IFB233: Analyzing Debt and Cash Flow using Weber Grill's Financials

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Dave

0:00

All right, folks, welcome to investing for beginners podcast; tonight, we have episode 233. Tonight we're going to answer a great listener question we got recently about the Weber grills company that just recently went IPO. I am a big fan of the product. I've used it for years. I have one on my balcony right now as we speak and actually used it yesterday to cook some mahi-mahi. So yeah, there we go. So alright, so we're gonna go ahead and talk a little bit about the company and some of the things that we noticed.

So after listening to your latest episode about value traps, it may be questioned our recent investment into Weber grills, the company just recently went public, and it's so it seemed as if the drop was due to the current economy. But after we get the debt to equity, I am seeking advice from you and your experience. Thank you sincerely, Ben. So Andrew, let's talk a little bit about Weber grill and their debt situation; we can kind of help answer this for Ben.

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Andrew

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Yeah, I would love to first; maybe why do we care about that?

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Dave

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Why do we care about that? Yeah, I think, as you have talked about many times and wrote a great book about debt, one of the things that can lead to a company going bankrupt is probably the number one reason why companies go bankrupt is when they have too much debt. And so that's something that we always want to kind of look at when we're trying to invest. Would that be a good summarization of it?

A

Andrew

1:21

That's perfect. Okay, so we want to look at that because we don't want to buy a stock that goes to zero. A second reason kind of just pops into my head, when you have a lot of debt, you don't have a lot of money to do anything else with because you got to pay back the debt. And you also have to pay interest on debt, just like when you get into credit cards. So companies can run into problems there, too. It could hurt their cash situation and their free cash flow situation. So if you want to follow along at home, you can think of debt, particularly the debt to the equity that Ben was referring to; in this question, think about equity, just like you would think about home equity. If you own a home, it would be the value of your home minus how much you owe. The rest is your equity.

The same thing with companies; they have assets, they have liabilities, and they have equity. And so we can use debt-equity as a shortcut tool, not the only tool, but a shortcut tool to compare and give us like a scale almost like just some context, some apples to apple context is this a lot of debt or not really. So, unfortunately, this is maybe a really bad company example to use for debt to equity because equity is negative. And the reason that their equity is negative is that they are Weber Grill; there's this really dumb accounting rule that if you create a brand yourself, you don't get to include that brand as an asset; that doesn't count for equity. And that's like really confusing. So like Home Depot, Nike, and Disney, those are big brands, even Apple, those are all huge brands that have a ton of value, but they get counted for zero on the balance sheet.

So you can't really use debt to equity for a company like Weber. But there are other things that you can look at; I think you can still look at the debt itself. And so again, if you're following along at home, you can use a website like quickfs.net. If you type in the ticker at the top, you can click down to the balance sheet. And yeah, there are like 20 line items. That's kind of annoying, maybe overwhelming if you're first starting out. But near the bottom, there's long-term debt, and you can look and see how it's progressing every year. And so, in this case, it goes from 576 to 900, almost doubles. So that's where you say, if I'm looking at a company like this, and I see that the debt has doubled, maybe it's time to go debt, investigate there, and figure out why that's the case versus maybe a company like Apple where the debt hasn't really changed much. So I don't necessarily need to put it on. Maybe that's a good exam.

Personally, I'm always looking at every aspect of the debt, and everything is very risk-averse. But as a general investor, maybe that's like a red flag, something that should jump out at you that, hey, the debt has changed. Maybe I better look deeper.

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Dave

4:23

Yeah, for sure. And I think before we dive too deeper into the debt and put our Sherlock Holmes head on to talk about debt, another, I guess, quick, easy way to assess the debt situation of a company is to kind of refer back to what I was talking about with Goodyear Tire a few episodes back. If you look at the overall debt of what weber grill owes versus the market cap of the company, the closer it gets to the overall market cap of the company, that's not a good sign.

And in this circumstance, like it was with Goodyear Tire with Weber grill, they have about 1.3 billion in debt and accompany worth around 2 billion overall. And so, you know, these elite finish plays. So basically, what that tells us is that if you sold all the shares of Weber Grill today and took all that 2 billion, you would pay off the 1.3 billion and have about 700 billion leftovers for everything else. That's not a lot. And that's not a good situation to be in. It doesn't mean that the company can't move past that at some point. But if you're fishing in the pond or the lake and looking for good investments, and you come across a company or whoever grill, and you see something like that, that's a, I guess, a red check in the mark of something like, you know, unless you see other things that are going to offset that, that make you go, okay, hey, they can move past this, then it's up to you whether you want to decide to do that, for me, it'd be a past.

