IFB353: Mastering Investment Checklists - A Deep Dive with American Express

All right, folks, so welcome to Investing for Beginners podcast. Today we have episode 353. Today, we're going to talk about checklists and you created this great value checklist that has seven I guess overarching ideas. We're going to talk about the pros and cons of each.

00:00:50 Dave

And kind of walk through a company American Express to kind of show you how this can be put into use in the real world. So I guess with that maybe let's touch briefly on 30,000 foot overview of why a checklist and why we think it's important. Well, you know you can learn the value of the checklist and.

00:01:09 Andrew

Use the the value of the checklist and find that you don't use it enough. I mean, how many times have you and?

00:01:14 Andrew

I talked about.

00:01:16 Andrew

A company got really excited about it and then in the last $11.00 you find something that's a huge red flag and then it's like all that.

00:01:23 Andrew

Work has been.

00:01:24 Andrew

Wasted so having a checklist and being able to run through as much.

00:01:28 Andrew

Of it as you can.

00:01:30 Andrew

Further in the process saves her a lot of time from.

00:01:33 Andrew

Sifting through bad ideas and also just kind of covers your bases, right? Like.

00:01:38 Andrew

It's hard again when you get emotional about stock, it's easy to come up with all these ideas. Why you want to buy it if you don't.

00:01:46 Andrew

We look at it from all angles systematically, you know, forget Oops, I forgot to consider if the company had a competitive edge or not. And that sounds simple, but it was surprise how often that could happen. And I will tell you because I just did it on Tuesday when we end our conversation about the one company.

00:02:03 Andrew

That I won't mention.

00:02:05 Dave

The little girl named.

00:02:06 Dave

Yeah, checklist.

00:02:08 Dave

They become vitally important when you realize you made a mistake because you didn't use it, and I think we have all I'm saying. All investors have come across companies that we fall in love with the one way, shape or form and we miss something in our analysis and then we buy the company and then the.

00:02:28 Dave

Performance is not what we expect and we come to find out that maybe there's a a small chunk in the armor, so to speak, that would have been uncovered if we had followed a checklist or had that particular item on our checklist to ensure that we don't miss.

00:02:42 Dave

That and that is one of the big reasons why having a checklist is so important, because it can help you sort out ideas very, very quickly. We had our friend Brian for all day on a month ago, and that's one of the.

00:02:56 Dave

Things he talked.

00:02:56 Dave

About and he was very big on trying to analyze different parts of the financials.

00:03:02 Dave

Really quickly so that you can turn off a lot of rocks, which is a great process, but I kind of go back to when I first got into investing. Manish Purai was one of my early gurus or hero.

00:03:14 Dave

And he is very big on checklist and he got that from Charlie Munger, who got it from observing pilots and hospitals using checklists and you know, to us it makes complete rational sense that a hospital would have a checklist before they go into surgery and cut you open, right. We all think that's like a normal thing, but that's actually not.

00:03:34 Dave

It's newer to the whole medical field, which is kind of staggering when you think about.

00:03:39 Dave

But the point is, is that no surgeon today would dream of going into surgery without having some sort of checklist. Same thing applies when you fly a plane. They would never take off. Well, they shouldn't ever take off without going through the checklist to make sure that you know the flaps are working. For example, you don't check that thing, you get up in the air. That's a real hard.

00:03:59 Dave

Place to learn that lesson and the stock market is kind of the same idea. It's a very hard place to learn lessons. Unfortunately, sometimes we have to learn those lessons to.

00:04:07 Dave

Learn the lesson.

00:04:08 Dave

Not a checklist can help you avoid some of those, and we'll go to practice. If we don't get to it is whatever you do, make a bubble or make a mistake on a company when you're analyzing it, you discover something that you missed. Put that on your checklist because the next time you go through another company, you'll go, oh, yeah. OK, so that could be real helpful. So I guess.

00:04:29 Dave

Without all that, you know, go with my soapbox and let's start looking at checklist. So let's talk about the first item on your value checklist, which is secular trends. So what does that mean to you? And let's talk a little bit about pros and.

00:04:43 Dave

Cons of that?

00:04:46 Andrew

The gist is basically why is the stock promising?

00:04:50 Andrew

I would like to be in.

00:04:53 Andrew

Companies who have easier races to run than harder ones, and the other run downhill than uphill. And so if there's a secular trend or if there's something particular about this, this particular business that makes that future promising, then I usually get excited. And the big kind of idea.

00:05:11 Andrew

That to tag along with that is not only should there be an exciting narrative, but I should also be able to prove the narrative with big picture facts. And so if I'm looking at a home builder or something, the home building industry, I want to know what's the general stats room starts and.

00:05:32 Andrew

Single home purchases and and those kinds of things. And so for the industry, I look a little bit different, but hopefully you can tie some data point that kind of makes sense and is.

00:05:44 Andrew

Separate from the business itself, that to me I like to have because it's a way of checking my narrative. I probably don't put put picture facts in there every time, but the general concept is, is there something that's promising about the stock, the company, the industry that will help?

00:06:04 Andrew

This company going into the future. Yeah. Do you look at that stuff? Like I kind of like it too. I like what you're saying about, you know, you're trying to find.

00:06:12 Dave

Not necessarily the easy button, but you're trying to look for tailwinds as opposed to headwinds. And I liken it to something that Warren has said off and off again, is he likes to work for one foot hurdles to step over as as opposed to 7 foot.

00:06:26 Dave

Hurdles and when?

00:06:28 Dave

I think of that secondary trends. That's definitely something that kind of pops into my head.

00:06:32 Dave

Company or industry experiencing?

00:06:34 Dave

A tailwind or headwind and how can I take advantage of that? So what are your thoughts on like a downside to looking at this?

