



smartwomanscurities

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# Analyzing Companies and Industries

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# Last Seminar Recap

- Finding a company that has investment potential makes your job a lot easier.
- To find investment ideas, start looking around you – what companies do you utilize services and products from each day?
- There are some great resources online and elsewhere to come up with ideas, such as various investing blogs or investor records.
- Company and industry analysis is very important to conduct, so have a clear process and plan for how you're going to approach it.
- And don't forget researching gets easier the more you do it!



# Tonight's Agenda

- Market Update
- Understanding the Business
- Company Trends
- Industry Trends



# This Week's Seminar

- After this, you should be able to:
  - Brainstorm trends and look to see how past trends affected certain stocks or certain industries
  - Be able to create a list of “interest” stocks within industries to research more in-depth
  - Research these “interest” stocks deeper to understand their core business model
  - Have a list of good companies that you believe MAY be good investments (pending sound financial review... to be covered next seminar)

# Tonight's Goal



# Market Update

- “U.S Stocks Fall on Trade Worries”
- “Fed Will Soon Announce Measures to Increase Supply of Bank Reserves”
- “IMF and World Bank’s New Leaders Warn of Deteriorating Global Outlook”
- “House Democrats to Subpoena Sondland, Sets up Trump Showdown”
- “Facebook’s Libra hits Regulatory Roadblocks in Europe”

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# Understanding the Business



# Understanding the Business

Now you have a list of stocks that you are potentially interested in investing

These may be across a variety of industries

Let's whittle this list down some more...

- Studying up on the company
- Porter's Five Forces
- Industry and Company Trends

- **Lastly... is it a Lynch stock?**

*"The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage." – Warren Buffett*





# Performing Fundamental Research

## PHILOSOPHY

### 1. RIGOROUS FUNDAMENTAL RESEARCH

- We believe we have built a repeatable, consistent, and proven investment process founded on treating each investment from a business ownership perspective.
- We seek to understand the keys that unlock exceptional business economics, the ability to maintain or improve those economics, the business' advantaged moat, and if the business deserves the right to succeed.
- We have developed three proprietary research frameworks to navigate through the research process and due diligence of qualified investments: Six-Sides of Great, a 72-point checklist, and M-Theory.
- We value independence in our research as we know a consensus view can lead to mediocre returns. A geographic separation from "Wall Street" is a conscious endeavor to filter noise and actively avoid the group-think mentality in investing.



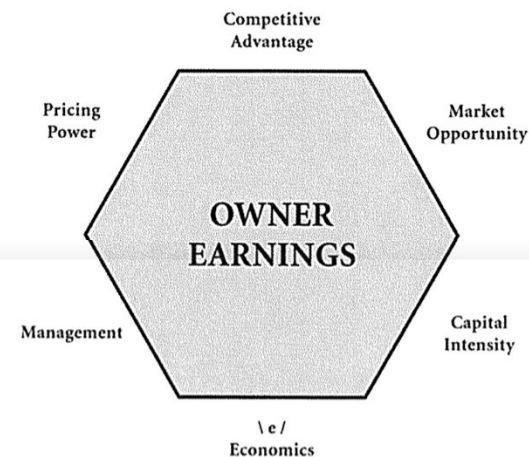
# Buy Good Businesses!

## 2. ATTEMPT TO FOCUS ON EXCEPTIONAL BUSINESSES

- We believe a focus on quality businesses can improve our margin of safety and long-term compounding opportunities.

- We evaluate the quality of a business by its:

- Operating economics
- Competitive advantage
- Market opportunity
- Pricing power
- Capital intensity
- Management skillset



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- We consistently seek to improve our knowledge of the universe of businesses that we define as great or that are blazing a trail toward greatness. These businesses must be understood in view of their long-term sustainability, not by short-term data points.

# The Joys of Compounding!



# Researching the Company

Visit its website, read blogs, find research reports (if available). Do as much as you can to understand the core business

Listen to conference calls to learn about current trends and issues

Earnings.com

Read its financial reports

Annual report, quarterly report, focus on Management

Discussion and Analysis (MD&A) section as this will describe their strategy

Know their management

Get to know the management ... read their bios

Understand what the industry thinks about them

Visit the company, use its products, visit its stores



# Porter's Five Forces Analysis

Porter's Five Forces are a way to understand the competitive position of a company or an industry.

