How to Evaluate Stocks as a Beginner with Brian Feroldi

Dave [00:00:16]:

All right, folks, welcome to Investing for Beginners podcast. Today we have a really fun episode. We have our friend long term guest long term.

Dave [00:00:39]:

He's been on the show many times. Brian Feroldi. He's been on so many times, I forgot how many times he's been on. We have Brian Feroldi from a financial educator from Long-Term Mindset is joining us today. And we're going to talk about all kinds of fun stuff. So Brian, why don't you say hi and give everybody a 32nd overview of who you are.

Brian Feroldi [00:00:57]:

Hey, Dave. Hey, Dave. Great to be back again. Yeah. I'm an author, youtuber. I generally call myself a financial educator, but I teach investors how to analyze businesses.

Dave [00:01:08]:

Yes. And he's very good at it. And that's actually what we're going to talk about today. We're going to talk about how to analyze a stock. So I guess, Brian, if you come across a company that you're interested in, what do you do? Where do you start?

Brian Feroldi [00:01:23]:

So, great, great question. I love learning about how other people think about this question because it helps me to refine my own process. So if I was to come across a company for the very first time, and I'm assuming that I've never heard of this company, I know absolutely nothing about its business or its

financials or its model or anything like that. The very first thing that I do is go to Google, type in that company name, and then investor relations. And pretty much every publicly traded company now has a robust investor relations website. And what I am quickly trying to do is to, as quickly as possible, assess if I think this business is worth investigating or not. You know, to research a company properly can take anywhere between one and 3 hours to really, like, dig in deeply, especially if you don't know it. So I'm looking for clues about the business, the business model, and if it's profitable, so I can eliminate the idea as quickly as possible.

Brian Feroldi [00:02:32]:

So what I like to do is I click over to the company's investor relations website, and I'm looking for a couple things. First, I'm trying to see what the company does or what the company is trying to do. I love it. When a company, right on their investor relations page has the company's mission, like Tesla, where we are trying to accelerate the adoption of electric vehicles, it's like super clear, super obvious what the company does in a few words, Shopify. We're trying to make commerce better for everyone. It's pretty clear what the company is trying to do. The next thing I do is I try and click through and find a company's investor relations presentation. Some people, some investors like presentations, others don't.

Brian Feroldi [00:03:15]:

I personally love them. Yes, they are cherry picked information that the company wants you to see and present its best foot forward. But if I can't get interested in, like, the best information that's out there, why would I go deeper? And I generally find that you can thumb through a presentation pretty quickly and within, you know, three minutes, you can get a pretty good idea of what the company does, what, what trends are with revenue and if the company is profitable or not. Learn about the business model. So that's what I do next. And if it, if it passes, my kind of like initial screen of this business is interesting me, or I want to learn more, the next thing I'll do is I will pull up the, the annual report, assuming that the company's been around for a while or if it's a more recent public company, the s one, the registration statement, and I will start reading from the top.

Dave [00:04:11]:

So that's, I mean, that's an awesome overview of how to get started. When you look at the investor presentation, do you have any ways of helping you prevent from so called drinking the Kool Aid, like getting so bullish after you read all the, the positive things that the company is saying, like how do you kind of balance the, you know, the enthusiasm versus maybe trying to be more realistic?

Brian Feroldi [00:04:36]:

Yeah. So the answer there is, I've looked at hundreds and hundreds of presentations. So the very first time that you look at one, if you've never, if you have nothing to compare it to in your mind, I can see how you'd be like, wow, this can't, look, this is the case. This is a guaranteed money making scheme, right? This invest. This company has so much going for it. They've covered all of their bases. So it is easy to become overwhelmed and kind of glamorize the first time you look at a presentation. And by the way, that means that the management team has done its job because their job is to get new investors interested in investing in that company.

Brian Feroldi [00:05:13]:

That actually tells you a lot about the communication skills of that management team, which is a very critical thing for any management team to possess at this point. It would take truly something outstanding that I almost hadn't seen before or some crazy high number for me to get truly interested. One that comes to mind. The last time that I was wowed by an investor presentation was when I looked at Crowdstrike. Crowdstrike, which has been a phenomenal company, the number that jumped off the page to me was their gross customer retention rate. So this was not upselling, not that it was just purely from one year to the next, what percentage of your customers do you keep? And for Crowdstrike, that number was 98%. Effectively, the company has, like, no churn at all. And when I saw that single number, I was like, wow, that is so unbelievably impressive.

