Buy These Companies to Beat the Stock Market

Description

As a growth investor, I aim to hold only the companies that have potential to beat market returns. Last month, I provided two characteristics of companies that should give you market-beating returns. If you have not read that article, I suggest starting there and coming back to this. Without further ado, here are two more characteristics that high-growth companies generally have.

The company has a strong moat

One of the best predictors of a stock's performance is to see whether the company's earnings are increasing over time. Since earnings are closely correlated to sales, one question that can be asked is: How can a company ensure consistent increases in revenue year over year?

This can be done by establishing a solid moat. For those that are unfamiliar, this would be the competitive advantage a company has over its competitors.

For example, the Big Five banks (**Bank of Montreal**, **Bank of Nova Scotia**, **Canadian Imperial Bank of Commerce**, **Royal Bank of Canada**, and **TD Bank**) are well known among investors for having an oligopoly in the Canadian banking industry. Their collective moat is well-described, as the assets and geographical reach of each company dwarf all other competitors in the industry.

Another moat can result in a high barrier of entry. For example, **Shopify** (TSX:SHOP)(NYSE:SHOP) has built up an incredible e-commerce infrastructure which will be hard for new competitors to compete with. As of June 2019, Shopify announced that there were 820,000 merchants using its platform.

Not only that, but the company provides more services than an outlet for online stores. Shopify offers shipping services, point of sale hardware, small business loans, and more.

Recurring revenue is superior

The next trait to consider in a company is how it makes its money. Companies that do not have a recurring source of revenue (e.g., single payments for products and services) will generally have a harder time scaling its business since they need to be sure that customers have a reason to keep paying.

Returning to the Shopify example, merchants are required to pay a monthly subscription fee to keep their stores active. Shopify also charges a transaction fee if the merchant decides to use a third-party payment provider to handle customer payments.

Shopify's monthly recurring revenue has been on a steady increase over the past six years. In Q2 2014, the company reported an average monthly recurring revenue of $5.10 million. By Q1 2020, this figure had grown to $55.4 million! The company's Q2 monthly recurring revenue should see a significant boost given the surge toward online shopping during the COVID-19 pandemic.

Other examples of companies that have recurring revenue streams are **Emera** and **Fortis** (recurring revenue from customers using electrical utilities).

Foolish takeaway

Although finding companies that provide market-beating returns can be tough, there are certain characteristics you can look for that will help narrow down the field of potential investments.

Generally, high growth companies will have a stable or expanding moat and its revenue sources will have a recurring aspect.

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jedlloren