Warren Buffett likes to invest in industries that have a “moat” around them or in other words, they have a strong position that competitors cannot easily penetrate

## **Five Forces:**

1. Rivalry
2. Barriers to Entry
3. Threat of Substitutes
4. Supplier Power
5. Buyer Power

# Porter's Five Forces Analysis





# Porter's Five Forces: Under Armour



# Competitive Rivalry

**Competitive Rivalry** – discusses the competitiveness of the industry and markets in which the company is located. Rivalry within that industry will be higher when there are:

A large number of firms – companies have to compete for the same finite customers and resources

High fixed costs – companies have to produce at capacity to attain lowest production costs and highest profits, leading to high production levels and large quantities

High storage costs or highly perishable products – producers must sell goods as soon as possible, leading to market flooding and price cuts to induce consumers to buy

Low switching costs – customers can switch between products easily, leading to less brand loyalty

High exit barriers – high costs associated with abandoning a product will prevent a fast exit from the market, especially when products used to make product are specialized and difficult to resell



# Porter's 5 Forces: Under Armour

- *Competitive Rivalry*: How many competitors are out there and what are they capable of doing?
  - Intense for Under Armour
  - Competitors like Nike and Adidas have tremendous resources
  - Low Switching costs to competitors
  - Minimal product differentiation, patents



# Barriers to Entry

**Barriers to Entry** – characteristics within an industry that protect the high profit levels of firms and inhibit additional rival companies from entering the market.

Entry-detering pricing: when firms keep prices artificially low to minimize profits and to prevent potential entrants from entering the market

Government barriers – monopoly restrictions, natural utility monopolies

Patents and proprietary knowledge

Asset specificity

Restricted distribution channels

Customer brand loyalty and difficulty in brand switching

# Porter's 5 Forces: Under Armour

- *Threat of New Entrants/Barriers to Entry: Are there natural 'moats' around the business (intense capex requirements, economies of scale, patents?)*

- Positive industry trends in sports compel additional competitors to enter the market
- Common technology, little is proprietary
- Ease of brand switching
- But branding and image of leading brands is high, expensive to replicate
- Threat moderately high



# Threat of Substitutes

**Threat of Substitutes** – a product's demand is affected by the price change of a substitute product or there is a product that could be easily substituted.

As more substitutes become available, the demand for a product becomes more elastic as customers have more alternatives and it constrains a company from raising prices

A substitute could be a direct competitor or a something that is just an alternative.

For example, substitutes for Coca-Cola could be other sodas, bottled water, or other drinks.

# Porter's 5 Forces: Under Armour

- *Threat of Substitute Products: Are there other different products and services people can use instead?*
  - Minimal threat that people stop working out
  - But sports apparel is fragmented market



# Buyer Power

**Buyer Power:** the impact that customers have or can exert on a producing industry; when buyer power is strong, the buyer has more influence in setting the price and there are multiple suppliers.

Buyers are powerful if they:

- Are concentrated such that a few buyers have a significant market share

- Purchase a significant proportion of output

- Can threaten to buy products from a rival firm

Buyers are weak if:

- Producers can take over their own distribution and retailing and not need the buyer to do it

- There are significant buyer switching costs (fees for breaking contracts early) or there is no substitute product to which the buyer can switch

- They are fragmented such that no buyer has significant market share or ability to influence prices

- Producers supply critical portions of buyers' input



# Porter's 5 Forces: Under Armour

- *Bargaining Power of Buyers/Customers:* How concentrated are the buyers and how easy is it for them to switch?
  - Power of consumer higher at the wholesale level for UA; Dick's, Sports Authority
  - Lower for consumers
  - Brand identity especially plays a role for retail consumer
  - But no switching costs and many options



# Supplier Power

**Supplier Power** – the impact that the supplier-buyer relationship has on the buying firm that purchases raw materials and inputs from another. Suppliers can influence costs by charging higher prices depending on their positioning.

Suppliers are powerful if:

- There is a credible forward integration threat by suppliers

- Suppliers are concentrated and coordinate together

- There are significant costs to switch suppliers

- Customers are powerful and can influence which suppliers a firm chooses

Suppliers are weak if:

