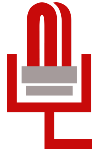

MASTERMIND COMMUNITY
BY THE INVESTOR'S PODCAST NETWORK

5 MINUTES TO NO

The Guide To Veto Poor Stock Investment Ideas In 5 Minutes Or Less

Kyle Grieve

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Glossary

Introduction

We live in an age where the internet is adding 1.145 trillion megabytes per day of information.

So we have much information at our fingertips. It can be incredibly easy for us to go down a rabbit hole of inaccurate or useless information. Stock ideas are no exception. Between the thousands of sites aiming to get your attention, to talking heads on the TV yelling at you to "buy this" or "sell that," it's hard to cut through the noise and get a subjective conclusion.

The media could be a better place to find investment opportunities, but they pass themselves off as THE place to go for financial guidance.

I wanted to build a framework that would help me sift through the garbage that is being thrown my way so I could quickly eliminate low-quality investment ideas. This would allow me to spend as much time as possible doing things with the highest return on my time. I've worked on this system for years, and now I want to share it with you so that you can learn to say "no" to an investment idea as fast as possible.

As a new investor, the biggest problem I ran into was spending hours on ideas that I would end up passing on.

During the COVID-19 lockdowns, this wasn't as big of an issue. But now that life is back to normal, spare time is no longer an abundant resource.

I realized that I needed to be able to say "no" to stock ideas nearly as quickly as they were coming in.

As I learned more and more about investing, I came across the work of Mohnish Pabrai. He discusses how he can say no to an idea in 5 minutes. He'll take another 15 minutes to maybe say yes to the ideas that make it through this filter.

Then an hour.

Then a few hours.

Then a few days.

Then perhaps a few weeks.

After this time, he may have actually found something.

I took this as a wake-up call. I needed to find a way to clone this mental model and make it a part of my arsenal. Mohnish Pabrai's mental model reminded me of a great Bruce Lee quote:

> *"Adapt what is useful, reject what is useless, and add what is specifically your own."*

As my knowledge base expanded, I began to see what I truly understood at a high level.

As I mixed my ability to understand businesses well with the tools outlined in this book, I could quickly filter out investment ideas in record time.

You can do the same.

If an idea comes your way and you don't understand, you skip it.

That is 99% of the ideas that come my way. So, instantly, I can eliminate nearly all investing ideas. The ones that tend to stick are the ideas that I find interesting and simple.

If I don't have the knowledge, the question becomes, "Am I willing to invest the time to gain that knowledge?"

As a result of this self-reflection and learning, I began to formulate a system that I could use to eliminate investment ideas quickly.

To be honest, the system started formulating just as ideas came into my head. In order to get my framework onto paper, I first had to clearly think about what I was doing. The synthesis of that thinking is what you are reading now.

The goals of this guide are to:

- Find shortcuts that will help you filter out poor investments so you can spend time on great investments
- Make sure the shortcuts you are using are adding value to your investing framework and not giving you false positives
- Allow you to spend more time doing the things you enjoy. There is only so much time we have on Earth. I think your time should be spent doing things that are productive and that you enjoy

It's important that I discuss what this guide is not.

This is not a guide for traders looking to improve their chart reading ability.

This is not a guide for speculators looking for confirmation bias to "go all in" on whatever is popular on Wall Street Bets on Reddit.

This is not a guide to using stock screeners. I use the word "filter" often, but please do not get this confused with the term "stock filter," which is another name for a screen. I haven't used a stock screener in a few years. I doubt that I will ever use one again.

Business climates are not linear.

Plus, the investment world is a wild place. 2020-2022 has been a heck of a time to be alive. The past few years have smacked us on the side of the head:

- Lockdowns
- European invasions
- Money printing at a scale that's never been seen
- Inflation levels that haven't been seen in decades

The list goes on and on.

Stock screens don't account for the volatility the world goes through. Plenty of stocks would've been instantly disqualified from most screeners in 2020. The lockdowns had massive impacts on the fundamentals of many great companies. Because the fundamentals were depressed, the screens would have eliminated ideas going through temporary headwinds.

You want to pay as close attention as possible to businesses going through temporary headwinds.

This is where the real money is made in investing. When you can clearly see that a business is going through short-term problems, you can make a fortune. A simple story of my own will illustrate this. When I was locked up with my then-fiancee, I researched Aritzia. This was a business that was clearly being impacted by store closures. But the interest in their product was clear due to their rapid expansion in eCommerce.

They also didn't close one store during the multi-month lockdown.

If there was a clear interest in the business's online products, it seemed obvious to me that once the stores opened up, there would be no drop off in foot traffic. If I had used a stock screener, Aritzia probably would have been disqualified because growth rates went negative.

But that would have eliminated a great opportunity for me. Since that time, Aritzia just picked up where they left off. So please don't allow stock screeners to remove potential ideas just because of the weakness of the screen!

Now that we have that out of the way, let's go over the most common mistakes that I see investors make when it comes to sifting through new ideas:

- They rely on stock screeners to generate new ideas
- They do not have a system to remove investments quickly
- They spend weeks researching a business, only to conclude it's not a good fit
- They focus on investing in companies with an exciting narrative rather than a business that creates value for shareholders

If you don't have a system in place to help you figure out when an investment opportunity is a pass, you'll continue making these mistakes. Many investors will spend their entire lives making these mistakes. As a result, they will encounter a host of problems.

These problems include:

- Wasted time
- Less wealth
- Sacrificing time and energy
- Decreased returns when you realize the business isn't as good as you thought,
- Zero conviction in stock ideas, which causes investors to sell at the moment of price weakness

The point of this book is to help you avoid making these mistakes.

How the Book is Formatted

This ultimate guide has six primary parts.

Part I will cover the analytical tools you should be using to help you quickly filter out incoming ideas.

These analytical tools are the tools I use on a weekly basis to say no to 99% of investment ideas in a few minutes. For instance, I love going over Tweets where the author asks what stocks everyone is buying right now. These can be a gold mine for generating new ideas. One thread might have 50-100 different stocks mentioned in them.

I'll use the tools outlined in this book to quickly go through each idea to find out which is worthy of my attention. 99% of the time, the ideas I find are either over my head or don't pass my filters.

If you utilize these tools, you'll be able to find the rare diamond in the rough that might be your next 100-bagger!

Part II will cover creating the benchmarks for each tool in Part I.

Once you understand how the tools work, you can easily figure out which benchmark numbers the incoming ideas should match or exceed. Since you know that all

businesses in your portfolio should be growing their net income at 15%, and you see a pitch, you can jump to check their net income. If the net income grows at 8%, it's a skip.

Easy. Peasy.

After Part II, you'll have a clearer idea of what metrics you are looking for and what the numbers should approximate if they are worthy of a deeper analysis.

Part III will take you through what I think is the most important metric out of all of them.

If I had to pick only one metric to give a pass or fail grade to a potential investment, this would be it. I'll cover why I think this is the most important number to follow and why it's so closely related to increases in intrinsic value. Don't worry; you'll also be presented with a great example!

Part IV will cover where to find these numbers specifically.

I take for granted the many tools I love using in my research process. I forget that not everyone knows about them. So I want to open up the floodgates for you and show you the specific tools I use. You, too, can then use these numbers and the processes I go through first to analyze a stock.

The best part about this is that the tools are free!

The internet is a wonderful place, isn't it?

I'll show you specific sites to use, where to look on these sites, and how to use them as quickly as possible. And so, the beginning of your analysis process will be a breeze!

Once you know what metrics to use, what your hurdle rates are, and where to find the metrics, it's time to apply what you know.

Part V will show you the specific steps to take from when an idea enters your mind to your decision to either say "no" or proceed further.

It's not that complicated, but I know you'll learn some interesting tricks to help you expedite this process.

I'll even show my favorite process for saying "no" by looking at 1 or 2 metrics. I've been told this shortcut will eliminate too many good opportunities. And maybe it's true. But I'd rather be able to spend time on the simplest businesses rather than have to dig down the rabbit hole to understand something complicated.

My thought process is that if there is a truly great business that doesn't pass my filters, it will resurface later. This has already happened to me many times.

Part VI will briefly discuss the next steps after applying your filters.

The part of the analytical process described in this book probably deals with only 1-2% of the due diligence process. So I want to arm you with a few more ideas to help get your analytical mind going.

The Analytical Tools

Revenue Growth

This is probably the most obvious tool you'll see in the toolbox.

It is so obvious because everyone and their dog talks about hot-shot tech stocks growing revenues at 80%. Even though it's the most used tool, it's also the one that might be the least important.

There is a massive problem with basing your investment decision only on revenue growth.

You miss the profitability portion of the business. Many investors of high-revenue growth businesses are making assumptions I don't think anyone has the right to make. One of the most dangerous ones I've seen is assuming revenue will continue growing at ridiculous rates, then assuming the operating margins or net margins will expand.

Could this happen?

Sure.

Will it happen?

Unlikely.

I prefer to skip making too many assumptions. So please still use revenue growth as your first tool. But I cannot stress this enough: **do not stop digging after looking at revenue growth!** There are simply too many businesses that ride short-term tailwinds, which boost revenue growth, then fizzle out.

So look for revenue growth rates that are sustainable through capital cycles.

This is far more important than finding super-high growth rates. If you don't take this advice, you'll learn some very expensive lessons. Don't be the leveraged cowboy who pays 100x revenues for an unprofitable business that goes bankrupt.

Let's look at an idea that burned many investors in 2022.

