The Source Is With You

Finding and Evaluating Securities Information

Objective A

The Source Is All Around You

Imagine being in a large room full of hundreds of people who all are talking at the same time. With so much noise, you could have trouble understanding what the person standing right next to you is saying.

Taking in the barrage of investing information that is available today can be like standing in a noisy room. There is almost *too* much information to sift through and *too* many sources to evaluate. Some market observers call this "noise" and caution investors against becoming discouraged by the information overload.

The good news is that it has never been easier to find information about stocks. Just a few years ago, only professionals and wealthy investors who could afford costly reports had access to in-depth stock information. Now, an explosion of resources has resulted in countless places for you to consider—some very good, some not so good at all.

Your job is to do your homework before you jump into the source pool. (No groaning! This homework can be fun!) To begin, you have to find the sources that are reliable, helpful, and suited to your needs.

Objectives:

A. Describe internal sources of securities information.

B. Explain the value of external investment information sources.

What Are the Basics?

Whether you are looking for a stock to invest in, or tracking one that you've already chosen, the first document you should study is the company's **annual report**.

Publicly-traded companies are required by law to provide **financial statements** to their shareholders every 90 days, a period of time also known as a quarter. These financial statements are also found in the annual report, which is typically a glossy, attractive, four-color publication that the company produces at great expense.

Annual reports include not only the financial statements, but also narrative information from company management about what the company did that year, what they consider to be important achievements, and some ideas about where they plan to go next. It can be easy to get caught up in the enthusiasm that pops off the pages of these reports. If you think of the company as a sports team, the annual report writers would be the cheerleaders. Pointing out missteps that might have occurred during the year is not something cheerleaders want to do as they're cheering on their team to victory.

As an investor doing serious homework, however, you need to pay the most attention to the financial statements. To do that, you have to go to the back of the annual report and look at the numbers.

Standard Financial Statements

The three standard financial statements to look for are the **balance sheet**, the **income statement**, and the **cash flow statement**. At a later time, you'll learn more about how to read these numbers and what to make of them. For now, here are a couple of things that you should know.

Balance sheet. This statement gives a summary, or "snapshot," of what some people call a company's "financial health" at a specific point in time. A balance sheet contains two major sections: a listing of the company's **assets** and a listing of its **liabilities**. Simply put, the assets are what a company *owns* and the liabilities are what a company *owes*.

Assets include such things as buildings, equipment, inventory, as well as the cash a company has on hand. Liabilities include employees' wages and any other debts, such as what the company owes on what it has bought or financed through loans.

Also included in the liabilities section of the balance sheet is an accounting of the **shareholders' equity**, which is the value of all the outstanding stock owned by shareholders. Shareholders' equity is determined by subtracting the liabilities from the assets. Or:

Shareholders' equity = assets – liabilities

A balance sheet gets its name because it "balances" the company's assets with the liabilities plus equities.

Income statement. On to the next important financial statement in the annual report: the income statement, also known as the profit-and-loss statement. The income statement shows a company's profitability over a specific period of time. It's a look into how much the company earned, and all of the money that it spent.

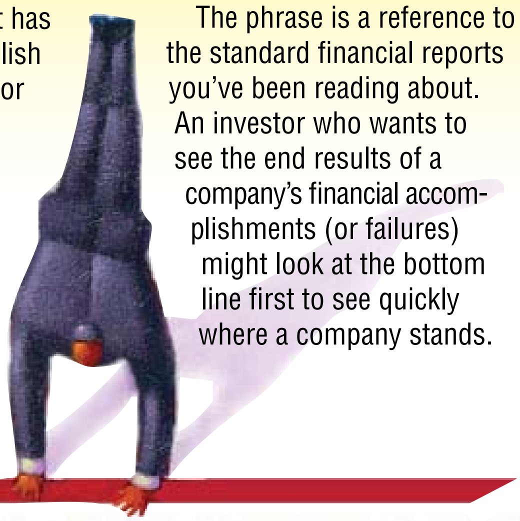
In the finance world, **revenues** is the word used to refer to money that is earned. **Expenses** is the word used to describe money that is spent as a result of doing business. When the expenses are deducted from the revenues, anything that is left over is profit.

Revenues come from customers who buy a company's products or services. Companies that consistently show a loss (when the expenses *exceed* the revenues) run the danger of going bankrupt. Companies can face a great deal of expenses, ranging from employees' wages, the cost of promotion and advertising, rent on their buildings, and money owed to suppliers.