- There are many competitive suppliers and none holds a strong market share

- The product delivered is standardized and can be supplied by many suppliers

- They purchase commodity products

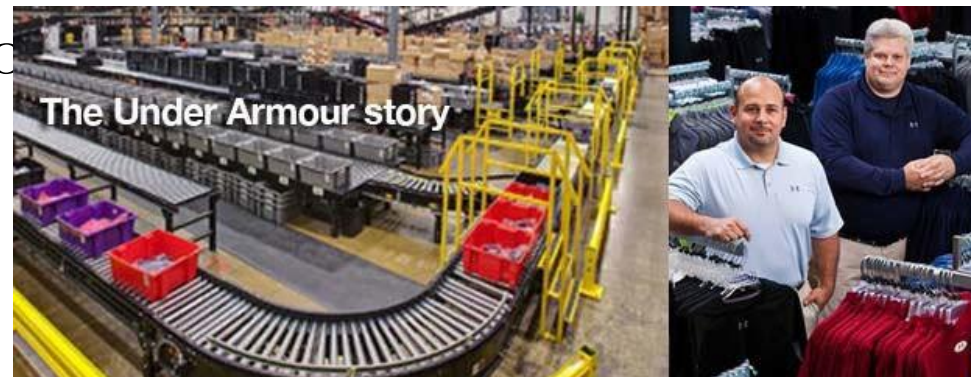
- Purchasers are concentrated and can push back on suppliers

- Customers are weak and cannot dictate which suppliers firms use



# Porter's 5 Forces: Under Armour

- *Bargaining Power of Suppliers*: How much control does a supplier to a business have? Can they force businesses to raise prices?
  - Under Armour has ~27 suppliers around the world
  - Well diversified, multitude of options
  - Supplier po



# Evaluate these Industries

Let's go step by step and see how these industries shape up with Porter's Five Forces...

Railroads (Burlington Northern, Union Pacific, etc)

Airlines (Delta, American, Southwest, etc)

Restaurants (McDonalds, Burger King, Wendy's, etc)

Soda Companies (Pepsi, Coca-Cola, Dr. Pepper, etc)

How about the following "newer industries"...

Clean Energy (wind and solar companies)

Social Media companies (Facebook, Twitter, etc)

# What are Your Results?

You may come to realize that some industries are easier to evaluate than others.

Additionally, some industries have more history that also makes it easier to evaluate.

Don't forget though, while an industry may be bad overall, a company may be tackling the sector with a new angle.

Porter's Five Forces gives you a lens at which to look at industries. It is a great way to get a feel for an industry.

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# Industry Trends



# Industry Trend Analysis

- Summary:
  - The purpose is to interpret the relevance of an industry to the needs of a market
  - In other words determine potential profits
  - Where is an industry in its life cycle?
  - An industry that is losing dominance to new technology likely not good for investment
  - Industries that are highly competitive and regulated make challenging investments
  - If an industry becomes irrelevant to consumer demands, it fails (i.e. the music industry)

# Industry Analysis... Where to Start

- Industry Overview, Internet Resources :
  - IBIS (<http://clients1.ibisworld.com/reports/us/industry/home.aspx>), via ND Lexis-Nexis
  - Hoover's Online ([www.hoovers.com](http://www.hoovers.com)), Companies and Industries Section
  - MarketResearch.com ([www.marketresearch.com](http://www.marketresearch.com)), retailer of private market research reports
  - ZapData – Dun & Bradstreet offers free statistical industry data on their website [www.zapdata.com](http://www.zapdata.com). Free registration is required.
  - BizStats – [www.bizstats.com](http://www.bizstats.com) o SBDCnet – [www.sbdcnet.org](http://www.sbdcnet.org)
- Industry Developments/Trends, Internet Resources:
  - Literature searches of newspapers, journals, and magazines –
  - Local publications and online databases (Dow Jones Interactive, InfoTrac).
  - Trade associations and industry magazines – Connect through association websites
  - Better Business Bureau ([www.bbb.org](http://www.bbb.org))
  - Library of Congress's Legislative Information (<http://thomas.loc.gov/>)
- Study Consumer Data
- Study Competitor Data

# PEST Analysis

- **After performing SWOT or Porter's 5 Forces Analysis, think through a PEST Analysis:**
  - **Political:** Government legal factors that can affect the success and profitability of a business. Examples include political stability, employment laws, safety regulations and trade regulations.
  - **Economic:** This encompasses all the economic aspects that can play a role in the success of a business. Examples include economic growth, unemployment policies, business cycle of the country, as well as economic, interest and inflation rates need to be taken into consideration.
  - **Social:** These are all the cultural and demographic aspects that determine whether the business can compete in the market. Examples include age distribution, lifestyle changes, population growth, demographics, environmental, health and educational consciousness.
  - **Technological:** This factor analyzes the factors which affect the means it can bring its product or service to the market. Examples include government expenditure on technology, technological advancements, life cycle of technology available, as well as the role of internet.
- PEST provides a simple framework for market analysis, and also helps reduce the impact and effects of potential threats to your business.