Let's go with Carvana $CVNA. This was an idea I actually spent some time on because an investor I highly respect, Robert Vinall, invested a hefty sum into this business for his fund. I just couldn't get to a point where I was comfortable with his assumptions.

This isn't to crap on Robert Vinall; I still highly respect his work.

But realize that by making fewer assumptions, I think you lower your risk significantly. In 2021 investors were paying up to 8.4x revenue for an unprofitable business in Carvana. This isn't even that high compared to other businesses, but it stresses two important points I am trying to make.

1. Revenue increased from $5.5 billion in 2020 to $12.5 billion in 2021. Buying a business with super high revenue growth like this can be dangerous because the market will likely assume the growth rate will continue at unsustainable rates. And so, they price the business to perfection.
2. Net profit margins were supposed to go up for the business. Instead, they have gone from -1% in 2021 to a trailing twelve months of -6%.

I have no opinion on Carvana other than what is written above, but the point remains: **do not buy businesses with sky-high revenue growth rates at high revenue multiples.**

Your revenue growth goal should be to ensure it meets your hurdle rate.

Make sure to note that if it's way above your hurdle rate, that could actually be a reason to skip.

Net Income Growth

Net income growth is the lesser-used and equally abused little brother of revenue growth.

But it should have a much higher importance than revenue growth. **A business with a net income means they have solved the profitability equation with the economics of its business.** It means:

- Their cost of revenues isn't too high
- Operating expenses are under control
- They can easily cover interest and taxes

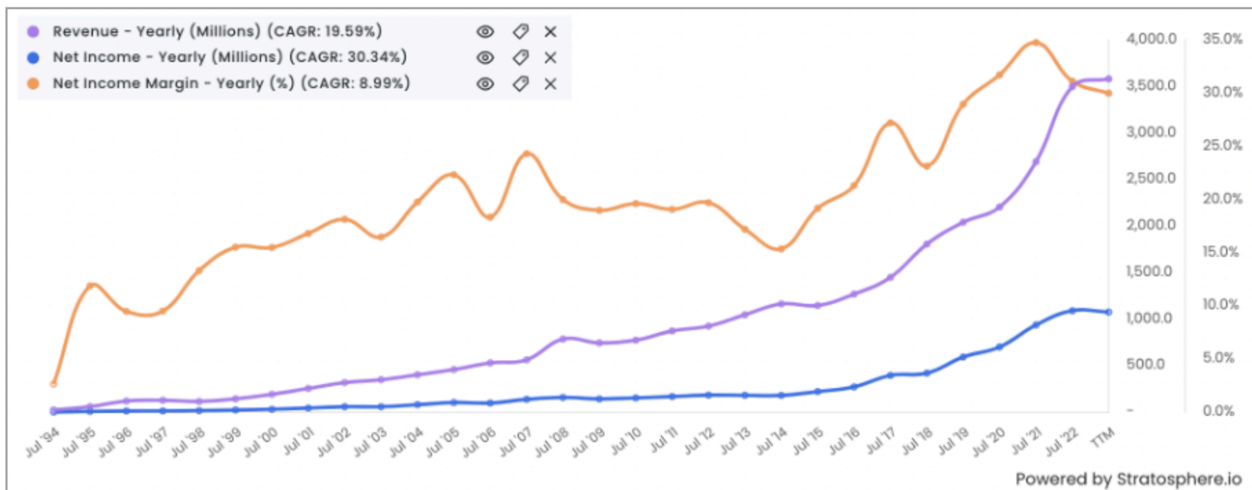
When you prioritize net income growth over revenue growth, you'll notice a few things.

You won't find as many businesses that can enter your portfolio as you thought. Many high-revenue growth businesses have 0 income growth (or negative net income). This means they are unprofitable. My investing style keeps me sticking exclusively with profitable businesses. Even if revenue growth is likely to be sky-high for a long time, it's not interesting to me if the business cannot generate income.

Don't make the mistake of ignoring this important metric.

Another interesting thing that can happen is that a business can produce massive shareholder value by increasing net income faster than revenue growth. This means their margins are increasing, which is always positive (as long as it's long-term sustainable).

A great example of this is Copart.



Revenue CAGR is still nice and healthy at 19.6%. But net income CAGR is growing at a 30.3% clip. This is because the Net Income Margin continues to expand slowly. This is due to various reasons, particularly their distribution model. As its Net Income grows, it can do things cheaper than competitors. This then shows up in increasing profit margins.

This means that even if a revenue growth rate doesn't meet your benchmarks, you might want to take the extra step and look at net income growth to see if the stock is worth further research.

Earnings Per Share Growth

Too many investors spend time looking at increased revenues and net income and then ignore if the increased growth is actually adding shareholder value.

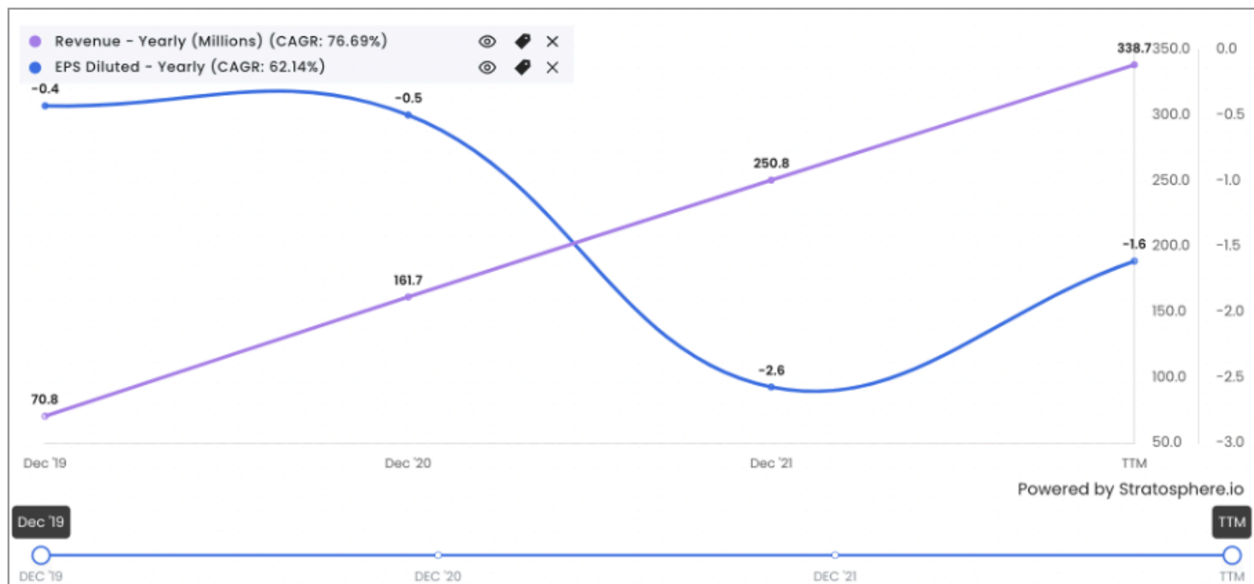
When you see revenue and net income growing at good rates, you're on the right track. Now you want to make sure this growth is being fuelled by the business and not by bringing in outside equity owners. They can cause massive dilution to the top and bottom lines.

Suppose you find a "wonderful" business with growing revenues and a net income of 20% over the past five years.

That's great, but then you check out EPS growth. It's only 3%. This indicates that the business has probably diluted its shareholders for acquisitions. The acquisition increased the top and bottom lines, but the deal to acquire them wasn't accretive to shareholders. This often happens when shares are distributed to the acquired businesses yearly for a predetermined amount of time.

It will be up to you to determine if the share dilution will stop and if EPS growth will once again be kicked up into high gear.

A good case study in this is Duolingo. Duolingo has seen tremendous top-line growth over the past few years. Yet this top-line growth has done nothing to increase the per-share value of earnings.



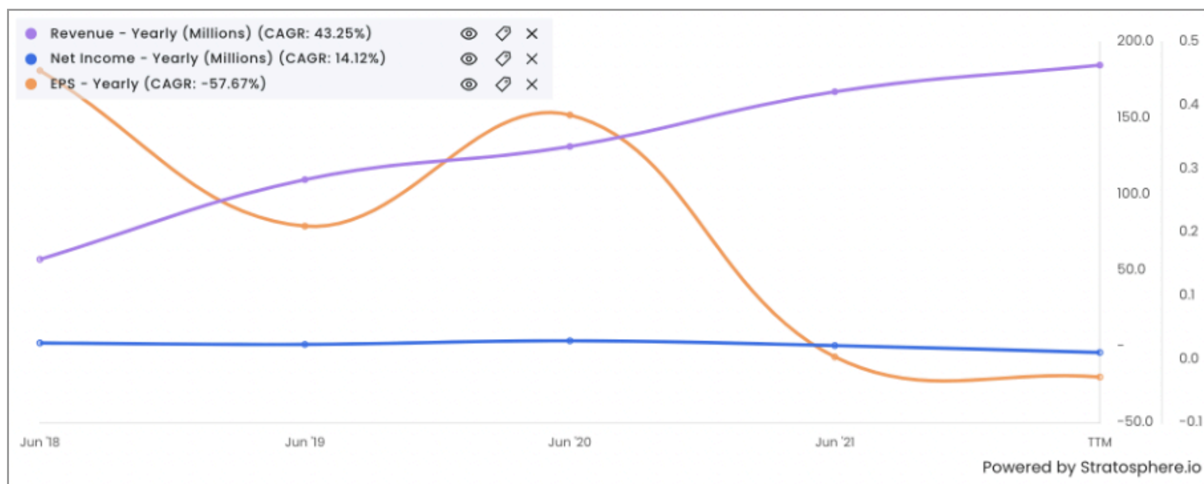
I barely know anything about this business. But I am instantly turned off by the lack of increase in the per-share value.