But if you see something like that, that certainly should give you pause. And like, for example, if we're looking at Microsoft at 1.8 trillion in market cap, and they had 1.3 trillion in debt, that would be a very, very bad thing, probably for the rest of the world, too, if that company had that much debt. But these are just some, I guess, good screening ideas that you can use when you're kind of looking at an overview of whether you want to dive deeper into the company. So now that we've kind of talked about debt to equity, and maybe kind of a market cap versus equity, let's talk about maybe some of the things that you find with your Sherlock Holmes, about the goings-on of the debt with weber grill.

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Andrew

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Yeah, I like that. So I did find so this interesting. As I said, the debt doubled; they added somewhere around 500 million from 2020 to 2021. So I guess the next logical thing to ask is, where did the money go can it move from the balance sheet to the cash flow statement? I promise, there are only three major statements, so we just hit two of them. So good job, you are on your way; we can look at the cash flow statement and see was there a big cash outlay somewhere; I see that they paid a lot of dividends, and they made an acquisition or two.

So the dividends are weird because they have a weird corporate structure due to their IPO. So again, this is an example of kind of enter tangled, but you want to look at the usage of that debt and think, you know, did it makes sense for the business or not? Does that make sense? Am I missing something there? No, no, no, let's talk about the dividends because the dividends are kind of scary. So it was 316 million. That's what Quickfs were showing for dividends. They have a very interesting corporate structure. I will say that so there is a holding company.

I don't know how familiar beginner investors are with Warren Buffett's Berkshire Hathaway. Basically, what Warren Buffett does in his company, they don't really do anything inside the business. What they do is they buy other businesses. And now he has this big collection of businesses. And that is the business. So he's got Geico, he's got General Re, he's got Berkshire energy, the BNSF railroad,

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Dave

8:10

He's got, I don't know, 50-60 businesses tied up underneath that umbrella.

A

Andrew

8:15

Yeah, so he's not personally going out; nobody in this company is going out and selling products; they are owning the businesses that sell them, owning them outright, and then also owning shares, like Coca-Cola and apple and Bank of America. So for Weber Grill, it's interesting because they are also a holding company, but they only hold the shares of one company, and that's Webber, but they only hold 25% of the shares. And so basically, the way they describe is the dividends they get from whatever they pay to their shareholders. But then they paid 300 and closed 320 million in dividends last year. So it's just one of those things where you have to look really hard, almost like almost too hard. You know, because it's a very unique, very weird corporate structure. They're not; they don't even own the entire Webber business.

And if you look at them, if you go deeper into like, how the ownership of this company works, somebody else is a majority owner of this company, too. So it's like you're the minority owner of a minority owner of the Weber brands, very interesting. And it's definitely not my cup of tea. So maybe these are no good lessons on like, do we know if they did well with the cash? I can't really answer that. But maybe it's an example of, like, when I'm looking at companies, and I'm trying to turn over rocks, I'm basically trying to uncover What's the story of this company. And you just that path can be different every single time, and you don't know, like the way I learned about the company's different ever. And this would be one example of like, you just kind of follow the trail and see where it leads you. So you looked at the debt that looks weird. And then it's like, well, what's the next question? Well, what are they doing with the debt, and then you look deeper there?

So when you investigate this company, they have an annual report, that's like 120 pages, you don't have to read that thing like a book, you almost want to think work smart, not hard. And as you gain experience, you can start to do those things. And that's how I would approach a company. And that's kind of how you pick out value traps too. And they start checking those red marks, like you were saying they've, well, this is Strike two.

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Dave

10:32

Yeah, for sure. And I think when you think about analyzing companies, Andrew brought up a great point when you look at reading through the 10k, or the 10, Q's, or any documentation that's involved with a company, you want to ask yourself questions, while you're going through looking at this information. And so the question about what did they do with the debt? Why is that important? That's important because when companies are trying to grow because all the companies are trying to grow, they're going to use the capital that they have available to them to grow. Ideally, that's the whole goal of this to grow. And the whole way to grow is through the capital resources they have.

Sometimes it's internal. So it's the cash flows, that the company generates the money, the cash that they generate, they can use to reinvest in the business to grow, or they can raise debt like we were just talking about, you know, the company raised almost $500 billion in debt. The next question you want to ask yourself is, Where did that go? What did they do with that? And then the other idea is equity, you know, they can sell shares of the company, whether they are an IPO like they did recently, or whether they want to go out and sell them in the open market, to raise money to invest in projects, so the business can grow. And every company has to do that; even Apple, as great as they are, still have to reinvest in their business, to grow to come out with those new iPhones that they come out with every year, the Apple watches, or all the great products that they produce the upgrade on all the time.

