Bird's Eye View of Analyzing a Company for the First Time with Topgolf

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Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we are going to do a bird's eye view. We got this great question from Bruce, and we're going to do a little bird's eye view of a company that neither one of us are super familiar with. We know the name, but we're not intimately involved. So we thought this would be interesting for you guys to see maybe what we look for in a company and how we start kind of digging in in something we're not as familiar with. So here's the question from Bruce. Hi, guys from Raleigh, North Carolina. Love the podcast, have been listening for a few years. One of the best stock market podcasts out there. Thank you, Bruce. So onto my question, can you do a deep dive on Top Golf ticker mod g? Thanks, Bruce. So, yes, Bruce, we can, and we're going to try. So here we go. So, Andrew, I guess let's talk about top golf and maybe give people maybe a quick overview of maybe what they are and who they are.

Andrew [00:00:51]:

Sure. I might have ran into you, Bruce. I mean, I'm more of a drive shack kind of guy, more so than topgolf. I don't remember if we've gotten our topgolf here in Raleigh yet or if that's coming. I may run into Bruce there one day. We'll see. It's basically a bowling alley for golfers, is the best way I can describe it. So they have all these different bays, and you can hit the ball, and they track the ball, and you order drinks and you order snacks and just have a good time. So I love that place. So I'm somewhat familiar with this company. I do know they are broken out into different segments. So maybe I'm not the best person to give, like, a fresh kind of viewpoint on the company because I have done some work on it a little bit. So for you, who I don't know. Have you been to a topgolf before?

Dave [00:01:39]:

I've been to one. I went to one in Phoenix, Arizona, and it was a blast. It was a lot of fun. And we went there during the day, so it wasn't very busy. And I actually got to kind of interview the server that was taking care of us because she didn't have much to do. And so I was, like, super curious about the place. I mean, it's beautiful location and the amenities and everything that they offer there were top notch. I was blown away with how cool it was, and she was kind of explaining to me how in the weekdays it's not as busy, during the days it's not as busy, but on the weekend, nights in particular, it's as packed with young people. It would become like the cool, fun place to go and hang out because of the way that they structured it. You have all these different stalls, I guess you could call them, and people can 6810. Twelve people can all pile into this little area and they can play together and they can have a lot of fun. And they got video games, and they got food and alcohol and other drinks. And so it's this great date hangout place.

Andrew [00:02:39]:

Did you know when you went there that it was public?

Dave [00:02:42]:

I did not. I had no idea. When we got this question and we talked about us doing it, I was like, they're public. That was the first thing out of my mouth. Really? I didn't know.

Andrew [00:02:52]:

All right, so take us back on the time machine. It's ten minutes ago. We read this question and you found out that this cool company that you're somewhat familiar with is actually a public company. Take us through your process. What's the first kind of things you do to see if this is a company that's worth your time to analyze and see if you want to buy the stock one day?

Dave [00:03:11]:

Right? So I guess the first thing I would do is I would try to pull up the financials. If I had enough time, I would pull up the ten K. If I didn't, I would go to someplace like Seeking Alpha and type in MODG into their little search bar. And they have a little kind of like overview synopsis that you can look at to find out what it is that

the business does. So if I can't even understand what the business does, then I'm going to go ahead and throw it in the too hard pile and I wouldn't even go any farther. And so just by looking at the brief overview, I can see I've been there, so I know it's about golf, and I know Callaway are one of the leading golf clubs that you can buy. And so they have other parts of their business, like you said, different segments and everything. So I understand that it's in retail, I understand it's in the golfing industry. And those are things I think I can understand. So then I would probably start to try to look at the financials to get maybe a sense of what it is they got going on with that. How about you?

Andrew [00:04:12]:

First thing I did went to Strasphere Software Earning KPIs, went to Quick FS and tried to see what's the company looked like over a long period of time. So the first thing that jumped out to me was in 2021 they had 97% revenue growth. So that was very interesting to me. I also see that they cut their dividend. So those are a couple of things that kind of pop when you and I talk about well, you talk about like making an actual question list. I kind of do it without writing it down. But those are the first couple of things where if I want to try to figure out what's been going on with this company, what can I learn about them? I go straight to the revenue growth. And I go to some of their earnings, and they have quite a bit of negative earnings. Not so much lately. They had some negative earnings during 2020. So when I try to figure out, okay, why did they grow Revenue 97%, I go to the cash flow statement because a lot of times a company will grow really fast by acquiring another company. So you can go in the cash flow statement, and you can look for changes cash from investing, where there's money spent for acquisitions. And if you see a big number there, then that could be the reason why they grew so much in revenue in such a short amount of time. And sure enough, when I look at Quick FS, they have the cash flow statement over ten years, they did an acquisition for 481,000,000 in 2019, when they usually earn about looks like 50 to 100 million a year. So four to five times their usual earning they spent on an acquisition. And it looks like it took two years to fully integrate into the business. So from there, I would probably want to find out, okay, what did they acquire? How does that play into what their financials look like today? And again, it just starts down this rabbit trail where I just keep following that white rabbit until I find something that tells me, hey, all right, this is either too hard to your point, or I don't understand it or don't want to spend the time on it, or it's just too much of a red flag and then move on. So that's a long winded way of saying every company for me is different. But that's kind of what I would try to do, is start to build those questions and figure out what jumps out and then try to work through that as quickly as you can.