Brian Feroldi [00:06:10]:

But seeing numbers that, like, really blow me away like that are rare.

Dave [00:06:16]:

Yeah. Yeah, for sure. Yeah. Crowdstrike is one of those companies that every time you pull up a chart, it's got that beautiful up to the right. Just everything that you look at it, it's. Yeah, it's a beautiful thing to see. So when you look at, when you read through the ten k and you look at the financials, what are some things that you kind of try to focus on to help you kind of narrow down whether this is something you should continue keep looking at?

Brian Feroldi [00:06:42]:

Yeah. When you look at the financial statements of a company, especially multiple years of financial statements of a company, you can learn a lot about the business. And you can, I can tell fairly quickly if it's a company that's going to interest me and deserve a deeper dive or if it's not. So the first thing, usually the first financial statement that's listed is the company's balance sheet. So I will quickly scan over a company's balance sheet, and I'm usually checking for a couple of key things. First thing, I want to know,

how much cash does the company have? And for there, I'm going to add a cash. Cash equivalents, marketable securities. And some companies also list long term investments under their long term assets.

Brian Feroldi [00:07:22]:

So I add up all those numbers together and get an idea for how much immediate cash is available to that company. To me, cash is king. Cash allows businesses to go on offense when times are bad, which is something that's really important to me. So first I look at cash, then I'm going to look down and I'm going to check out a couple other numbers. I'm going to see if they have receivables at all and how big those receivables are compared to their total assets. That tells you right there if the company is selling primarily for cash or if it's selling on credit between the two. I want. I want a company to sell for cash and get paid immediately.

Brian Feroldi [00:07:58]:

I'm also checking for inventory. If a company has inventory, then it's selling and manufacturing some kind of physical product. If a company does not have inventory, then it is likely to be a service based business that does not have to physically make something between the two. I would rather prefer to invest in a company that doesn't have to worry about inventory. Next thing I'm going to look for is goodwill, and I'm going to compare the company's goodwill number to its total assets. Goodwill will give you an indication of if that company has grown organically through homegrown products and services. That is my preferred way for a company to grow, or if it's grown primarily through acquisitions, which is not my preferred way to grow. Now, some companies can make acquisitions work very well.

Brian Feroldi [00:08:46]:

Danaher Transdime, Berkshire Hathaway. But as a general rule, I avoid companies that grow via acquisitions. So that's the company's assets. Then I look over on the other side of the balance sheet. I check the company's liabilities. I look for debt levels. How much debt does the company have, and how does that compare to the company's assets? What type of debt does the companies have? What are the companies biggest liabilities? I look for things that interest me from a liability perspective. For example, if I see deferred revenue, boy, is that a positive sign.

Brian Feroldi [00:09:22]:

That is the best liability you could possibly have. If I see operating lease liabilities, that, to me, is a nothing burger. I just ignore that number. And for a lot of, like, retailers and restaurants, that can often be a very big number. But the main thing I'm trying to do is assess how the company's key liabilities, and the key liabilities, to me, are primarily debt. How does that compare to the company's current asset base? And then

once I have a good sense of that, I look at the company's shareholders equity. I'm looking primarily at additional paid in capital. So how much capital has been raised from investors over the years? I look at retained earnings.

Brian Feroldi [00:09:58]:

Is retained earnings a positive figure or a negative figure? And then if the company lists it treasury stock, that tells me if the company is buying back stock. So there's like eight to ten numbers on a balance sheet that I quickly check, and that can tell you a whole lot about the history and current liquidity of a business.

Dave [00:10:15]:

So are there any things when you're looking through the balance sheet that if you see something that's maybe not a good thing, I'm out. Like, are there any, like, drop dead. This is, I'm done.