What's the bottom line?

"The bottom line" is a phrase that has worked its way into common English usage. If you want the end result or conclusion of a story right away, you ask for *the bottom line*. Here's an example:

"Don't tell me everything you have to do after school today. What's *the bottom line*? Are we going to the movies tonight or not?"



The phrase is a reference to the standard financial reports you've been reading about. An investor who wants to see the end results of a company's financial accomplishments (or failures) might look at the bottom line first to see quickly where a company stands.

Some investors believe the income statement is the most important document to review because it shows the company's "bottom line," a term that refers to net income. You "read" an income statement from top to bottom. The top line shows the revenues. Each line below the first line deducts expenses, until you get to the bottom line that shows the net income.

Many investors like seeing a steady growth in revenues and a healthy bottom line. A company that is profitable has more money to pass on to shareholders.

Cash flow. The third financial statement you have to pay attention to is the cash flow statement. This statement tracks the money that comes into and flows back out of a company. The money can flow in or out in one of three ways:

a. *Operations*
(cash that comes in from selling products or services)

b. *Financing*
(cash that comes in from selling securities)

c. *Investing*
(cash the company spends to invest in growth)

The cash flow statement tells you the actual amount of money that a company has. It also can give you an idea of how a company manages its cash.

The Watchdog of the Securities World

As you've read, publicly-traded companies are required by law to provide financial information to their stockholders. Most of them do so in their annual reports. They also provide this information on forms filed every quarter with the U.S. Securities and Exchange Commission, or SEC for short. The SEC is a government agency that is responsible for protecting investors, enforcing regulations, and watching out for fraud in the securities world. The agency is also a good source of general investment information.

Form 10-K (annual report). Once you have the attractive annual report in hand, you can compare it to its less attractive sibling, known as **Form 10-K**. Although the 10-K, also filed yearly, doesn't have the attractive graphics of the annual report, it is actually more detailed. The new investor might find it daunting to look at. However, it is an important document for research, and not that difficult to use once you know what you're looking for.

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Some of the things included in the 10-K are:

- A description of the company's business, its competitors, and any risks involved with the industry
- A listing of any legal proceedings the company is involved with
- A list of the executives' salaries

Form 10-Q (quarterly report). For the first three quarters of the fiscal year, publicly-traded companies file 10-Q reports with the SEC. Unlike 10-Ks, these reports do not include a lengthy discussion of the business, its management, etc. Instead, 10-Qs focus on the company's financial situation for that period of time. Another important difference between the 10-K and the 10-Q is that the financial statements in the quarterly reports are not audited. This means that the company provides the numbers themselves, without any oversight. Annual reports, on the other hand, are audited by independent firms who confirm that the company is presenting the most accurate numbers possible. 10-Qs also include a description of noteworthy changes, if any, that occurred in the business during that quarter.

Form 8-K (current report). If a significant, non-recurring event occurred before a 10-Q was due, companies can file **Form 8-K**. These changes include such things as changes in key management, acquisition of another company, introduction (or cancellation) of a product or service, or legal actions. It's important for investors to know about such things because they could affect a company's fundamental value. Companies are required to file an 8-K within 15 days of such an event.

Insider ownership reports. Watching the trading activity conducted by company insiders is one way that investors make decisions about a company's stock. Owners, directors, and key management are known as a company's insiders. When insiders own a great deal of stock, some investors believe that the company is financially strong. Forms filed with the SEC tell you when insiders buy stock.

There are also forms that tell you when insiders sell, but most investment professionals warn against reading too much into these sales. Insiders can have many reasons for selling stock—many of which are not necessarily negative for the company. Two of the forms to look for are **Form 4**, which tells you when insiders are buying or selling, and **Form 13-D**, which is filed when an investor acquires more than 5 percent of a company's stock.

Wading Through the Source Pool

Objective B

You might have a hard time envisioning a pre-Internet world, but there was a time, not all that long ago, when investors didn't have the 24/7 access to resources they have now. Investors used to have to wait for a mail carrier to *deliver* an annual report to their door. Now, anyone can hop onto a company's web site and download the report in the time that it'd take you to address an envelope and find a stamp.

Most publicly-traded companies have web sites where you can find their annual reports and any other information and filings they have made public throughout the year. Look for the Investor Relations section of the web site.