Dave [00:06:30]:

I mean, I think that's great. That's actually not something I've ever really thought much about. And so I think I like that kind of quick overview and thinking about what trying to assess why has there been such a big jump in revenues? If I was just looking at the numbers and didn't think about your reference relation to the free cash flow statement, I would have assumed it was a bounce back from COVID because 2020 would have been the COVID year when most things were shut down. In particular, something like Top Golf. I think depending on where you lived, I think I remember in Wisconsin, they were allowing people to go play golf because it was outdoors, there weren't a lot of people around, and it was much easier to be separated from each other. But something like Top Golf would have definitely been shut down. So I would have just naturally assumed that it was just a rebound. But if you look farther back, like you said, you can see that the numbers they're putting up now are three to four times bigger than they were prior to the Pandemic. So that doesn't explain why there was such a big jump. Just because they came back to life and it's not Carnival Cruises, they're completely shut down. So that's a great catch.

Andrew [00:07:34]:

So what's next then? You've talked about going on seeking Alpha, trying to understand the business a little bit. What would be your next step here?

Dave [00:07:42]:

For me the next step would be if I'm liking the things that I'm seeing and I want to kind of keep looking further into it, I would probably try to, I guess, another snapshot of the overall company. And Stratosphere has a great, I guess, overview at the top of their page of any company you look at that has kind of an overview of all the different metrics, valuation metrics, margins, the returns, the growth, all those things you can kind of see at kind of a quick overview. And so for me, if I'm going to continue looking at the company, I would look at those and see if anything jumps out at me. Like if you're seeing negative earnings, for example, or if you're seeing any returns that are negative, or if the PE is 97, in this case it's 29. I don't know if that's good or not, but just something to notice. It doesn't jump out at me as like super Egregious. But one thing that did jump out at me was the market cap is a little over 3 billion, but their enterprise value is over 7 billion. So that would be something that I would want to investigate, is why is there such a huge difference to that? And I suspect before I dig into it, after our just recent conversation here, is that it relates to the acquisition that they made, that they probably took on a lot of debt because that's a big part of enterprise value of any company, is the debt. And that would lead me to think, okay, they took on a lot of debt to buy this acquisition.

Andrew [00:09:05]:

Yeah, that's a good one too, because then you start to think, all right, is the ownership structure different than your average company? So if you buy a company like Microsoft, it's pretty cut and dry. You're getting shares of Microsoft, I buy a share of Microsoft, Dave buys a share of Microsoft. We're all in this together. But particularly with some of the smaller companies, the ownership structures can be a little bit opaque, where I might own a share of a small company, but then the founder CEO owns 60% of it and that 60% is not for sale. Yeah, that's a good one to dig in. Like, why is the enterprise value so much bigger than the market cap? So where would you go for that?

Dave [00:09:46]:

I would go to the balance sheet. That would be the first place I would probably look to see where they are with any sort of debt and see that if that's gone up, that's where I would look. So in the liabilities section of the balance sheet we can see that they did take on some debt for sure, but it looks like it's more related to long term leases, which is considered part of the debt. But it would be an operational expense, if you will, of the Top Gulf facilities because they may or may not own that land, they may or may not own the buildings that are being built and so they would have to pay leases to be able to operate those. And so that would explain why there's a bigger portion of the debt that was taken on. And I guess the other place you could look too would be the cash flow statement and to look in the financing activities and we could see if they had taken on a lot of debt. We see that they have taken on gradually increasing amounts of debt over the last four plus years. It doesn't seem extreme at this point. What about you?

Andrew [00:10:48]:

Yeah, I'm seeing in Quick FS, the same year they did the acquisition they also acquired, they added 562,000,000 in debt. So that explains where they got the money to do the acquisition, right?

Dave [00:11:01]:

Because they didn't have cash flow at the time, right?