Brian Feroldi [00:10:29]:

I would, I would not say that it eliminates, but boy, does it give me a good sense if I see a company with, like, let's, let's pretend the balance sheet is horrible, right? Let's pretend the company has very little cash, tons of debt. Tons. Like the number. The company's biggest asset by far is goodwill and shareholders equity is negative. I just described Teladoc's balance sheet, by the way. That to me is a. Forget it. I would, I would say I wouldn't completely eliminate it, but, boy, is that a massive red mark against the business.

Brian Feroldi [00:11:02]:

And I better be wowed by damn near everything else that I see. Otherwise, I'm just going to skip, skip over it. You know, I've heard it said that when you buy a stock, what you're really buying is a balance sheet and a management team. I'm kind of like that idea.

Dave [00:11:14]:

Yeah, that's a good idea. So besides the balance sheet, do you look at the income statement and the cash flow statement as well? Do they fall into this category?

Brian Feroldi [00:11:24]:

Absolutely. But usually companies list a balance sheet first, income statement second, cash flow statement third. So that's the balance sheet. I can quickly, in like 30 seconds, I can scan those numbers and I get a quick, I get a quick read of, is this a fortress balance sheet? Is it an average balance sheet or is it a really weak balance sheet? So I'm going to assume the balance sheet was fortress. So check there

financially. Next, I look to the income statement. I'm looking at a couple of things. First off, I'm hoping to see multiple years of income statements.

Brian Feroldi [00:11:54]:

Most s, one s and annual reports have three years of financial statements. And I'm looking at one, what is the trend for revenue? Ideally, it would grow every single year. Two, the next thing I check for is what is the trend for gross profit? And what is the relationship between gross profit and revenue, aka what is the company's gross margin? My favorite is when a company has a gross margin of 80% or higher. I view that to be an extremely positive sign. I don't like it when a company has a gross profit that gyrates wildly and is below 20%. Some businesses can do great with low gross margins. Costco comes to mind, for example. But generally speaking, I prefer to invest in companies with high gross margins.

Brian Feroldi [00:12:46]:

After that, I'm going to quickly look at the company's operating expenses, see what sticks out. Do they break them out into sales and marketing and research and development and general administrative, or is it all lumped into one? Then I'm going to look at the company's operating income and I want that to be a positive figure. Then I'm going to scroll all the way down to the company's earnings per share and see what the general trend is for earnings per share. Is it a positive figure? Is it a negative figure? And then I'm going to look at shares outstanding and I want to just get a quick sense for the dilution rate that the company has done over the last three years. Generally speaking, in an ideal world, revenue would be growing, gross profit would be growing right alongside it, and stable. Operating income would be positive. Shares outstanding would be decreasing, and earnings per share would be positive and rising. But you can get a quick send about the recent operating history of a business with a quick spin of the income statement.

Dave [00:13:44]:

Yeah, yeah. And I guess lastly, the cash flow statement. What are your thoughts on that cash flow statement?

Brian Feroldi [00:13:50]:

Probably my favorite of the three, to be honest. And it's the hardest for investors, especially new investors, to wrap their head around and learn to analyze. But I think of the three, it's the most powerful. So when I'm looking at a cash flow statement, starting at the top with net income, like we see the same trend with what happened with net income recently, then I'm going to look right below that and say, okay, what are the key things, the key non cash expenses that this company takes on? How big is depreciation and amortization? How big is stock based compensation? And then what is the company's cash flow from operations, CFFO?

And how does that number compare to net income? Ideally, cash flow from operations is always bigger than net income, perhaps substantially bigger than net income since it adds back in non cash charges. From there, I'm going to do a quick mental calculation to figure out a company's free cash flow, that is, cash flow from operations minus capital expenditures. And then I'm going to do some quick mental math and see how that number free cash flow compares to net income. First off, is free cash flow positive? Is it growing and is it bigger than net income? That would be the kind of like ideal. If it's negative, if it's shrinking, and if it's less than that income, that deserves some investigation.

Brian Feroldi [00:15:11]:

After that, I'm going to scan down to the financing activities. I'm just going to look at is the company issuing debt? Debt not issuing debt at all? Or is it repurchasing debt? Is the company issuing stock? Is it, or is it buying back stock? Is the company paying a dividend? And then finally I'm gonna look at what is the company's ending cash balance, and how has that trended over the last couple of years? It's kind of remarkable how much information you can learn about a company just by quickly looking at its cash flow statement. But the most important numbers to me is, the most important number to me by far, is free cash flow. I want to see that free cash flow is positive and growing and.