00:06:43 Andrew

Yeah, that's a great question. Then the answer would be over indexing into a tailwind or a secular trend. I will see people do this all the time and I will do it too. Obviously, whether it's a 5G, cloud computing, whatever medical breakthrough it is, whatever new world we're all imagining.

00:07:04 Andrew

It's easy to get to fall in love with them, so that's something to keep in mind when you're looking at a second.

00:07:05

That.

00:07:08 Andrew

I'm like, you want it there, but don't make it your end all be all. And hopefully that's why I have the list of items on the checklist and another one is this is really hard and it applies to everything, but don't force the members to make.

00:07:21 Andrew

An idea that you.

00:07:22 Andrew

Would like. It's really easy to align with data and to make it look like how you would like it to appear, and so we'll be.

00:07:28 Andrew

Careful about that.

00:07:29 Andrew

Start by trying to figure out what's going on while then trying to prove some.

00:07:34 Andrew

Idea you're excited about?

00:07:36 Dave

Yeah, exactly. It reminds me of a quote I saw recently. Miller fiction has been written in Excel than any other place in.

00:07:42 Dave

The world.

00:07:45 Andrew

That's my kind of fiction.

00:07:48 Dave

Yeah. And it's just getting hot up here. It's very easy. You know, the confirmation bias can be a real, real thing to fight.

00:07:55 Dave

Against and I also wrote this great also way that we kind of talked a little bit about the other day was.

00:08:01 Dave

That this idea of the AI or the Internet, for example, there were certainly when they first came out, people were super excited about them and there was lots of predictions about how much it was going to change the world. But almost all those.

00:08:17 Dave

Predictions were right.

00:08:18 Dave

But ten years too early, and so the fruits.

00:08:22 Dave

Of the Internet didn't really start to kick in for another 10 years or so, and this person was speculating or postulating that the AI advances that we're.

00:08:33 Dave

Seeing right now.

00:08:35 Dave

We all can see how awesome it's going to be, but it may not really kick in for just the overall global population for another 5 or 10 years. And so, you know, sometimes you have to balance the enthusiasm for a particular thing with the reality of when it may actually occur in electrical.

00:08:54 Dave

Vehicles, you know crypto, I mean just you look at the market and it's littered with those kinds of enthusiasms. Sometimes they come to pass, but sometimes they don't. So you always have to try to temper your enthusiasm with as Andrew was saying, all right, so we've kind of talked about our thoughts about secular trends. Let's maybe put this in real case use form and talk about American Express. So what?

00:09:15 Dave

Any thoughts on?

00:09:17 Dave

Secure training with American Express.

00:09:20 Speaker 5

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00:09:39 Speaker 5

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00:09:51 Andrew

Yeah, I don't know if I should spend time kind of talking about the American Express. How would you describe them?

00:09:57 Dave

Somebody who maybe is not familiar, not familiar with them, I would say that they are a. If I had to assign them with a label, I would say they're a leading.

00:10:07 Dave

Credit card processor that also is a bank.

00:10:12 Andrew

Yes, perfect. Thank you. So that's a good way to think of them because they're not quite like a visa MasterCard because they do the credit cards as well.

00:10:16 Dave

Alright, sure.

00:10:23 Andrew

As a bank.

00:10:24 Andrew

But something about American Express that makes them exciting and has been for several years now, is how they are doing.

00:10:32 Andrew

Really, with the millennial and Gen. Z groups. And so something I did when I ran American Express, the more value checklist was like.

00:10:42 Andrew

Data from visual capitalist actually they I guess they collaborated with the World Economic Forum and they took the average annual expenditure.

00:10:50 Andrew

Year in 2021, for each generation and kind of how that breaks out. So it looks like a bell curve in Gen. X right now is is the highest earners and so.

00:11:02 Andrew

You can kind of look at that and get a.

00:11:07 Andrew

Almost like I didn't quite do this because again, you can live with Excel but.

00:11:10

Yeah.

00:11:11 Andrew

Just an idea of how much growth is possible if they capture more millennial and Gen. Z and I know that's like obvious, right? Like they're going to increase their spending power as they age. And just now it's interesting thought experiment and some of the things that and that starts about example their.

00:11:32 Andrew

Average frequency score, which measures credit quality of of a customer and Lindsey cover was 750 in 2021. That's pretty good there also.

00:11:43 Andrew

Finding that the jeans and the meetings are more interested in higher fee credit cards and so that becomes an important part of the whole annex stock story and that that we can talk about later on. But the fact that this color is kind of getting with the program, if you will, we will sign up for the higher.

00:12:03 Andrew

The fee cards because they give you the higher rewards as a signal that they become very little and that's a lot of long term revenues and profits for American Express. That sounds like a great nice tailwind for the company to lean into for sure.

00:12:19 Dave

Yes. All right. So let's move on to financial. So this is Part 2 of your value checklist. What does that mean to you?

00:12:27 Andrew

Well, I mean it fits with the way I'm trying to invest. So anyway, the world I'm finding a few good businesses and letting them do all the work for me and.

00:12:37 Andrew

Then have to.

00:12:38 Andrew

Kiss some friends to find the Princess, but you can find those types of businesses we've seen them over and over again that will generate a lot of wealth, and all you have.

00:12:45 Andrew

To do is buy and hold.

00:12:47 Andrew

So.

00:12:48 Andrew

So we need to find those kinds of companies. I'm looking for companies that have a track record of growth or as their revenues been will have their profits been and raise up and going. It doesn't need to be perfectly straight up into the right line, but it should be a long term trend of growth. I mean, just wearing margins, that's the other piece of this.

00:13:09 Andrew

So are the profit margins.

00:13:11 Andrew

Contracting or are they expanding? And if the problem margins are getting worse, that may not be about 5 for me, but that would be something I would wanna learn more about and get context on it and it can be a good place to start to dive into some additional research like OK, what's going on with the business and how they.

00:13:32 Andrew

Don't perform later. You can now tell me about how everything with the business is going.

