THE EASY WAY TO FIND **UNDERVALUED STOCKS**

BASE CAMP TRADING

THOMAS WOOD

Risk Disclaimer

The Easy Way to Find Undervalued Stocks by MicroQuant

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About the Author:
THOMAS WOOD

Hi. Thank you for downloading *The Easy Way to Find Undervalued Stocks*. My name is Thomas Wood, and I'm a partner here at Base Camp Trading. Before diving in, I thought I'd let you know how I got started in the markets.

LIKE MOST OF YOU, I DIDN'T COME FROM A WEALTHY BACKGROUND.

My father owned a construction company where he built houses for a living. From time to time, I would help out with the work. It was an honest way to make a living, but it wasn't the kind of life my dad wanted for his kids.

Like any good parent, my father desperately wanted to find a better way to provide for his family. That's when he first learned about trading. He started buying courses and following the advice of experts. He was so excited at the time that he even helped me make my first options trade when I was 14.

Unfortunately, he ended up losing hundreds of thousands of dollars blindly following gurus instead of learning how to trade the right way.

That's when I decided to become a trader myself. Not just to make money for me and my family, but to teach real trading advice and actually make a difference in the lives of people.

After graduating in 2007, I ended up trading full-time under the guidance of a man I considered my mentor, Drew Day (one of the founders at Base Camp Trading). He ended up teaching me the tips and tricks used by real traders to earn a full-time income.

It took a while to master, but once you wrap your head around the principles used by successful traders, it's not that hard to make a consistent profit. On one of my best days, I cleared over $50,000 in profit. However, what's more important is that I've mentored dozens of individual traders to do the same thing.

One of my most profitable trading strategies involves finding and trading undervalued companies. While you could spend years reading countless books on the subject, I'm going to give you a crash course in exactly how you can start finding undervalued businesses in just a few minutes.

Best of all, you don't need to have any accounting knowledge. I'll show you everything you need to know, in 15 minutes or less, to pick out stocks that have massive upside potential.

Once again, thanks for downloading this eBook. I'm excited to show you exactly how to discover undervalued stocks that most readers are missing right now.

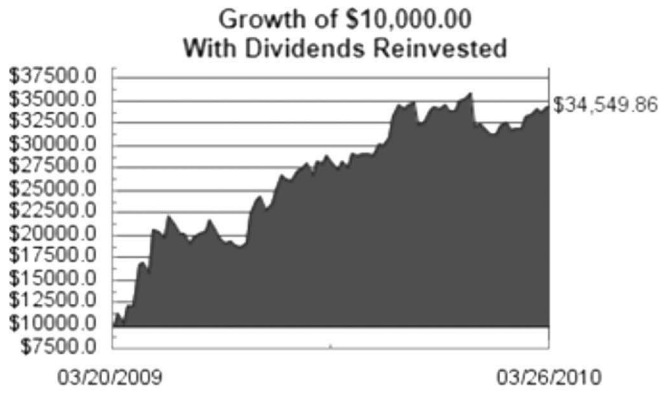
Thomas Wood

BALANCE SHEET
VALUE AND GROWTH INVESTING?

There are two main schools of thought when it comes to investing in stocks. On the one hand, you have value investors. This is a strategy used for decades by some of the world's best investors, where you look for companies trading less than what they should be worth.

For example, a value investor would have looked at American Express (AXP) back around the 2008 financial crisis, where shares had fallen to just $12.3. While the markets were skittish about financial companies, American Express was reporting strong revenue figures and profit margins. Less than 12-months later, shares jumped to over $44.8.

That means if you bought $10,000 worth of AXP on March 20th, 2009, your investment would have grown to over $34,459.86 in just one year.

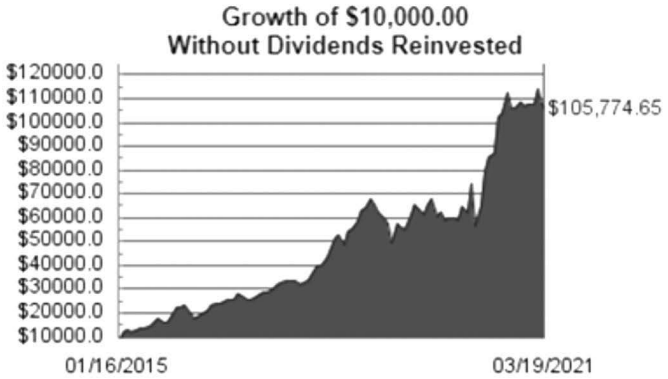


During the same time frame, the S&P 500 would have made you just $15,124.70 instead.

On the other hand, there are growth investors. As the name suggests, the most important thing for a growth investor is that a company is growing at a strong and steady pace instead of focusing on cash flow.