Andrew [00:11:04]:

Yes, 100% maybe for the newer beginner investor. Is that a bad thing then for a company to do an acquisition?

Dave [00:11:10]:

Like anything in finance? It depends. It's not black and white with topgolf. I guess for me, it might be something that I might be. I would probably have to do a little more work on what it is they bought and try to understand what it is they bought and how risky that is in comparison to what the company is doing simply for the fact that they more than doubled their enterprise value and the majority of it is debt. And if they don't have the cash flow to pay that down over time, or if it puts their interest coverage, which is a metric where you measure how much their debt payments are compared to their operating income, if that's really low, then that could be kind of scary. Because if they experience a downturn in revenues, that means they might run into trouble paying their obligations, and that can lead to bankruptcy. And so those kinds of things would be something that I would want to understand, but for me it would all come back to trying to understand what it is they bought and seeing if they have a history of buying companies and how they've done it. For example, you look at Google or Microsoft, they buy a lot of companies, a lot of people don't realize this, but they do. And like YouTube for example, it came from an acquisition that Google made, but because of the cash flow that that company generates, they don't have to use debt or much debt to buy things like this. Microsoft's the same roper roper technologies. Another company that I follow, they are what's called a serial acquirer. They buy lots of companies and they use debt to do it. But for them, it kind of goes in ebbs and flows. So they take on a lot of debt, then they pay it down. They take a lot of debt and then pay it down. And it's kind of a cycle for them, and it's just part of their operation business. So they have a history of doing it well. And so that to me, would make me sleep better at night if they bought something. But a company like Topgolf, for example, who doesn't have as big long a history of making big acquisitions like this, then that would probably make me a little more nervous. What about you?

Andrew [00:13:11]:

Like you said, it depends. In this case, I bet a normal person would probably just Google Topgolf 2019 acquisition, but I have to do it the hard way. So I pulled up their 2019 ten K, their annual report, and then used our buddy, our favorite search function control F and search acquisition. So I found in their risk factors, they say over the last several years, the company is expanding its focus by doing acquisitions. They named a couple of acquisitions they did in 2017, and then they did a company called Jack Wolfskin in 2019, and then they wrote about a little bit about that business. It's an international premium outdoor apparel, footwear and equipment brand. So I'm actually being a us guy. I'm not necessarily familiar with that company. They might

have brands that I'm more familiar with, but it's all related to that Callaway brand, which, if you play golf, you know that brand. And so it seems that that acquisition makes it look like they're targeting more of the apparel side than they are the Topgolf side. And so, again, answering that question leads to more questions is, as an investor, do I agree with that strategy? Do I think that Topgolf helps them drive business to that apparel business? And then you also want to ask, okay, how much of the business is apparel? How much of the business is Topgolf? So we have more questions to go down, further down the rabbit hole. That's how I would probably start to look at an acquisition like that. You can also look at numbers too, which can tell a lot as well, right?

Dave [00:14:51]:

Yeah, they tell a story. It's our job to try to decipher what they're telling us.

Andrew [00:14:54]:

Yes, 100%.

Dave [00:14:57]:

All right, so I guess moving past kind of the whole enterprise, the whole debt idea, I guess, what would be something else that you would start trying to kind of pick apart to get a better sense of what's going on with this company.

Andrew [00:15:10]:

So one of the things I like to do, if a company is split into different segments, I want to see how profitable are each of these segments. So this is where you have to dig into the annual report. And we know because we've been talking about it, and it's actually in the name. They have Topgolf and they have Callaway, and those are two different businesses. So they do have those broken out into different segments. So you can find the segments in the annual report, or you can search segment until you find where is the segment operating income, where's the profits for each of these businesses, the segment businesses. So I look at 2022, and I see that over half of the operating profit for that year came from golf equipment. So you have more than half of the business is golf equipment. About 20% is Top Golf, and about 20% this segment they're calling active lifestyle. So based on that information, and then you look at 2021, and it's a similar breakdown where a

majority of the profits is coming from golf equipment. So as much as I love Topgolf, as much as I would love to go visit Topgolf as part of my market research boots on the ground, you got to go into the golf equipment and figure out that business first. So that's kind of the process elimination I would take. And it doesn't have to be the whole answer, but it's a good place, probably the best place to start there.

Dave [00:16:35]:

So how would you do that? How would you unpack the golf equipment part of it compared to the Top Golf? Because the Top Golf is something that for me, as an outsider, I've been there, and I wouldn't say I know it, but I've been there, and I've at least know what it is, where the golf part of it, the golf equipment part may be something that's unfamiliar to me. So how would I kind of start to unpack that kind of the part of the business?