00:13:37 Andrew

Yeah, that doesn't.

00:13:38 Speaker 5

Like to look at, yeah.

00:13:39 Dave

That's perfect. I have a group of like 5 or 6 different metrics that I like to look at using the financials to kind of see where the company is going. Obviously revenue growth is one of them and then also look at the margins as well. I'll also look at the balance sheet and see kind of where they are.

00:13:57 Dave

With cash versus debt on the balance sheet, you can use the debt to equity ratio to quickly see that. But I like to actually physically look at it. Sometimes I'll look at the market cap versus the debt or the cash to kind of see how that like the enterprise value like how that really fits with the overall.

00:14:15 Dave

Equity value of the business. I also like to work at return. Electrics normally are to use Roc, but because American Express sort of a bank then that's not really a useful 1. So then for them I would work for return on equity and.

00:14:32 Dave

So those are things that I just will use to help me scan through the financials before I really dive in. This is more when I'm looking at this process, it's more of a filtering process like OK, hey, if they have more debt than than cash.

00:14:49 Dave

That's not necessarily a red flag, but it could be yellow flag and if I've seen the deck go up and up and up over like a 5 or 10 year period, if I use thin chat and I could see that over a longer period then that would be possibly a red flag and I would be out. So I'm trying to look at this part of the equation as a filtering process. What are your thoughts?

00:15:11 Andrew

I want to represent just don't want to follow with the numbers right? Just want to make sure that this investment looks like it's going to fit what we're looking for the long term exactly so.

00:15:21 Andrew

All those same metrics too, that you just beyond.

00:15:24 Dave

Yeah. What I've probably gotten from you what are some of the downsides to analyzing the financials?

00:15:32 Andrew

So I'll give you one example and again to talk about the company that you and I talked about on.

00:15:37 Andrew

Tuesday, I will.

00:15:39 Andrew

Passing on them, but there are situations like that company that actually would be great opportunities. And so one example is you know if the business has stumbled around for a long time and then now they've turned it around and maybe for two or three years.

00:15:54 Andrew

Beverly.

00:15:56 Andrew

You can tell the numbers they've done something differently and that's a couple in your business. But if you're looking at the metrics or the five to 10 year period and you just kind of glance and be like oh, that's gross and move on, then you might miss opportunities and we do that all the time too. And that's kind of like part of the game, it's you have to balance between saving time and.

00:16:16 Andrew

For the opportunity, but that is a downside to the winds will start on these filters as you might miss some of that. And so that's where we made the break. And I think in general it saves a lot of time and it's it's a good part of the process. It is I think having those.

00:16:32 Dave

Those.

00:16:32 Dave

Can also help you avoid owing in love with the numbers or the company. Sometimes you may come across a company that everything but maybe one or two things really stands out as exceptional, and maybe those other two things may also be to the extreme, ugly and so.

00:16:52 Dave

You can be off putting, but if you.

00:16:54 Dave

Have some guides?

00:16:55 Dave

Then you can help you kind of navigate through that and as your game more experience then you can choose pick and choose whether you want to.

00:17:04 Dave

And your I guess deepening look at that company based on certain factors sometimes debt for example may look really ugly. But then when you dig further into it, you may find other factors about the debt that could give you like, OK, maybe this isn't so bad because maybe it's structured a certain way.

00:17:24 Dave

Or maybe the interest payments are really, really low, and so even though it's a high number, maybe historically for the company.

00:17:32 Dave

Based on how it's staggered when it's due, when it's actually costing the company, it may not be. It may not be as offensive, so that to me is, you know, it's part of the game of learning how to invest, but that's kind of how I try to look at maybe potential bad things that I see in the in the financials, but.

00:17:52 Dave

I always come back to this one thing I always look for a reason to say no and something.

00:17:56 Dave

Charlie learned a lot about and in his letters, you know, or I always called him the abominable no man. And what he was really getting at was, you know, Charlie always look for a reason to say no. It's easy.

00:18:07 Dave

To look for.

00:18:07 Dave

Reasons to say yes, it's a lot.

00:18:09 Dave

Harder to look for.

00:18:10 Dave

Reasons to say no. And I think if.

00:18:12 Dave

You keep that in your mind and it'll help.

00:18:13 Dave

You avoid. Maybe some missteps.

00:18:16 Dave

So.

00:18:18 Andrew

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00:18:29 Dave

And now I've done.

00:18:30 Dave

That let's kind of talk about the financials in relation to how you'd look at.

00:18:34 Dave

Them with American Express.

00:18:36 Andrew

Like for example using friends from from chat, I like to look at what's the revenue and the earnings per share and the operating margin trends. And so those, all pacifying colors company, when I last looked at this company for the average return on equity is 29%, although safety metrics, the quality.

00:18:55 Andrew

The other looked good.

00:18:57 Andrew

That that deal. But there are more cash and securities than that. So passing with our flying cars making express as far as some of these metrics and only like when we go, it's not like buying anyway, but about

6.3% came over the last 10 years including with some buybacks, dividends and you have a pretty nice sustainable long term return.

00:19:17 Andrew

So.

00:19:17 Andrew

That's that looks good on the front for all.

00:19:20 Dave

Of that, yeah.

00:19:20 Dave

Exactly. It's not flashy, but it's companies burials at the 1860s, I believe, so not exactly a new, you know, fast growing company, but doesn't mean you can't get great returns. It's beating the beating the S&P over the last three years. Just as an FYI. So let's talk about competition. So what?

00:19:37 Dave

There's competition. How does that? How do we analyze that?

00:19:42 Andrew

So that's one of those things, right? Just because a company has done well up to now.

00:19:48 Andrew

It doesn't mean it's going to do well in the future, particularly with the competition is heating up and then on the flip side.