Dave [00:15:50]:

Yep, exactly. So we've kind of covered all the, like, I guess, tangible things that you can do when you're kind of, when you're starting to analyze a stock, can we talk, maybe talk about maybe some of the untangible or intangible? So, for example, competitive advantage or a moat like, how does that fit into your analysis?

Brian Feroldi [00:16:10]:

It's absolutely critical. Moat is one of the things that takes a lot of nuance to kind of interpret. But this is something that you can infer from one is the company's presentation, if they have one, a good management team will make it clear to investors what their competitive advantage is, why investors should believe that competitive advantage is durable, and how that competitive advantage allows the company to generate high returns on capital. So the company should make that immediately clear to you as the investor. If they haven't done that, then you have to kind of do some digging. Now, if I'm going to be investigating a company, let's say it passes all those financial tests that I'm like, I'm like, oh, I'm interested in this business. I'm going to go to the annual report, and I'm starting to read the business description, how the company describes itself in there. You should read all about the company's products.

Brian Feroldi [00:17:04]:

You should read about the company's business model. You should read if the company has recurring revenue or one time sales. You should read about the company's operating history, the market that it operates in, any competitors that are in the industry, and how the company has done from there. As you're reading down there, you should also be giving clues to key business metrics that the company thinks are very important. For example, if you're analyzing a software company, that management team better report their company's dollar based net revenue retention rate, which is same customer spending from year to year. If you're analyzing a restaurant, the company better report same store sales. If you're analyzing a bank, the company better report its efficiency ratio. And oftentimes, looking at those non financial metrics, but key numbers, they can indicate, indicate whether a company has some sort of moat or not.

Brian Feroldi [00:17:58]:

But I view that there's five big moats. There's a network effect, there's switching costs, there's low cost production, there's intangible assets like brand name trade secrets, license or I or government. Government license. And then five would be business model. So counter positioning, as I'm reading through the company's description of itself, what I'm mentally trying to look for is how defensible is this idea? Why should I believe it as an investor, that this company's revenue will be higher five years from now and ten years from now than it is today? If I don't see clear signs that a company is, has a moat or is actively building one, it's an immediate pass for me. Why bother with that company?

Dave [00:18:40]:

Right. So are there any metrics that you could use to maybe give you a gauge of whether a company has emote or not?

Brian Feroldi [00:18:48]:

Yeah. So again, this is kind of where you have to use your inference. So remember for when I mentioned CrowdStrike, CrowdStrike's gross retention rate on customers with 98%, meaning if they start the year with 100 customers, they end the year with 98. That's almost unbelievable. It's so, it's so good. Like, basically, if you install CrowdStrike, you ain't getting rid of it. So that gives the company strong switching costs. So that is a sign to me that come.

Brian Feroldi [00:19:15]:

That customers that sign up with CrowdStrike are very hesitant to change vendors. That tells me a company has switching costs. If I'm analyzing a network effect company, such as a social network or a business marketplace like the New York Stock Exchange, I'm looking for signs that that company has established itself as the top dog in its industry, and it should say something about our market share is 40%

or 60% or something along the lines, or we have the most users by far, or we have, we have the most buyers and sellers on our platform. I want to see some sign that the marketplace has determined that that particular company is the leader in its industry, because companies that have network effects are basically winner take all dynamics, and investing in the second place or the second biggest company makes zero sense to me. If I'm trying to find if a company has low cost operations, I'm looking for something that says internally, we have something that our competitors can't do, we have massive buying power, or we have a unique business model that allows us to deliver a product or service to a customer cheaper. Finally, if it's something that is dependent on an intangible, such as a premium brand or a patent, in the case of a drug company or some kind of government license, again, the company will make that readily apparent to me. But of them all, Brand is probably the hardest to really, truly analyze because brands are only valuable if they position you differently in the hearts and minds of your consumers. All right, so if I say the name Apple, you think differently about that company's products than if I said the name Magnavox or if I said Sony or something like that, right? People won't pay a premium for generic electronic devices, but they will pay a premium simply because the name Apple is on there and what that name infers in the customer mind.