Another great case study involves a mistake I made myself.

I made a mistake on a business called Sangoma ($STC.V, $SANG). I initially thought that the revenue increases would continue for a long time. I also thought they had a decent chance of being near the top of the market in a few years' time.

Sangoma purchased another company that had good synergies with them. And when I saw how the deal was structured, I concluded that, yes, the top line would increase. Even that, maybe the bottom line would increase too.

The problem was the number of shares they distributed to the acquired company. It basically cut my ownership stake in half. So although revenue and net income would grow, because my ownership stake was cut in half, I now only owned half of the business's profits. So even if profits doubled, I'd still have the same value as I did before the deal was consummated.



I exited this investment at a small gain once I realized my mistake.

I hope you will avoid making these mistakes by utilizing the tools in this guide! I've learned a lot from my mistakes when investing in this company. EPS matters; make sure growth will result in EPS growth at an acceptable rate, or take a pass.

Free Cash Flow Growth

Free cash flow will always reign supreme in the investing world.

Yet, look at how investors have propped up the prices of high-tech names in 2020 and 2021. If we invert the process they took to convince themselves to buy these companies, they clearly did not use FCF as a valuable metric to base their thesis.

Do not make this mistake.

Businesses that produce FCF have a moat and competitive advantages. There is a reason they don't need to spend money to produce cash. There is a reason they don't need to spend too much capital to keep gushing cash. When a business doesn't have FCF, you can't come to the same conclusions.

Look at a company like Berkshire Hathaway.

The entire business has been built from finding FCF-generating subsidiaries. These private businesses produce so much FCF that they can write cheques to their parent company. Then you get the best capital allocators of all time, Warren Buffett and Charlie Munger, to re-distribute this cash into more private and public investments (which also produce a tonne of cash).

Then when you add Berkshire's dividend payments from its publicly owned businesses, you supercharge the amount of capital they can reinvest.

Return on Invested Capital

If I had to pick only one number to filter out poor businesses, it would be ROIC.

Most retail investors have yet to learn what this metric even means. ROIC shows you how much return the business generates from its capital base.

Let's go over a simple example that I would use to try to explain it to a five-year-old.

You're a 5-year-old boy or girl, and you're looking to purchase a friend's lemonade stand, which has recently gone public.

You've narrowed it down to 2 choices — Sam's business or Lauren's business. To make your decision, you want to find out the ROIC of each business. You come up with a great little chart showing the difference in the businesses as they both earn $1.00 in EPS or Earnings per share.

	Sam	Lauren
Current EPS	$1.00	$1.00
Desired EPS Growth Rate	5.00%	5.00%
Return on Invested Capital (ROIC)	20.00%	10.00%
Reinvestment Rate (Retained earnings / Net Income)	25.00%	50.00%
Growth	5.00%	5.00%
Left for distributions (1 - Reinvestment Rate)	75.00%	50.00%
Free cash flow per $1 of EPS	$0.75	$0.50

Sam's business has a higher ROIC, so you are leaning towards buying shares in that business.

At the surface level, we can see that a business with a higher ROIC can produce larger amounts of FCF. As we previously discussed, FCF is king. If the business with a higher ROIC will produce more FCF over a long period than an alternative, that's the business that will be more valuable. Since we aim to make money, we are almost ready to pull the trigger and put some of our hard-earned "allowances" into Sam's business.

After checking the ROIC, we then have to ask an additional question.

We need to know if the ROIC of Sam's businesses isn't being propped up by short-term tailwinds. If we aren't going to get a 20% ROIC continually, then our returns will actually be subpar once the ROIC drops. If Sam were to get 20% ROIC one year, then it would drop to low single digits over the next nine years, and we aren't going to be very happy.

So, when comparing businesses based on ROIC, you must consider how sustainable the ROIC number is.

If you don't think that ROIC is sustainable, you won't get an accurate picture of which is the better business. But let's conclude this section by saying that Sam's ROIC seems sustainable. He has a deal with a lemonade powder distributor where he can get prices much cheaper than Lauren. You deem it impossible for Lauren ever to get the prices that Sam is getting, and the ROIC for Sam seems like it's going to be sustainable.

Okay, maybe that explanation wouldn't work for a 5-year-old, but I think you get the point.

1. Place a large emphasis on a business's earnings and a high and sustainable ROIC.
2. As you dive deeper down the rabbit hole, ensure this ROIC isn't a one-time occurrence that will regress.

Debt

You should have a quick way to look at the debt that will show you the financial health of a business.

The metrics I like to look at for this are long-term debt / free cash flow. I'm looking for a number under 3. So if a business has $10,000,000 in debt, I would deem them healthy if free cash flow was $3,333,333.33 or higher. How do I get these numbers? $10,000,000 / 3 = $3,333,333.33.

The other way to look at this is to check the current FCF.

If a business currently produces $1,000,000 in FCF, I can multiply that number by 3. I get $3,000,000. Then I check long-term debt, and as long as it's under $3,000,000, I'm happy with that debt situation.

Why is this number important?

It just means that a business could easily pay off the debt within 3 years using funds from the business. No debt is needed. No need to sell off valuable assets. 3 years is a good time because it decreases bankruptcy risk while allowing you to buy companies that use leverage intelligently.

Debt isn't bad when it's allocated properly into a wonderful business by great management teams.

The mistake that some people make is buying companies that require lots of debt in order to operate and grow. This is where the danger comes into play.

If a business is heavily leveraged, it means that one bad year, where they can't cover interest expenses, could bankrupt the business.

> ***GOLDEN NUGGET***
>
> Not losing money should be the primary objective of your investing. So do yourself a favor and find a number you find comfortable. Use that to make sure you aren't putting yourself in danger of losing money. Many great investors have had their investments go to zero. If they had been using a filter such as this, they would've saved themselves a lot of money.

One miscalculation I made in this arena was with a business called Bausch Health Companies Inc. ($BHC.TO).

I made many errors in this business, but the company's debt issue was arguably the biggest.

First of all, the business wasn't even profitable. That should've been my first prompt to tell me to forget it. But I didn't.

Secondly, the businesses used EBITDA / Net Debt to discuss their debt situation. The problem is that EBITDA isn't money the business can readily use to pay down debt. There are numerous other expenses the business has to spend this money on. Thirdly, even if I did choose to use EBITDA / Net Debt when I bought the business, it had $676 million in EBITDA and $24 billion in long-term debt. These numbers don't get me anywhere close to paying off that debt in 3 years.

I exited this investment at a loss and learned my lesson!

Shares Outstanding

This metric is important for various reasons I've discussed above.

Your main focus should be that when a company has a change in shares outstanding (S/O), it's doing something good for the company. Like my Sangoma example explained, the business was going through massive growth in its top and bottom lines, but this wasn't accretive to shareholders due to the stock dilution. It had the function of looking good to the unsophisticated but not really adding any value **to the wise investor** in the long run.

There are three things you should look at when you look at a company's shares outstanding (S/O):

1. If S/O is increasing, you want to make sure this is creating some sort of shareholder value.
2. If S/O is going down, you want to ensure the buybacks are being bought at a price that makes sense.
3. If S/O is staying steady, you want to ensure they are using that capital intelligently rather than spending it on buybacks!

> ***GOLDEN NUGGET***
>
> If you made a rule never to buy businesses where the share count goes up, you'd probably do well.
>
> I cannot see a massive flaw in this reasoning. Yes, it would eliminate a heck of a lot of companies from your investable universe. But if you look at the three points above about s/o, you can see that just because a business has an increasing share count does not mean the business is necessarily worse off.

Let's use an example like InMode $INMD.

This is a business that has been dilutive due to stock-based compensation payments made over the years. In 2017 they had 63.9 million S/O. Currently, they have 82.7 million S/O.This is a 5.56% compounded annual growth rate in S/O. Usually, this would be a major red flag. But then you look at the business's growth over these years in terms of revenue and EPS.

You can clearly see that the dilution didn't destroy shareholder value.

It created shareholder value. SBC is used to retain talent. And the personnel they've kept around have done an incredible job increasing revenue and profits for shareholders.

Insider Ownership

The final metric we want to look at is insider ownership, which tells us whether or not management has skin in the game.

We want management to be incentivized to increase the per-share value of the business they are working in. If an executive has no shares in the business, they are just working for a pay cheque. If they earn fat bonuses for doing foolish short-term things like rapidly increasing profits (at the expense of the long-term), you will want to be heading for the exit.

This happens all the time.

Some companies will give bonuses to their executives if they increase EPS. On paper, this seems like a good idea.

The problem is that management can go out and buy a company at an outrageous price, which instantly adds EPS to their company. So short term, maybe management can double EPS. In the meantime, they earn a $20 million bonus cheque. Shareholders are happy for the moment.

The next year, the business they acquired for way too much money began to be a drain on the parent company. They begin losing money.

Now you have a larger debt pile, and the EPS begins to fade.

The CEO got paid for making a short-term decision. But they are not punished for the transgressions of this decision in the long run. Perhaps they will receive a smaller bonus check the next year, but they are still getting paid.

Contrast that with a business where the CEO owns 20% of the company.

His entire net worth is in the company that he created. If he does the right things and the business increases in value over a long period, both he and the company's shareholders will be happy. If he does something to hurt the business, he will suffer because his stock holdings will be worth less.