Andrew [00:16:57]:

What I would do is start to read about what the company says about that business in its annual report. Because we're recording a podcast, I'm going to punt on that part, and I'm just going to assume we're talking about their golf clubs, their golf balls, stuff like that. So then the next step for me, once I understood generally what the business is about, what are the other businesses that directly compete with that business segment? So as a golfer, tailor made, right. Nike, to a certain extent, I'm not that good of a golfer, so I'm blanking on any other brands that should be considered.

Dave [00:17:36]:

Yeah, me too.

Andrew [00:17:38]:

Good. So that would be the next starting know. Okay. Is Taylor made publicly traded? Are they a private company? Can we figure out what their ticker is or if there's a company that owns that business? And then one of the tricks I've been using a lot lately is the search function in Bamsec. I talked about this at least once before, but if you're a premium user for Bamsec, you can use their search function, and you can search for anytime anybody's mentioned a particular company in their own annual report. So if Callaway doesn't happen to list all their competitors in their annual report, I'll type in Callaway in that search function, and if

TaylorMade's parent company was talking about Callaway, they would show up, and then I could read all about TaylorMade's business. So you start to kind of build an industry map, and then once you have those major players compare, how big are they compared to the others? Who's the leader, who's the small player, who's the fastest grower, all those sorts of things. And then along the way, is this still an attractive opportunity? Or maybe one of their competitors is an even more attractive opportunity than this one. Again, going down the hole. But that's what I would do.

Dave [00:18:57]:

That's awesome. Would you look at numbers like margins or anything like that to try to give you maybe some easy comparisons, especially if the other companies are traded publicly just because it's a segment within Topgolf. You may not have those readily available, but hopefully they give you enough information to calculate them on your own. And then would you compare those to other outside companies?

Andrew [00:19:22]:

Yes. Yeah, I've had to do that with Texas Instruments, for example, because the semiconductor companies can be in multiple segments. It is a lot of digging, and that's why people pay money for research, because it can be a lot, and it's not as simple as taking Walmart or something and comparing it to Target. Those are a little more easy. So, yeah, it depends on the industry.

Dave [00:19:47]:

Okay. All right, so now that we kind of understand, let's say that we have a pretty good working knowledge of Topgolf's revenue breakdown and their segment breakdowns, where would you kind of go next?

Andrew [00:19:58]:

Yeah, that's hard to answer. I think there's probably a lot to be said for having a process you follow with every company. And just for whatever reason, I'm not built that way. So I think from there, the questions have probably piled up, and I'm just trying to solve them. I probably try to wrap it up with what we were talking about in our last episode of if the company's cheap, why is it cheap? And let's figure out that question, especially if the company is very cheap. That might come not even from anything you can research, but just either general knowledge or something that you pick up after researching for several days. Right. And then

what are the risks? Whatever company you're looking at hopefully is one of the best or is the best. What are the reasons why they will no longer be that way, which could make you overpay for this stock? And I feel like those are things you and I try to bounce back over and over again with a lot of these companies. But to me, I think it's important. Are there things you would look at, as far as you've mentioned, margins and some of that other stuff. What have we missed here that people can also look at when they're trying to analyze a brand new company?

Dave [00:21:06]:

I think once I've kind of gotten my head around a lot of the things that we've talked about, I would probably spend some time the risks are very important. And I think really understanding that and being able to invert why you think this is a great company, I think is a great exercise to kind of, I guess, destroy your babies, see what could take this down, I think is a good exercise. But another thing that I would do would be looking at financial analysis and trying to really understand the company as far as what the financials are trying to tell me, whether it's kind of looking at the income statement and not necessarily picking it apart line by line, but at least understanding the margins and comparing those to the industry looking at revenue growth or not revenue growth, and comparing that to the industry looking at things that maybe are not talked about a lot is maybe the capital allocation of the company. Looking at returns on capital, how do they spend the free cash flow that they do generate? Do they pay a dividend? Do they not? Do they give back? Do they reinvest? Do they buy back shares? And if they do buy back shares, how often do they do that? Just all those things would be stuff that I would want to know. What is management doing with the money that they generate? How are they going to take care of me as a shareholder? How have they done that now and how have they done that historically? Another thing that I would do would be to look at the proxy of the company, and I would try to determine a few things from that. Number one, I'd want to know how long has management been in place? Who sits on the board of directors? And then maybe looking at how they get paid or what they get paid, and then comparing that to others in the industry. Sometimes you may look at a number and go, oh my God, that's a lot. But then if you look at three or four of the other companies in their sector or their industry, and they're all getting paid roughly the same, or maybe our person at topgolf is the lowest, those can help you understand maybe some of the incentives and what drives them to make the decisions that they make. Those are things that I like to look at, especially in related to capital allocation, because as Michael Mobison said, that's job number one. And if they don't, allocate the money they make, well, then eventually it's all kind of pointless. And so that's something that I would really try to take a bigger deep dive into.

