three months ended December 31, 2009 increased 29%..... compared to...the same period in '08,
- due to increased enrollment and a
- 5% tuition increase which commenced in January of '09.



For example, here are some excerpts from the recent 4th quarter earnings conference call for another stock many of you may be interested in, Strayer Education.

If you own this stock, you know they are on the hot seat due to proposed changes in government student loan requirements. Much of the tuition they collect (their sales) is paid for by government loans.

Here is a statement that will help to quantify for you what type of exposure their revenues might have if they do not have the same access to the funds in the future as they've had in the past.

Next, they talk about the increase in their revenues and the reasons for it. They've had increased enrollment and have

instituted a 5 percent tuition increase. These are both positive reasons their historical sales growth levels might stay the same or improve. However, a potential restriction on their access to students that are using government loans means that it is probably prudent to lower growth expectations until the effect is clear.

Earnings Conference Calls Strayer 4th Quarter

- For the winter term, our total student enrollment was up 21%, our new student enrollment was up 16%, and our continuing student enrollment was up 22%.
- Enrollment at mature campuses grew 10%.
- Global online students grew 39%
- In this quarter, we will open four new campuses

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More comments that discuss sales growth include changes in their total , new and continuing student enrollment.

They discuss, increases at existing campuses.

Increases in online enrollment

Increases in numbers of campuses.

All positive drivers for increasing sales. If you own this stock, you would keep tabs on these types of factors from quarter to quarter to see if they change. Does their total enrollment continue to increase? Is their enrollment of new students increasing? Are they increasing the number of students at their existing campuses? Are new government regulations putting restrictions on their recruiting which means enrollment is declining. Are they opening new campuses at the rate they were projecting when you purchased the stock?

Types of Things that might affect future sales growth rate

- Product obsolescence/new products
- New/expanding markets/locations
- Increased sales to current customers
- Purchase of other companies
- Sale of divisions
- New sales initiatives
- Economy

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Again, what types of things do we look for when we're reading the company information or listening to the conference calls? Don't forget we are trying to determine the rate that sales will be increasing not just whether or not they will increase.

Will they be phasing out old product lines or adding new ones? There was a frenzy right before the most recent Apple earnings release as everyone guessed how many I pads they were going to report they had sold.

Are they expanding into new markets or new locations? Chipotle is opening new restaurants at a fast pace. Strayer is increasing the number of campuses they have. Yum brands is being very successful with KFC restaurants in China.

Are they increasing the sales they make to existing customers? Retailers frequently discuss "same store sales" changes. Restaurants also talk about same store increases or Average bill increases. In the most recent quarter Chipotle reported that their same store sales increased by 11%. Since last quarter they reported an 8% increase and everyone was happy, it appears as though they are continuing to execute as well or better than expected. I also know that their business is seasonal and that this may traditionally be one of their better quarters.

Purchases of other companies- sometimes companies purchase other companies to add revenue which compliments their existing business. Oracle is a prime example of a company that is growing it's sales this way. One main thing to be aware of when companies are purchasing or selling divisions, is to understand the effect that has on comparable sales numbers. If the year ago quarter did not include the new division, make sure you understand whether the original business is still growing, even without the addition of sales from the new company.

Sale of divisions – companies that have diversified business activities may decide to get out of certain businesses. Proctor and Gamble recently sold it's pharmaceutical business to Warner Chilcott. They apparently felt that it would help their sales growth to limit the core businesses they were going to focus on. What do you think? How has their sales growth changed since the sale?

New sales initiatives- During the most recent Paychex earnings conference call, they discussed a new marketing initiative they are implementing across the company. Obviously the reason for doing that is to increase sales. How might that affect your sales growth projection? Do you think they will be successful? How important is it to your projected return that they are successful? I'm pretty conservative when new initiatives like

Coming up with a Number

Purchase growth expectations

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How do we turn all this information into a change in sales growth projection?

