

Company Size vs. Expectations



Mini Investment Class by the OKI Tri-State Chapter

*Courtesy Cincinnati Model Investment Club
Based on Original Presentation by Gretchen and Jim Hurt*

Revised 3/6/10 by Sandy and Bob Lowery

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Market Cap

- **All of the news media and almost all of Wall Street uses “Market Cap” for size.**
- **“Small Cap”, “Mid Cap”, “Large Cap”**
 - **Market Cap is Price per share times number of shares**
 - **Price goes up 10%, Market Cap goes up 10%.**
 - **Price goes down 10%, Market Cap goes down 10%**

Better Investing Size

- **Because of its dependence on price, a volatile number, we Better Investors do not use Market Cap to measure size.**
- **Better Investors use sales to measure size.**
 - **“Small”, “Mid-sized”, “Large”**
 - **More sales, bigger company.**

Boundaries on Size

- **SMALL**
 - Sales < \$400 Million
 - 70% of all companies in Reuter's screen
- **MID-SIZED**
 - \$400 Million sales < \$4,000 Million
 - 20% of all companies in Reuter's screen
- **LARGE**
 - Sales over \$4,000 Million
 - 10% of all companies in Reuter's screen



Life Cycle of a Successful Company

Graph from "Fundamental Investing: An Introduction" by Bob Adams, Gary Ball, and Seymour Zeenkov.

Start-Up Company

- **Starts with no sales.**
- **Early sales are “missionary” sales.**
- **Most fail.**
- **Most of the rest fail to grow.**
- **Very big rewards if successful (“IPO”).**
- **Very risky.**

Small Companies

- **Simple market:**
 - **One or two products.**
 - **Little or no competition.**
- **Few pay dividends (no yield).**
- **Need to read MD&A* to double and triple check quality of management.**
- **Look for well-managed growing small companies with over 15% historical growth rates.**

* Management Discussion and Analysis found in the Company Annual Report

Mid-Sized Companies

- **Uncomplicated Market.**
 - **Several products.**
 - **Some competition.**
- **Some pay dividends (low yield).**
- **Need to read MD&A to double check quality of management.**
- **Look for well-managed growing mid-sized companies with 10% to 15% historical growth rates.**

Large Companies

- **Complicated Market.**
 - Many products.
 - A lot of competition.
- **Pay a lot in dividends (high yield).**
 - Reinvesting dividends helps our return.
- **Need to read MD&A to double check quality of management.**
- **Look for well-managed growing companies with 5% to 10% historical growth rates.**

Diversify by Size

- **Some have suggested that we invest:**
 - **25% in small companies**
 - **50% in mid-sized companies**
 - **25% in large companies**
- **Percentages are by value**
 - **Price times number of shares in the portfolio.**

Small Company 'Problems'

- **Small companies do not have many shares, hence price is very volatile.**
 - **Fundamentals can be growing for years before the price catches up.**
- **Not all small companies are well managed.**
- **Most small companies fail.**
- **Well-managed small companies tend to become mid-sized companies.**

Biggest Small Company Problems

- **Finding a small company that is well managed and has high growth rates is very difficult.**
- **Keeping a small company when some bad news causes the price to crash.**
 - **Is the bad news temporary or serious?**

Mid-Sized Company 'Problems'

- **Mid-sized companies do not have many shares, hence price is volatile.**
- **Not all mid-sized companies are well managed.**
- **Most mid-sized companies are unable to maintain growth rates.**
- **Well-managed mid-sized companies tend to become large companies.**

Large Company 'Problems'

- **Large companies have many shares, hence price is not as volatile.**
- **Not all large companies are well managed.**
- **Growth for large companies is very difficult.**
- **Where to invest profits?**
 - **Usually pay large dividends, buy back stock, or buy other companies.**

Summary

- **Small Companies – 25% of portfolio**
 - High risk, high rewards.
- **Mid-Sized Companies – 50%**
 - Medium risk, medium rewards.
- **Large Companies – 25%**
 - Low risk, low rewards.
- **In all cases, keep your eye on management and the fundamentals.**

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Cincinnati:

Mary Thomas
Mcthomasp@fuse.net

Dayton:

Gene Senter
EMIDDLE42@aol.com

Columbus:

Dianne Jordan
dijord00@aol.com

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