(Contains copyrighted material; if you have additions to this listing which have been helpful in your investment experience please send me an email; I strongly recommend the Papers and Speeches articles on the Tweedy-Browne Website, esp the checklist in Appendix C and D of the "Investing for Higher After-tax Returns" article)

**GENERAL RULES & COMMENTS**

All rules are meant to have exceptions.

When purchasing a stock, hold for change in story or 3-6 months unless the business itself if particularly volatile. Wait for new information, for a new card to turn over in your hand. Hesitate to buy brand new positions without a 20% pricing change.

Review the color code changes on a weekly basis (one time). Again, look for story changes to explain price moves.

Consider your own frame of mind before making decisions. No stock buys or sells without an entry into the notebook beforehand.

When you buy one stock you are picking one alternative among thousands. Wait for the right decision.

Have faith in your own decision-making. Don't be overconfident – check assumptions against facts. You have a set of investment principles which has led to success in the past and there is no reason to believe much will change in the future. Lynch works.

Frequent price checks represent an impediment to investment success if done to no purpose. Download prices directly into spreadsheets and evaluate new information instead of new pricing.

It's amazing how hard you have to fight the different mindset that comes from owning stocks that drop versus watching stocks that drop. When you're watching and waiting for a good price, it's easy to pounce when the market offers it to you...but when you already own a bit (or others) and watch it fall, it's much harder to do the old, cold value-price calculus. One of the many bear market demons.

If you buy a stock because you hope something will happen, and it doesn't happen, sell the stock.

The best results flow from a progression of surprises. Let the evidence form your impression, not your impression form the evidence. It is isn't necessary to predict trends before they happen, but the earlier you identify the moment of change the higher the opportunity for profit. From Train: *This is a reminder that Lynch's basic objective is to* ***catch the turn in a company's fortunes…***

You have to have a clear conception of the true value and work only off that, not off the stock's recent performance history.

**STOCKS IN GENERAL – DATA POINTS**

- The Category. Give this some thought and make it specific.
- The P/E ratio. Is it high or low for this particular company and for similar companies in the same industry? Compare it to historical measure. Remember that pe's are not predictive – they only measure the past, and a company with a high growth rate in earnings (whether by sales or margins or a combination) will quickly render past pe ratios as meaningless.
- The P/B ratio. This is especially important for mature companies that are known to have significant fluctuations in earnings, as the balance sheet should be far more stable. Compare to historical measures.
- The pricing history of this security (4 year monthly price or chart). Determine the relationship between the business and the stock (how volatile).
- Where are margins? What was the highest and lowest margin level for this company? What is the projected margin for next year and beyond (provide supporting justification and catalyst)? A doubling of the margin makes even a slow top line grower very exciting.
- The percentage of institutional ownership. The lower the better.
- The percentage of insider ownership. Whether the insiders are buying and whether the company itself is buying back shares. Both are positive signs; List the insider holdings. Is there anything unique about these particular insiders (VC firms, etc.)?
- The Options History. Review at least 5 years and make a conclusion on whether this management team can be trusted in this

area. Options are the clearest sign of a management team treats it shareholders, but note that options can be a valuable resource for young and growing companies.

- The record of earnings growth to date and whether the earnings are sporadic or consistent.

- Whether the company has a strong balance sheet or a weak balance sheet (debt to equity ratio) and how it is rated for financial strength.

- List cash position, cash flow, capex, free cash flow. Calculate 5 year averages for cash flow, CapEx, and free cash flow. How do current numbers compare to history and what changes will occur in the future?

- List the competitors. Is capacity increasing faster than demand? What competitive advantages/disadvantages does this company have over its competitors?

- List the last time you've called this company. I never hang up on a source without asking: what other companies do you most admire?

- Review the Value Line sheet. Check the Wall Street Transcript?

- Can this company be trusted to use its capital wisely?

