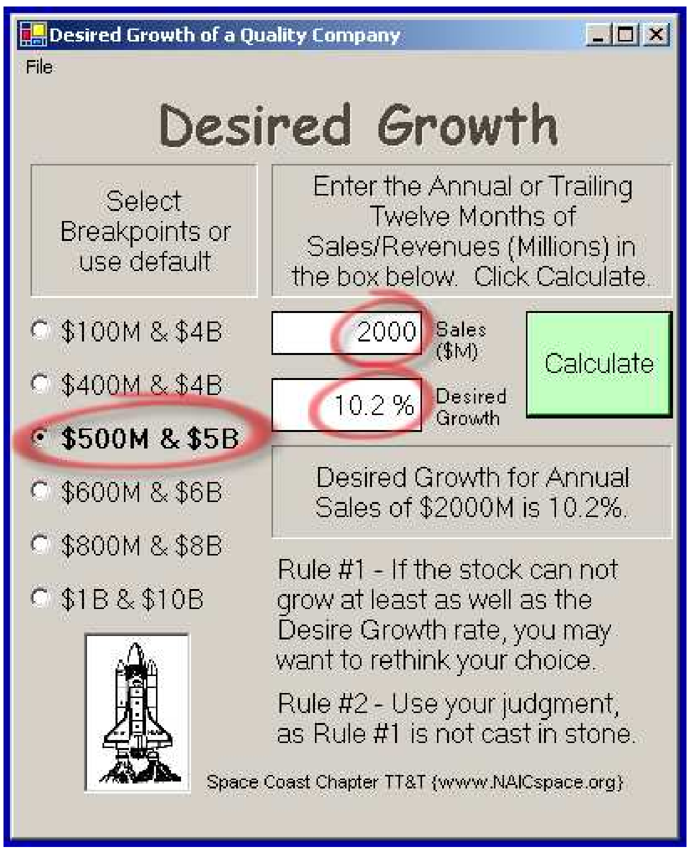
BetterInvesting™ Space Coast Chapter

Tips, Tricks, & Techniques

Desired Growth Calculator

The Desired (or Expected) Growth of a Quality Company is a concept first introduced by Ellis Traub in the manual for earlier versions of the Investor's Toolkit software and in his *Take Stock*.

We have all become so hung up on 15% total return that we have lost sight of the fact that Sales and Earnings need not grow at 15% to achieve our desired result. Following the NAIC principle of reinvesting dividends a large-sized company with sales and earnings growth of 7% may and probably will achieve a 15% total return for long term investors.



DG.exe is a simple windows based calculator that you may want to make a part of your stock studies.

In the example, we have used the default breakpoint between small and mid-sized companies at $500 million and between mid and large-sized companies at $5 billion. Next $2000 million (or $2 billion) of annual sales was used. Clicking on the Calculate button returns the Desired Growth, 10.2%.

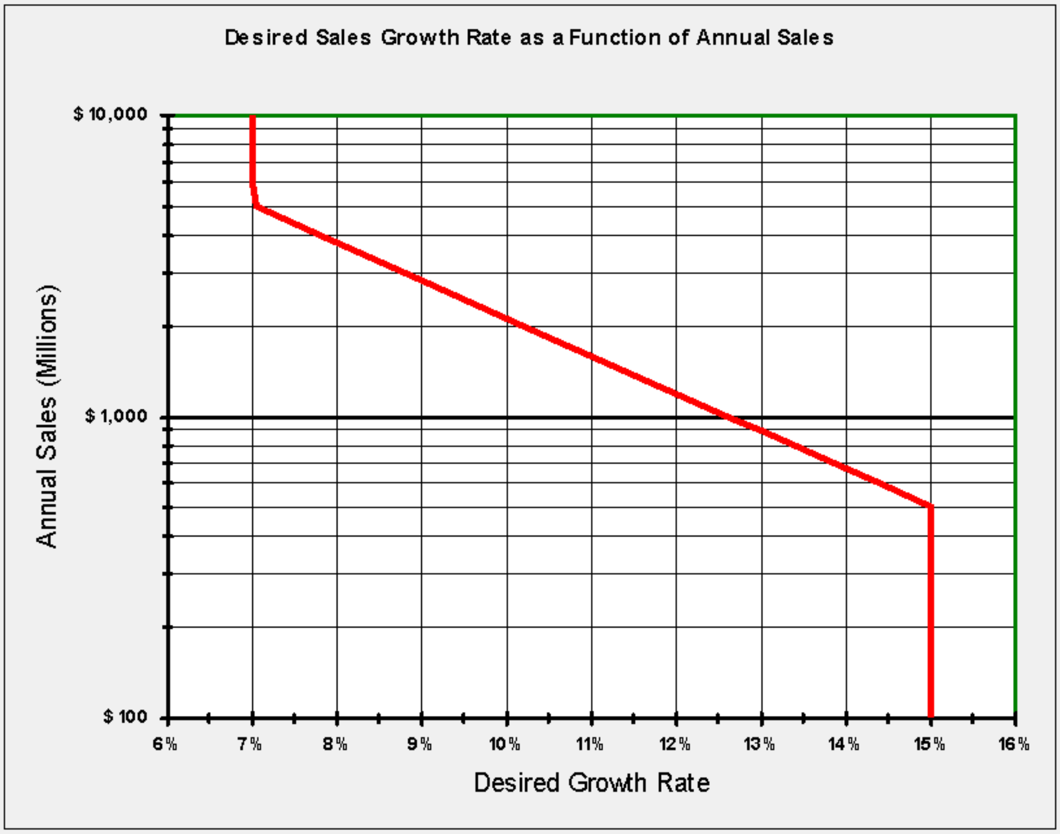
If you follow the 2 simple rules, paying particular attention to the second one, you may find this tool helpful.