00:19:55 Andrew

Going along those lines, company might be doing well, but the whole list you might be doing great, and maybe they're actually falling behind instead of getting ahead. Maybe they're overextending themselves. So those are the things we want to do and consider looking at what's all the other companies in that ecosystem doing. They don't have to be beaten down on every other company.

00:20:16 Andrew

That's in there, but they won't be able to hold their own. Don't think competitiveness and really show that they have some.

00:20:22 Andrew

And that's either different or can compete. And as I'm falling behind all those sorts of ideas is why I like to look at the competition, and I always look at that competitive advantage and the model that kind of all ties in to another one of my checklist items. I'd like to separate the competition.

00:20:42 Andrew

Start to its own section, because that's where I focus. More on.

00:20:48 Andrew

And through all the other people there and the other businesses in there, or is there more to me that would be like like specific so 2 two different things to look at. It's the same thing, but it's such an important part of living there for a business that I've, you know, that's why I've been like a double emphasis on it.

00:21:08 Dave

Right.

00:21:08 Dave

Enjoying working competition and and how do you do it? Yeah, yeah, absolutely. Look at it. And I stole an idea from you and that I take. I look at what I think the competition is and then I'll look at the five year revenue growth of each company.

00:21:10 Andrew

Oh yeah.

00:21:26 Dave

And.

00:21:27 Dave

In the industry and just kind of chart it out on Excel and so I can kind of visually see, OK, this is how American Express is done, this is how visa is done. This is how Mastercard's done. So Capital One is done and discover and so on. And so it gives me an idea of how they've done. You know, I'm not necessarily looking for them to crush Visa, MasterCard.

00:21:48 Dave

I'm just looking to make sure that you know, because I feel like they have a different niche than Visa and MasterCard due and a different niche than discover and capital loan due and so I want to see how they're doing on themselves, but also in relation to others in their industry.

00:22:04 Dave

And then if I'm unsure like this example is something that falls into my wheelhouse. But let's say I'm looking at the train industry or something that I'm not as intimately knowledgeable about, then one of the things I will do is I will go to the proxy of let's say.

00:22:23 Dave

One of the leading railroads in the in the country, and I'm going to give them a name right now, Union Pacific. So I will go to Union Pacific's proxy and see who they consider in the proxy. A lot of times in the compensation.

00:22:35 Dave

Section. They will list all the companies that they compare numbers to to compensate their CEO's. And so that's a really good place to find who they think are their competitors. And then I would do the exact same thing. I would just kind of map out the revenues over a period of time to give me a, I guess, kind of a snapshot of where I think the industry is as well as the Union Pacific.

00:22:55 Dave

In particular, in that industry, and I find that helpful.

00:23:00 Andrew

Yeah, I love that. So what are some downsides to thinking about competition? Are there any I guess you can get 2 if you're using it as a filter maybe and then you're seeing a company that looks like it's falling behind. I think Texas Instruments will probably be.

00:23:20 Andrew

Like an example of this, if and start at the competition and say, oh, you know the last.

00:23:27 Andrew

4-4 or five quarters are behind the appears by this match, and they're this thing, blah blah blah. But if you don't like when they kept you away from instruments, then you understand that the company is in a very unique investment things right now building out these huge, expensive films that.

00:23:47 Andrew

That they're making their results look worse and also shifting from a distributed model to a direct direct to consumer model, which is.

00:23:56 Andrew

No.

00:23:57 Andrew

That's not how the think about it. I would also reduce revenues compared to compared to others. And so that's where you can.

00:24:07 Andrew

If you just are basing decision on just based on the competition or the relative competition, then.

00:24:15 Andrew

You can miss opportunities or just miss not really understanding the whole picture, so jumping to conclusions, maybe without gathering all the information, those are.

00:24:25 Andrew

Things that can happen if you're just so focused on the competition and have closed your mind. Anything else, anything else you see around there?

00:24:32 Dave

Yeah, those are.

00:24:34 Dave

I think that's probably probably the biggest 1 is just kind of misjudging where you think the company sits among competition and who they're who their competitors are. And I think that could be.

00:24:47 Dave

I mean, if you try to, you know if you use your example, you try to compare Texas Instruments to NVIDIA and that's, you know, not apples to apples comparison. So I think that's probably the.

00:24:58 Dave

Biggest challenge when?

00:25:00 Dave

You're looking at competition is make sure you're comparing apples to apples at least as much as you can, you know, don't don't compare American.

00:25:07 Dave

Exposed to Google or NVIDIA because that's just not, that's not a fair competition. So speaking American Express then how do you or how would you look at competition for them?

00:25:18 Andrew

Yep, so.

00:25:20 Andrew

Again, because there are also a bank and a credit card processor, and then you can make sure that.

00:25:29 Andrew

People are leaving American Express from from the credit card side, but you don't really compare them to Visa MasterCard because Visa, MasterCard are on the.

00:25:39 Andrew

Like high transaction, high volume kind of game and they're not a bank. So they're playing, playing different ball game and how they're generating revenues than some of like American Express. So the good comparison for American Express is discover. So what I'll do when the American Express I want to look at, all right, what's the difference between?

00:25:59 Andrew

Amex customers discover customers has Amex performing last 5-6 years.

00:26:07 Andrew

Americans have better growth in the income, also better rewards expense, which is then kind of reinvesting in the growth of their business and also another current risk of their members compared to discover. And that's really important for a credit card company like American Express, profits from the current book.

00:26:27 Andrew

It's it's. It's one of those things that showed to me the way I interpreted the data that you can express.

00:26:35 Andrew

Is another pick than discover was when.

00:26:38 Dave

When I looked at it.

00:26:39 Dave

Yep, Yep. I agree. Yeah, that's.

00:26:41 Dave

Those are very important.

00:26:44 Dave

API's to look at when you're looking at a company like American Express and I think that's important to consider when you're looking at different companies, understanding what the important KPI's are and how they kind of stack up against competition can help you get a better sense of whether this is a good investment or not.