**<u>PURCHASE CRITERIA – BUY AND SELL</u>**

- Before buying a stock, I like to be able to give a two-minute monologue that covers the reasons I'm interested in it, what has to happen for the company to succeed, and the pitfalls that stand in its path.

- There are 5 basic ways a company can increase its earnings: reduce costs; raise prices; expand into new markets; sell more of its product in the old markets or revitalize, close, or otherwise dispose of a losing operation. These are the factors to investigate as you develop the story. If you have an edge, this is where it's going to be most helpful.

- Lynch's endless quest, his endless searching among companies, is directed above all toward the *obvious winner*, *based on changes to the key variable.*

- Ask yourself: if there a notable and significant change in the business? Is management conservative or aggressive? A management team that is cautious about the future may just be hedging their bets? Attempt to determine if the change is sustainable – the degree of conviction you have should help determine the position size.

- List total return expectations for the stock.

- List a buy order for a reduced stock price and specific reasons for a further commitment.

- List how this is a better purchase than existing holdings.

- List other companies that compete in this space? Why haven't you looked at them?

- Consider letting 3 to 6 months pass before doing another buy or sell of a security unless business is clearly turning downward or you made a mistake. There are always other stocks to buy.

- Justify position sizes in writing.

- The best way to handle a situation in which you love the company but not the current price is to make a small commitment and then increase it in the next sell-off.

- You need some indication that earnings would improve. Just because a stock is cheaper than before is no reason to buy it, and just because it's more expensive is no reason to sell it.

- You don't get hurt by the things that you don't own that go up. It's what you do own that kills you.

- Review your written profile on this company. Does it make sense? Does the allocation make sense? Is it something you want to hold for a period of time? Does it have a good balance sheet? Is it a position you will buy anew in a brand new account?

**<u>LYNCH CATEGORIES</u>**

**Slow Growers**

- Since you buy these for the dividends you want to check to see if dividends have always been paid and whether they are routinely raised.

- When possible, find out what percentage of the earnings are being paid as dividends.

**Stalwarts**

- The key issue is price, and the P/E ratio will tell you whether you are paying too much.
- Check for possible diworseifications that may reduce earnings in the future.
- Check the company's long-term growth rate and whether it has kept up the same momentum in recent years.
- If you plan to hold the stock forever, see how the company has fared during previous recessions and market drops.

**Fast Growers**

- Investigate whether the product that's supposed to enrich the company is a major part of the company's business.
- What the growth rate in earnings has been in recent years.
- Has the company has duplicated its successes in more than one city or town, to prove that expansion will work.
- Does the company still have room to grow? Determine the inning of growth.
- Whether the stock is selling at a P/E ratio at or near the growth rate.
- Whether the expansion is speeding up or slowing down.
- That few institutions own the stock and only a handful of analysts have ever heard of it.

**Turnarounds**

- Most important, can the company survive a raid by its creditors? How much cash does the company have? How much debt?
- What is the debt structure, and how long can it operate in the red while working out its problems without going bankrupt?
- If it is bankrupt already, then what's left for the shareholders?
- How is the company supposed to be turning around? Has it rid itself of unprofitable divisions?
- Is business coming back?
- Are costs being cut?
- If there is a division being let go, how much losses are in those assets?

**Asset Play**

- What's the value of the assets? Are there any hidden assets?
- How much debt is there to detract from these assets?
- Is the company taking on new debt, making the assets less valuable?

**<u>FINANCIAL STATEMENTS</u>**

**Balance Sheet**

- Review all data in relation to previous year and/or previous quarter.
- Review cash balances and debt levels.
- Review accounts receivables very carefully, esp. for technology companies.
- For retail companies, review the inventories especially carefully.
- Determine how much actual cash the company will generate in the next 3 to 5 years

**Income Statement**

- Address each line in the income statement and project to the next quarter. Consider the next quarter if you already have the data for that quarter of next year.
- Define how the company might improve its margins.
- Consider how much margins would improve if the company paid down debt.