EDGAR

The SEC web site houses all of the filings, such as the 10-K and 10-Q, on www.sec.gov. Look for the section called EDGAR, which stands for Electronic Data Gathering and Retrieval.

Company web sites and EDGAR, while very important stops on your research journey, are just two sources that are available. They also have something in common: they provide *internal* information, meaning the financial data and narrative information come from the company itself. The financial world is also full of *external* information about publicly-held companies. This information comes from outsiders looking in at a company. Using this information, in addition to internal information, is one way to get the whole picture of a company. Let's start with the most well-known sources.

Independent Investment Information and Advice

To do your serious research, you'll have to take a trip to your public library. Begin by looking at *The Value Line Investment Survey*. (You could subscribe to this yourself, but it is very costly.) This well-regarded publication provides detailed reports on approximately 1,700 stocks. Another publication to consider is the *Standard and Poor's Stock Guide*. In these reports, you can find information on the stock's price performance, earnings estimates, the best and worst performing stocks of the past 13 weeks, and many other kinds of data.

Your library will have other print and online publications and databases. Some others to look for are *Hoover's Online*, *Mergent Investment Manuals*, and *Mergent Online*. Once you find a source that you are comfortable with, you may find it easier to use it consistently. Each source portrays the information a bit differently, so becoming familiar with just one can save you time.

Brokerage Firm Research

If you use a full-service brokerage firm for trading stocks, you have access to various research reports and recommendations. Brokerage firms employ research analysts. Analysts typically specialize in an industry and a few companies within it. Some analysts actually travel to the headquarters of a company they are studying to interview management. As a result, analysts can provide detailed reports to help their firm's clients make decisions about their portfolios.

In recent years, brokerage firms have come under fire because some analysts felt pressured to recommend only those companies that did business with their firms. As a result, the SEC has placed restrictions on analysts. They have to make public any potential conflicts of interests they may have with the companies they are following.

Free and Fee-Based Information and Advice

Now you know that you can get investment information from the company itself, from a federal agency, from well-known publications available at the library, and from research analysts. But wait, there's more!

Radio and TV programs— as well as an entire channel devoted to finance—offer advice and information, as do books, magazines, seminars, web sites, online discussion boards, blogs, podcasts, and newsletters. Some of this information is free, while some is fee-based. Of the fee-based, some are quite expensive.

The Internet has completely changed the way individual investors can obtain information. Financial web site portals have become rich depositories of securities information. With a few clicks, you can obtain all of the financial statements you need as well as financial histories going back for years, a comparison of analyst recommendations, and press releases for the latest company news. You can even receive e-mail alerts when something significant happens to a company and its stock.

What's the downside? Think of that noisy room we started out in. Sometimes when you have too much information coming at you, it's hard to pay attention to what's important. As you're evaluating all of the available sources, just remember the basics and stick to them.

The amount of investment information available today can be overwhelming. Here are the most well-known sources:

Newspapers

Wall Street Journal
Investor's Business Daily
Barron's (weekly)
Also: *The New York Times "Business Day"* and *USA Today "Money"*

Magazines

Better Investing
Black Enterprise
Business Week
Forbes
Fortune
Kiplinger's
Money

You can also ask a reference librarian to help you search business databases, such as EBSCOHost or ProQuest to find articles about the company, its management, and the industry that it's in.

Books

(This is just a small sampling of the hundreds of books on investing.)

If You're Clueless About the Stock Market and You Want to Know More, by Seth Godin (Dearborn Trade)

The Motley Fool Investment Guide for Teens, by David and Tom Gardner (A Fireside Book)

One Up On Wall Street, by Peter Lynch (Simon & Schuster)

Investing for Dummies, by Eric Tyson (IDG)

Television and Radio

Cable Channel: CNBC
Public Radio Programs: *Marketplace, Sound Money*
Television Programs: *CNN Business News, CNN Money*, *Nightly Business Report* (PBS), *Wall Street Week* (PBS)

Web sites

(Note: Many print publications have online versions.)

CNBC Online www.moneycentral.msn.com

CNNMoney www.money.cnn.com

Hoover's Online www.hoovers.com

InvestorGuide.com www.investorguide.com

Morningstar www.morningstar.com

The Motley Fool www.fool.com

Standard & Poor's Index Services www.spglobal.com

ValueLine.com www.valueline.com

Yahoo Finance www.finance.yahoo.com