00:27:03 Speaker 1

Oops, right.

00:27:03 Andrew

Alright, let's move on to the boats.

00:27:06 Dave

Are one of our favorite topics. So what are your thoughts on boats?

00:27:11 Andrew

It's how are we going to thwart the competition, right? Previous previous growth, previous perfect growth, that's all nice, but that stuff goes away unless you have something that differentiates you. And note that allows you to extend that advantage and compound on it. And so lots of companies.

00:27:31 Andrew

Lots of them can dress up like the ones that are able to.

00:27:35 Dave

Stay. They usually have a Moat, whether it's obvious or not. Yes. Yep. And having a strong load that is growing is one of the ways that you can find companies.

00:27:48 Dave

When you identify them, are companies that you can hold on to 10/15/20 years because those are the kinds of companies that will?

00:27:55 Dave

Speed against competition over a very long period of time. It's not just a matter of a high ROI C, It's whether they can maintain that high ROI. I see against other people because you know.

00:28:07 Dave

To quote Jeff.

00:28:08 Dave

Bezos, your margin is my opportunity. So that's kind of the shark mentality. You see somebody that's successful and you think hey.

00:28:15 Dave

They can do what they're doing.

00:28:16 Dave

You and if you can't defend that person or defend them off, then you start to lose some of your advantage, and eventually it may not be the death knell your company, but it can certainly ruin your competitive advantage and pricing power and all those things will lead you to not have as greater terms.

00:28:37 Dave

Is if you invested in another company, so that's where we're understanding modes and being identifying them, and the only ones that can, you know, beat off the the alligators and the sharks from in the Moat. That's where you really can find a long, great long term investment.

00:28:54 Dave

Yes. So what are some? What are some downsides about?

00:28:59 Andrew

About everything, the price you pay matters a lot and so.

00:29:05 Andrew

Investing in something unless you're able to hold it for a long time, the evaluation can drive a big part of your overall outcome, and this is sort of that, which is kind of complementary is might seem really strong now, but that doesn't mean it's going to be strong in 1520 years. So it's still forming.

00:29:25 Andrew

Are the science team trying to determine that? But that quote?

00:29:29 Andrew

Explain something as as simple as you can. The most simpler, yeah.

00:29:31 Dave

Yeah, I.

00:29:33 Speaker 1

Right.

00:29:34 Andrew

So some of the longest lasting minutes and business models into that where?

00:29:43 Andrew

You can intellectually understand why the Moat is there and why it will continue. Technology is notorious for having notes that just disappear overnight, while other businesses and other industries or other structure, or the way the business delivers value.

00:29:59 Andrew

All these things can make something.

00:30:03 Andrew

Learn the lesson than others, but that makes it hard. I mean, makes it really hard because today is not more in 10 years. And so to me, the whole is the hottest part is like getting that time frame correct and then if the longer you zoom out, the more.

00:30:20 Andrew

Realizing less and less option set and that makes it hard too. So I've dealt with all of that. I've dealt with all that up to now by.

00:30:30 Andrew

I was talking about and being like, OK, I want evaluation my lot. I'm strong about too and it makes a little bit easier to find a newer company every month that would probably going insane.

00:30:44 Speaker 1

Right. Yeah, if.

00:30:45 Dave

It would drive you insane for sure. It would be almost near impossible.

00:30:50 Dave

And we think about Warren Buffett, who's arguably one of the greatest investors of our time but all time. And he has been able to find a few companies that have had really strong votes that have been.

00:31:03 Dave

Knowing and we look at all the companies he's bought and sold through the years and it's because he he finds what he thinks is a mode and it turns out that it's not. And then he OK sells and, you know, tries to learn from that from that experience and also doesn't mean that companies will go in and out of favor or.

00:31:24 Dave

Have most for a period of time, and then maybe they, you know, develop different technologies or different products that become more popular. And can you know allow them to sustain a different kind of boat over periods of time. And Amazon would probably be a good example of a company that seems to be kind of pivoting to different things to create.

00:31:42 Dave

More, you know, competitive advantage for themselves and that's one of the things that I think sets sets both it apart is he's really good at looking at the obvious things that maybe some of us don't always take into consideration like when he was first, when he first bought American Express back in the 60's. The big reason why he bought it was.

00:32:01 Dave

You also you went through the numbers and you figured out it was going through a big controversy at.

00:32:05 Dave

The time and he.

00:32:08 Dave

Are people still using their cards? He talked to people on the ground. He used the kind of the scuttlebutt idea. He talked to customers that used American Express cards A they weren't aware of the scandal and B it didn't impact their use or not use of American Express's product. And he deduced that.

00:32:28 Dave

And this will be a short time short term you.

00:32:31 Dave

Hurt. And then once they got past that, the company would go on to strength, that their strength and that's exactly what ended up happening. And when you think about Coca-Cola, the big reason why I bought it wasn't because of its coke is because he couldn't see a reason why they wouldn't be selling more Cokes five years now for 10 years.

00:32:51 Dave

Now and that people have developed, myself included, an addiction to it and we we will willingly pay.

00:32:59 Dave

You know any price to keep consuming it and he he deduced that that consumption and pricing power based on the customer behavior was definitely gives it, you know, a strong competitive advantage in mode. And the company has been around for 150 years and who knows if it's ever going to go away.

00:33:19 Dave

I may be owning book share and they're still owning Coca-Cola 50 years from now, so we'll we'll see, but I guess so. What are your thoughts on like downsides to this? Like how?

00:33:29 Dave

How can people avoid bad stuff?

00:33:33 Andrew

You know, I guess keep it in perspective, I get really excited about them out just like anybody else will. And so just it is very important you mentioned this takes up to two checklist items basically this ability to defend yourself against competition. But remember that there's other factors in play and I think that's the best thing.

00:33:51 Andrew

You could probably do.

00:33:53 Dave

Yep, Yep, I agree. And.