**Cash Flow and CapEx**

- Track the capital expenditure budget in the annual report and how this matches with cash flow. Track buybacks and other uses of cash.

**Future Projections**

- For store companies, list the current store counts for now (including franchised totals) and a projection for the next several years, and consider how much this will cost. Carefully track whether the company is matching its expansion plan.

- For acquisition related activity, define the prospects of the acquisition.

- Consider if regional issues or industry-specific issues are creating a problem for the company (esp. if a competitor results are bad) and how these issues will be resolved.

**Accounting Issues**

- Review possible option dilution, deferred tax assets, etc.

- Review footnotes for possible changes in depreciation methods.

**<u>PROXY</u>**

- Check for background of directors, salaries, insider holdings, option grants, percentage of option grants to top people, other compensation, changes to the option grant program, any unusual changes, etc.

**<u>CHECKUP</u>**

- Review what needs to change for you to buy the company back.

- If selling a partial holding, consider whether the existing percentage makes sense from the viewpoint of a new holding at that rate,

**<u>BUFFETT QUESTIONS</u>**

Ask is this is a good investment:

· the certainty with which the business can be evaluated

· the certainty with which management can be evaluated, both as to the ability to realize the full potential of the business and to wisely employ its cash flow

· the certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself

· the purchase price of the business

· If you owned this business and there was no daily quote to measure its performance, how would you determine your progress? Think long term business prospects.

· Look at what you already own. The old things are your measuring stick. Can be look-thru earnings, return on equity, margin of safety, etc. Think about ways to raise your benchmark. The job of a manager is not to make the train longer but to find ways to make it run faster.

· Does this manager think and act like an owner? Is this management candid? Review reports for a few years back. Was what they said fully realized? Compare the strategies a few years ago vs. today….has the thinking changed? Compare these reports to companies in a similar business.

· The task for investors is to narrow the field, to identify and remove what is most unknown, and to focus on the least unknown.

· Calculate probabilities. Adjust for new information. Decide how much to invest. Wait for the best odds.

**Business Tenets**

· Is the business simple and understandable?

· Does the business have a consistent operating history?

· Does the business have favorable long term prospects?

**Management Tenets**

· Is management rational?

· Is management candid with shareholders?

· Does management resist the institutional imperative?

**Market Tenants**

· What is the value of the business?

· Can the business be purchased at a significant discount to its value?

· Is this a franchise? Commodity?

**Six Month Review**

A healthy portfolio requires a regular checkup – perhaps every six months or so. You are trying to get answers to two basic questions; 1) is the stock still attractively priced relative to earnings (or assets), and 2) what is happening in the company to make the earnings go up?

You can conclude:

Story has gotten better
Story has gotten worse
Story's unchanged

Read quarterly reports, 10Q, press releases, call the company.

**Year end Review and Risky Investments**

- A useful year-end review for a stock-picker: go over your portfolio company by company and try to find a reason that the next year will better than the last. If you can't find such a reason, the next question is: why do I own this stock?

- For stocks to do better than expected, the company has to be widely underestimated. Otherwise, it would sell for a higher price to begin with. When the prevailing opinion is more negative than yours, you have to constantly check and recheck the facts, to reassure yourself that you are not being foolishly optimistic. The story keeps changing, for either better or worse, and you have to follow those changes and act accordingly.

- Here is the key question to ask about a risky yet promising stock: if things go right, how much can I earn? What is the reward side of the question?

**A List of Basic Questions (Wall Street Transcript):**

- Give me some idea of the competitive environment that your company faces. What are the types and sizes and breadth of companies that are our there competing with you or units of divisions that compete with you?

- What are long term goals you've set for your company? And over the next 3 to 5 years, what do you see are the changes, the adjustments, or perhaps, the further developments that your company must undergo in order to meet these goals?

- Are there plans for acquisitions in your strategy?

- What are the dynamics that you see that your company has? What are the dynamics that you see that your company has to balance in attaining shelf space for the various products and product lines?

