NATIONAL ASSOCIATION OF INVESTORS CORPORATION
BETTERINVESTING™
Rocky Mountain Chapter

CHAPTER NEWS

SECOND QUARTER (APRIL - JUNE) 2016 eNEWSLETTER

UPCOMING EVENTS AND CLASSES (all times are MT):

- Spring -Fall 2016
  - Mutual Funds and ETFs, March 20, 6:30pm to 9:30pm, CFU
  - Small Talk Stock Study, April 19, 7pm to 8pm via Webinar
  - Why Invest in Stocks? August 8, 7pm to 8pm, Koebel Library
  - Annual Mtg. & Education Program, September 7, 7pm to 8:30pm, Webinar
    - Guest speaker: Doug Gerlach
    - Register Today!
  - Mutual Funds & ETFs, September 14, 6:30pm - 9:30pm, CFU
  - Intro to Investing, September 17, 9AM - 12:30PM, CCUM
  - Small Talk, September 20, 7pm to 8pm via Webinar
  - Intro to Stock Selection Guide (SSG), October 1, 9am - 3pm,CCUM
  - Investors Education Day, October 15, 9am to 3pm, CCU
    - Guest speaker: Allen Holdsworth
  - Small Talk, October 18, 7pm to 8pm via Webinar
  - Mutual Funds and ETFs, October 26, 6:30pm to 9:30pm, CFU
  - Judgment on the SSG, October 29, 9am - 2:30pm, CCU
  - Small Talk, November 15, 7pm to 8pm via Webinar

Class and Event Location Addresses

Christ Church United Methodist (CCUM) 690 Colorado Blvd, Denver Co 80206 SmallTalk Seminars via Webinar at 7pm MT	Colorado Christian University (CCU) 8787 W Alameda Lakewood, CO 80226 Colorado Free University (CFU) 7653 E. 1st Place, Denver, CO 80230

EDUCATION

INVESTORS' EDUCATION DAY
Saturday, October 15, 2016

We have an excellent program lined up for the Rocky Mountain Chapter's **Investors' Education Day on October 15th of this year**. Our featured guest speaker will be **Allen Holdsworth** who will present four great topics. Chapter director John Rogers will present an updated version of his popular StockUp presentation of this past January.

Here are the scheduled presentations:

By Allen Holdsworth:

- Screening for Stocks
- Investing for Income
- Investor Beware
- Fours Keys to a Great Portfolio

By John Rogers:

- The Hidden Dimensions of the P/E Ratio

A 21 year Better Investing veteran, **Allen Holdsworth** is a popular speaker who has taught classes and lectured on investing in over thirty states. He has taught classes in eleven Better Investing National Conferences. He was a founding member of his investment club of twenty years. Allen has been a chapter director of the Illowa Chapter for eighteen years. He is a past president of the Better Investing Volunteer Advisory Board (BIVA) and an active member of that board for eleven years. Over the past six years, Allen has performed more than 75 portfolio reviews for as many investment clubs in the Iowa and Illinois area. He was guest on Bob Brinker's "Moneytalk" syndicated radio program

Allen Holdsworth is a graduate of the University of Illinois and was a successful farmer for thirty years before becoming a stock analyst and joining a regional brokerage house. On December 29, 2006, Allen had the privilege of ringing the closing bell on the New York Stock Exchange. After seven years as a broker/financial planner, he "retired" to devote full time to teaching at the local Community College, teaching online classes, and serving retail investors and investment clubs through Better Investing. Allen is also a passionate model railroader, amateur magician, and an active member of the Rotary Club. He still lives on the family farm which has been in the family over 150 years.

EQUITY ANALYSIS

IMPORTANCE OF THE CASH FLOW STATEMENT

By Shirley Pfister and John Rogers

There are two main methods to determine the value of a Company: 1) Multiple Valuation and 2) Cash Flow Valuation.