00:33:55 Dave

Sometimes you'll get lucky and what you think was the mode doesn't turn out to be the mode, but something else does. And I've had that happen several times, and so it just always remember that it's a learning process and what you think.

00:34:10 Dave

Is the right thing. May not be the right thing, but just be open minded to discovering. Hey, I was right or wrong about this.

00:34:18 Andrew

And try to learn from it, because it it can happen for sure. So let's talk about the mode for American Express only called it, whether this for those other to make it short called it the virtuous cycle Firewall original right 's magic.

00:34:37 Andrew

Is they have higher spending customers and so basically a lot of I don't get super into the details, but basically because they have a higher spending.

00:34:49 Andrew

Client and level as the Alex card. If I'm a hotel or find a restaurant, I want to be able to make sure I accept Amex and so.

00:35:00 Andrew

Failed to accept the Amex is higher than the field accepting this and MasterCard and so and still is and and this is the special part is still keeping that extra fee for themselves. They give it back to the customer and something like a Costco. And so they mix.

00:35:17 Andrew

The tourist is not the right word, but the everyone really knows that they have some of the best rewards in the industry and whether that's being able to be filled by the fact that they generate higher fees and so it's it's a virtual cycle in the sense that.

00:35:34 Andrew

As in that my.

00:35:36 Andrew

Core members of our spending and you know more merchants won't.

00:35:37

So.

00:35:40 Andrew

That, and then the more merchants accept and the more transactions are done to the merchants, the more critical roles that they can give back to the numbers and the more the Members can spend and they kind of.

00:35:50 Andrew

Goes in the.

00:35:51 Andrew

Snowball effect. And so that's, that's what makes American Express unique and different. And so they come in that position in the marketplace.

00:36:01 Andrew

No credit card really has gotten close to, and it's been the reason why they're doing well.

00:36:06 Dave

And and why they will continue to do well. Yep, exactly. Alright. Let's talk about risks. Let's talk about the risks on the checklist. So here we go. One favorite part, right.

00:36:14 Andrew

All right.

00:36:20 Andrew

But yeah, you definitely want to try to find the holes in your thesis. Try longer likes to say, and there always in there if you take that mental model and apply it to buying the stock. Really wants to think about how much money can make. How can the stock succeed to invert that question means how can the.

00:36:39 Andrew

Not fail. The reasons why this idea might be a bad idea, and so the risk factors can help you get there, and they're different probably for every company. But by dedicating the space.

00:36:53 Andrew

In in my mind, for looking at the risks forces me to.

00:36:59 Andrew

Tempered down my bullishness because I've got them finally two or three and try to debunk them so because that's the task I have to do with the stock I'm forced to look at it in the most positive lens and that can really help you. Sometimes there's some words that maybe many times of having.

00:37:19 Andrew

And buy the stock and then six months later, the honeymoon period.

00:37:22 Andrew

Over and there's something glaring with the business. And you're like, oh, crap, This is why the stock was cheap. So hopefully by looking at the risks as early as you can in the very beginning, it saves that kind of pain later on, but it's not something that I like to look.

00:37:38 Andrew

At.

00:37:39 Dave

I think it's it doesn't get a.

00:37:40 Dave

Lot of love.

00:37:42 Dave

In the social media world and it doesn't get a lot of love and just investing in the world, there's not a lot of discussion on the importance of uncovering the risks.

00:37:53 Dave

Some of it probably is because if you try to read through the with section in 10K, it can be you know it can be sleep inducing. It's written by lawyers. They're trying to cover their butts. A lot of his bull played or just, you know, standard language that you'll see in just about every company. And some of them are so generic like we're, you know, we're subject to.

00:38:13

Oh.

00:38:15 Dave

Competitive risk really we're subjected to, you know, cyber security risk, really you know, so it's like, come on. So I think once you can identify the.

00:38:28 Dave

Holes in your thesis. I think that can really be helpful as you're analyzing companies, we just have to remember there is no perfect company. There's always a company that has something. There's a check in the armor somewhere and it's just a matter of whether a can be exploited by another company or whether management.

00:38:48 Dave

Or other forces could cause it to stumble, and that's what you that's the emerging of safety part of investing is trying to look at the risks and determine how much am I willing to pay to offset my taking on this risk. That's the the tricky part to me. So what are your thoughts on American Express?

00:39:08 Dave

And risk.

00:39:09 Andrew

So that would be one that kind of ties into what we've discussed already.

00:39:14 Andrew

These merchants could steal or surcharge if the IMX, and so you know, that could cause an Amex card or maybe not use the Amex and then the virtual cycle starts to be Rd. So that's something the business is there with for a long time, but it's going to be aware that, hey, that is.

00:39:34 Andrew

That is a problem potential problem if it starts to show up again and again and again, then we don't want to start paying attention, then figuring out what we.

00:39:44 Andrew

Can do from there. Yep, Yep.

00:39:46 Dave

Exactly. All right, let's move on to the next to last item on our checklist, which is management.

00:39:54 Andrew

What?

00:39:55 Dave

Are your thoughts on management?

00:39:57 Andrew

Yes, this one is probably this one is the hardest for me and the one.

00:40:02 Andrew

That I get.

00:40:02 Andrew

Wrong the most.

00:40:04 Andrew

You know I.

00:40:06 Andrew

If it's a manager, I'd like to give him the benefit of the doubt. If if a manager has having a track record, I usually like to also give them the benefit of the doubt.

00:40:16 Andrew

And therefore improving wrong and and some things have come in and I'm thinking 2 very good examples in the last 10 months or insiders, they're not to go with me and kicked out the CEO's.

00:40:27 Andrew

Like I loved.

00:40:27 Andrew

It so, you know, comes to that stuff, but it's also important to to look at because even though it is very soft.

00:40:36 Andrew

You know, to analyze some person you've ever met can also force you to look at things like capital Allocation, acquisition history, how they were investing in the business, how are they managing that, all those things?