- Looking at your current management team and your internal operations, are there any planned changes or adjustments in these areas, or do you see specific needs that you will have to address over the next two to three year time frame?

- For the long term investor looking at the financial reports and the annual statements, what would you suggest for that long term investor as the one or two items or ratios, or perhaps, the one or two sets of information that the investor should focus on over time to gain insight into what the company is doing and where it is going?

- Addressing the shareholder constituency, what level priority does shareholder value have in the overall equation?

- What are the management incentives? And how are they tied to recognizing shareholder value?

- Do you feel the current market price reflects what you see as a stable long term value for your stock when compared, first, to the overall market, and second, relative to your peer group?

- What are the weaknesses that you see competitively for your company? And over the next two to three year time frame, how are you addressing them?

- What are the basic business principles or underlying tenants that you use in managing the company and setting the goals and getting the company to execute the strategy?

- What, then, is the essential message that you would like to convey to long term investors about your company? What do you see, or what do you feel investors should see as the four or five strengths and advantages that your company has as an investment?

- Are there areas or issues you would like to present to investors that we've not covered?

***INDUSTRY SPECIFIC***

**Asset Managers**

- AUM Totals
- AUM Composition
- AUM vs. Last year and 2 Years Ago
- Fund Flows
- Valuation
- Use of Cash – Balance sheet

**Retailer**

- Store count
- Growth in count and sqft
- Growth – historical
- Point in Growth cycle
- SSS trends and comparisons
- Niche
- Inventory levels
- Enterprise Value/Stores
- Store Profit
- Margins – now vs. History

**Restaurant**

- Count
- Growth and count
- Growth – historical
- Point in Growth cycle
- SSS trends and comparisons
- Balance sheet, esp. debt
- Franchising

References:
- One Up on Wall Street, Peter Lynch
- Beating the Street, Peter Lynch
- Warren Buffett Way/Portfolio/Essential, Robert Hagstrom
- Wall Street Transcript
- Several books by John Train

**Biggest Mistakes in 2004**

1. AEOS – I saw a saturated retailer with uneven options and a history of cyclicality undergoing strong sales and invested only a very small amount. I failed to identify that margins were at a multi-year low (offsetting sqft issues) and that higher comps could be sustainable. I also allowed a pre-determined position size (5%) to scare me away from a smaller position

Fix – when doing evaluations, always review a multi-year spreadsheet to put the current situation into historical context. When momentum changes, identify what changes in the business – esp. margins. NEVER use position guidelines as rules – write out a justification for ALL position sizes.

2. TOO – I saw a retailer at a multi-year low in margins but with improving business conditions. I failed to be aggressive enough.

Fix – When evaluations state that "momentum has turned", be more aggressive if the valuation and margin is at multi-year lows and the business has a history of cyclicality. Pay attention to the balance sheet for downside protection. Again, when assigning position sizes, document the process.

3. CTR – I saw a company with modest sqft growth but a nice dividend yield, slightly improving sales, and easy comparisons. I failed to be aggressive enough.

Fix – same as TOO

4. FII – I saw a company with a reasonable pe and pcf ratio, allocating its capital effectively, but experiencing some pressure on its business lines. I failed to note that pe's can be a mirage, as they do not forecast improving business conditions.

Fix – Pay attention to the normal factors which are involved in any particular industry group; with asset managers, flows and valuation in tandem. Identify catalysts, and if they don't exist either live with the situation or adjust appropriately.

5. JNC – I saw an asset manager whose price was under pressure from news that its CEFs were transitioning from premiums to discounts as interest rates began to rise. I failed to invest aggressively.

Fix – Be a contrarian, especially with a situation where a business has other charms (flows at JNC were not just in CEFs and bond funds; captive CEF assets). Even if a change in fortune clearly impacts the business, the valuation change may be significantly overstated. Use 10% or 20% increments to judge the situation anew.