Multiple valuation equates a stock multiple relative to something else. The SSG uses this method: the PE. PEs are compared to the historical PEs, average PEs, the PEs of other companies in its sector, or the average PE of the Stock Market as a whole. A determination can then be made if the company is expensive or cheap based on the PE. The weakness in this system is that it relies on comparison. During the Tech bubble a number of companies might be seen to be "fairly valued" when compared to others in the same Sector, however, in reality they were quite over -valued. By reviewing the Cash Flow Statement, which reflects the cash coming into and out of the Company, these problems may have been identified earlier.

How successfully a company operates is reflected in the Financial Statements. There are three important sections of the Financial Statement to review:

- Income Statement,
- Balance Sheet
- Cash Flow Statement.

Here is a brief definition of each:

- The Income Statement indicates the amount of money the company made or lost over a specific period of time and is reported annually or quarterly.
- The Balance Sheet states what the Company owns (assets) and what the Company owes (Liabilities) at a specific point in time such as the end of the year or end of the quarter.
- The Cash Flow Statement is the cash flowing into AND out of a Company. It indicates how much cash a company makes annually or quarterly.

Because some values are not documented on the Income Statement or Balance Sheet, the actual explanation of where cash is flowing may not be crystal clear in a timely fashion. Net Income is an accounting estimate that contains a lot of noncash items (such as depreciation and amortization) and assumptions. This makes it difficult to follow the real cash money path. A company can post Sales/Revenue for its products or services on the Income

Statement if it is reasonably certain the bill will be paid even though the money has not yet been received. This is the concept of accrual accounting. Accrual accounting recognizes revenues/expenses when earned/incurred and not necessarily when received/paid. It tries to match sales and expenses for the period covered by the Income Statement. For instance a sale made on credit (shown as accounts receivable) is revenue on the Income Statement even though no actual cash has been received. But since the earned revenues aren't actually received as cash, the company may not have the ability to pay its bills which can actually lead to bankruptcy. Expenses incurred but not paid (shown as accounts payable) also show on the Income Statement. Accounts receivable may hurt the company's cash flow while accounts payable may help. The Cash Flow Statement makes the actual money path crystal clear. It documents exactly how much cash the company made: what actually came in and went out! It reflects the company's performance on a "cash accounting" basis which is how our personal accounts are treated.

In 1988 the SEC required that the Cash Flow Statement of companies be available for review so it is now part of the quarterly and annual reports. This statement can also be found on your favorite web sites: Yahoo, MSN, Morningstar, etc. The Cash Flow Statement begins with the calculated NET INCOME from the Income Statement. All the monetary activity of the company (operations, investing, and financing) are added or subtracted from that net Income resulting in the balance. This balance then is reflected in the Balance Sheet.

The three sections of the Cash flow statement are

- Cash from Operating Activities,
- Cash from Investing activities
- Cash from Financing.

Let's take a quick look at each of these.

1) Cash Flow from Operating Activities

The cash flow from operating activities is the first of the three sections of the Cash Flow Statement and it reflects the money the company made from the actual business (what it generated and spent).

When operating activities generate positive cash, the company makes cash money and can sustain itself. With positive cash flow, a company can use the cash for growth (organic and acquisitions), share buybacks, invest in future opportunities.

If the company is using more cash than it brings in, a negative cash flow exists. This is usually *not* good. The company may be forced to take out loans or sell additional shares to keep the business progressing. Investors will want to investigate the cause of the negative number from the operating activities. When the market is a bit shaky, negative cash flow may indicate a difficult time for the company. As stated in Pat Dorsey's book, *The Five Rules of Successful Investing*, the cash provided by operating activities is the Holy Grail for determining the company's financial health! When the actual operating cash flow is identified, compare it to the earnings. If earnings are growing but the operating cash flow is stagnate or shrinking, something is "rotten" according to Dorsey.

2) Cash Flow from Investing Activities

If the Company manufactures a product, money spent to build factories where the products of the company are made is identified here. If a Company is in the Service sector, office buildings, equipment and employees would be needed. These areas require cash and would be itemized on the Cash Flow Statement in this area. Items listed in this section might be labeled PP&E (property, plant & equipment). It includes anything that is needed to keep the business going. Money spent here is for things that last a long time.
At times, companies may utilize extra cash by investing it in bonds or stocks. Here the thought is that for a time, a better return can be gained by the company utilizing the cash in this way than by other uses.