# Under Armour Example

Key industry trends to highlight:

- Rise in consumer appeal towards healthy lifestyles, emergence of new sports and an increase in sports participation rates
- Footwear sales across shoe industry projected to grow for next 5 years
- Labor costs for manufacturing expected to rise
- Technology and innovation important part of sports apparel industry – wearable devices, mobile phone





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# Company Trends



# Company Trends: Under Armour

- In 2015 UA spent \$710m on fitness apps and devices
- "If we believe that our future is going to be defined by these hard pieces of glass or plastic that sit in our back pockets, you're crazy. It is going to convert into apparel," says Under Armour CEO Kevin Plank. (Plank has estimated that 50 billion retail items will have a connected chip within five years.)
- 2016: It trades at 87x earnings. High for an apparel company, but does it have the growth potential of a technology company?



# Company Trends: Under Armour



- Above average company growth since inception
- Revenue and EPS growth around 30% since 2005
- Company highlights the following areas for growth beyond 2014: Revenues outside North America
  - Direct-to-consumer sales
  - Footwear
  - Women's Apparel

# And the Crash!

Under Armour Inc (NYSE:UAA)

**12.07** -0.10 (-0.78%)

Real-time: 2:38PM EST  
NYSE real-time data - Disclaimer  
Currency in USD

Range	11.88 - 12.22	Div/yield	-
52 week	11.40 - 33.45	EPS	0.32
Open	12.14	Shares	185.13M
Vol / Avg	2.89M/8.33M	Beta	0.03
Mkt cap	5.05B	Inst. own	74%
P/E	37.85		



1d 5d 1m 3m 6m 1y 5y Max



# Predicting Trends

- Predicting Trends = Predict Earnings (EPS)
- Stock price = EPS x P/E
- EPS is a function of:
  - Revenue – expenses = earnings
    - **Revenue growth:** how long will people be willing to buy Crocs? Will people own more than one pair?
  - Costs
- Where to look:
  - News
  - Every day life
  - Gut feeling
  - Basics of economy