Amazon (AMZ) is one famous growth stock example. While its stock price was incredibly high compared to earnings, growth investors were okay with this because Amazon had tremendous growth potential with no serious competition. Back in 2016, shares were trading around $300. Now Amazon's stock is worth over $3,100.

That same $10,000 investment in AMZN back in 2016 would be worth $105,774 today.

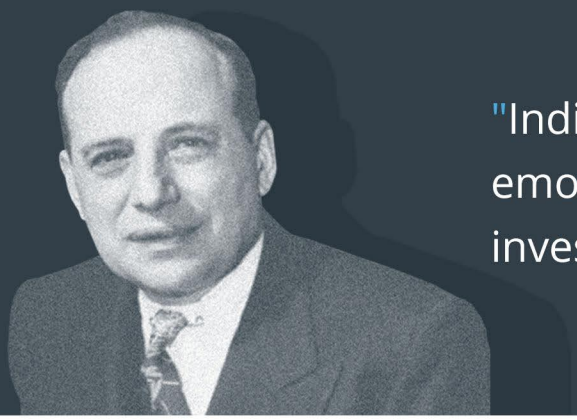


In comparison, a similar investment in the S&P 500 would have only produced $21,803.

While there's always some debate between which is better, growth or value investing, both styles have made many people millionaires and billionaires.

Here are a few notable examples:

VALUE INVESTING LEGEND AND WARREN BUFFETT'S MENTOR: **BENJAMIN GRAHAM**



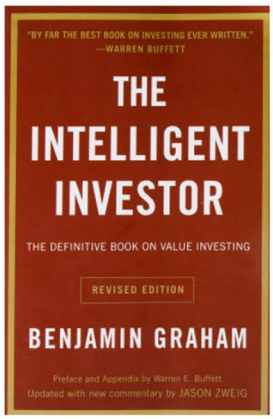
"Individuals who cannot master their emotions are ill-suited to profit from the investment process."

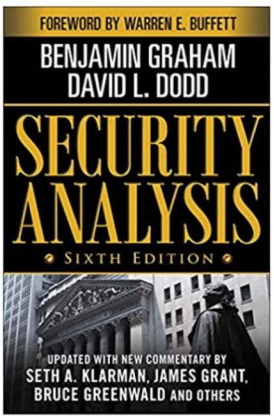
– Benjamin Graham

Few names are more synonymous with value investing than Warren Buffett. However, not as many people know about his investing mentor. Buffett first learned how to invest from another famous investor named Benjamin Graham.

Besides being an investor himself, Graham was also a professor at Columbia, where he taught a class on security analysis. As it turned out, a number of his students that attended his class ended up becoming billionaire investors. This included Warren Buffett, Charlie Munger, David Gottesman, William Ruane, and many other billionaire investors. All of them took Graham's class and credited him as an inspiration for their own success.

While Graham's legendary investing class isn't offered today (he passed away), you can still read his books, including The Intelligent Investor and Security Analysis.





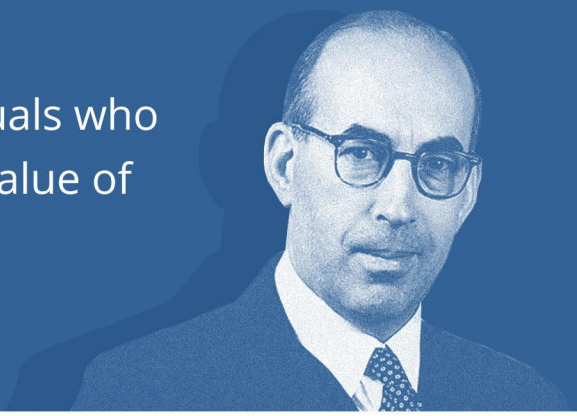
Graham made his fortune investing during the Great Depression. At the time, companies were trading at such cheap stock prices that you could buy up an entire company for less than the cash it had on its balance sheet. This still happens today, and it's an incredibly easy way to make money on an investment. Buffett never forgot the lessons taught by his mentor during this time and he's now worth over $90 billion.

Value investing can often be a little contrarian, with Warren Buffett often buying up companies during bear markets or crashes while other investors are cashing out. During the 2008 financial crisis, Buffett made a fortune buying up companies like Goldman Sachs at incredibly low prices, and he continues to do so today.

THE FAMOUS GROWTH INVESTOR
PHILIP FISHER

"The stock market is filled with individuals who know the price of everything, but the value of nothing."

– Philip Fisher

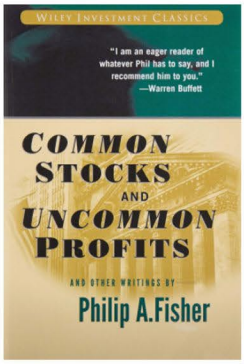


Philip Fisher is another investing legend that takes a different approach. Living around the same time as Benjamin Graham, Fisher was another influence on Warren Buffett, although this isn't as well known. Unlike Graham, however, Fisher was a fan of targeting small-cap growth stocks instead.