00:40:49 Andrew

All tangible numbers we can look at that is kind of separate from the growth picture and by doing that, I think it's a valuable checklist item to other businesses. The what its track record is. It's arguably one of the hardest parts of analyzing a company because there's no there are some.

00:41:10 Dave

You know, vague metrics you can use. You know, I think like ROI C You can use that to kind of measure management, but sometimes.

00:41:19 Dave

Managers don't really. They have an impact on it, but they don't. And so it can be nebulous like to the quality of the CEO. If you look at a company like Visa or MasterCard, I'm not saying that the CEO's are running them are ham sandwiches, but you could probably put me or Andrew in charge of those companies and they.

00:41:39 Dave

Probably would still produce, you know, because the business in and of itself has gotten to the point where it can not run on its own, but kind of and.

00:41:51 Andrew

So.

00:41:52 Dave

When you think about management, you really want to find, you know, people that are have skin in the game and so things you can look for are like how much, how much have they invested in the company, like how much of their personal wealth is tied up in in the company, whether that's through the salary, whether it's through stock options, hang out.

00:42:12 Dave

You know, shares that they are.

00:42:13 Dave

You know you know, the higher the better because you know the more skin in the game they have, the more they're going to be induced to do a good job. So they get a good return, right? So and things like that, you know, a little trick that I like to do is search through Spotify and look at, look for interviews from the CEO's and.

00:42:34 Dave

That way you can actually hear them talk, because when you hear them talk in pre prepared speeches and earnings or even investor presentations, it's very it's kind of scripted. And so except for the analyst portion of it which you know the analysts are are trying to probe, but they're also don't want.

00:42:51 Dave

Step on toes because they don't want to lose access to, you know, insiders in the company. So it's a fine balance. Those people have to to run, but when they're just being interviewed by somebody just randomly on podcast, all that stuff goes away. And so you can actually hear either thoughts be whether you think they're really insightful or a ham sandwich.

00:43:11 Dave

Or you can, you know, determine some of those things.

00:43:14 Dave

So some of those can.

00:43:15 Dave

Go a long ways towards.

00:43:18 Dave

How you feel about somebody and the way they treat other people? So if they're treating an interviewer poorly, well, what's to say they aren't training employees like crap too? So you can induce a lot. It's a soft scale for sure, unfortunately. But I think those things can be very helpful when you're kind of trying to assess management and.

00:43:38 Andrew

It's it's not an easy skill, but it is something I think you need to practice because it's, you know, it's vitally important. Yeah, the last tip and in today's day and age, more and more CEO's are getting comfortable that things are good thing.

00:43:52 Andrew

Yep.

00:43:52 Dave

Yeah, exactly. And truthfully, one of the big reasons why I fell in love.

00:43:56 Dave

The login was when they were doing their interview or or when they're doing their quarterly calls, they which they do every six months and the CEO and the person talking to and they literally sitting on a couch in a living room and they just, you know, having a conversation on a couch. And I was like.

00:44:12 Dave

OK. Yeah, I like these people.

00:44:14 Andrew

This.

00:44:14 Dave

Just because it was so relaxed and way back and it wasn't stuffy.

00:44:17 Dave

For the tie and so serious, if that's the way they are with this kind of stuff, that's the way they are with their employees and that's a company I would want to work for and somebody like that so that that attracted me to them. So what are your thoughts on American Express's?

00:44:32 Speaker 5

Manager.

00:44:34 Andrew

Yeah, I mean, not necessarily groundbreaking research on this part, but you know, trying CEO Steven Squarey, he's been there since 2018. He's maintained the high return on equity that long term shareholders have come to expect and now also growing.

00:44:53 Andrew

Rate while maintaining that return on equity so you know from 2019 to 2023, the PS grew at 8.8% CAGR which is good. So I want to say.

00:45:05 Dave

You know, check this more off the list and move on and that's that's how I looked at American Express. Yeah. When I looked at that, I threw out there, too, about them. About him was the pandemic was very hard on American Express because they rely on a lot on travel or income and he did not freak.

00:45:26 Dave

He didn't panic. He didn't try to change the business model or.

00:45:31 Dave

Determine that they need to go in a completely different direction. He just stayed the course and kept doing what they do and when we came out of the Pandemic American Express, you know, thrived after that and has done well since. And I think to me that indicated a very stable personality and that that was a bonus to me.

00:45:50 Dave

Yes.

00:45:52 Dave

All right, so.

00:45:52 Dave

Let's move on to the last part of the checklist, our favorite valuation.

00:45:58 Andrew

Yeah. What's the price we're paying for our stock? The risk being, if you pay a price that's too high.

00:46:08 Andrew

The chances are that even investors who are expecting.

00:46:13 Andrew

They have huge expectations and with those expectations are not met, then we're going to leave the stock and the higher the evaluation goes, the more of those type investors you got to generate want to jump on the next high gold kind of thing. And so when those people leave, you got stock crashes.

00:46:31 Andrew

And there's an evaluation tool. It's not going to save you from one of them, but it does save.

00:46:36 Andrew

You from a.

00:46:36 Andrew

Lot of them. And so that's the idea because it's hard to, it's hard to compare your money and then hard enough when you're trying to do that from behind so.

00:46:51 Andrew

Avoid those kinds of situations.

00:46:54 Dave

Yeah, yeah, absolutely. The price you pay matters and.

00:47:00 Dave

Having the margin of safety helps deflect.

00:47:03 Dave

If you make a mistake in any of the other parts of the analysis that we are talking about up into this point, so if we miss on the management or if we miss on the risks or if we miss interpret something in the financials, if we think that the revenue growth is all tied to this particular thing, but it's actually not having a margin of safety can help you avoid.

00:47:24 Dave

Totally losing.

00:47:25 Dave

Your.