Brian Feroldi [00:21:26]:

So generally speaking, if it's a newer company, brand is unlikely to be a strong indicator of that company has a moat. But if it is an established company that's been selling something for at least ten years, brand might be something that separates them.

Dave [00:21:41]:

Yeah, those are all great explanations. So we've talked about like maybe the past. When you talk about financials, those are things that have happened in the past. Most are something that you can try to get your head around whether they have a competitive advantage. How do you think about the future potential of the company? Because that's really what we're investing in. So how do you think about that?

Brian Feroldi [00:22:02]:

Yep. So when I think, broadly speaking, about the balance sheet and the company's moat, that's really about the company being able to play defense, really protect what it already has from the forces of capitalism. Now, playing defense is important, but that's not going to make you money as an investor. It's a company going on offense and being able to grow from where it is today. That's how you make money as an investor. So I'm looking for signs in the company's financial statements or the reports that indicate to me that the company, that the market opportunity that the company is going after is far bigger than what

the company has currently captured. Now, there's a couple of ways to get there. One simple way is to have a teeny tiny slice of a big established market that everyone has heard of.

Brian Feroldi [00:22:52]:

If you're a new shoe maker, if you're on running or on cloud, on running, I think is their name, they're doing a billion dollar sales in a category that does globally probably $200 billion in sales. So they're literally sub 1% of some massive market that everybody has heard of and everybody needs. If a company is in the cybersecurity industry, that's a newer market that is very likely to grow over the next coming years as cybersecurity becomes even more important in the future than it is today. Or if a company is establishing a brand new market from scratch that really doesn't exist of like Netflix did back in 2008 when it kind of entered the streaming space in a big way. You just had to believe as an investor that the consumers were going to switch from watching cable to watching streaming and that market would gradually grow in time. But it is absolutely critical when you're looking over that you believe that this company is capable of growing its revenue and its profits alongside them for a long period of time. That's what makes for a great investment.

Dave [00:24:05]:

Yeah, it really does. So what are your thoughts on, like, optionality? I've, I've heard people talk about that in relation to Google and Amazon and some other companies.

Brian Feroldi [00:24:13]:

So I have. Optionality to me is an incredibly important topic to understand. I define optionality as a company's ability to launch new products and new services to the market that generate, importantly, needle moving revenue. Needle moving revenue. So my definition of optionality has changed over the years. Previously a company take a couple of Alphabet, aka Google. I used to get, I used to think, wow, I can't believe how much optionality Google has, right? It has all of these products and services that it is working on. The trouble with Google is the company is generating hundreds of billions of dollars from its legacy core search business.

Brian Feroldi [00:24:59]:

So while it might have lots of shots on goals for any of them to really benefit investors, not only does it have to work, it has to work on the scale of tens of billions of dollars. So to me, Google might have a lot of options, but will they lead to needle moving revenue for investors? I think the odds of that happening are actually fairly low just given the pure scale that the company is operating at. If you converse that with a company like Axon Enterprises. Axon started out its business by making tasers. So like the stun guns that

are used to take people down that are being kind of crazy. And the company had a couple hundred million in sales of tasers. Then a few years, a few years ago, it launched the body camera and software business that complemented the company's taser business. Now, because the size of that opportunity was actually just as big, if not bigger, than the taser opportunity, that new product could actually generate needle moving revenue for the business.

Brian Feroldi [00:26:02]:

So to me, a company like Axon Enterprises get full full credit for optionality because it can launch new products that generate needle moving revenue for investors and big companies, multi trillion dollar companies or $100 billion companies. They just have a harder time GEtTing that same level of credit for me simply because of their current scale.

Dave [00:26:24]:

That's awesome. I love that phrase, needle moving revenue. That's going to stick with me. All right, so I want to talk about SOMETHing that I struggle with of how to assess this, and this is CustoMers. How do you think about a company's customers? We're talking about crowdstrike, 98% retention rate. How do you, I guess, how do you analyze that?

