## Options to specify in the Toolkit Software, v 5.x

Under 'Options', 'Preferences':

1. On the 'General' tab, check all options and select 'library first' for data source
2. On the 'Stock Study' tab, enter your name under default prepared (there is a 10 character limit), select 'Last quarterly data', '25-50-25', 'scaled', and check the first two check boxes
3. On the 'File Locations' tab, select ‘BetterInvesting S&P Data Feed' and provide your Userid and PWD. Point the 'Default Path for Export' to a directory where you wish export files to be sent. The 'E-mail Attachments folder' can be left as Empty
4. Do not modify the 'Internet' tab.
5. Values on the 'Thresholds' tab should be set to 7, 30, 60, 0.9, 14
6. Save all changes by clicking on 'OK'.

## Adding Judgment to an SSG for BUYING

1. Above section 1, top, right-hand corner, is some basic company data. The last row of this box contains a cell called, “% to Tot. Cap.” This debt should be < 1/3 of assets (< 33%), except for financial corporations. If it is more, then skip this company.

2. 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 straight or trending upwards, especially the most recent 3-5 years. Straight lines are better than wavy lines. Straight, up and parallel is our goal!

3. 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, although Even is acceptable. 2B numbers above 20 are excellent. Around 15 is average; lower is not good.

4. 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 (high quality) and **sections 3-5** will tell us at what price to buy it.

5. 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. Never project future growth rates to be greater than historical rates (without an *exceptional* reason).
    d. ***Rarely*** use rates greater than 15%, and **NEVER** greater than 20%. It is better to be conservative than aggressive.
    e. 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.
    f. Your EPS $ should never be greater than that of the Analysts' Estimate shown.

   g. Alt-S shows growth sustainable from cash flow. Your growth estimates should **NEVER** exceed this number.

6. In **section 3**:
   a. Check for obvious outliers in columns D & E. Definitely remove an *excessively* high one; consider removing an *excessively* low one. It is excessive if removing it changes the average by 15% or more. 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.

7. Within **section 4**:
   a. Click in 4a and you will see up to 10 years worth of high and low PE values. Remove the five highest values (Alt-M will do this) by clicking on them; the new average will be displayed at the bottom of the screen. If one more value is still obviously not part of the remaining values, then select it also. Click the 'Use Average From Above' button.
   b. Rarely will the projected High P/E be above 30. If it is, you can be conservative by setting the High P/E to 30 and the Low P/E to: (Avg Low)/(Avg High) * 30
   c. Many people limit High P/E to 2 x Projected EPS Growth (from 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 7a, 7b or 7c.
   e. There is an ultra conservative approach for deriving future high and low P/E values. For the high P/E, take the lowest of the step 6a-c process, 1.5 times the estimated sales growth (from SSG 1(2)), or 30. For the low P/E, take the lowest of the 6a-b process or 1 times the EPS growth (from section 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 selected here should be less than the low price this year as shown at the top of section 3. 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 present price in 'Other', select the 'Recent Severe Market Low Price' or consider the 52-week low price.
   h. If the US/DS ratio (4D) is greater than 10:1, review the low-price estimate in 4B. This stock will probably be too risky without deeper analysis.

8. Inside **section 5**:
   a. If Relative Value is between 85% and 105% (a little less *may* be ok, more is *not*) and Proj. Relative Value between 80% and 100% [Relative Value is computed as Current P/E (section 3.9) / Average P/E (section 3.8). Proj. Relative Value is computed as Projected P/E (above 4) / Average P/E], and
   b. Tot. Ret. is >= 15% and/or 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 when **ANY** of A - D is not met.
   g. Alt-B shows the maximum price at which the stock should be purchased to satisfy a 3:1 US/DS ratio and a 14.9% compounded rate of return.

## 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 original values in the notes section:

- Estimated 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 click 'Use Median'. This will generate the Median values for both high and low P/E. Click 'OK' to transfer the two averages into 4A & 4B. Click on the third green box in section 4 to select a new Estimated Low Price.

## 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!

## Bibliography

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