This is the alignment you want with management.

Although there are more complicated things to discuss when management owns too much of a stock, that's outside the scope of this book.

Mistakes I've made:

I've made numerous mistakes that have cost me $1000s while running these tools.

These mistakes include:

- Being too undisciplined
- Allowing FOMO to skip steps,
- Thinking I'll "remember" the numbers,
- Not writing my ideas on cloud software,
- Spending time looking at an opportunity out of "moral" responsibility to a friend/person you respect

The fact is:

- You won't remember the growth metrics of 10-20 different companies unless you have a photographic memory.
- You won't remember where you placed your data if you don't have a dedicated place to store your notes.
- You might be undisciplined and skip certain metrics that don't meet your hurdle rates.
- Fear of missing out might kick your analytical framework to the curb, and you'll skip using it entirely.
- A good investor you follow might buy a stock, and you end up skipping your analytical tools to allow you to buy it when it doesn't pass the filters.

> ***GOLDEN NUGGET***
>
> If you want to succeed in investing, you should avoid these mistakes as much as possible. So make sure you use these tools. Be a disciplined analyzer as well. Just because everyone is talking about a specific stock does not mean it belongs in your portfolio.
>
> If the numbers don't meet or exceed your benchmarks, then taking a pass is a completely logical move.

Creating Benchmarks For Each Tool

Why is it important to have benchmarks for each number?

Because following them will make it so you don't make big mistakes. Mistakes the market makes regularly include:

- Jumping from one investment style to another as regularly as the sun rises and sets
- Loosening their discipline to fit a company into their portfolio even though they know it doesn't meet their hurdle rates
- Allowing themselves to get swept away by a story/meme stock

The reason these benchmarks work is they help prevent you from allowing your emotions to make your decisions.

Now you know what each tool is.

You'll need to know what these numbers should be for them to be useful. I'm writing this guide through the lens of finding high-quality companies.

I will show you the levels I like to use to find the highest quality companies to put into my portfolio. If you want to alter them to fit your own needs, then feel free to alter them. The higher your benchmarks, the fewer companies will clear your benchmarks. So if you want to be super picky, increase your benchmarks. If your desired rate of return is less, you can lower your hurdle rates so more businesses pass your filter.

No matter what numbers you decide to use, just try and be consistent. Try not to be strict one day, then reduce your benchmarks just to "fit a square peg into a round hole."

If you do this, you will make expensive mistakes.

My goal is to make 15% returns in the long run. So keep that in mind if you decide to alter the numbers. If you desire higher returns, increase the benchmarks. If you desire lower returns, you can use lower hurdles.

These are the benchmark numbers that I look for when a business I've never heard of comes into my radar:

- Revenue Growth - 15%+ CAGR
- Net Income Growth - 15%+ CAGR
- EPS Growth - 15%+ CAGR
- FCF Growth - 15%+ CAGR
- ROIC - 15%+
- Debt Structure - 3x FCF/Long-term Debt
- Shares Outstanding - >1% CAGR
- Insider Ownership - 5%+

You'll notice a lot of the numbers align with my desired rate of return.

That's because the stock price will follow intrinsic value. And if the business's intrinsic value is increasing at 15%, I think there's a good chance that the stock price will follow suit (over long periods of time). If you use this strategy for only the short term, you'll be disappointed. Nobody can predict what a stock will do in a given year. But over longer holding periods, a stock goes up at a rate that approximates its increase in intrinsic value.

It is up to you if you want to but super strict on all these numbers or just a select few.

The Most Important Benchmark Of Them All

The most important number is probably not what you think.

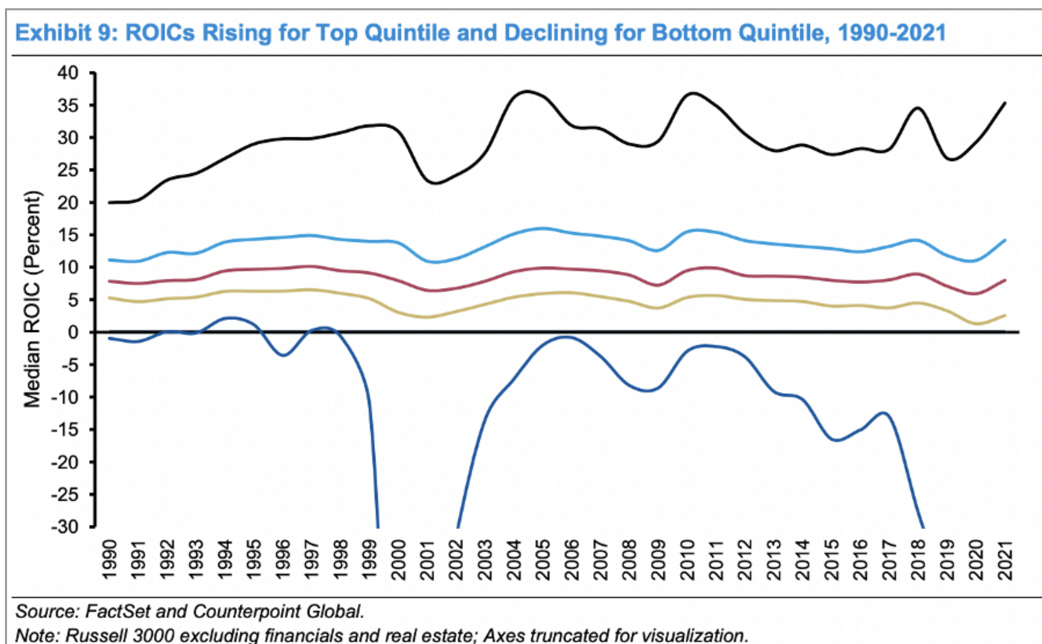
If you guessed "revenue growth," I got a dunce cap waiting for you in the corner!

The number that I think is non-negotiable is returns on invested capital (ROIC).

The reason is simple. High ROIC companies generate higher returns. Businesses that have higher returns generally have higher growth rates in profits.

Let's let Michael J. Mauboussin explain this as he can do a much better job than I can:

> *"Exhibit 9 shows the ROIC over time broken down by quintile. Here, we re-sort the population of companies into quintiles each year and measure the median of each over time. While each series bounces around, the median ROIC rises substantially for the top quintile and drops meaningfully for the bottom quintile from 1990 to 2021. The middle three quintiles remain relatively stable."*



"The rise of intangible investment may help explain the results for the top and bottom quintiles. Firms with high ROICs, sometimes called 'superstar' firms, have been the most aggressive in investing in intangible assets. Including internal investments in intangibles would lower the ROICs for many of these companies.

Exhibit 10 shows the distribution of economic profit for companies in the Russell 3000. Here, we broke the universe into deciles for each year from 2017 to 2021. We calculated the sum of economic profit for all companies in each decile and adjusted the totals for inflation. We then took the average of those sums over the five years.

The tails are heavy as they are with the distribution of ROICs. The top decile of companies created $675 billion of economic profit, the bottom decile destroyed $220 billion of value, and the middle 80 percent contributed only $70 billion. During this period, Apple, Microsoft, and Alphabet combined produced $120 billion of economic profit, or about one-fifth of the total amount."

"The percentage of companies losing money is substantially higher today than in 1990. Companies can be unprofitable because their costs are greater than their sales. Companies can also lose money due to substantial intangible investments that will pay off handsomely. These companies may have poor ROICs before

adjusting for intangible investments but look substantially better after properly reckoning for them."

What his data is saying is that the businesses that have the highest ROICs are the businesses that generate the highest economic profit. If you believe businesses that generate high economic profit are likely also to have great share price appreciation, you can see why this number is so important!

If you want an example of this in real life, I ran some quick numbers in mid-2022 on two American businesses. One great one in Apple. And one former great one in General Motors. Here are my findings.

	ROIC Median (2008-TTM)	**Return CAGR (Share Price Only)**	**Dividend Yield**	**Total Return**
Apple	23.20%	32.80%	1.81%	34.61%
General Motors	6.10%	-0.70%	4.28%	3.58%

(https://www.nasdaq.com/articles/why-return-on-invested-capital-is-the-most-important-investing-metric)

You can see that total returns approximate ROIC. It's not an exact science. As you can see, the numbers aren't direct mirrors. But you can clearly see that the business with the higher ROIC had much higher returns.

Let's look at why high ROIC generates higher profits for business and why you should be making ROIC a high-priority number.

We'll look at two hypothetical companies for this example. One business will have a 10% ROIC with a 100% reinvestment rate. The other will have a 20% ROIC with a 100% reinvestment rate. They both start with $1 in EPS. We can assume the following:

- No changes in shares outstanding
- No buybacks

Here is the 10-year outlook for a business earning 10% ROIC:

10% ROIC Business. Retained Earnings Rate 100%			
Year	**ROIC**	**EPS**	**Retained Earnings**
		$1.00	$1.00
2023	10.00%	$1.10	$1.10
2024	10.00%	$1.21	$1.21
2025	10.00%	$1.33	$1.33
2026	10.00%	$1.46	$1.46
2027	10.00%	$1.61	$1.61
2028	10.00%	$1.77	$1.77
2029	10.00%	$1.95	$1.95
2030	10.00%	$2.14	$2.14
2031	10.00%	$2.36	$2.36
2032	10.00%	$2.59	$2.59
2033	10.00%	**$2.85**	$2.85
Total Return			285.31%
Compound Annual Gain			11.04%

Now, here is the 10-year outlook for a business earning 20% ROIC:

20% ROIC Business. Retained Earnings Rate 100%			
Year	**ROIC**	**EPS**	**Retained Earnings**
		$1.00	$1.00
2023	20.00%	$1.20	$1.20
2024	20.00%	$1.44	$1.44
2025	20.00%	$1.73	$1.73
2026	20.00%	$2.07	$2.07
2027	20.00%	$2.49	$2.49
2028	20.00%	$2.99	$2.99
2029	20.00%	$3.58	$3.58
2030	20.00%	$4.30	$4.30
2031	20.00%	$5.16	$5.16
2032	20.00%	$6.19	$6.19
2033	20.00%	**$7.43**	$7.43
Total Return			743.01%
Compound Annual Gain			22.20%

Charlie Munger said:

> *"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you're not going to make much difference than a 6% return—even if you originally bought it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive-looking price, you'll end up with a fine result."*

When you look at the compound annual gain figures above, you can see that he most definitely is correct. The businesses above aren't using any debt to grow, just reinvested earnings. If a business were to use debt, it could add a few percentage points to returns.