Brian Feroldi [00:26:47]:

Yeah, this is something that I think not enough investors really spend the time to think through. But customers are the lifeblood of a BusinesS. Customers determine whether a business can grow or whether a business is dying. So the behavior that customers have in the relationship they have with a customer, with a company, matters tremendously to me when I'm trying to figure out, does this company have a good relationship with its customers and great customers or a bad relationship with its customers? I think about a few different areas. First thing I think of is how does a company acquire new customers? Most companies, especially publicly traded ones, spend hundreds of millions of dollars, if not billions of dollars, every year on sales and marketing and advertising expenses. I want to see is all of that spending generating new customers at an effective rate. Now that could be hard to, hard to figure out if you are an investor, but the clues that I look for is, generally speaking, how much of a company's gross profit, gross profit is spent on sales and marketing. As a general rule, I want less than 30% of a company's gross profit to be spent on sales and marketing.

Brian Feroldi [00:28:01]:

And if they're spending that much, I want revenue to be growing at least 20% per year. That, to me, is an effective trade off. The worst scenario is a company is spending 70% of its gross profit on sales and

marketing, and its sales are growing less than 10% per year. That to me, is a horrible trade off. That means that the company has to spend a ton of money just to essentially stand in place. So one, how expensive customers are, how expensive growth is to is to acquire as relates to spending on sales and marketing. Second thing I think about is customer dependence. How dependent on the product or service are the company's customers? Aka, if a inevitable downturn in the economy comes, do customers stop buying this product or service, or do they keep the buying it? My favorite is when a company is.

Brian Feroldi [00:28:54]:

When is when a company's relationship with customers is so great that that customer will not stop spending even if a downturn comes. So again, getting back to crowdstrike, you're going to be spending money on cybersecurity no matter what is happening in the economy. That is a mission critical expense nowadays. Conversely, are you going to be buying a premium electric vehicle if the economy takes a downturn and you lose your job? The answer there is no. So if a company has mandatory spending, I view that as great. If a company has optional cyclical spending, I view that as less appealing. Next thing I check for is the company's revenue recurring once it acquires a customer, does it get revenue from that same customer again and again and again? And how often is the customer buying from them? Best case scenario for me is a comp, is a customer is buying from that company monthly, if not weekly. Like if you become a Starbucks fan, you're probably going to buy Starbucks constantly throughout the year.

Brian Feroldi [00:29:57]:

Whereas again, if you're buying something that's like patio furniture or just furniture in general from a company like Wayfair, you're probably going to buy that once and then not again for a couple of years as you use that. Good. And the final thing that I try to think through is pricing power. Does the company have the ability to pass along price increases to consumers without changing their customer behavior? That's something you just kind of have to get a feel, a feel for, but I want customers that can do so. So to review, there's a lot there. I want customers that are cheap to acquire once they're acquired. They spend. Even during recessions, their spending is recurring in nature.

Brian Feroldi [00:30:42]:

And the company can raise prices without losing customers if it has those fall hallmarks. Boy, is that a great business.

Dave [00:30:49]:

Yeah, no kidding. Yeah, those are ones that we all want to buy, right? So I guess another area that I don't think investors, especially newer investors, spend a lot of time on is management and culture. And I don't think people realize how important that really is to, to great businesses. So what are your thoughts on that?

Brian Feroldi [00:31:10]:

Yep, management is absolutely critical to me. And you're right that a great management team is very important. I will say as a general rule, as a general, one thing way to think about management teams. The younger, the smaller, the more uncertain the future is. The more management team matters. The bigger, the more established, the more dominant, the more wide mode of businesses, the less a management team matters. You want a great manager no matter what, but I'm pretty confident you could put a ham sandwich in charge of Mastercard, and the ham sandwich would do a great job, right? Like, Mastercard is so big and built out. Like, you can make me the CEO of Mastercard, and I could just not go to the office and be like, keep doing what you're doing, everybody.

Brian Feroldi [00:31:51]:

And we would do fabulously well, but you would not want, you would not want a great manager in charge of, like, an AI based company, right? Their future is so uncertain, and there's so much to navigate. But generally speaking, when I'm trying to assess if a management team is good or not, there's a couple of things I look at. Number one, how much stock does that person own? In an ideal world, I would want 99% of that CEO's net worth tied to that company, because if that stock falls, I get hurt as a shareholder. But I want the CEO of that company to be really hurt financially if the stock falls. So that is a good. That is a good indication. Finding out, figuring out what to use for that can be a little bit tricky, because it would be unreasonable to assume that, like, Tim Cook owns 5% of Apple, for example. That would be an unreasonably massive number.