And when they do that, they're, they're spending their capital to make those products better to sell to us. So we want to go out and spend $900 on an iPhone. And so my point with all this is that you have to ask questions, why is this? Why is this, and sometimes you don't have to dig that deep to come to an answer quickly and go, No, Warren Buffett always talks about, so it's Charlie, that they're too hard pile is really, really tall. And they're I understand his pile is much, much shorter. And sometimes, when you're looking at a company, let's say we're looking at Weber Grill, if I came across some of the ideas that we came across earlier with the debt, some of the equity things that we're going to look at the free cash flow, some of the things Andrew was talking about, those ideas are things that would lead me to go, you know, the whole ownership stake of the company, the minority of the minority owner, that just becomes for me, it's too convoluted.

I don't understand it, you know, not that my puny one vote is really going to make any sort of great, you know, the difference in what the company decides to do. But it's just the whole idea that I don't really understand who owns it and who's driving the bus. And if I don't know who's driving the bus, why am I going to invest in it, so it would go for me, it would go into the too hard pile. And if I'm looking at something like Microsoft, for example, I understand the ownership structure; I know who's driving the bus. And it's somebody that has proven to me with their capital allocation skills that they're going to put that money to good use and for the business, which is good for me as an investor.

And so those are all questions. And I would ask, are the people driving the bus? The CEO or the management team? Are they doing the right thing for the business, and for me, if I don't understand what it is they're doing, then either it goes into a too-hard pile, or I don't trust them. And I'm going to move on kind of thing. And I'm not trying to be super bearish about Webber. Because again, I love the product. But when I look at the financials of the company, it's like, you know, nobody can see my face, but it's the bitter beer face like, yeah, no, no, thank you.

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Andrew

14:16

Burn your steak.

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Dave

14:18

Yeah, exactly; I just burned my steak on my Weber grill. I mean, good grief. So anyway, my point with all this is, is that these are all questions you want to ask yourself when you're analyzing a business, and they don't have to be hard questions. And they can be fairly easy things to figure out quickly. You know, do I understand the business? Do I understand the structure of the business? Like who's making the choices and the decisions?

What is the debt look like? What is the debt load look like? You know, all those things are things that you can go into. So now that we've kind of talked about all that let's talk about cash flow. So Andrew touched on the cash flow statement, and I want to talk a little bit about the cash flow statement and kind of what in the cash flow statement was kind of another red flag, if you will. So do you want to kind of broach that subject? And we can chat about that a little bit?

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Andrew

15:04

Sure. So Dave and I both identified this as something we really don't like to see too much. In general, with companies, it needs to be done responsibly. And I understand that younger companies do this a lot more than mature companies. We're talking about stock-based compensation. And to understand that, that's a lot of words. To learn what it means, just think about, let's say, we wanted to hire you for our startup. But instead of paying you a salary, we said here; you can have part of our company.

And then we hired another person, we said the same thing you got pharma company, and we did this with like all of our employees, right? So on, from the company standpoint, the company didn't pay anything. But from my and Dave's standpoint, owners of the startup, we're getting less and less of a slice of the business because we keep giving away more and more and more of it. And this is exactly what stock-based compensation is. And it happens with lots of companies, and you'll see it, especially happen egregiously, mostly, with young growing companies. And sometimes it works out great; you have a get a team of crazy, talented developers and come up with you get the next Facebook or Netflix, right.

But not every business model needs to go out and find all these super highly talented tech guys; you know, there could be more boring business models with boring consumer products that don't have much innovation, and why in that case, why are you giving out so many parts of your company. So when you're a shareholder, and the company is basically giving out pieces of itself to employees, that's a problem for you because your slice of the company is getting smaller and smaller and smaller. So even though it doesn't show up in the company's cash, they didn't have to spend the cash; you're losing because your slice is getting smaller. And when we look at their cash flow statement, the amount of cash that they're generating from the business, versus how much of that cash should have been taken out as salary, but it was instead divvied out and made the slices smaller when it's really big. And as it is, in this case, that's not sustainable. And I don't like it.

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Dave

17:25

No, I don't like it either. And to kind of back up for just a second. So if people are a little bit lost on what we're talking about, when you think about the cash flow statement, I think the easiest way to think of it is it's the checkbook of the company. It's the actual place where you see the money, the cash of the business generates going in and out to operate the business to pay for the bills, the salaries, the inventories, the r&d, the property, the debt, the dividends, you know, all the stuff, the share buyback, everything is all in the cash flow statement. And when we're talking about cash flow, it really stems from the income statement; the bottom line of the income statement or the net income is really an accounting term.

And it's from the p&l of the company, the business of the term. But the cash flow statement is really where the money goes in and out of business. And so stock-based compensation, if that makes up a huge portion or a greater portion of the cash that the company generates from its operations, that's not a good sign.