Where To Find These Metrics

There are two ways to find these numbers, but only one will get you to the promised land in 5 minutes or less.

The two ways:

1. Calculate these numbers from official documents (SEDAR, SEC, Etc.)
2. Use a tool that does all this for you.

I prefer option 2 to save time. There is one small downside to using this method. Sometimes the numbers might not align with the numbers you get from official documents. This can be because the equations, exchange rates, and mistakes are different. I still prefer option 2.

During the analysis period, after you think you have a winner, you can start running numbers from official documents to see that the numbers are all exact or in the right vicinity or reality.

On top of saving time, you'll get a neat dashboard view of what you need to see to pass or fail an incoming business.

Free Tools

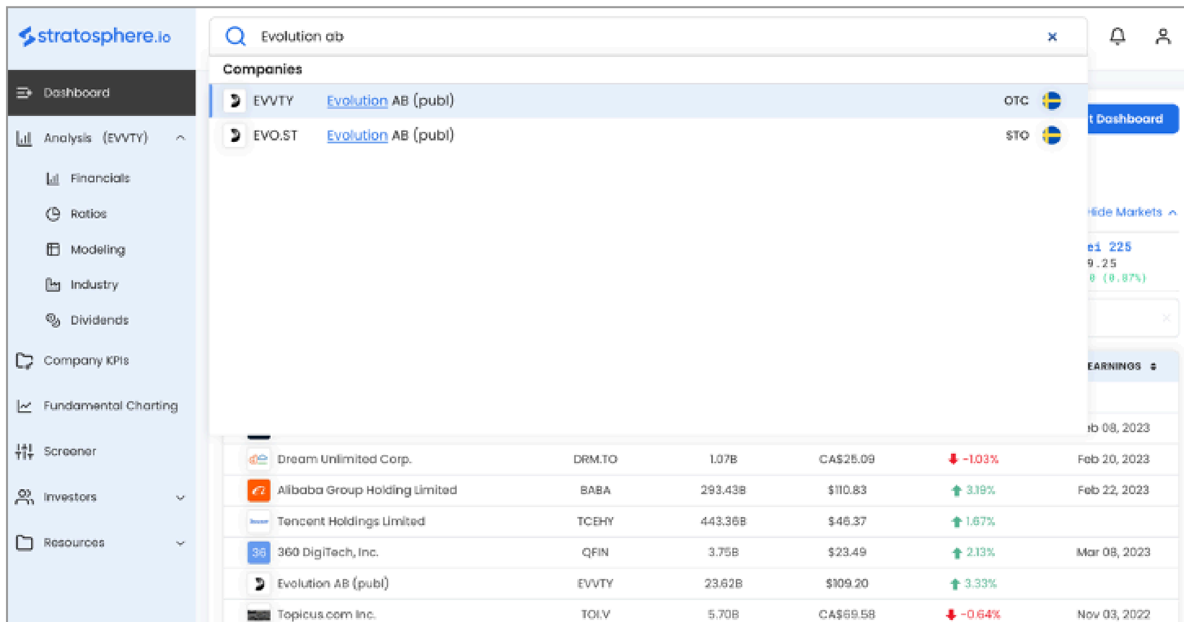
The best free tool I've seen is Stratosphere.io.

There's one other tool you can use for insider ownership I'll go over as well.

Stratosphere.io is so good because you can load up all the metrics I've outlined in one easy-to-use chart.

Here is how to do it, step-by-step:

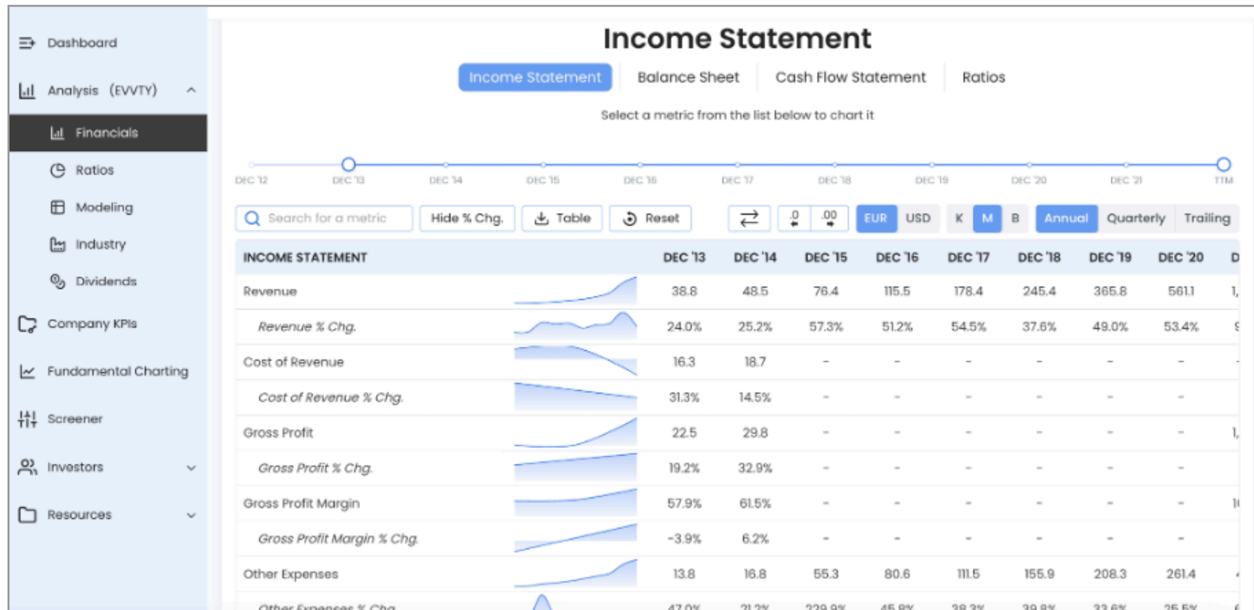
Enter the name of the business you want to analyze. In this example, we'll use Evolution AB. We'll use $EVVTY.



Now we build out our chart, which gives you all the CAGRs you need to see if they pass your benchmarks. Here they are again, along with where you can find them in the Stratosphere dashboard:

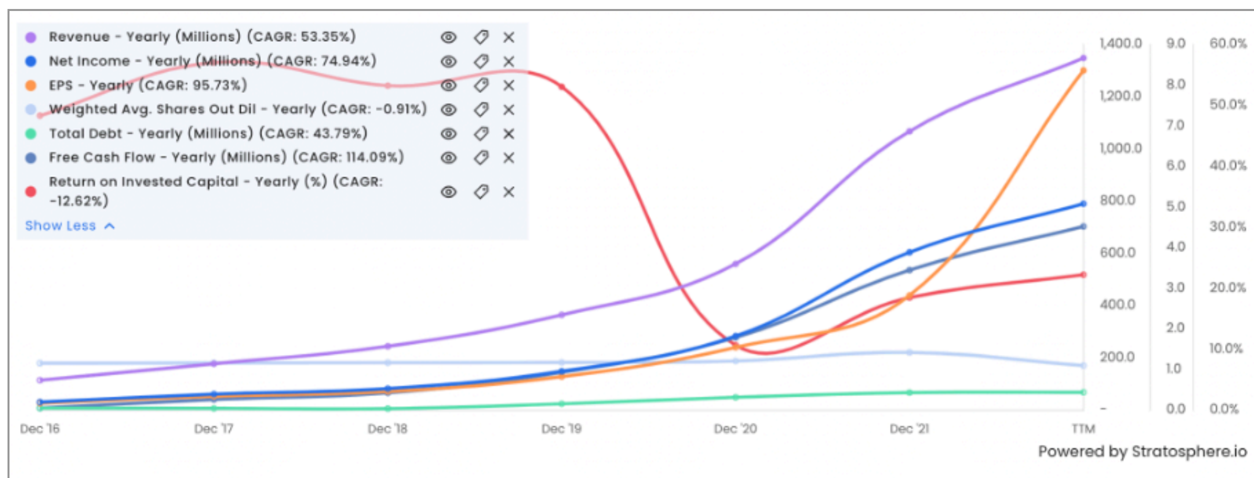
- Revenue Growth (Income Statement > Revenue)
- Net Income Growth (Income Statement > Net Income)
- EPS Growth (Income Statement > EPS)
- FCF Growth (Cash Flow Statement > Free Cash Flow)
- ROIC (Ratios > Capital Efficiency > Return On Invested Capital)
- Debt (Balance Sheet > Liabilities > Long-term Debt)
- Shares Outstanding (Income Statement > Income Statement > Weighted Average Shares Out)
- Insider Ownership (Requires a different tool, unfortunately)

