

Managing your managers

It's easy to forget sometimes that when you buy shares, you're actually buying a piece of a business.

Indeed, investing in a business listed on the stock market is no different to acquiring 50% of your local newsagency. Both represent part-ownership of a business.

Every business begins with an idea, at least one shareholder, cash and a business model. Staff are employed and in some cases, dividends are paid. For larger companies, a leadership team is put in place to manage operations.

The story of a company, regardless of whether the business is owned by one shareholder or many – its history of earnings, dividends, equity, debt, cash flow and capital growth – is told the same way.

That's one of the golden rules of sensible investing: approach businesses listed on the share market the same way you would a private business.

However with all the noise that comes from the stock market, removing yourself from the day-to-day rhetoric can be a challenge.

When you buy a piece of a business, you're relying on the leaders of that business to operate it with your interests at heart (most of the time it works out).

That's why monitoring the performance of your managers is an important part of portfolio management.

How to monitor your managers

What's a simple process you can follow to monitor the performance of the managers of your businesses?

Step 1: Collect Annual Reports

Get your hands on to as many Annual Reports as you can find – 10 years is a good start – and print off the Chairman's and Managing Directors report from each.

Step 2: Extract Chairman and MD Reports

Create two piles, one for the Chairman's report and the other the Managing Directors. Put the most recent reports at the bottom of the pile, and the oldest on top.

Step 3: Start reading

Read the reports like you'd read a book, from cover to cover.

Step 4: Investigate

Time to do some thinking...

What did management say they were going to do in 2005? By 2006, did they achieve what they set out to do?

How have their views of the business changed? And the competitive landscape?



Do the reports mention any ongoing issues? Project delays, debt collection issues and a changing market place are a few things to look out for.

The Managing Director who wrote the report in 2005. Is he still writing the report today, or is the company churning through senior management? Changing management styles can severely disrupt the underlying business and impact staff retention.

Finally, follow the transactions of the company's directors. If you find a situation where you feel the business' prospects have deteriorated and management are selling, that can only reinforce your analysis.

If however you believe the business has bright prospects, management's decision to sell may be of a personal nature and whilst should be investigated, may not necessarily be a reason to cause alarm.

Use Skaffold to focus on the best businesses and your job as your own private fund manager becomes a whole lot easier.

A smarter way to invest in shares

In 2011 a new way of researching companies and selecting shares was released in Australia. It's called Skaffold and is designed to tell the story of a business.

Skaffold is a state-of-the-art online stock-research application that interprets key historical financials and broker forecasts into image-rich visuals. Every stock is rated, from A1 to C5. It's entirely automated and updated daily using information sourced from top-tier

financial institutions. Skaffold was designed to save time on research and simplify share-market investing.

With Skaffold, you can see the story of every ASX-listed business and easily answer the key share-evaluation questions. Understanding the business, its performance and future growth prospects allows you to invest in the very best businesses and avoid those with doubtful fundamentals that may be potentially wealth destroying.

So with that in mind, here's how to evaluate companies using Skaffold.

1. The business of the company

What is the business of the company? Does the company operate in a sector exposed to future economic growth, or is the business model susceptible to fluctuating economic conditions?

2. Earnings and Dividends

Have earnings been rising and are they expected to continue rising in a northeasterly direction? Avoid companies whose earnings are stagnant or declining. You should also question if the company can afford to pay a dividend and how that dividend is funded. Investigate how companies fund dividends and avoid those incapable of generating organic growth.

3. Debt and profitability

We are all familiar with the real-world consequences of debt. If mismanaged, debt can be disastrous. Borrowing to fund a new venture, or adventure, adds risk. In business, the use of debt directly impacts

the bottom line – debt costs money and requires ongoing servicing. Do the companies in your portfolio rely too heavily on debt to fund their business activities? How have their businesses and shares performed over the past few years? Are you satisfied with your returns?

Skaffold calculates the ratio Return on Equity (ROE) to describe a business' profitability. ROE compares how many dollars of equity were required to produce the company's profit. If a company has \$100m of equity and produces a profit of \$5m, the resulting return on equity is 5%. If another company produced a profit of \$25m on \$100m of equity capital, return on equity is substantially higher at 25%. Which business would you prefer to own?

How have the companies in your portfolio used their equity and are they profitable? Attractive businesses are able to increase profits each year without the need to raise additional capital or take on debt. These companies produce increasing profitable returns on their equity without increasing risk.

4. Cash flow

Every business operates to generate cash. The amount of cash generated in a given period is known as cash flow.

Think about it this way. At the start of the year your business had \$50,000 in its bank account. At the end of its financial year, after receiving revenues from sales, paying staff, taxes and all other operating expenses, you have generated an additional \$100,000 in cash. Great!