First, start with the sales growth you expected when you purchased the company. What did you think was going to drive its sales to increase? Does the information in the financial reports and earnings conference calls confirm your expectations or has something changed?

Coming up with a Number

- Compare
- Growth rate reported in current quarter
 - Year Over Year
 - Quarter to Quarter

Purchase Sales Growth Expectation	20%	Current Quarter	29%
	20%	Current Quarter	20%
		Current Quarter	13%

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Compare the current growth rate with your purchase judgment. What percentage change is being reported?

Year over year and

quarter to quarter.

Compared to the expectation you had when you purchased the stock

Is it higher,

lower or the

same as what you expected?

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012
Revenue	1,533,313	1,478,715
Revenue operating costs (includes depreciation and amortization (shown separately below))	147,488	148,475
Fuel, freight and packaging	112,534	98,659
Labor	32,688	28,871
Overseas	28,066	20,945
Other operating costs	72,801	60,034
General and administrative expenses	39,332	24,733
Depreciation and amortization	17,218	15,851
Pro-operations costs	1,840	2,533
Loss on disposal of assets	1,912	7,542
Total operating expenses	368,385	333,532
Income from operations	1,164,928	1,145,183
Interest and other income	385	152
Interest and other expense	(122)	(20)
Income before income taxes	1,165,191	1,145,115
Provision for income taxes	(28,777)	(23,452)
Net income	1,136,414	1,121,663
Basic	1,136,414	1,121,663
Diluted	1,136,414	1,121,663
Weighted average common shares outstanding	31,429	31,849
Basic	31,429	31,849
Diluted	31,429	31,849

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The company will sometimes provide you with a growth rate but you can also easily calculate it. In their financial reports, companies present not only information from the current period but also information from another period for you to compare to. For example, in quarterly reports you will usually find the

current quarters sales and the

sales for the same quarter 1 year ago. In annual reports, you will usually find at least the previous years data if not data from further back.

www.morningstar.com

Quarter	2009-09	2009-06	2009-03	2008-12	2008-09
Revenue	31.3	29.7	29.1	24.2	26.6
Cost of Revenue	14.8	14.9	14.9	12.8	14.8
Gross Profit	16.5	14.8	14.2	11.4	11.8
Operating Expenses	11.2	11.2	11.2	11.2	11.2
Operating Income	5.3	3.6	3.0	0.2	0.6
Interest Expense	0.0	0.0	0.0	0.0	0.0
Other Income (Expense)	0.0	0.0	0.0	0.0	0.0
Income before taxes	5.3	3.6	3.0	0.2	0.6
Provision for income tax	0.0	0.0	0.0	0.0	0.0
Net Income from operations	5.3	3.6	3.0	0.2	0.6
Net Income	5.3	3.6	3.0	0.2	0.6
EPS	0.13	0.09	0.07	0.00	0.01
EPS Diluted	0.13	0.09	0.07	0.00	0.01

You can also find comparison data free from various data sources such as morningstar

This is a sample of data from the past 5 quarters from Chipotle's income statements. You can also find annual data from the past 5 years. You can easily download both types of data into spreadsheets to analyze.

Just make sure that if you use data from a service that you understand whether they have "massaged" it at all.

How to Calculate Sales Growth

Sales growth (year to year) =

$$\frac{\text{Sales}_{\text{current quarter}} - \text{Sales}_{1 \text{ year ago}}}{\text{Sales}_{1 \text{ year ago}}} \times 100$$

You use the numbers from the different periods to calculate sales growth from quarter to quarter and from year to year. It is a very simple calculation.

For example, to get the year to year sales growth, you just subtract the sales from a year ago from the current sales number and divide by the sales from a year ago.

Then multiply by 100 to make it a percentage

How to Calculate Sales Growth

Example: CMG

$$\frac{(\$476,874 - \$387,581)}{\$387,581} = .23$$

.23 x 100 =

23% increase in sales

For example, we would calculate the sales growth using the income numbers from the Chipotle income statement that I just showed you.