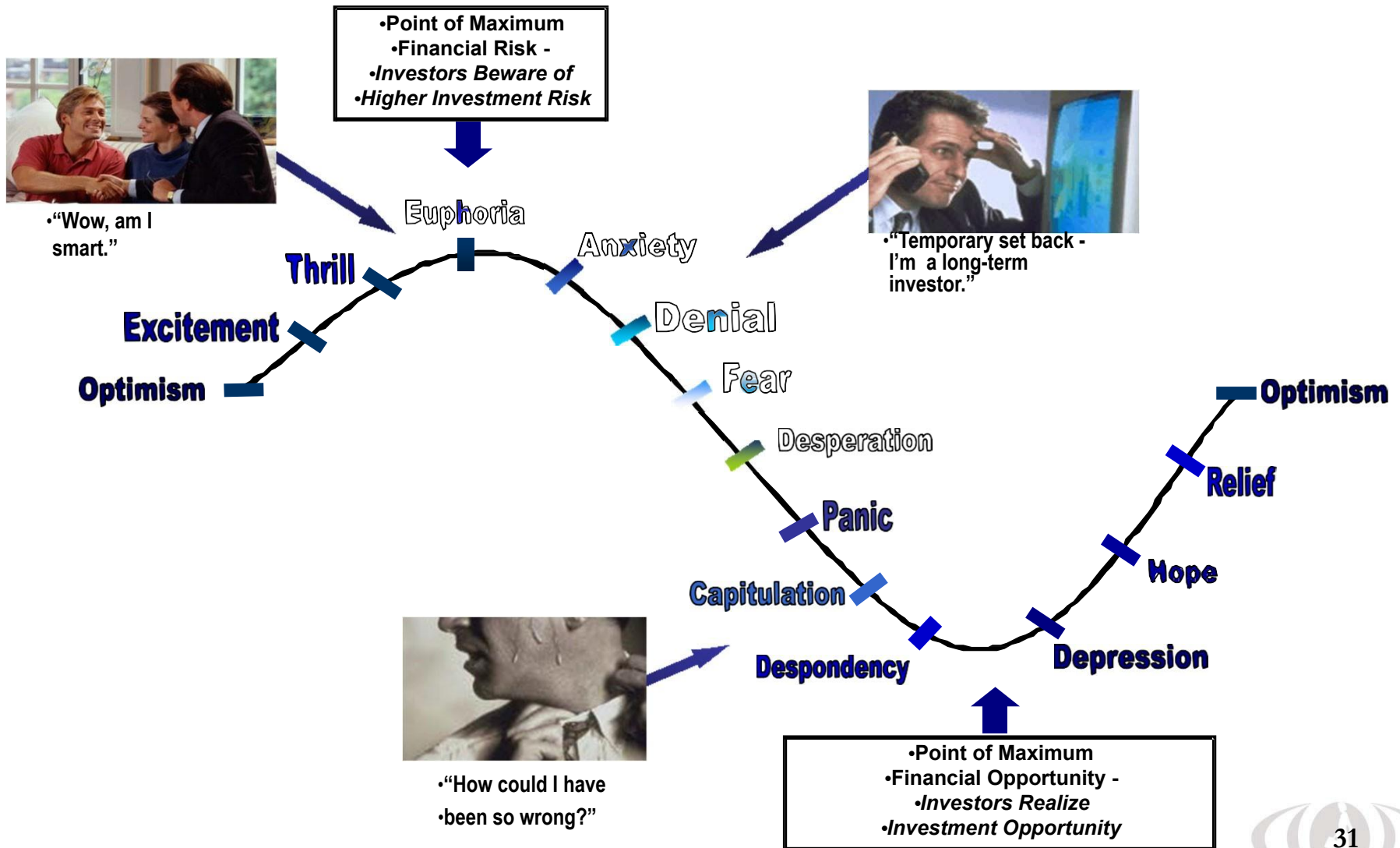
# Notes on Company Trends

- Trends can highlight undervalued companies
  - Rising oil prices  $\square$  higher demand for railroads
- Your investing time horizon matters when looking at trends
  - Don't jump on the bandwagon
  - Don't worry about "crazes"...unless you think it will continue for 30 years

# Trends are a Good Start

- In addition to trends, make sure to consider:
  - Porter's 5 forces
  - Quality of management
  - Sound operational strategy
  - Financials & Valuation >> P/E, P/B, EV/EBITDA
- Sometimes you have to wait it out and be patient. If you are confident in your analysis, stick with your stock!
- Ideally you want to foresee trends, not jump on the bandwagon. If the market sees a trend, it's already too late!

# Don't Invest with Emotions



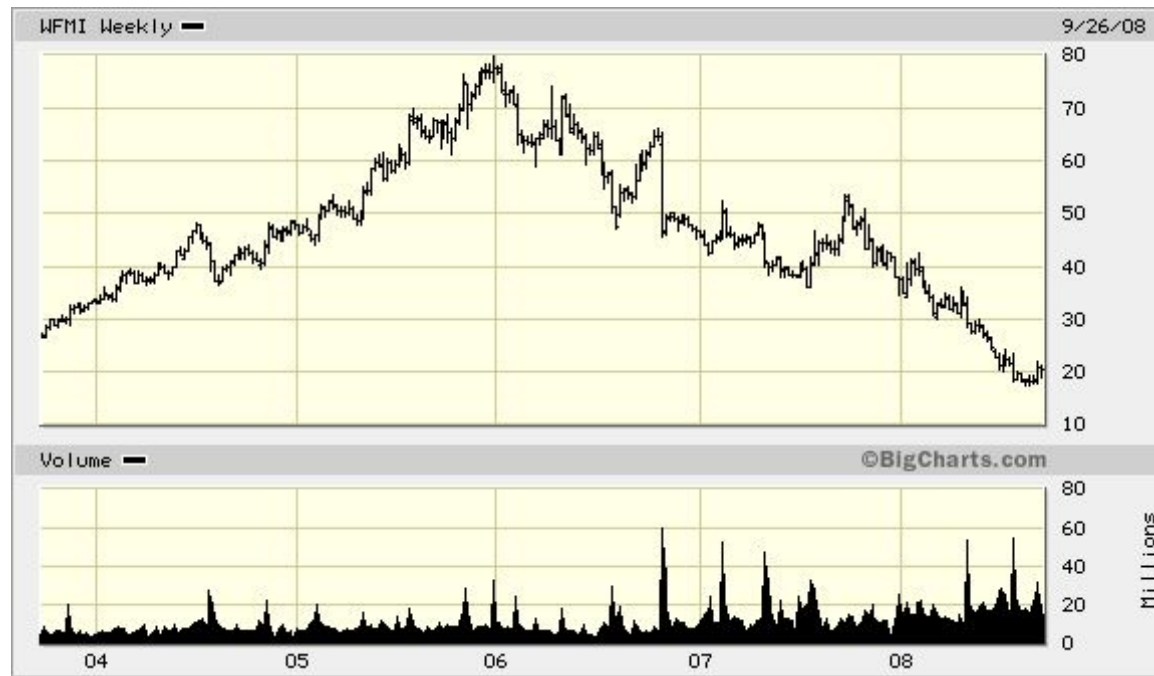
Source: SWS Oct. 3, Intro to Investing, Preston McSwain, Neuberger Berman



# Trends are Still Predictions

Trends you predict may not materialize because the company will not perform well or consumers will change their minds

If America is more health conscious, why is the Whole Foods (WFMI) stock price getting killed?



