Options to specify in the Toolkit Software

Under 'Options', 'Preferences':

1. On the 'General' tab, check all options
2. On the 'Stock Study' tab, enter your name under default prepared (there is a small limit to string length), check all three check boxes, select 'Last quarterly data' and '25-50-25'.
3. On the 'File Locations' tab, only the Default Data Path needs to be modified. It makes sense to have another directory where only exports are sent.
4. Do not modify the 'Internet' tab.
5. Save all changes by clicking on 'OK'.

Adding Judgment to an SSG for BUYING

1. In **section 1,** click on the graph to organize the lines. Move earnings (E) to the bottom. Place price history just above it. Pre-tax profit (P) should be right above this, with sales (S) on top. Verify that the three lines (S, P, E) are all flat or trending upwards, especially the most recent 3-5 years. Straight lines are better than wavy lines. Flat lines are good, demonstrating consistency; flat lines rising to the right are best!

2. In **section 2,** click Alt-R to compute 2B using beginning book value. Verify that, after eliminating any obvious outliers, management is on the "up and up". See Appendix A for further discussion on this topic. Compare the most recent 2A value to the industry average and to the closest competitors. We want this value to be higher (better) than both of these. We do NOT want to see an obvious "down" trend in 2B, especially into single-digit numbers.

3. If either section 1 or 2 isn't acceptable, **QUIT NOW**. This is the "Barbed-Wire Fence". We don't cross it unless the company's stock is worth owning and sections 3-5 will tell us at what price to buy it.

4. Return to **section 1** and apply judgment to sales growth and earnings estimates:
   a. If you delete an outlier (sales or earnings) and it decreases the historical growth rate, it probably makes sense to delete it.
   b. Never project earnings at a rate higher than sales (without an *exceptional* reason).
   c. ***Rarely*** use rates greater than 15%, and **NEVER** greater than 20%. It is better to be conservative than aggressive.
   d. Do an analysis of the most recent 10, 7, 5, and 3 years to identify any historical trends for both sales growth and earnings estimates. Alt-G will display the earnings and sales history for the past 9, 8, 7, etc. years. We'd prefer to see this graph flat or going up, but a 'drop' to the upper teens or better is still ok.
   e. Never project future growth rates to be greater than historical rates (without an *exceptional* reason).
   f. After entering your estimates for sales and earnings growth, click "Preferred Procedure" to make a comparison. Your EPS $ should never be greater than that of the Analysts' Estimate.
   g. The stock price should track to EPS long term. A price below EPS could represent a buying opportunity; a price above EPS could be a hold while we wait for Price and EPS to re-align.

5. In **section 3**:

   a. Check for obvious outliers in columns D & E. Definitely remove an *excessively* high one; consider removing an *excessively* low one. Moderate outliers should be left alone. The values in this section are used to create the relative value and projected relative value shown at the bottom of section 4.

6. Within **section 4**:
   a. Click in 4a then use Alt-X to display up to 10 years worth of high and low PE values. Leave the five lowest values by selecting the five highest values from each column (to delete them); the new average will be displayed at the bottom of the screen. If one, possibly two, more values are still obviously not part of the remaining values, then select them also. Click the use button to transfer the two averages into 4A & 4B.
   b. In the rare case where the projected High P/E is above 30, set the High P/E to 30 and the Low P/E to: (Avg Low)/(Avg High) * 30
   c. High P/E should never be greater than 2 x Projected EPS Growth (section 1(4)).
   d. If the most recent 4-5 years show a definite downtrend, then use the most recent year's P/E if it is lower than what was calculated in steps 6a or 6b.
   e. There is an ultra conservative approach for deriving high and low future P/E values. For the high P/E, take the lower of the Alt-X process, 1.5 times the estimated sales growth (from 1(2)), or 30. For the low P/E, take the lower of the Alt-X process and 1 times the EPS growth (from 1(4)).
   f. Use Ctrl-Alt-Q to set the value in the second yellow box in section 4 to be "Current P/E Based on Last 4 qrtr. EPS" (shown just above and to the right). Or, use analysts' estimates of the next 12 months' EPS.
   g. Click inside the third green box (4Bd). The value entered should not be greater than the 52-week low price. Generally, click in the first radial button (forecast low price) and then click OK. If the stock pays a dividend that, divided by price times 100, approximates the T-bill rate, then select the fourth radial button. If the current stock price is too close to the 4Bd value, then enter 80% of the current price in 'Other' or consider the 52-week low price.
   h. Use Ctrl+Alt+N to display the current year period on the bottom of the page. If it is anything other than 5.00, then use Ctrl+Alt+T to project section 1 estimates out for a full five years.
   i. If the US/DS ratio (4D) is greater than 10.1, review the low-price estimate in 4B.

7. Inside **section 5**:
   a. We want Relative Value between 85% and 110% (a little less *may* be ok, more is *not*) and Proj. Relative Value between 80 and 100%. Relative Value is computed from Current P/E (section 3.9) / Average P/E (section 3.8). Proj. Relative Value is computed from Projected P/E (above 4) / Average P/E.
   b. If P.A.R. is >= 13% and
   c. US/DS is between 3:1 and 10:1 and
   d. Total debt < 1/3 of assets (shown above section 1, called % to Tot Cap.)
   e. **…then this is a stock that can be purchased now.**
   f. **…otherwise we put it on our pounce list and wait.**

Adding Judgment to an SSG if OWNED

When buying a stock we want to exhibit very conservative estimates. Once we own a stock our estimates no longer need to be as conservative. An SSG for an owned stock serves two purposes. One is for analyzing whether the company is growing according to our original estimates. The other is for determining whether it has peaked and should be replaced.

Prior to changing our original SSG, we should save the following values in the notes section:
- Estimates Sales and EPS growth.
- Average High and Low P/E
- Buy range
- High price
- PAR and Total Return

One change to make (but not the only one!) is in section 4. Click in 4a then use Alt-X followed by Alt-M. This will generate the Median values of both high and low P/E. Click the use button to transfer the two averages into 4A & 4B.

Appendix A

The ***Best*** companies will have increasing values for the last 5 years. Trends of "Up and even" or "even and up" indicate ***Better*** companies. The minimum acceptable trends are "even" and "even". The only time a company with a "down" trend is considered is when the values are all 20 or higher AND the last four years are not obviously decreasing. Otherwise, we *ALWAYS* abandon the SSG if "Down" appears anywhere!

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