First, subtract the sales in the first quarter of 2009 from the sales in the first quarter of 2010. Then, divide by the sales in the first quarter of 2009.

Multiply the result by 100

You'll see they had a 23% Year to Year increase in sales this quarter.

Coming up with a Number

- Year to year
- Quarter to quarter
- Adjust judgments?
- Comparison to analysts

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You can make several different comparisons to decide what you'd like to use as your judgment.

For example, you can compare year to year like we just did and you can also look at

quarter to quarter changes. What changes do you see year to year or quarter to quarter? Don't forget to take seasonal effects in to account when you are comparing quarters. Make sure you understand why you are seeing the changes you are and whether you think they will continue. For example, if you see big year to year changes, and you have a good understanding of why they have happened, you can decide whether you think the growth will continue at that rate or not.

How does your purchase growth rate judgment compare to what you are seeing? Are the company sales growing faster, slower or the same as what you expected when you purchased the stock?

Based on your calculations and the information the information from the quarterly report, do you feel you may need to adjust the judgments you are using to make your earnings projections?

Finally, how do your judgments compare to the analysts expectations? If you are trying to learn how to be a better investor, I would suggest that you do this last. You won't learn unless you try doing it yourself first and you'll learn even more if your results are dramatically different from theirs.

Analysts Estimates

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Don't forget, when you make a sales growth projection, you are doing the same thing analysts do. They are making judgments just like you. If you are a beginner, you may want to rely heavily on their numbers, but as you do it more frequently and watch a company quarter after quarter, you may find that you'd prefer to use your own.

You can find analysts estimates for sales growth in many places. Here are some examples.

Manifest Investing

Company	Symbol	Shares	Price	Value	% of Total	Growth	Proj P/E	Proj Yield	File Size	EPS	Div	Yield	PAE
Chippie Mexican Grill	CHMG	4,789,989	\$210.21	\$1,006,279.93	15.4%	23.0	0.0%	100%	69	0.21	5.8%		
Microsoft	MSFT	28,532,92	\$26.66	\$740,211.11	8.0%	14.0	1.4%	95%	92	0.16	14.4%		
St. Jude Medical	STJ	18,367,6	\$36.30	\$666,193.51	7.3%	16.0	0.0%	86%	92	0.16	13.2%		
AFLAC	AFL	8	\$55.89	\$447,124.41	13.1%	11.0	2.1%	75%	87	0.53	14.7%		
American Public Health	APHL	13,321,6	\$27.96	\$370,811.94	20.0%	24.0	0.0%	95%	70	0.14	24.4%		
Cardinal Health	CHS	337,85	\$0	\$0	0.0%	19.0	0.0%	79%	62	0.14	13.4%		
CVS	CVS	330,13	\$0	\$0	0.0%	14.0	1.0%	88%	90	0.13	16.1%		
Express Scripts	ESRX	448,52	\$0	\$0	0.0%	20.0	0.0%	81%	75	0.13	14.8%		
Vanguard S&P 500 Index	VFINX	\$109.04	\$0	\$0	0.0%	14.7	1.9%	87%	73	0.07	11.5%		
Wellpoint	WLP	333,88	\$0	\$0	0.0%	15.0	1.9%	96%	37	0.11	11.4%		
Cash		\$262	\$7.23	\$1,891.86	0.1%								
Total & Average		\$3,409	100.0%	\$3,409	12.4%	18.4	0.6%	92%	81	\$0.19	11.9%		

The column labeled growth on a Manifest Dashboard is the 5 year sales growth estimate Manifest is using to project Annual Return. It is a compilation of analysts estimates from a variety of sources.

If you go to finance.yahoo.com and select Analysts Estimates from the links on the left side of the page,

You will see this page.