# Notes on Company Trends

While trends may seem to favor “growth” stocks, trends can also highlight undervalued companies

For instance, macro trends like rising oil prices can be a good thing for railroads (companies decide to ship by rail instead of by truck because of higher gas prices, a derivative of oil)

You can then conduct analysis on the company’s financials in order to determine it is undervalued

Your investing time horizon matters when looking at trends

A “trend” doesn’t have to be new in order for it to give you good stock ideas, but jumping on a trend after it’s been “discovered” won’t give you the highest returns

Then again, jumping on a trend before it’s discovered necessitates that it gets discovered. Risk vs. return again!

If you’re investing for 30 years from now, you probably won’t have to worry too much about a health food craze...unless you think it will continue for 30 years

# Learn from the Great Investors

- "The most important quality for an investor is temperament, not intellect. You need a temperament that neither derives great pleasure from being with the crowd or against the crowd." – *Warren Buffett*
- "In the short term, the market is a popularity contest. In the long term, the market is a weighing machine." – *Ben Graham*
- "I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." – *Warren Buffett*
- "To buy when others are despondently selling and to sell when others are euphorically buying takes the greatest courage, but provides the greatest profit." – *John Templeton*
- "What makes stocks valuable in the long run isn't the market. It's the profitability of the shares in the companies you own. As corporate profits increase, corporations become more valuable and sooner or later, their shares will sell for a higher price." – *Peter Lynch*
- "If the job has been correctly done when a common stock is purchased, the time to sell it is almost never." – *Phil Fisher*
- "It's only when the tide goes out that you learn who's been swimming naked." – *Warren Buffett*



# Lastly, is it a Lynch stock?

- Lynch's tips:
  - Invest in what you know
  - Understand the basic
  - ~~Keep it~~ simple (“the simpler it is, the better I like it”)
- *“A stock is not a lottery ticket...it's part ownership of a business”*
- Lynch's “perfect” stock
  - Dull, depressing, disagreeable, no one follows it, has a niche market, and insiders are buyers or company is buying back shares
- Stocks he'd “avoid”
  - The hottest stock in the hottest industry, a company that “diworsifies”, the “whisper” stock

# Seminar Recap

- Identifying trends are a way to come up with investment ideas.
- Action steps:
  - Create a list of “interest” stocks within industries
  - Research these “interest” stocks deeper to understand their core business model
  - Have a list of good companies that may be good investments

# Contact Information

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# Coming Up

## Week 5:

Reading and understanding financial statements  
Interpreting the story the numbers are telling  
Learning about the balance sheet

## Week 6:

Interpreting the story the numbers are telling  
Learning about the income statement and cash flow statement

## Week 7:

Understanding and calculating important financial metrics  
Analyzing what ratios mean about a company or industry

## Week 8:

Putting it all together with an investment recommendation

## Weeks 9-10:

Guest lectures/presentations





# What to Read

- *“The Intelligent Investor”* (1949) by Benjamin Graham
- *“The Essays Of Warren Buffett: Lessons For Corporate America”* (2001)  
by Warren Buffett and Lawrence Cunningham
- *“Margin of Safety”* (1991) by Seth Klarman
- *“One up on Wall Street”* (1989) by Peter Lynch
- *“Common Stocks and Uncommon Profits”* (1958) by Philip Fisher
- *“Stocks for the Long Run”* (1994) by Jeremy Siegel
- *“A Random Walk down Wall Street”* (1973) by Burton Malkiel
- *“The Manual of Ideas”* (2013) by John Mihaljavic

# Online Resources

## News:

- <http://www.wsj.com/>
- <http://www.zerohedge.com/>
- <http://www.ft.com/home/uk>

## Investing:

- <http://greenbackd.com/>
- <http://www.cornerofberkshireandfairfax.ca/>
- <https://punchcardblog.wordpress.com/>
- <http://www8.gsb.columbia.edu/valueinvesting/resources/newsletters>
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