# QUANTITATIVE METRICS

## MTY Food Group

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***"In the short run, the market is a voting machine, but in the long run it is a weighing machine."***
*- Benjamin Graham*

MTY Food Group is a Canadian fast-food franchisor that was profiled by MicroCapClub in 2015 by Chip Maloney. MTY is a prime example of a company that had attractive financials early, which hinted at its rise to becoming a 100-bagger. In 2003 MTY reported revenues of $11.5M and EPS of $0.10. Inside these financials, though, were several important metrics as to the quality and potential of the business. First was the massive returns on invested capital (ROIC) of 60% or more. Next was the much higher than average gross profit margin at over 70%, achievable back then as the company was more of a pure play franchisor. On top of these exciting metrics is the supercharged revenue and EPS growth from 2003 to 2013, when the company became a 100-bagger, which continued onward after 2013 as well.

This collection of quantitative factors was an early indicator of MTY's super compounding potential. The market caught on to this over time, re-rating the stock from a P/E ratio of around 3 during much of 2003, to a P/E ratio of over 25 during 2013. This multiple expansion drove MTY's stock performance beyond its earnings growth, which by itself expanded about 13 times. With deliberate attention and an understanding of the quantitative metrics used in analysis, it is possible to identify potential multi-baggers—maybe even 100-baggers—and achieve outsized returns.

### The "Twin Engines"

Christopher Mayer, author of the book 100 Baggers, describes the "Twin Engines" of 100-baggers as sales growth and multiple growth. However, it is important to note that the preferred growth is sales and earnings growth on a per share basis. The key is to find a company with the ability to grow without needing to raise equity capital, which creates dilution. A company that consistently increases the number of shares outstanding is eroding any EPS growth that could occur with increased sales and corporate earnings growth. Additionally, as illustrated by the MTY Food Group example, accelerated earnings growth is often the catalyst for the multiple expansion necessary for super-compounders.

### Market Cap/Multiples

To maximize the effect of multiple growth on the path to 100-baggers, it is important, though not always necessary, to begin your search for 100x candidates in the companies which currently maintain low multiples. Low multiples are preferred because the higher the multiple being paid, the higher the earnings growth rate must be since one is unlikely to get a major boost in re-rating from multiple expansion. But investors must remain wary, as these low multiples most often indicate a company with bad prospects. Therefore, it is important to do proper research to determine truly undervalued companies.

Another factor to consider in the search for super-compounders is the market cap of the company. Naturally, it is much easier and more likely for small companies to become 100-baggers. For example, a company with a $10 million market cap needs to expand to a market cap of $1 billion to achieve a 100x return (assuming no share dilution). In contrast, a company with a market cap of $10 billion must grow to a size of $1 trillion to achieve 100x status—a size rivaling the dominant, technology giants of today, and a size few companies have ever achieved. In Mayer's book, the median market cap of the 365 companies that rose 100-fold in his study was $500 million. This is well within the small-cap sector, and close to microcap status.

### Predictive metrics for the "Twin Engines"

To find these companies with the "Twin Engines," investors can look to a few metrics on the financial statements:

- ROIC, or return on invested capital, is a solid metric for how well management is employing retained cash flows. If this number remains consistently above 20%, it indicates a management team that is particularly adept at employing capital and creating shareholder value, and possibly that the business can continue to reinvest at high rates, which is one of the keys to the long-term compounding of capital.

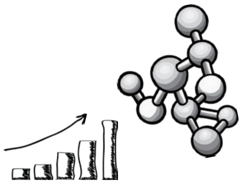
- ROE, or return on equity, measures a company's profitability in relation to its net assets. This can be both a measure of health and capital employment, although it can be misleading if shareholder equity is kept exceptionally low or high, or if it changes meaningfully over time through things such as share buybacks. An ROE above 20% consistently can be a strong indicator of a great business, and potential multi-bagger (or more), as it indicates robust growth and strong management choices.

- Gross Profit Margin: This metric can be an indicator of high-quality operations if the margin for a specific company is consistently higher than its industry average. This is particularly useful as gross margins are not highly mean reverting, meaning they have the benefit of persisting over the longer periods.

Investors also need to be aware of the tools managerial teams utilize to avoid taxation and retain more capital to reinvest. Often R&D, Depreciation, and Amortization are utilized as non-cash costs and allow companies to reinvest these cash flows back into the company without the government taking their share. Alternatively, many brilliant investors are wary of these accounting practices as they can be indications of over leverage or bloated cost structures. These tools are something an investor needs to pay close attention to as they can either indicate strong management or a struggling company with remarkably similar looking financial statements.

In summary, there are quantitative metrics that can be used to help one identify companies with multi-bagger and 100-bagger potential, but these metrics must be combined with proper research efforts. The path to outsized returns often involves identifying companies that are about to experience significant growth in revenues, earnings-per-share, and valuation multiples, all while maintaining a stable number of shares outstanding. But it is also important to remember that the future is unpredictable and holding good companies through the ups and downs of the market is often the hardest part of achieving the biggest winners. As Thomas Phelps wrote in his book 100 to 1 in the Stock Market:

"The investor trying to buy right and hold on could buy as many different stocks as appealed to him. The difference is not in the focusing of investment money but in the intent of the buyer. The trader believes that in a swift-moving, rapidly changing world, with visibility always limited, he can make a series of commitments with better chance of success than trying to decide which companies will do well for the next twenty years. The investor dedicated to buying right and holding on picks managements, products, and processes he thinks able to cope with the unforeseeable as it hoves into view."



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