3 Lessons From Philip Fisher to Make You a Better Investor

Description

Philip Fisher is the author of the book, *Common Stocks and Uncommon Profits*. The book earned him a meeting with Warren Buffett, who wanted to learn more about Fisher's strategies.

Fisher's core idea is that investors should look for investments that have growing sales and profits. Fisher also believes in investing in your circle of competency and having a focused portfolio of superior companies instead of owning a diversified portfolio of some great companies and some mediocre ones.

Lesson 1: Sales are key to success

Businesses should have the capability to increase revenue over time. This makes sense. If a business cannot grow sales, that could mean there's not enough demand for their products and services, or that their competitors filled the demand with better products and services.

Lesson 2: Growing sales should be followed by growing profit

We cannot say that a business is great only after looking at its growing revenue. At the same time a business is growing sales, it should also be growing its profits. Otherwise, if a business is only able to sell one more product by cutting the profit per product in half, the business hasn't increased its profitability.

So, at the same time a business's sales are increasing over time, its profit margins should also increase over time. Growing profit margins indicate that the business is becoming more profitable. In the end, profits should generate healthy cash flows for the business.

Lesson 3: Invest in your circle of competency

By investing in industries you understand thoroughly, you should be able to pick out superior businesses that outperform competition. Holding a concentrated portfolio of superior stocks should lead to better returns than a diversified portfolio that also consist of mediocre stocks.

Tying the ideas together

Using **Avigilon Corp.** (TSX:AVO) as an example, since its full year of sales in 2011, it has grown sales at a compound annual growth rate of 65% until 2014. Its trailing 12-month (TTM) revenue of $316 million indicates more growth from 2014’s $271 million.

From 2011 to 2014, Avigilon’s gross margin increased from 46% to 56.6%. Its TTM gross margin is 57.9%, indicating further expansion.

In the same period, Avigilon’s operating cash flow grew from -$3 million to $15 million. Its TTM operating cash flow was $21 million, indicating continued healthy cash flow generation.

By looking at the numbers, we can see that Avigilon is growing its sales and profits. It’s also generating healthy operating cash flows. On initial research, it’d seem that Avigilon is a great business to own, especially since it has retreated 46% from a 52-week high of $25 to $13.4 per share.

The next step should be to compare Avigilon’s numbers with its competitors. Unfortunately, the video surveillance and electronic access control markets that Avigilon is in are very fragmented, with no dominant player.

As Avigilon’s annual information form that was dated March 2015 states, “In 2013, the top five companies in the global video surveillance space comprised only 30.5% of the total market, the top 10 less than 42%.” So, without knowing exactly who Avigilon’s competitors are, I cannot make a comparison.

In conclusion

Nonetheless, a great business should consistently grow its revenue and profitability and be able to turn profits into stable cash flows. You can start investing in your circle of competency by looking at the industry you work in, the products you buy, and the services you use, especially if you use the products or services repeatedly.

Repeated sales imply consistent cash flow generation. Utility bills, cell phone bills, and grocery bills are the first items that come to my mind. How about you?

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Date
2025/08/27
Date Created
2015/10/22
Author
kayng