Because really what it's telling you is that the business before it gets to the cash flow statement is unprofitable based on the costs and the operations of the business, including the debt that we're talking about earlier, because that is that impacts the income statement in the interest that the business has to pay on that debt, that reduces the amount of cash flow that the business has to pay its bills. And so stock-based compensation, like Andrew, was saying, is it's money that they're not spending now, but they're gonna spend it at some point. And one of the problems with stock-based compensation, especially with younger tech companies, it's interesting that a company like Weber grill had this issue when I was looking at block a few minutes ago, and probably 95% of their cash flow is stock-based compensation, which I guess is not surprising, but it's also very offsetting because they have negative earnings. And so the money that they're generating is really coming. It's kind of a double whammy for an investor because it's not really cash that the company is spending, but it's also diluting the shares that we own at the same time because without getting into the whole nitty-gritty of stock-based compensation.

The basic gist of it is its money that they haven't spent, but they will because the Employees at some point will exercise those shares, to get cash to do whatever it is, you know, whether it's they want to buy a house, buy a car, you know, pay off their mortgage, any of those kinds of things, which you cannot fault them for. But as an investor, when we see that those are really high levels, that's money that's going to come out of the business at some point, it may be in one year, it may be in five years, but when it does, that also impacts the operations of the business, it's also going to impact our own level of the business. So instead of the pizza being eight slices, it now becomes 20.

And we only own, you know, less than half of it now. And so that's how you know who wants that, you know, you spent your hard-earned money, investing in a company. And now, all of a sudden, the employees are exercising their shares, and we have less ownership of the business. And so it's not always a great situation. And so when I see something like that, for me, it's another red check. It's like, No Pass moving on. Because I don't want to invest in a company like that because they're diluting my ownership of the business by delaying when they pay their employees, and I think that's one of the ways that I think about it. I'm curious if you have any additional thoughts you want to bash me on?

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Andrew

21:16

No, no. That was actually a really great way to describe it. I hadn't heard that talk that way. But it is very, very true; you are just delaying that liability. And so we have the cash in the bank now, but not really; it's actually earmarked for something else, right?

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Dave

21:35

Yeah, exactly. Yeah, you're kind of robbing Peter to pay Paul kind of thing. So, you know, weber grill has $146 million in their checking account that they're going to use to buy inventory. But someday, they're gonna have to pay that back. And if they don't have the cash to generate it later, that could cause a ripple effect for the business. So you know, it's just not a game you want to play. So if you see elevated numbers compared to the cash from operations, which is the next few lines down on the cash flow statement, that should be a red flag for you. So that was a red flag for me,

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Andrew

22:10

I'll give you an average. So if there's a people who still listen to our show, or like, advanced to that level, where they're looking at stock-based compensation, most of the companies in the s&p 500, when I found stock-based compensation makes up about 4% of their cash from operations. So for whatever, it's actually more than 100% because they don't generate that much cash from operations.

But just to give you a ballpark. Yeah, if a company starts having like, 20% 25%, I really start to get concerned. Not to say that stock-based compensation is bad. It's just like Dave was saying when you use it way too aggressively. You're gonna have to pay it eventually.

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Dave

22:55

Yeah, it's to kind of put that in perspective. You know, the 4% and the 20%. I was looking at a block just a few minutes ago. And there are the last two years of range between 85 to 75% of the cash from operations. So crazy. Yeah, really, really high. So that's a lot of money that they're going to owe people at some point. It's sitting on their books, and they're going to use it to pay for other things, but they're going to come to sooner or later. Buyer beware.

A

Andrew

23:19

What are the other terms? Semper?

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Dave

23:22

Semper Tyrannis? No, and that's why. A

Andrew

23:26

But hopefully, that helps Ben; these are just like a taste of some of the things that we would look at. It certainly doesn't encompass everything. But I think looking at the debts is definitely a great place to start.

D

Dave

23:36

It definitely is; it's the like Andrew has said many times that is the leading cause for bankruptcies in companies in starting, there is a great starting point. And, and again, you know, kind of go back to our buddies, Uncle Charlie and Uncle Warren, I think they probably spend more time looking for reasons to say no, to invest in companies, then yes.

And that may sound like a negative way. But when you're thinking about putting all your hard-earned capital into a company, you want to know that you're putting it in the right place. And I think by looking for the nose as opposed to looking for it, it's easier to look for yeses; it's harder to look for the nose. And if you look for a nose and kind of start from there, and if you can pass these tests that we're talking about, that's going to lead you to stronger investment in the long run. 100%. All right. Well, I guess with that, we will go ahead and wrap up our conversation for this evening. I wanted to thank Ben for sending us such a great question.

Thank you very much. That was a lot of fun to talk about. And hopefully, we helped answer your question and give you guys some good things to think about as you kind of go along in your investing journey. So without any further ado, go ahead and sign us off; you guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week, and we'll talk to you all next week.

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