Andrew [00:23:37]:

Yeah, that's perfect because as you said that I looked at income statement, look at the shares, like you said, are they buying back shares. Are they diluting shares? In the case of this company, they're diluting shares and buy a lot. So 2021 2022, a lot of dilution. And that explains the high growth in 2021 2022. So is dilution always bad? No, there's a lot of companies that use dilution and they invest. And really, those are some of the best investments you'll ever make if you can find a company like that. That for me is too hard pile. So when I see that kind of dilution at this point in my analysis, as soon as I saw it, I would probably move on or just see if another company in there is more attractive. So, for me, the capital allocation can help you find something like that. And then that's the hard part, right? To determine whether some of these capital allocation is good or not, right? It's not always black and white.

Dave [00:24:40]:

No, it isn't. A lot of times we love ROIC, and we've talked about that ad nauseam many, many times, and even more off air. But sometimes the number doesn't tell the whole story, and it can be misleading. And so that's why you really have to look at the numbers and understand what it is they're doing and what they're not doing. And perfect example is the whole dilution aspect that would not show up in the ROIC. And so you could have a company with a super high ROIC, but they're diluting the crap out of their shares. You wouldn't know it. And so that's why it's really good to kind of have a holistic view of the company so that you can really appreciate all those things. And I think something you just said is something I think we probably should emphasize. When you find something that falls into your too hard pile at any point, you can move on. You don't have to. Just because you think Top Golf or Mocado Libre is the greatest thing since sliced bread, it doesn't mean that if they don't fit your criteria, you can't move on and find another pitch to swing at, because there's 7000 plus public companies traded in the world. There are opportunities. So it's just a matter of trying to find a thing that's going to fit best for you. And so I think that's something that probably we maybe don't talk enough about, but you can easily move on. So at any point, doesn't matter whether you've spent 5 seconds or 50 days working on a company, you come across something that just you don't like, if you want, you can move on. You don't have to swing.

Andrew [00:26:12]:

What do you say to the investor who maybe is like, close to that 50 days that they feel like now is wasted learning about a company? What do you say to somebody like that?

Dave [00:26:21]:

It's absolutely not wasted because it gives you that much more insight into that particular company as well as the industry. And maybe that thing that's causing. You to pass on it, maybe that alleviates in three to five years, and you come back to it, and you've already got all that knowledge about this company, and it's just a matter of kind of updating yourself, especially if you've taken notes along the way. And so there's that. Then there's the other aspect of it. John, we're talked about this. It's the it's you've put in the time to analyze this company that thoroughly and that deeply, you can easily emulate that in the next company, and that could be your next Google. And so those skills and experience that you've gathered, by doing that, you can easily transfer that to the next opportunity, and you can just build on that. So it's absolutely not wasted. All time spent is what? Is that the 10,000 hours you need to become a master. Right. Whether or not that's true is under controversy, apparently. But the execution and the skills of all that can absolutely help you with that. I've done that. I've spent endless hours trying to find a solar company that I can invest in that would fit my criteria. And I can't tell you how many ten K's I read. Ten Q's. I read listened to annos reports and listened to CEOs talk and articles hours and hours and hours and hours and hours and hours and hours of stuff. And I didn't buy any. But those are all things I use to find other companies. It's a different business, but it's all the same process. So, yeah, even if you go into 50 hours and you decide at the last second you just don't want to do it, that's okay. It's all in the accumulation of knowledge and getting better at your craft. Why do you think Warren Buffett is so good at it? He doesn't have to do a DCF, because the guy's been doing it in his head for 70 years, so he doesn't need a spreadsheet to do it. Mere mortals like me, I need an Excel spreadsheet. So it is what it is.

Andrew [00:28:21]:

That's wonderful advice. Clap emoji. Clap emoji.

Dave [00:28:24]:

Clap emoji. All right, folks. Well, with that, we will go ahead and wrap up our show for this week. Don't forget to subscribe to the show on your preferred podcast app. If you enjoyed our little show, if you would kindly consider giving us a five star review, it really helps our show. And don't forget to browse the incredible materials that we've created for you envestingforbeganners.com last week. Continue growing your knowledge as an investing for Beginners Insider with insights and educational tips delivered right to your inbox for free. Sign up today. And with that, we will 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. Bye.

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