Now the bad news... in order to generate that cash you had to buy additional equipment for \$200,000. Your shareholders also insisted on a dividend that equated to \$50,000. So despite your operating cash flow of \$100,000, your net cash flow for the year is a gap of \$150,000. That gap will need to be funded, either by taking on debt or asking shareholders to contribute additional equity. If this situation continues it will soon lead to difficulties.

Have the companies in your portfolio been spending more money than they've earned? Have they raised capital, taken on debt or paid dividends they couldn't afford? Poor and worsening financials can result in falling share prices.

Australia's Top 20

The table to the right lists Australia's 20 largest companies and includes Skaffold's A1 - C5 Score, 2012 return on equity, forecast dividend yield and forecast EPS growth.

Australia's Top 20 companies, rated by Skaffold (data as at 5 December 2012 close of trade)

Company Name	ASX Code	Skaffold Score	Return on Equity	Forecast Yield	Forecast EPS Growth
BHP Billiton Limited	BHP	B1	31.1%	3.3%	-30.6%
Rio Tinto Limited	RIO	B2	28.3%	2.6%	-33.8%
Commonwealth Bank of Australia	CBA	A1	18.7%	5.7%	-0.4%
Westpac Banking Corporation	WBC	A4	14.1%	6.7%	7.6%
Australia and New Zealand Banking Group	ANZ	A3	16.3%	6.0%	-5.1%
News Corp (CHESS)	NWS	A2	12.3%	0.8%	34.8%
National Australia Bank	NAB	A5	9.8%	7.5%	29.6%
Telstra Corporation Limited	TLS	B2	30.1%	6.4%	3.4%
Wesfarmers Limited	WES	B3	8.5%	5.1%	7.8%
Woolworths Limited	WOW	B2	29.1%	4.5%	0.9%
Woodside Petroleum Limited	WPL	C3	14.4%	3.9%	16.3%
CSL Limited	CSL	A1	28.0%	1.8%	27.6%
Westfield Group	WDC	C4	5.6%	4.7%	58.3%
Newcrest Mining Limited	NCM	B3	7.5%	1.6%	-1.9%
AMP Limited	AMP	A4	14.1%	5.3%	13.7%
Suncorp Group Ltd	SUN	A4	4.8%	6.3%	54.8%
Origin Energy Limited	ORG	B4	6.4%	4.5%	2.0%
QBE Insurance Group Limited	QBE	A3	6.8%	5.5%	45.2%
Fortescue Metals Group Limited	FMG	B3	51.2%	1.8%	-21.4%
Brambles Limited	BXB	C3	25.1%	3.8%	3.9%

About Skaffold



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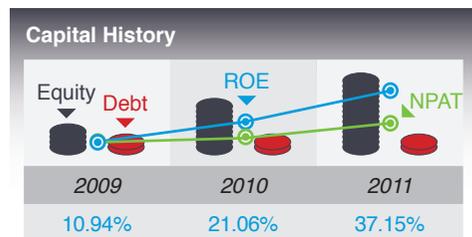


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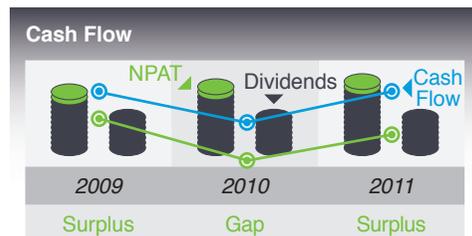
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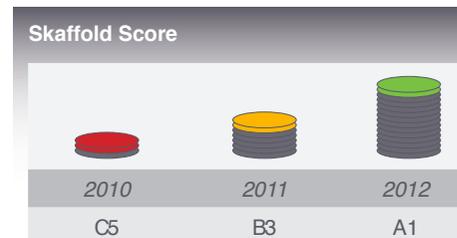
View up to ten years of historic Earnings and Dividends Per Share and where available, three years of forecasts. Instantly see if a company's earnings and dividends have been rising, and if growth is forecast over the next few years.



Capital History displays a company's relationship with its owners and lenders to help you understand its history of equity, debt and performance. Are profits rising? Are you comfortable with the level of debt? What about return on equity? A table provides even more granular information.



Skaffold's Funding Surplus / (Gap), the green line, reveals how the cash generated has been utilised and whether the company has required external funding to finance its activities. Skaffold makes it easy to evaluate these vital aspects of a company's performance.



The Skaffold Score rates the quality and performance of every company. It rates a company's consistency of earnings, debt levels and the quality of cash flow, from A1 to C5. Instantly see if a company meets your criteria and is worth further investigation.



A key component in evaluating a company and deciding when to purchase it is to estimate its intrinsic value. Every Skaffold Line chart, for every ASX-listed company, displays up to three years of future valuations and ten years of historical valuations so you can identify historically good-performing companies forecast to offer future growth.



Join online at www.skaffold.com

Call the team on 1300 SKAFFOLD

Send your cheque to GPO Box 3324 Sydney NSW 2001.

Data accurate as at 5 December 2012.

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