Here is a sample of where I'd find Revenue:



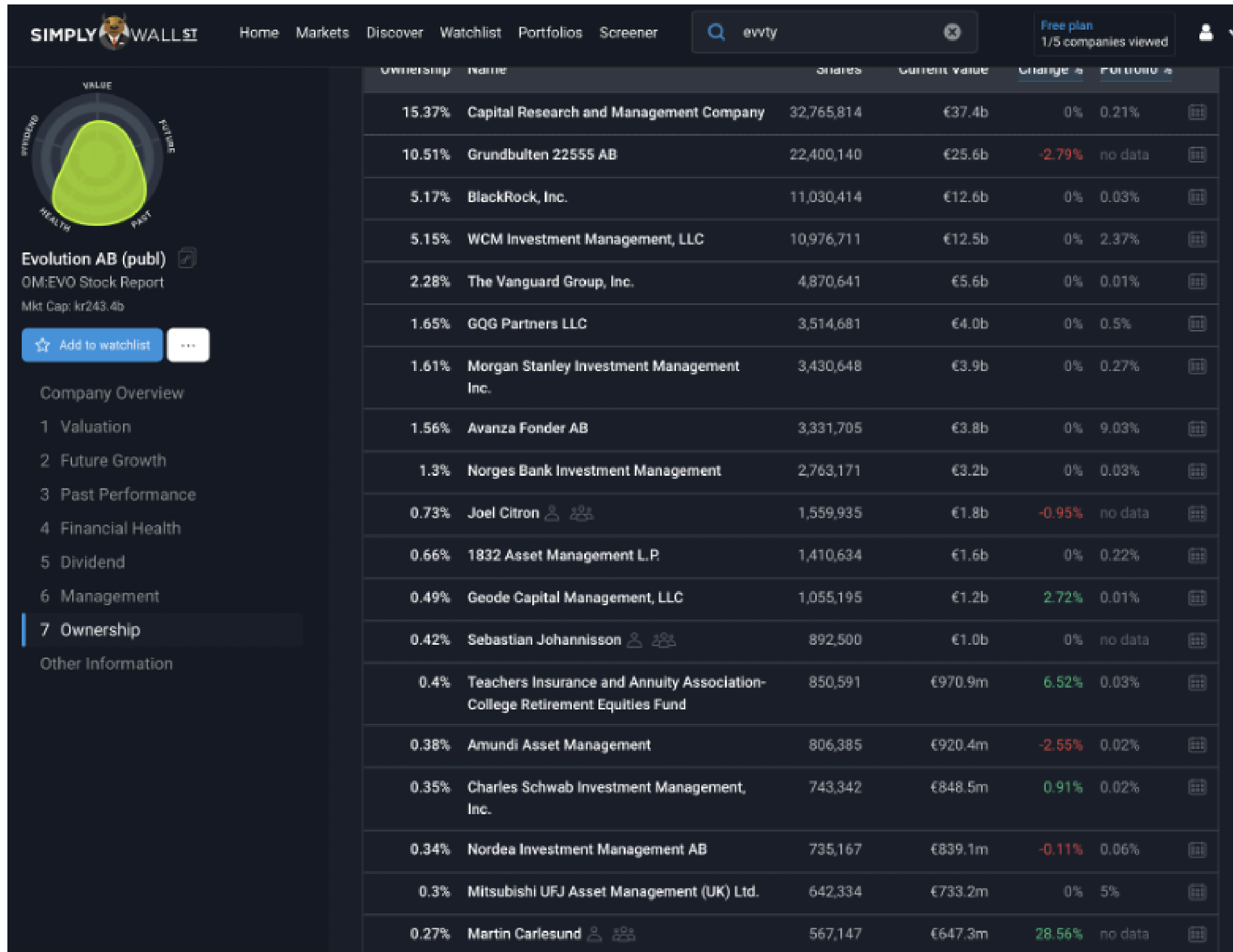
INCOME STATEMENT	DEC '13	DEC '14	DEC '15	DEC '16	DEC '17	DEC '18	DEC '19	DEC '20
Revenue	38.8	48.5	76.4	115.5	178.4	245.4	365.8	561.1
Revenue % Chg.	24.0%	25.2%	57.3%	51.2%	54.5%	37.6%	49.0%	53.4%
Cost of Revenue	16.3	18.7	-	-	-	-	-	-
Cost of Revenue % Chg.	31.3%	14.5%	-	-	-	-	-	-
Gross Profit	22.5	29.8	-	-	-	-	-	-
Gross Profit % Chg.	19.2%	32.9%	-	-	-	-	-	-
Gross Profit Margin	57.9%	61.5%	-	-	-	-	-	-
Gross Profit Margin % Chg.	-3.9%	6.2%	-	-	-	-	-	-
Other Expenses	13.8	16.8	55.3	80.6	111.5	155.9	208.3	261.4
Other Expenses % Chg.	47.0%	21.2%	229.9%	45.8%	38.3%	39.8%	33.6%	25.5%

Here is what the graph would look like when it's all complete:



I timed myself getting these numbers, which took me 43 seconds.

Next, we need to get some info on insider ownership. For that, we must use another tool Simply Wall Street. This tool gives you a really good look at insider ownership and, as a bonus, if insiders are buying or selling in the last year.



Ownership	Name	Shares	Current Value	Change %	Portfolio %
15.37%	Capital Research and Management Company	32,765,814	€37.4b	0%	0.21%
10.51%	Grundbulten 22555 AB	22,400,140	€25.6b	-2.79%	no data
5.17%	BlackRock, Inc.	11,030,414	€12.6b	0%	0.03%
5.15%	WCM Investment Management, LLC	10,976,711	€12.5b	0%	2.37%
2.28%	The Vanguard Group, Inc.	4,870,641	€5.6b	0%	0.01%
1.65%	GQG Partners LLC	3,514,681	€4.0b	0%	0.5%
1.61%	Morgan Stanley Investment Management Inc.	3,430,648	€3.9b	0%	0.27%
1.56%	Avanza Fonder AB	3,331,705	€3.8b	0%	9.03%
1.3%	Norges Bank Investment Management	2,763,171	€3.2b	0%	0.03%
0.73%	Joel Citron	1,559,935	€1.8b	-0.95%	no data
0.66%	1832 Asset Management L.P.	1,410,634	€1.6b	0%	0.22%
0.49%	Geode Capital Management, LLC	1,055,195	€1.2b	2.72%	0.01%
0.42%	Sebastian Johannisson	892,500	€1.0b	0%	no data
0.4%	Teachers Insurance and Annuity Association-College Retirement Equities Fund	850,591	€970.9m	6.52%	0.03%
0.38%	Amundi Asset Management	806,385	€920.4m	-2.55%	0.02%
0.35%	Charles Schwab Investment Management, Inc.	743,342	€848.5m	0.91%	0.02%
0.34%	Nordea Investment Management AB	735,167	€839.1m	-0.11%	0.06%
0.3%	Mitsubishi UFJ Asset Management (UK) Ltd.	642,334	€733.2m	0%	5%
0.27%	Martin Carlesund	567,147	€647.3m	28.56%	no data

That's all you need to do!

You need to follow a few tips when using these tools:

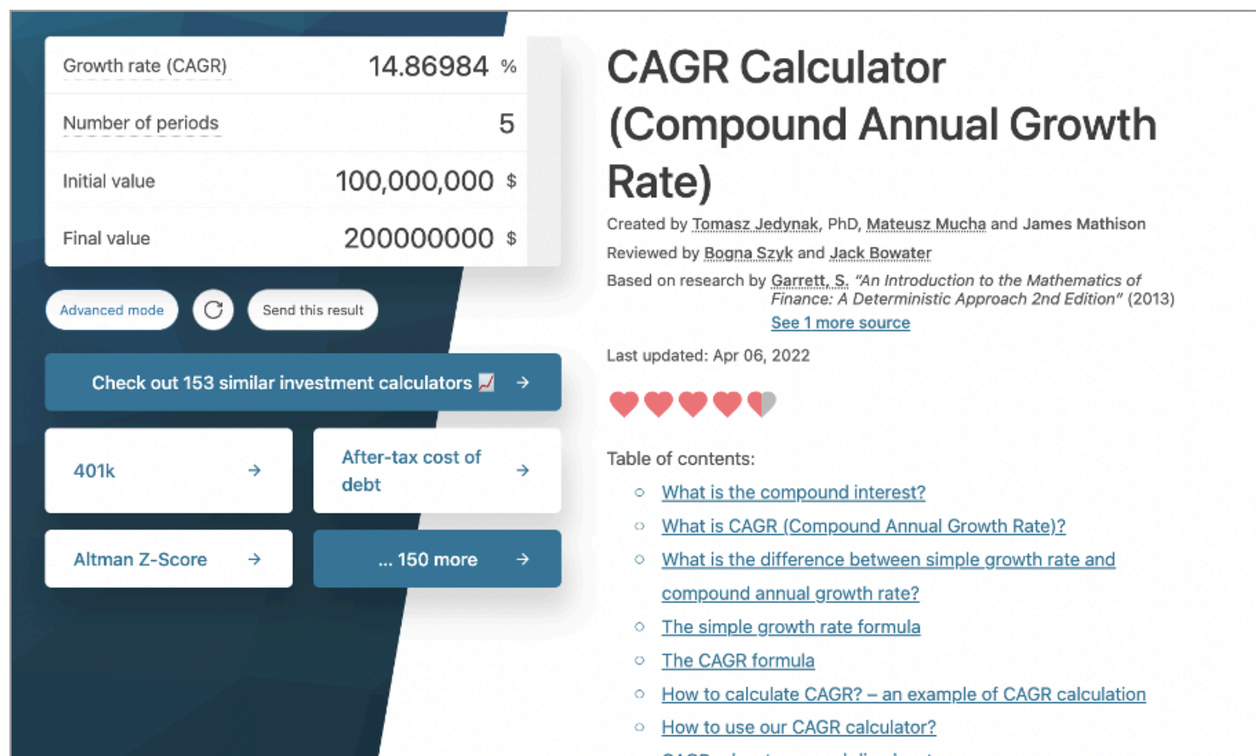
Once you have an idea you like the company, some official docs as you deep dive to confirm the numbers are correct. You want to be 100% sure your numbers are reasonably accurate and aren't painting a picture that is not true. I haven't encountered this issue yet (in a major way), but you never know. Always fact-check.