These were small companies with the potential for major returns, often on the cutting edge of a new business or technological trend. He famously bought stock in Motorola back in 1955, which turned every $1,000 he invested into over $1,933,864.

Both Fisher and Graham were experts at identifying undervalued companies, although from two different perspectives. Fisher also published another investing book that's become a classic, Common Stocks and Uncommon Profits.

IN HIS WORK, FISHER ALWAYS STRESSES THE IMPORTANCE OF LONG-TERM INVESTING, GOING SO FAR AS TO FAMOUSLY SAY THE BEST TIME TO SELL A STOCK WAS "ALMOST NEVER."



WHICH APPROACH IS BEST?

Value and growth investing are two totally different approaches. But they both require you to know how to identify undervalued companies in the first place. Both approaches can make you a lot of money over your trading career if you master them.

Historically, value investors have done best when the markets are fearful. Big crashes, depressions, or any other big event that drives share prices down too much is a good time for value investors. However, when there's a long bull run, it might be hard to find good deals and cheaply traded companies.

Growth investors are the opposite. There's plenty of promising growth stocks to choose from when the markets are doing great. However, bear markets can slow down the growth rate of all but the best of companies.

In my opinion, there's no reason to just pick one. By knowing how to be both a value and growth investor when the market demands it, you can make money no matter if we're in a bull or bear market.

But to do that, you'll need to know exactly how to discover an undervalued stock. And to do that, you need to understand financial statements.

UNDERSTANDING A COMPANY'S
FINANCIAL STATEMENTS

No matter what kind of investor you want to be, you need to know how to look at a financial statement.
If you haven't looked at one before, they can be a little intimidating...

FINANCIAL STATEMENTS	Historical Results 2012	2013	2014	2015	2016	2017
Income Statement						
Revenue	**102,007**	**118,086**	**131,345**	**142,341**	**150,772**	**158,311**
Cost of Goods Sold (COGS)	39,023	48,004	49,123	52,654	56,710	58,575
Gross Profit	**62,984**	**70,082**	**82,222**	**89,687**	**94,062**	**99,736**
Expenses						
Salaries and Benefits	26,427	22,658	23,872	23,002	25,245	26,913
Rent and Overhead	10,963	10,125	10,087	11,020	11,412	10,000
Depreciation & Amortization	19,500	18,150	17,205	16,544	16,080	15,008
Interest	2,500	2,500	1,500	1,500	1,500	1,500
Total Expenses	**59,390**	**53,433**	**52,664**	**52,066**	**54,237**	**53,421**
Earnings Before Tax	**3,594**	**16,649**	**29,558**	**37,622**	**39,825**	**46,314**
Taxes	1,120	4,858	8,483	10,908	11,598	12,968
Net Earnings	**2,474**	**11,791**	**21,075**	**26,713**	**28,227**	**33,346**
Balance Sheet						
Assets						
Cash	167,971	181,210	183,715	211,069	239,550	272,530
Accounts Receivable	5,100	5,904	6,567	7,117	7,539	7,807
Inventory	7,805	9,601	9,825	10,531	11,342	11,715
Property & Equipment	45,500	42,350	40,145	38,602	37,521	37,513
Total Assets	**226,376**	**239,065**	**240,252**	**267,319**	**295,951**	**329,564**
Liabilities						
Accounts Payable	3,902	4,800	4,912	5,265	5,671	5,938
Debt	50,000	50,000	30,000	30,000	30,000	30,000
Total Liabilities	**53,902**	**54,800**	**34,912**	**35,265**	**35,671**	**35,938**
Shareholder's Equity						
Equity Capital	170,000	170,000	170,000	170,000	170,000	170,000
Retained Earnings	2,474	14,265	35,340	62,053	90,280	123,627
Shareholder's Equity	**172,474**	**184,265**	**205,340**	**232,053**	**260,280**	**293,627**
Total Liabilities & Shareholder'	**226,376**	**239,065**	**240,252**	**267,319**	**295,951**	**329,564**
Cash Flow Statement						
Operating Cash Flow						
Net Earnings	2,474	11,791	21,075	26,713	28,227	33,346
Plus: Depreciation & Amortization	19,500	18,150	17,205	16,544	16,080	15,008
Less: Changes in Working Capital	9,003	1,702	775	903	827	375
Cash from Operations	**12,971**	**28,239**	**37,505**	**42,354**	**43,480**	**47,980**
Investing Cash Flow						
Investments in Property & Equipment	15,000	15,000	15,000	15,000	15,000	15,000
Cash from Investing	**15,000**	**15,000**	**15,000**	**15,000**	**15,000**	**15,000**
Financing Cash Flow						
Issuance (repayment) of debt	-	-	(20,000)	-	-	-
Issuance (repayment) of equity	170,000	-	-	-	-	-
Cash from Financing	**170,000**	**-**	**(20,000)**	**-**	**-**	**-**
Net Increase (decrease) in Cash	167,971	13,239	2,505	27,354	28,480	32,980
Opening Cash Balance	-	167,971	181,210	183,715	211,069	239,550
Closing Cash Balance	**167,971**	**181,210**	**183,715**	**211,069**	**239,550**	**272,530**

While some people spend years learning all the intricacies of financial reporting, finding undervalued businesses isn't necessarily that hard.