Brian Feroldi [00:32:50]:

In fact, I think that would make him the richest person in the world if he did that. But you want to see that somebody like Tim Cook owns hundreds of millions of dollars worth of Apple stock, and that is very likely to be the big chunk of his net worth if it's a smaller company. I love finding founder led businesses, and those founders can usually own 1015, 20% plus of a company stock. So inside ownership is good. Second thing, tenure. How long has that person been with the company? Best case scenario, they founded the business. Next best case scenario, especially if it's an older business, is that person has spent their entire career at that company and worked their way up from work, their way up from graduating, all the way up to being in the c suite. That tells me that they have soul in the game at that point.

Brian Feroldi [00:33:40]:

Their friends are working there. They've probably been to their colleagues weddings. Right? They have a personal relationship with the people at their company that goes deep, and they have a higher likelihood of actually caring about the company more than they care about their compensation package. Next, I look at employee reviews. Do employees like working at the company? So, Glassdoor. Indeed. LinkedIn, you do a quick scan of those sources and just say, do employees like working there? Generally speaking, I don't invest in companies that have happy employees, not those with angry employees. And then, fourth, I look at the company's communication style.

Brian Feroldi [00:34:19]:

Do they have a clearly defined mission statement? Do they have nicely presented, easy to understand financial statements. Do they have good presentations that make what they're trying to do easy? Is their annual report easy to read? How good of a communicator are they with shareholders? So those are a few ways that you can check to see if a management team is likely to be good or bad.

Dave [00:34:41]:

So if you come across a company that you really, really like and you find management that you're like me, how does that do you keep? Would you invest in the company or would that be an out?

Brian Feroldi [00:34:54]:

Again, it depends on the stage of the business. If it's a smaller company, if it's a smaller company, more dynamic, more uncertain future. If I did not like the CEO pass full stop. It's risky enough investing those businesses. I have to be able to trust the management team. If it's a company like Visa or Home Depot or something like that, like some big established company, even if I'm not, even if. Even if I don't really love the management team, so long as I believe in the business enough, I would be willing to buy that stock that is betting on the horse, not the jockey. So the stage of development of the horse really matters to me.

Brian Feroldi [00:35:36]:

But as a general rule, there are so many great leaders out there. If I really did not like a CEO, or if that CEO came across as overly promotional or something, I would probably just avoid that business. Even great businesses can be destroyed by terrible management teams. So if I get the sense that a management team is, is not got my best interest at heart, or I don't, I just don't think that they're the right person for the job, I have no problem taking the pass.

Dave [00:36:03]:

Yeah. Yeah. I. I think one thing that's lost in all this is that you don't have to swing at every pitch. So even if you've gone through this whole list so far, you don't have to swing at every pitch. If you find something you don't like, you can always pass.

Brian Feroldi [00:36:15]:

Yep. Absolutely. I mean, I've made this mistake in the past where I've bought companies that were small and growing, and when I would listen to the investor conference calls, even if the CEO sounded good on paper, they just came across as a slim, as a sleazy salesman, and I could hear that they were just so over promotional of the business and how great job that they were doing, and they just gave me kind of, like, bad vibes, and I just let that pass and then that stock would go down as the company kind of failed to live up to the hype. So it can be hard to see through those things, but sometimes using your spidey senses as a general human is a good idea.

Dave [00:36:55]:

Yeah, I totally agree. So I guess the last group of questions is kind of around, like, the past performance of the company and how you think that impacts what could happen in the future and maybe some shareholder friendly actions. We always want to find management that's looking out for us.

Brian Feroldi [00:37:12]:

Yeah, absolutely. So this is something that I always try and look at while I am a fundamental investor. I do think that looking at the long term performance of the stock, a five year performance of the stock versus the S and P 500 can actually tell you a fair bit about the business. Studies show that roughly two out of every three publicly traded companies will underperform, underperform the index over time. So your general thing, when you come across any idea, your default answer should be no, this is a bad idea. I should pass. The burden of proof is on the company to convince you otherwise. One quick test that I do is, has the company beaten the market over the last five years and since it came public? Ideally the answer to both of those tests is yes and yes.