What do you do in the case that the numbers are inaccurate?

First, I'd shoot an e-mail to Stratospher.io as they try to maintain up-to-date and accurate numbers. Your next step would be to calculate these manually.

The simplest way to do this would be to use my favorite CAGR tool. All you need is the starting number, the ending number, and the periods between, and you have your CAGR.

Fair warning, if you have to do these numbers manually, you probably won't be able to finish them in 5 minutes, but I want to show you how you'd find the CAGR numbers anyway! Hit this link. Let's say we have a business with a starting revenue of $100 m and an ending revenue of $200 m. There are five periods between the first and second numbers.



Bang, we know our CAGR for that metric is 15%!

Applying the Analytical Tools To Incoming Ideas

Now, let's go over from start to finish what it looks like using this filter on incoming ideas or pitches.

5 Steps to Cementing Your Idea

STEP 1: The idea comes to you.

You find the idea from something like Twitter, Commonstock, Seeking Alpha, Value Investors Club, Etc. The business looks interesting, but you want to see if the business meets your hurdle rates.

STEP 2: You run the filter using Stratosphere.io.

You do the steps on Stratosphere.io to find the necessary numbers you want to see. From here, everything is passing your hurdle rates. Great, move to insider ownership.

STEP 3: You run the business through insider ownership on Simply Wall Street.

We easily find out whether the insider ownership % meets or exceeds our hurdle rate. We also see insiders have been buying up stock. Another bonus!

STEP 4: You continue down the rabbit hole.

I'd suggest you first take screenshots of your chart and insider ownership for safekeeping.

This is where the real work begins. I won't be covering this in detail as entire books have been written on this. Even though you've only touched the tip of the iceberg, if you look at businesses this way, you are doing things differently than 99% of retail investors. It's an edge and will save you many headaches down the road!

Now that you have your data, you will want to…

STEP 5: Find a central location to store it.

Where to store your data?

I've used multiple tools in my investing career, and there are two I couldn't live without.

These two would be Google Sheets and Notion. I've also used Google Docs and Notes, but I don't think they are as robust as Sheets and Notion. That's just me. The only thing that matters at the end of the day is that you have some sort of ability to store your data.

I like storing it somewhere I can access it with my phone. Docs and Notion does that easily for me.

You want to store this so you can easily reference it. Once you dive down the rabbit hole, you should spend some time figuring out why the numbers are the way they are. A few checklist items off the top of my head would include:

- Why is revenue growing?
- Is net debt growing at scary levels?
- Is the ROIC sustainable in 5-10 years?
- How much stock do individual insiders own?
- Is FCF likely to continue growing at previous levels?
- Why is net income growing faster/slower than revenue?

My Journey with These Tools

Let me take you back to 2020, during the depths of the bear market in March and April.

Times were tough. I owned my own business and could not do any work because Covid shut down my "office." I had a side job that helped pay the bills. I began my adventure as a value investor at this point.

For the first few stocks I looked through, I basically just went A-Z on the Canadian index.

I tried making a spreadsheet with numbers I thought mattered (they didn't). I bought stocks just because I heard they were good from people I barely knew. It was easy to rationalize buying these things at the time. But now, when I look back at some of the names I bought, there is no way I would've ever bought them.

A few names:

- Air Canada
- Chorus Aviation
- TD Bank

TD is a solid company. However, I had no framework in place to filter out poor investment ideas. Luckily, I simply bought these when they were cheap. I was able to get out of those investments without a loss on any of them. If I had the framework I've gone over in this guide, there is no way these businesses would have ended up in my portfolio.

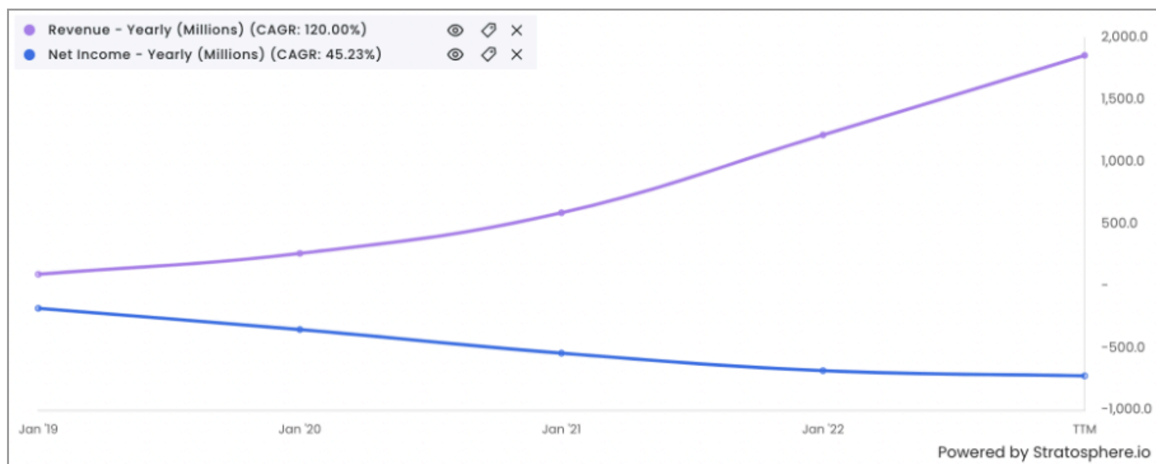
While it didn't cause me to lose money, this mistake had a large opportunity cost.

I bought my two best-performing holdings in the spring and summer of 2020. I could have allocated more capital to these positions, or maybe I would've uncovered some more great businesses to invest in. There was a lot of cheap stuff then that would've made a killing if held until now. As a result, I would have more money in great businesses that would have boosted my overall returns.

Another important way to triage your analysis to make it even faster (yes, it's possible) is to triage the numbers from least complex to most complex. I would go in the order I listed them in. You'll often find that you don't even need to go past Revenue and Net Income before you realize the stock isn't for you.

For instance, a business like Snowflake comes on my radar.

I start the process. I hit Revenue, and it looks really good. I hit Net Income, and I'm stopped dead in my tracks. Net income has decreased since 2019.



The instant I see this, I can forget about Snowflake. That took all of 10 seconds.

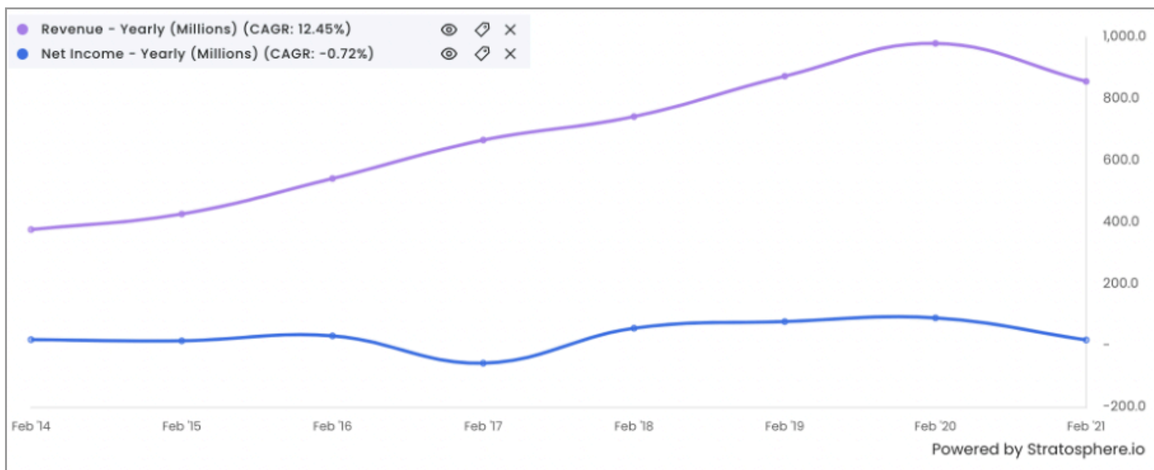
I've heard people say you will skip great opportunities if you do this. To that, I can't disagree. Some businesses might turn things around. If you were a specialist in the Snowflakes industry and had a clear vision of how they could turn it around, then perhaps you'd skip the profitability portions of the screen.

Just realize you'll be increasing risk unless you have some serious insights.