00:47:26 Dave

Shirt investing in a company like that and.

00:47:28 Dave

So that's why.

00:47:30 Dave

Looking at what you pay for, the company matters and you need to. There's a many different ways Andrew and I like this kind of capital models, but we also invest in companies that are are a little more on the mature side. And so those makes sense. If you're investing in IPO's.

00:47:51 Dave

And startups and stuff. DCF may not work so great for you, but it it really just kind of depends on where the company is in their in their life cycle. And you can find a method that can work for you. The the biggest take away that I could.

00:48:06 Dave

Give to you whether you use spreadsheets or whether you use other methods of valuation a make sure you're consistent with your inputs. As we said earlier, there's a lot of fiction written in Excel and bigger and better doesn't always necessarily mean better. Professor Oswald the Motoren swears by using 5 or 6 inputs.

00:48:26 Dave

To value a.

00:48:26 Dave

Company.

00:48:27 Dave

You know you don't need.

00:48:29 Dave

To know everything to the NTH degree, to figure out, and also don't worry so much about precision. It's more about being directly correct or approximately right than precisely wrong, and so don't get wrapped up in like I got to buy the company $72.13 that's.

00:48:46 Dave

Not important. What's?

00:48:47 Dave

More important is finding out a range.

00:48:49 Dave

What you think is appropriate for that particular business and trying to be conservative, it's natural to drink the kool-aid. It's natural to get excited about a company that you really, really like and you think that.

00:48:59 Dave

The.

00:48:59 Dave

Market is missed, but just try to temper your expectations that you know 75% revenue growth from now until you know eternity.

00:49:08 Dave

That's not going to happen and so.

00:49:10 Dave

Just trying to.

00:49:11 Dave

Temper, you know the enthusiasm because it's easy to get excited. But that to me is when I look at valuation, those are some of the things I try to keep in mind.

00:49:20 Andrew

Yeah, that's some state movements in there that really helps if you start doing your evaluation. Those are all things that hopefully will pick up. If you didn't listen.

00:49:32 Andrew

To that park. So that's really good.

00:49:33 Dave

Right, right.

00:49:35 Dave

And I think the last thing I'll throw out there is just like weight lifting or gymnastics like we just saw the Olympics, you got to put in the wraps, you can't just value a company once in a while and you got to do it on a regular basis. And the more you do, the better you'll get and the more consistent you'll get with it and then help improve your your output, IE returns.

00:49:55 Dave

By that as.

00:49:56 Dave

Well, So what are your thoughts on American?

00:49:58 Dave

Express's valuation.

00:50:00 Andrew

So for you can express because it's a bank. I do it slightly differently. Usually I'll calculate free cash flow appreciation. In this case, use kind of something inspired building.

00:50:12 Andrew

Basically, what's their names? And then let's leave a little bit for the reserves. So take 90% of APS and get to an effective pulling quotation marks for casual discount the cash flows.

00:50:27 Andrew

Assume a growth rate and so I really like what you said there about being conservative about those impacts being conservative about the growth rate, so.

00:50:37 Andrew

The next 7 1/2 to 10% growth I felt like.

00:50:40 Andrew

Was conservative enough.

00:50:42 Andrew

It could be like it could be well and and we'll see how that plays out. So for me, I came up with the value of anywhere from 200 to 240 and you know about and mix again six months ago. So I was, I was based on those numbers and so we found there was.

00:50:58 Andrew

Maybe slightly too a little bit is either failed or a little bit undervalued. The time I purchased it so these onto Excel on the pen and paper if you will, and some numbers conceptualize.

00:51:13 Andrew

Exactly how cheap is this thing and what does the business need to do for me? For my thesis to play out? So in the case of Mark Express, they need to go free. Council equity by 7, 1/2 to 10% and so some of that can be revenue. So that can be.

00:51:32 Andrew

Expansion so they can be buybacks. That's kind of how we get to that. That's where I get to that valuation. But everybody I feel is a little bit different. So 2 point being consistent and.

00:51:46 Andrew

Being realistic and all this with yourself about how optimistic person is securing that's really is probably the most important part. Most important. It's like how the bacon is made, right? Yeah.

00:51:58 Dave

Very good. Yeah. That's a great way to go. Look at it. Yeah, that's perfect.

00:52:04 Dave

All right. So kind of wrapping up, how would you suggest somebody take all the information we use today and help them use it?

00:52:11 Dave

Going forward.

00:52:13 Andrew

There's a couple of things you could do. I mean, you could take notes and just take the seven.

00:52:19 Andrew

Seven pieces and use that and I think it would be an insane, valuable China in 345 companies and just building your process and see if it works for you. You know, see if it helps you find companies.

00:52:32 Andrew

But you're like, oh, I'm glad I caught that. You know, before I put money into this thing. And the other idea, if you want to see this kind of fleshed out in the wild, you could subscribe to value spotlight. If you take a value spotlight issue, which is a monthly newsletter I'll send out with that, with the stock recommendation, it's basically. And I don't do this on purpose, but it's basically.

00:52:52 Andrew

Structured with each step.

00:52:54 Andrew

Each step is almost like a page along of the checklist, and so you can see kind of how I do it, how I look at the second try and how I look at, I look at the note and so we will just want the next. I was the recommendation back in February.

00:53:11 Andrew

That was just pulled from that. So that's kind of.

00:53:15 Dave

You can see how how that's done from some of these done before. That's perfect and that's that's a great way for people to learn how checklists can help them just by seeing it happen in the wild in, in real time and see what people, how people are thinking about it. That's one of the many, many things I love about what you're doing with value.

00:53:35 Dave

Right. Yes, I will put all that in show notes so people can find the links.

00:53:40 Dave

All right. With with that, we'll go ahead and sign us off. You guys go out there and invest with the margin of safety and sign the safety. Have a great week and we'll talk to.

00:53:48 Dave

You next week.