A Systematic Approach to Reviewing a New Stock

Description

This morning's news mentioned a company that you've never heard of. You thought it sounded interesting. What's your next step?

If you're like most people, including myself, we fire the ticker into our quote provider of choice and find out what the price of the stock is and perhaps check out a chart of how it has behaved over a certain period of time. We should stop doing this. Stock prices are nothing more than noise and have no relevance to the quality of that company's business or what it's actually worth.

To illustrate a more relevant, systematically unbiased way to approach a new idea, I randomly grabbed a name out of this morning's paper that I had never heard of before (honest). The company is **Mediagrif Interactive (TSX:MDF)**. Without looking at a quote, or stock chart, let's form an opinion on this name using more fundamentally based analysis.

Step One

I'm going to write this in "real-time", documenting findings as we go. At this point, I have no idea what's going to turn up.

Before even looking into what Mediagrif does, our first stop is the company's financial statements – namely, the balance sheet and statement of cash flows. Personally, I like my investments to show low financial risk and an ability to generate free cash flow (cash from operations – cap ex). If Mediagrif can't pass these tests, we'll toss it to the curb.

Two quick observations from the balance sheet. First, there is essentially no debt. The company perhaps made an acquisition in fiscal 2012 as debt and goodwill/intangibles jumped, but has since paid this loan off. A good sign. In addition, book value per share has grown steadily from $4.34 at the end of fiscal 2008 to $6.99 at the end of December 2012. Another positive. Still interested.

The cash flow statement provides several more encouraging bits. Free cash flow is consistently positive as capital expenditures are miniscule. Changes in working capital are steady. The company paid down the debt that we mentioned above by issuing equity. And, there is a quarterly dividend of

$1.2 million which represents a payout of just 32% of the average quarterly free cash flow over the past four quarters. Not only is this dividend affordable, it has room to grow. Another item to look for on the cash flow statement is share buyback activity. Mediagrif does not have any. Aside from this, all looks reasonable on this front.

Step Two

With these checks cleared, it's time to look at the income statement. Margins and profitability metrics are important when judging the quality of a business. If both are growing over time, wonderful. Generally though, a sustainable business will be able to at least maintain margins and ROE through thick and thin. The table below provides a look at Mediagrif's relevant historical figures:

	2006	2007	2008	2009	2010	2011	2012
Operating Margin	28.0%	14.5%	5.8%	5.6%	20.7%	26.2%	27.2%
ROE	11.8%	5.8%	2.6%	-2.1%	4.1%	12.6%	14.3%

Source: Capital IQ

Drawing from the dip in both figures that occurred through the financial crisis, it appears we've got a business on our hands with some degree of economic sensitivity. In addition, given that these metrics have popped right back up, Mediagrif's model seemingly has significant operating leverage.

Growth is another important consideration that we can take from the income statement. Outlined below are sales and earnings growth figures.

	2006	2007	2008	2009	2010	2011	2012
Revenue Growth	8.2%	-8.1%	3.7%	0.4%	-4.6%	3.0%	14.3%
EPS Growth	32.5%	-47.2%	-57.1%	n/a	n/a	222.2%	19.0%

Source: Capital IQ

Both figures echo the previous table. Sales and profits got bounced around in the recession and have rebounded nicely. Top line growth is not explosive, perhaps indicative of an offering with steady demand, as opposed to fad type qualities.

Where we at?

I'm intrigued. Nothing that we've looked at has made me want to dismiss this name entirely. Quite the opposite in fact. I want to know more!

An opinion on Mediagrif has begun to form without knowing what the company does. With this impression set, it's time to take look at the stock price/chart and speculate about what our opinion may have been had this been our first step. Even though this look will impact our perception, at least it's not our first impression. Off to Yahoo! we go.

The stock has had a 5 year gain of 230%. It's safe to say that had I simply looked up this information after initially reading about Mediagrif I would have chalked it up as another small cap that got away and moved on.

Instead, we're going back for more! **Join in for Part II of this discussion** where we'll get into what Mediagrif does and hopefully come up with an idea of what the stock might be worth. With the information we have thus far, the company looks cyclical, and therefore perhaps better to buy on a downswing. Seemingly, it is at least a watch list type name. Maybe more?

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