

Putting it all together

Tips and pointers to maximize your Merriam Report experience.

Financial statements are a history lesson of a company's business operations during a specific period of time. The income and cash flow statements are very important, but their data is exclusive to the period(s) reported.

In contrast, the balance-sheet provides a more substantial and forward view of how a company is valuing its assets and liabilities.

With the Merriam Report, investors get a clear picture of the important changes within these “relationships” over multiple periods of time. We believe this provides an accurate view of earnings quality while also offering predictive analysis capability of a company's prospects going forward.

Stocks exhibiting favorable upside potential:

- **Bullish** confirmed and recent dual cash-flow signals*
- Improving OCF **and** declining BSCF trends
- An accrual ratio of -5 or less
- Improving revenue metrics and capital productivity ratios
- Declining goodwill trends
- A stock price that does not yet reflect improving fundamentals

Stocks exhibiting likely downside potential:

- **Bearish** confirmed and recent dual cash-flow signals*
- Improving BSCF **and** declining OCF trends
- An accrual ratio of +5 or greater
- Deteriorating revenue metrics and capital productivity ratios
- Increased goodwill and intangible assets
- A stock price that does not yet reflect deteriorating fundamentals

* Companies with improving earnings quality potential will display positive OCF and negative BSCF. Companies with declining earnings quality potential generally show positive BSCF and negative OCF.

The written summary portion of the MR will highlight those areas of the data we believe to be important, but readers are encouraged to review the entire data and realize the full potential of the Merriam Report's rich content and analysis.

Stocks displaying mixed signals

One of the unique aspects of the MR is its ability to detect potential shifts in a company's financial situation much sooner than traditional analysis will. Every industry experiences fluctuations in their business cycles differently, but the MR will help investors identify which way the wind is blowing. Keep in mind however, that one quarter or period does not make a trend.

Recent Bearish & Confirmed Bullish: A possible indication of deteriorating earnings quality in the most recent period. Look to see if the recent signal is verified by an accrual ratio turning positive (+) or heading that direction. Compare this to changes in revenue metrics and capital productivity. Are these declining also?

Recent Bullish & Confirmed Bearish: A possible indication of improving earnings quality. Look to see if the recent signal is verified by an accrual ratio turning negative (-) or heading that direction. Compare to changes in revenue metrics and capital productivity. Are these improving?

Other Considerations and Suggestions

1) Generally, companies with higher earnings quality will display rising levels of positive (+) operating cash-flows (OCF) and declining levels of balance-sheet cash-flow (BSCF). The bullish dual cash-flow trends should also be validated by bullish trends in the accrual ratios discussed earlier.

In contrast, companies with deteriorating earnings quality typically have declining OCF and rising BSCF. These bearish trends will often be validated with a corresponding bearish trend in the accrual ratio.

2) The MR is an excellent comparison tool when comparing companies in similar businesses, industries and sectors. It is not recommended to compare MR analysis between companies in different industry groups or sectors.

Example: The data signals and indicators generated for a Coca Cola will likely be significantly different than those for a chemical, technology or steel company, etc. This can be for many reasons such as the capital intensity of the business, debt loads, etc.

3) Always review the balance-sheet data on **page one** of the MR for signs of unusual changes in the relationship of assets. Things to look for include treatment of: receivables, days-sales-outstanding, inventory (incl. their relationship to sales), P/P&E (capacity), accounts payable, etc. Compare these to changes in revenue. This is particularly true with companies experiencing transitional earnings quality.

For example: a build-up of inventory in advance of a new product launch is not unusual. But, if the ramp-up or sales don't go as planned, the company might be forced to carry the higher inventory longer than expected. –Look for rising inventory as a % of sales.

Or, a company's new product launch appears to be going well. Sales are rising, but accounts receivable are rising at a faster clip than revenues. –Look for an increase in days-sales-outstanding.

4) Anytime you see a noticeable shift in revenues accompanied by an abrupt change in the balance-sheet items, it makes good sense to peruse the footnotes and see if management has provided a reasonable explanation for the changes.

Final Thoughts: We can't emphasize enough to conduct thorough due diligence of **any** security before investing your money. The Merriam Report is intended to provide investors an essential research tool...not a crystal ball.

As any investor realizes, global financial markets are working through one of the most significant disruptions since the Great Depression. What should have been a garden variety recession got pushed to the edge of disaster by the cumulative effects of excess risk and leverage.

Capitalism didn't fail, but its participants came pretty darn close to spoiling the party. This isn't your father's stock market and it isn't your brother's either. It's a reflection of human nature today. Get used to volatile markets and the swings of global economies.

The Merriam Report won't guarantee success, but we are quite confident its uniquely predictive analysis will increase your chances for profitability significantly and help to preserve your capital. long before traditional cash-flow analysis detects changes in company fundamentals.

However, we can promise that the MR analysis will filter out much of the static in a company's financial statements long before traditional cash-flow methods detect fundamental changes.

Remember, the balance sheet is the first place a company's management turns to when they need "cash". What the MR will do is show you how much cash is coming from paying customers and how much is coming from changes in accounting techniques.

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