3) Cash Flow from Financing Activities

Companies can borrow money from banks or investors and at times issue more stock. These activities represent cash flow from financing. These activities should help finance the company's growth. Young companies generally need the cash in order to get started and are more likely to issue stocks. For an established company, using cash from financing activities to cover the cost of operations might be a red flag requiring further investigation. Financing investments are acceptable if these investments help a company grow!

Below is an example of how the annual Cash Flow Statement of a company on the Yahoo site might appear. The years of December 2013 and 2014 are reflected for evaluation. Note at the top of the table, as discussed earlier, is the Net Income. Next is the Operating Activities and the Total Cash Flow from Operating Activities. Next is Investing Activities and the Total Cash Flow from Investing Activities. Finally, we see Financing Activities and the items that are listed here are again totaled at the bottom of that section. The bottom line is then calculated change in cash & cash equivalents.

Free cash flow is cash flow from operating activities less cash needed for capital expenditures (i.e., capex). It is important because it is the amount of money that can be taken out of the business each year without harming its ability to continue to do business/operations! This free cash flow is what benefits YOU, the investor. The money can be used to 1) pay dividends, 2) buy back stock (decreases the number of share outstanding and increases the percent ownership of each shareholder or 3) retained to invest in the Company (research & development, acquisitions).

A company with abundant free cash flow is financially healthy and has great latitude in charting its future. For example, Apple Computing's 2015 cash

View: **Annual Data** | Quarterly Data

Period Ending	Dec 31, 2014	Dec 31, 2013
Net Income	**494,150**	**448,636**
Operating Activities, Cash Flows Provided By or Used In		
Depreciation	72,672	64,191
Adjustments To Net Income	17,221	19,520
Changes In Accounts Receivables	(63,418)	(51,593)
Changes In Liabilities	72,169	20,944
Changes In Inventories	(87,622)	(68,685)
Changes In Other Operating Activities	(5,780)	(16,893)
Total Cash Flow From Operating Activities	**499,392**	**416,120**
Investing Activities, Cash Flows Provided By or Used In		
Capital Expenditures	(189,474)	(206,540)
Investments	451	(97)
Other Cash flows from Investing Activities	242	4,845
Total Cash Flows From Investing Activities	**(188,781)**	**(201,792)**
Financing Activities, Cash Flows Provided By or Used In		
Dividends Paid	(296,581)	(237,456)
Sale Purchase of Stock	(45,245)	226
Net Borrowings	90,000	-
Other Cash Flows from Financing Activities	-	-
Total Cash Flows From Financing Activities	**(249,732)**	**(234,443)**
Effect Of Exchange Rate Changes	(4,889)	(990)
Change In Cash and Cash Equivalents	**55,990**	**(21,105)**

flow from operating activities (i.e., operations) was $81,266MM and its free cash flow was an astounding $69,778MM which was 86% of its cash flow from operations and 30% of its total revenue of $233,715MM. Compare that to Hewlett-Packard's 2015 cash flow from operations of $6,490 and free cash flow of $2,887 representing a rather robust 44.5% of its cash flow from operations but only 2.8% of its revenue of $103,355. A company generating 30% of its revenue as free cash flow gives management the opportunity to pursue and fund new ideas and enterprises on a huge scale. Apple's future growth is constrained only by the imagination of its management.

In review, the Income Statement reflects the sales, profits, & earnings for a company over a period of time. The Balance Sheet identifies the Assets & Liabilities at a point in time. The all-important Cash Flow Statement links the Income Statement to the Balance Sheet. By close inspection of the Cash Flow Statement you link the Income statement to the Balance Sheet AND can spot any problems or opportunities which are present.