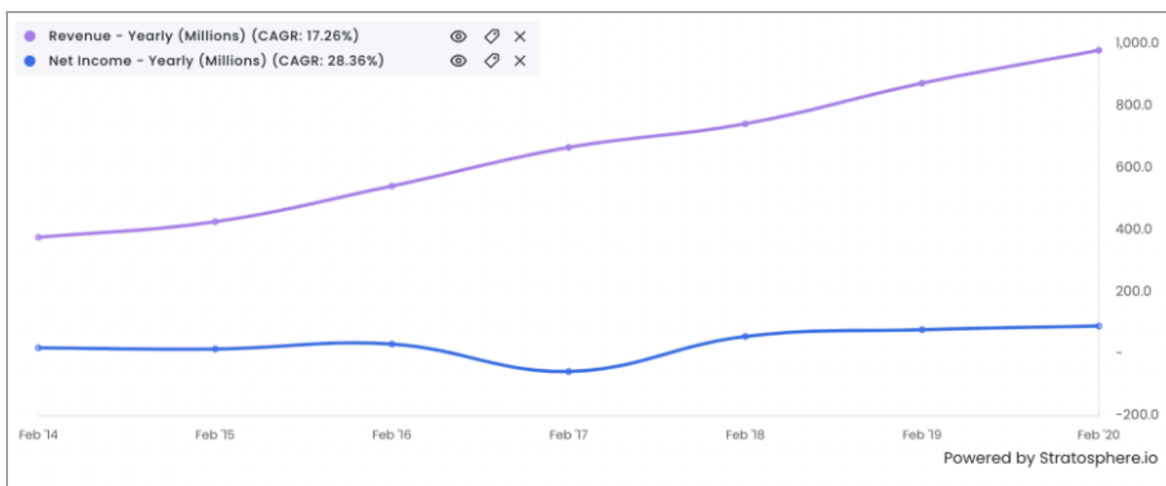
Another common issue is that a business has a horrible year that drops its numbers significantly. You understand the business well enough to see that this is just a short-term headwind. In that case, you can choose to remove that year from your analysis. Again, when you do this, you increase risk; this is where having an understanding of the business is a must.

You will only know if a problem is short-term if you truly understand the business.

Here are two graphs to illustrate this point. Aritzia with 2021 as the final year vs. Aritzia with 2020 as the final year.



In this example, if I had the 15% hurdles in revenue and net income. Look at the CAGRs and how low they are. But If I understood that fiscal 2021 was likely to be an outlier year and removed it, things look much different.



When I remove the one-off bad year of business, things look great.

I can't stress the importance of knowing the business well enough to make this adjustment. If you arbitrarily remove a bad year, make sure you have high levels of conviction that things will return to normal.

Otherwise, you're playing with fire.

The other strategy you can do is simply add a business like this to your watchlist and wait. If there is a metric you're not sure can come back up, give the business a few quarters or years to see if it can get back above your benchmark. It will end up either meeting your benchmarks or not.

Just because a business comes on your radar does not mean you have to go out and buy it tomorrow.

Take your time. Learn the intricacies of the business, its competitors, and its industry. Once you are more comfortable with the business, then pull the trigger. If you aren't comfortable with it, take a pass or patiently wait as you learn more about it.

The lessons I have learned from these stories can be summarized as follows:

- These tools help me do more and faster
- Make sure the tools I'm using are accurate
- Record all my findings on the cloud
- Stay disciplined when using these tools or risk losing capital
- Be ruthless with eliminating ideas (no matter the source)
- Learn from your past mistakes then forget about them

Common Mistakes:

- Lacking discipline
- Skipping steps
- Using short sample sizes

Your ability to answer these and any other questions you may have will determine your success in investing. So make sure you find these answers in detail! If you forego this important part of the analysis, you risk:

1. Not having enough conviction
2. Selling when prices decrease
3. Selling when the price goes up a minuscule amount
4. Not having a good enough understanding of the business

Mistakes I've made:

I've made numerous mistakes that have cost me $1000's even while running these tools. These mistakes include…

- Being too undisciplined
- Allowing FOMO to skip steps,
- Not writing them on cloud software,
- Thinking I'll "remember" the numbers,
- Spending time looking at an opportunity out of "moral" responsibility to a friend/person you respect

The fact is, you won't remember the growth metrics of 10-20 different companies unless you have a photographic memory.

You won't remember where you placed your data if you don't have a dedicated place to store your notes.

You might find you're being undisciplined and skipping certain metrics that don't meet your hurdle rates.

Fear of missing out might kick your analytical framework to the curb, and you'll skip using it entirely.

A good investor you follow might buy a stock, and you end up skipping your analytical tools to allow you to buy it when it wouldn't pass the filters.

> ***GOLDEN NUGGET***
>
> If you want to succeed in investing, you should avoid these mistakes as much as possible. So make sure you use these tools. Be a disciplined analyzer as well. Just because everyone is talking about a specific stock does not mean it belongs in your portfolio. If the numbers don't meet your exceed your benchmarks, then taking a pass is a completely logical move.

What To Do Next

Once a business passes your filter, congrats. You can now start researching the business further.

Your next job is to discover why the business has such great numbers. What is its moat? What needs to happen for the business to continue growing at the rates they've done for the past 5-10 years? What needs to happen for the business to break?

The list of questions you could ask could be endless.

I have a general system I like to use after I eliminate stocks.

1. Read the latest 10k
2. Read earlier 10k's
3. Listen/Read Q&A's
4. Go through checklist items to find areas I need to learn more about
5. Evaluate the business
6. Buy the business when the price is right

Each step has many moving parts to it.

I think analysis is like any skill. The more you do it, the better you get. It starts to feel more natural, and you don't necessarily have to be so regimented. But having a specific framework can be great when you are starting out. Otherwise, you won't have any idea where to start.

6 Steps in Brief

Here is a brief overview of each step and why it's important in the grand scheme of the investing process.

STEP 1: Read the latest 10k.

Reading a 10k of a business you own puts you ahead of probably 95% of investors.

It can be time-consuming and boring, but if you know what to look out for, you can skip quite a bit and still get the necessary information. I like reading:

- What the CEO has to say
- The Financial Statements and notes
- Business Detail
- Risks

If you read these, you'll know the majority of what you need to know about the business.

As you read more, the grey areas will be filled up.

STEP 2: Read earlier 10ks.

After deciding that the initial 10k impressed you, you'll need to look further back.

The reason for this is that you want to see what kinds of goals and strategies the business has had in the past. You want to see what their outlook for the company was. Then you want to see how well they executed these strategies. You want businesses that execute their strategies.

Avoid the ones that speak loudly about a new initiative; then you hear nothing about it after they fail miserably.

STEP 3: Listen To or Read Q&As.

Once you have an idea of the business's history, and like what you see, it's time to look at how they interact with analysts.

You can ignore the irrelevant short-term questions like, "Do you expect to hit or miss on EPS next quarter?" Look at how they answer questions:

- Are they honest about the future or ducking hard questions?
- Are they trying to paint a rosy picture that doesn't seem to exist, or do they accept that the short term will be bumpy?

Once you go through some of these, you'll have an even better idea of management's talent and integrity.

STEP 4: Go through checklist items to find areas you need to learn more about.

A checklist serves as a tool that minimizes obvious analytical mistakes. A checklist is a dynamic thing.

It should be constantly updated when you realize certain items are more or less impactful than others. You can make this checklist as long or as short as you see fit. My checklist has about 90 items. Yours might have more or less. There is no "perfect" amount of items; just make sure you're trying to remove as many possible blind spots as possible.

Some items may only require a quick look, and you can check them off. Others may require additional digging. Make sure you use the checklist!

STEP 5: Evaluate the business.

After you have done your analysis of the business and have deemed it worthy of entering your portfolio, it's time to figure out what the business is worth.

Investors use all sorts of methods. I like forecasting earnings, putting a multiple on those earnings, then discounting that price to present value. Then I'll slap a 50% discount on that price. Using this method is my north star for valuation. I mix some other methods, but that's how I evaluate my businesses.

Make sure you have a clear understanding of the value of what you are buying. Without understanding a business's value, you have no idea if you are paying way too much or getting a great deal. By the way, you can buy optically expensive businesses and still get a great deal. Don't get married to the idea that you need to buy under an arbitrary PE number.

You should skip businesses where you pay too much and load on businesses that you are getting at a great price.

STEP 6: Buy the business when the price is right.

This is both the easiest and the hardest step in the process.

It's easy because you know what price you should pay for your desired return rate. It's hard because the market, media, friends, and family members will build up the "value" of a stock by talking about it incessantly.

When you hear all this positive news, your mind screams, "Buy, you bum!" This is where your ability to be rational comes into play. If you can be rational when everyone around you is losing their mind with fear or greed, you'll win. When investors are greedy, you win by not joining in the festival of greed. When you skip this, you avoid the risk associated with overpriced assets. When the market is fearful, you win by not selling out of fear. You also win by buying assets that are on sale!

> ***GOLDEN NUGGET***
>
> When you can consistently take advantage of these fluctuations by exhibiting patience, you'll be miles ahead of other investors. If you want great returns, you should aim to exhibit patience as often as possible. Your portfolio will thank you.

Thank You for Reading!

Thank you for reading "5 Minutes to No."

Looking for more investing resources?

Here are a few I think you'll enjoy:

1. Check out my show on The Investors Podcast network: We Study Billionaires.
2. If you want to learn more about how investors work and live better lives, check out the Richer, Wiser, Happier Podcast.
3. If you want to network with like-minded value investors and get new stock ideas, join our highly vetted community – The Investor's Podcast Mastermind Community.
4. Get the free daily email that makes understanding the financial markets easy and enjoyable by We Study Markets.

Glossary

EPS — Earnings Per Share

FCF — Free Cash Flow

PE — Price to Earnings Ratio

ROIC — Returns On Invested Capital

S/O — Shares Outstanding

CAGR — Compound Annual Growth Rate