It should be noted that originally the breakpoints were $100 million and $4 billion. Again this is a judgment item but note that the further you move down in breakpoint selection, the more conservative you become.

The calculator is available at www.NAICspace.org in the Toolkit Visual Analysis collection of Tips, Tricks & Techniques. It is a small executable file. Contact Webmaster@NAICspace.org to report any problems or suggestions for improvement. DG.exe has been tested with 98SE, ME, and XP Op Sys. If it will not run on your computer you may have to install Microsoft's free .NET Framework.

Desired Growth Calculator (continued)

Background – The concept introduced earlier by Ellis Traub showed a plot of the Desired Sales Growth Rate as a function of annual or trailing 12 months of sales like the following chart except that the breakpoint between Small-sized and Mid-sized companies was at $100 million and the breakpoint between Mid-sized and Large-sized companies was at $4 billion of sales.



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The breakpoints shown here, in the opinion of the writer, are more in line with current judgment. They are $500 million and $5 billion. These are the default values for the calculator (shown bolded). The user of the calculator, however, may select breakpoints inline with his judgment. Choices are:

- $100 million and $4 billion
- $400 million and $4 billion
- **$500 million and $5 billion**
- $600 million and $6 billion
- $800 million and $8 billion
- $1 billion and $10 billion

Inflation creep will inevitably shift the default value higher.

Following the Life Cycle of a Successful Company

from ICLUBcentral's *Small Cap Informer*

As a company succeeds and grows, it gets harder and harder for it to maintain the high growth rates it may have enjoyed when it was a much smaller business. For this reason, it is very important for investors to understand where a company stands in its life cycle to gauge its past results and likely future growth.

A successful company typically passes through several growth phases. The**Startup Phase** is when earnings are below the break-even point (the company is losing money). **Explosive Growth** is when the percentage increase in sales and earnings tends to be spectacular, often approaching or exceeding 20% annually.***SmallCap Informe***r typically spotlights companies in this phase. The **Mature Growth** period is when revenue becomes so large that it is difficult to maintain consistent growth rates. And when companies do not continue to rejuvenate their product mix and fail to expand their target markets, they can go into a period of**Stabilization** or **Decline**.

Investors using the BetterInvesting approach focus on companies that are into their explosive growth period and are not yet past their primes. Small and midsized companies typically are entering their explosive growth phases.

What kind of growth rates do successful companies have? It depends in large part on the size of the company. Expected growth rates from typical companies vary from a low of about 7% for large companies to a high of around 20%. If a company is well established and has annual sales above $5 billion, a growth rate of as little as 7% is acceptable. The stock's yield in such cases should provide an additional component of return. Some additional return should come from expanding P/E ratios (from the practice of buying the stock when it is cheap relative to its historical valuation levels and future expected growth).

Newer companies in the explosive growth period should show double-digit growth. Companies profiled in ***SmallCap Informer*** belong to this category. Growth rates above 20% cannot be sustained forever, but higher growth rates are some compensation for the increased associated risk of investing in these smaller businesses.

In our stock studies, we often project growth at rates below maximum expected results to modulate enthusiasm. By being conservative in this fashion we attempt to limit surprises to those of the upside variety. If a company's growth fails to meet our expectations, we will likely be disappointed in the stock's performance, but if a company exceeds our growth projects we will be pleased with the results.