

A Systematic SSG Study

From Corry DalMasco/ Classic Manual: Completing the Steps of a Stock Study

On the SSG Graph:

Step 1: Assessing Consistent Growth “The SSG Graph gives good visual information about a company’s growth . . . when the sales and earnings lines show peaks and dips, it suggests that management has had a difficult time growing the company . . . the inconsistencies must be investigated and then decisions made about whether they are likely to reoccur.” (pg. 79)

Step 2: Measuring Historical Trends “Your next goal in the SSG Graph is to measure the growth (slope) of the sales and earnings per share (EPS) lines (pg. 79) . . . Generally you will find that the (each of the different) methods (for measuring trend lines) will yield similar percentage results unless you have widely ranging data. (pg. 81) . . . NAIC Classic Plus allows you to exclude years of data that don’t fit the trend (pg. 82)

Step 3: Projecting Future Growth “The process is similar for both sales and EPS. This is one critical part to projecting future growth. You must know enough about the company to predict whether it will increase, decrease, maintain its past growth into the future.” (pg. 82)

- ❑ **Guidelines for Projecting Growth Rates** 1) “computer projections are useful when there is regular growth; 2) projected EPS growth should be equal or less than sales growth; 3) it is difficult to maintain growth more than 15% for long periods – even fewer can sustain 20%; 4) are quarterly sales and EPS figures equal to the historic growth trends and are keeping with your growth projections; 5) project for 5 full years (see page 88); 6) cross check with Preferred Procedure” (pg. 83)

On the SSG Analysis:

Part 2 – Evaluating Management

Step 1: Determine Consistency and Trends “Make sure the trend for past 5 years is fairly consistent or trending up. If trending downwards or variable, it shows that management has had some problems (pg. 92) . . . Numbers within a variation of + or – 5% from the 5-year average are considered consistent.” (pg. 93)

Step 2: Industry Comparison “Confirm that the company has high profitability and high return on equity numbers in relation to other companies in its industry (pg. 93) %Pre-tax Profit on Sales (also called Pre-tax Profit Margin) measures how well management converts sales into dollars into profits . . . Look for profitability of 12% to 15% or better . . . Investing in leaders is usually a good practice.” (pg. 93) “%ROE measures the amount of money (the return) made by the company in relation to the amount invested (the equity) . . . Higher %ROE numbers usually indicate superior management. However, balance sheet leverage (debt) and buyback of stock can skew these numbers . . . Numbers of 10% to 12% or higher are good results for %ROE.” (pg. 94)

Part 3 – Price – Earnings History

Step 1: Looking for Unusual Figures “Look at the columns of data for numbers that seem abnormally high or low. A number may properly be excluded if: 1) a value varies by more than 50% from the average, and 2) you are satisfied that whatever happened to cause the problem has been corrected . . . and is not likely to reoccur. High, wide ranging, or rising PEs can pose a judgment problem for beginners.” (pg. 95-96)

Step 2: Looking for trends “You should expect prices and EPS to increase over time. These are the same items plotted on the SSG Graph . . . you should note if the PE column D (High P/E) and E (Low P/E) show any trends up, down, or if PE ratios keep within a range. PEs that vary substantially present challenges for analysis

... PEs that are greater than 50% of the average make assessment more difficult and involve greater risk. Numbers that vary much more than this should be flags indicating volatility and/or questionable management. . . look at the dividend payout to make sure that it is not excessive, 60% or higher is excessive.” (pg. 96)

Step 3: Determining Value “Over a period of 5 years or more the high to low PE spread for a company remains fairly constant . . . the historical average PE becomes the basis of comparison for value. The average high and average low PEs are characteristic of the company’s valuation range . . . (economic factors and investor sentiment) tend to move price-earnings ratio up and down within a normal characteristic PE range for the company . . . The long-term investor should be prepared for long periods of pessimism in the market. In pessimistic periods, PE ratios tend to decline, even as a company continues to grow. . . A current PE that is less than the historical average is deemed to be ‘undervalued’ and ‘on sale’ . . . When you buy a stock with a current PE ratio below the average PE, you have the opportunity to benefit from PE expansion.” (pg. 97)

“Be wary of an unusually low current PE . . . A current price substantially lower than the 52 week high should be looked at suspiciously . . . Review the management performance in Part 2 and the latest quarterly results to learn more about the company . . . A (dividend) payout (ratio) much above 15%-20% would likely affect the company’s growth.” (pg. 99)

Part 4 – Evaluating Risk and Reward

Step 1: Developing a Potential High Price “Part 4A develops the highest price possible within the next 5 years. This is the product of the average high PE and the estimated high EPS (from the SSG Graph) . . . An average high PE more than 1.5 times the expected EPS growth rate could be considered excessive in most instances. Confirm that you still agree with your estimated high EPS . . . Finally look at the 5-year ranges for both high and low prices. . . Look at the current price and where it fits within its latest 52-week period.” (pg. 100)

Step 2: Estimating Low Price “The low price should be the lowest price to which the company could drop, in the worst case scenario . . . The low price makes the most impact on the size of the upside-downside ratio . . . Unreasonable upside-downside ratios (10 or more) most often result from unreasonable low price estimates” (pg. 101-102)

Step 3: Zoning and the Upside-Downside Ratio “If you should get strange results for the upside-downside ratio, check where your current price lies.” (pg. 103)

Step 4: Noting Potential Price Appreciation “If you buy the stock when the current PE is at or below the average PE, there is a possibility that your return will be even better.” (pg. 103)

Summary for SSG Part 4 – Risk and Reward “You may find it difficult to find high quality growth companies with favorable upside-downside ratios. Be patient. If you will like a company, keep it in your database and follow its sales and earnings progress. You will likely find a point in time when the price declines for a while and you can buy at your desired price level. “(103)

Part 5 – Five Year Potential

“It is unlikely that every company you purchase will be able to sustain 15% growth . . . Part 5 measures the company’s potential return should you buy at the current price and the company performs the way you expect. A potential annual total return of 15% (compounded) over the next five years should be the minimum expectation... Data for this section is derived from Parts 3 and 4 of the Stock Selection Guide . . . The Estimated Potential Total Return depends upon your application of judgment... As a result of your judgments, the potential total return on investment includes two parts: 1) The potential price appreciation (as calculated in Part 4E) and 2) The average annual yield from the dividend payment... Your total return figure should be considered in the context of the company’s growth. Consider the projected growth rate for sales or earnings as a benchmark. Total return generally should be in line with the company’s growth.” (pg. 103-104)