IMPORTANT TAKE HOME MESSAGE: Cash Flow is the true reflection of the corporate cash value it creates. It states the cash the company generates from year to year. Cash is what counts! When the cash actual comes into a company and when the cash actual goes out are the only figures on the Cash Flow Statement! Free cash flow is cash available for exploring new frontiers of growth

The References used are listed below. I encourage you to review them as both are just excellent!

1. BI Handbook: *Using Portfolio Management Wisdom, Chapter 8: Analyzing Financial Statements*, by Bonnie Biafore,
2. *The Five Rules for Successful Stock Investing* by Pat Dorsey
3. *Cash Flow for Beginners* by Bart Womack found on the BetterInvesting website.

NEW COMPANY SIZE DEFINITIONS

by John Rogers

BetterInvesting defines company size by sales/revenue volume instead of the more widely used capital value (stock price times the number of shares) of the company's stock. Revenue forms the basis of a more stable definition as stock price can and does vary all over the place hour by hour, day by day, etc. However, as inflation slowly erodes the purchasing power of the dollar, it becomes necessary to increase the dollar amount of the size classifications accordingly.

The small, medium and large classifications for company sizes are being changed in BetterInvesting tools and education. Small companies are now considered those with annual revenues (based on the most recent fiscal year) of $1 billion or less. Medium-size companies have annual revenues between $1 billion and $10 billion (previously $500 million to $5 billion), and large companies have revenues above $10 billion (previously $5 billion).

Company size tends to reflect risk. In most instances, the smaller companies have less financial and economic clout compared to the larger, more established companies. BetterInvesting advises that one way the risk of owning the smaller companies can be mitigated is by insisting on greater projected growth rates. The inherently more risky small companies should have growth rates of at least 12 percent annually (compared with 15 percent in the *Stock Selection Handbook*'s 2003 edition), medium-size companies should have projected growth rates between 7 percent and 12 percent or more annually (versus 10 percent to 15 percent previously), and the least risky category of large companies may have projected growth rates between 5 percent and 7 percent or more annually (versus 7 percent to 10 percent previously). Helping to make the quest for fast growing smaller companies easier is the simple fact that the smaller companies tend to grow faster anyway. Just remember that the more risky category of smaller companies warrents increased caution and insistence on a greater growth rate to compensate the increased risk.

Based on a revenue definition of company size, BetterInvesting recommends a portfolio be diversified by size as well as sector/industry. The guideline recommends about 25% of a portfolio be large companies, about 50% mid-sized, and 25% small-sized companies.

Many clubs tend to be overweight in large companies as it is much easier to find information about them compared to the smaller companies. **Your Rocky Mountain Chapter initiated the Small Talk webinar program to help bridge this information gap**. The Small Talk seminars are free and available to all via webinar. They feature a focused, in-depth discussion of a small or mid-sized company each month. The Chapter sends out an email ALERT each month for the Small Talk seminar for that month. Watch for these in your email. Since these sessions are webinar broadcast over the internet, they are available to everyone in the chapter no matter where you may reside. All you need is a computer connected to the internet.

WORKING TOGETHER

The Rocky Mountain Chapter directors see their main duties as 1) supporting clubs and individuals, and 2) providing quality education for everyone. All directors are unpaid volunteers who want to "give back" for the support they've received in the past. The board meets monthly over the internet using GoToMeeting. But the chapter has the special challenge of providing for a membership spread across Colorado, Utah, Wyoming, and the northern 2/3 of New Mexico. If you live in one of these areas, please volunteer to become a contact for those in your area. For more info email our chapter president.

The Rocky Mountain Chapter board of directors meets the third Monday every month at 7pm MT. If you are interested in attending a meeting as a visitor to make suggestions on how to improve the program or to just listen in, then send your request to John Rogers and you'll be sent a GoToMeeting invitation with instructions on how to attend the meeting over the internet. Please include your name and the name of your club if you belong to one. All members are most welcome! We look forward to seeing you at one of our upcoming meetings.

WORDS OF WISDOM

"The one thing I will tell you is the worst investment you can have is cash. Everybody is talking about cash being king and all that sort of thing. Cash is going to become worth less over time. But good businesses are going to become worth more over time." **– Warren Buffett**