Brian Feroldi [00:38:09]:

If a company has lost to the market over the last five years, or it has lost, is destroyed shareholder value since it came public, they better have a damn good reason why that's the case for me to be a buyer of that stock. Now, this isn't a test that you can do with companies that haven't been public for five years. So any of the stocks that came public since. Since 2020, and, boy, was there a lot of them. They simply haven't had a long operating history that you could, you could use their chart. But if a company came public in, like, the

2010s or the two thousands or the 1990s, just looking at the long term chart and asking, has this company created value for shareholders since it came public? That, to me, is just a wonderful, simple test to put some.

Dave [00:38:53]:

Yeah, it really is. That's. That's probably one of the better tests. Right? So we've gone through all of these, all these different ideas and thoughts. How could an investor kind of collect these into a collection that they could use to, I guess, standardize their analysis?

Brian Feroldi [00:39:12]:

So one thing that I recommend all investors do is go through the following exercise. Step one, write down all of the positive traits that you like to see in an investment. Make a big list of if a company has this, I'm more interested. So it could be strong balance sheet, positive free cash flow. Founder led management team history of outperformance, wide moat optionality et cetera, et cetera. So make a big list. Next, make another list. All the things you don't want to see in an investment.

Brian Feroldi [00:39:48]:

If an investment has this, you are turned off. For me, that's things like accounting irregularities, customer concentration. It's in a declining industry that is being disrupted. That company is dependent on market prices for success, for example, the price of oil or interest rates. It has very high stock based compensation. Dilution rates are high, et cetera. So make these two lists, then rank them from most important to least important. Boy, will that exercise tell you a lot.

Brian Feroldi [00:40:24]:

Congratulations. You have now a checklist for yourself that you can take any potential company through. And having a checklist is the closest thing to an investing cheat code that I know of. Keeping all this stuff in your head is extremely challenging. But once you write it out on paper or have some kind of system that you can take things through, quality of your decisions will improve dramatically.

Dave [00:40:47]:

Yeah, dramatically. And I would add a caveat. If you, when you make a decision, good or bad, about a company, write it down somewhere, because our memories are way more fallible. As Brian was just saying, we can't keep track of all this stuff, and we think we can. And at the end of the day, it's about our decision

making. And I think keeping track of something like that can really help you try to make better, hopefully make better decisions in the future. So you have a checklist. Do you have.

Dave [00:41:14]:

I know you've created lots checklist, because I follow you on social media. Do you have one you could share with us?

Brian Feroldi [00:41:21]:

Yep. So if you go to my website, longterm mindset dot co checklist, you can access and download my investing checklist for free. Now, my investing checklist not only has those categories, actually has a scoring system that I use for each of them, it also has my business partner, Brian Stoffel, his investing checklist in there. But there's no bonus points for originality, right? Steal, copy, borrow from the best investors. That's exactly what I did when I made my investing checklist. So you can download my checklist for free. That can be a good starting point, but I would encourage everybody after you do that, make it your own. Right.

Brian Feroldi [00:41:58]:

What are the things that matter to you as an investor? They might not be the same things that matter to me.

Dave [00:42:03]:

Yep. Yep, exactly. Brian, this has been an awesome conversation. Where could people find more about you? Where are you online? And I know it's a lot.

Brian Feroldi [00:42:13]:

Yeah. Pick a social platform. The odds are pretty good that I'm there tweeting or posting on LinkedIn under my name, which is Brian Feraldi. I'm on YouTube, I'm on Instagram, I'm on Twitter, etcetera. So pick a platform, find my name. I'm likely to be there.

Dave [00:42:27]:

Yes, he is. And if you want to learn more about investing in general or just specifically check out any of the platforms that Brian's on, you will learn a ton. I know I have. So he's been a, he's been a great follower, and I really appreciate him sharing all of his knowledge with us because it's, it's, it's invaluable. So, Brian, thank

you very much for joining us today. We really appreciate it. And I will put all that stuff in the show notes so people can check everything out. And with that, we'll go ahead and sign us off.

Dave [00:42:53]:

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 out. All right, stop recording.

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