In this section are their estimates for revenue growth for the

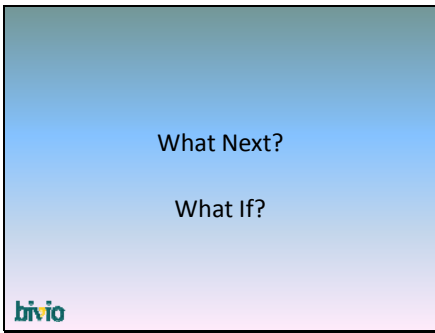
current quarter, the next quarter, the current year and the next year.

Revenue Est	Current Qtr	Next Qtr	Current Year	Next Year
High Estimate	489,234	492,070	1,828	2,119
Low Estimate	481,839	491,454	1,768	2,033
High Estimate	497,492	498,400	1,808	2,108
Low Estimate	487,492	488,400	1,788	2,098
Mean (Street Consensus)	489,363	491,762	1,803	2,103

If you have access to Valueline information, you can find a Valueline projection for sales growth in a box on the left hand side of the Valueline page.

ANNUAL RATES	Past 5 Yrs	Past 10 Yrs	Est'd '07-'09
of change (per yr)	19.7%	5.7%	5.7%
Sales	15.0%	15.5%	8.5%
Cash Flow	12.0%	11.5%	17.5%
Earnings	13.0%	11.0%	12.5%
DIVIDEND	-	41.5%	7.5%
Book Value	8.5%	-7.5%	18.5%

Here you'll find average sales growth rates for the past 5 and 10 years and their projection for sales growth 3 to 5 years into the future.

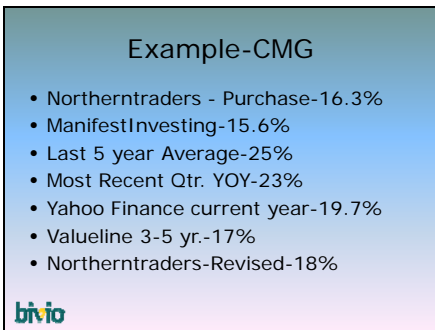


Once you've decided on a growth rate that you are comfortable with, it's time to determine what that will mean to your projection of return in the future.

We are lucky to have tools readily available on the computer that allow us to do "what if" studies that will help us decide whether this is an investment we want to keep or we might need to look at replacing.

Plug your updated sales growth numbers back into the worksheet you used to project earnings when you purchased the stock and determine whether you think this company will still provide the return you need to keep your portfolio return where you want it to be.

Here's an example of how that might work.



So what do you do with all this information?

Here are a variety of Sales growth projections for a stock my club owns, Chipotle grill. When we purchased the stock, we based our purchase decision on a projected sales growth of 16.31%

Currently,

Manifest Investing is using 15.6% to project return out over the next 5 years, the

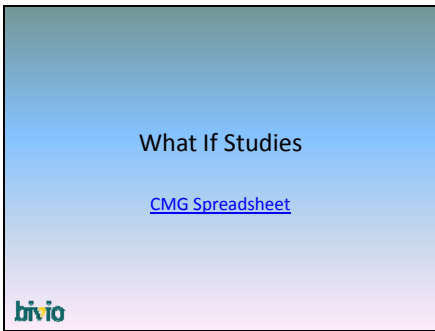
average growth rate for the past 5 years is 25%, the

YOY result for the most recent quarter is 23%

Yahoo Finance is projecting 19.7% for the current year and

Valueline is projecting a 17% growth rate out 3 to 5 years.

It looks like things are going better than we anticipated for Chipotle so we decided to revise our sales growth judgment to 18%



Our next step is to plug the updated information back into our projected return calculations and see what it means.



Remember, following a stock doesn't mean just following its price.

It means following how its business is doing.

If you owned a candy store on main street in your town one of the main things you would follow about its business is the growth in its sales. It's no different if you own stock in a company. You need to understand where its sales are coming from and how they are growing.



The more you pay attention to this, the better you'll get at "seeing things coming"

and moving in and out of investments at appropriate times.