In fact, I promise you that in as little as 15 minutes, you'll know the most important things to look for in a financial statement.

Before we start looking at specific metrics and figures, you need to know the basic structure of how a financial statement is structured. If you never took an accounting class, don't worry; I've made this simple enough that almost anyone can understand it.

When a company reports its financial results every quarter, the information is found in three different types of financial statements.

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1. **THE BALANCE SHEET:**
   This is a snapshot of the company's current assets, debts, and its current valuation. Value investors tend to focus more on the balance sheet, as you can see exactly how much cash a company has on hand, as well as whether it's in debt or not.

2. **THE INCOME STATEMENT:**
   This is where you're going to see an exact breakdown of a company's revenues and expenses. While a balance sheet just shows you a snapshot of whether a company is profitable or not, the income statement offers a deep dive into exactly where the money is going.

3. **THE CASH FLOW STATEMENT:**
   This is where you can see all the cash inflows and outflows during a company's quarter. The cash flow statement is great for accountings looking to see exactly where the company's cash is going.

While the cash flow statement can be very important, you can get a good picture of whether a business is undervalued or not just from the first two types of financial statements.

THE BALANCE SHEET

A balance sheet can be broken down into three areas, assets, liabilities, and equity. No matter what kind of balance sheet you read, it's always broken down into a simple formula:

ASSETS = LIABILITIES + EQUITY

Assets include everything a company owns, like real estate, equipment, intellectual property, as well as its cash. It also includes assets receivable as well.

AMAZON.COM, INC.

CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)

	December 31, 2016	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,334	$ 20,522
Marketable securities	6,647	10,464
Inventories	11,461	16,047
Accounts receivable, net and other	8,339	13,164
Total current assets	45,781	60,197
Property and equipment, net	29,114	48,866
Goodwill	3,784	13,350
Other assets	4,723	8,897
Total assets	$ 83,402	$ 131,310

LIABILITIES are what business owes to others. This is generally a combination of both short-term and long-term debt, in addition to deferred revenue and other less common types of liabilities.

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 25,309	$ 34,616
Accrued expenses and other	13,739	18,170
Unearned revenue	4,768	5,097
Total current liabilities	43,816	57,883
Long-term debt	7,694	24,743
Other long-term liabilities	12,607	20,975
Commitments and contingencies (Note 7)		

EQUITY refers to the company's net worth, represented in the outstanding shares that a company has issued over its history.

Stockholders' equity:		
Preferred stock, $0.01 par value:		
Authorized shares — 500		
Issued and outstanding shares — none	—	—
Common stock, $0.01 par value:		
Authorized shares — 5,000		
Issued shares — 500 and 507		
Outstanding shares — 477 and 484	5	5
Treasury stock, at cost	(1,837)	(1,837)
Additional paid-in capital	17,186	21,389
Accumulated other comprehensive loss	(985)	(484)
Retained earnings	4,916	8,636
Total stockholders' equity	19,285	27,709
Total liabilities and stockholders' equity	$ 83,402	$ 131,310

Think of it this way. If you just bought a house with a $300,000 mortgage (and you own nothing else, just for this example), then your assets are worth $300,000. However, since you haven't paid any of your mortgage off yet, your liabilities are $300,000, while your equity is zero. Once you've paid off your mortgage, your liabilities will have gone down to $0, while your equity would be worth $300,000, since you now own your house entirely.

It's the same principle when it comes to companies and their balance sheets.

THE INCOME STATEMENT

An income statement is broken down into two parts, revenues, and expenses.

REVENUES – EXPENSES = NET INCOME

At the top of an income statement is the total revenue, which is sometimes further broken down into specific revenue areas. Usually, a company will subtract the Cost of Goods Sold (COGS) here, which gives us the gross profit.

Then the income statement breaks down the various expenses for the quarter, such as administrative costs, operating expenses, etc. Once you've subtracted this, you get your operating income.

The last expenses to be put on an income statement are any interest paid out on loans as well as other expenses, like taxes. After that, you get your net income or net profit.

If anything you've read so far sounds confusing, don't worry about it. I promise you that after you look at a few financial statements for yourself, they aren't nearly as complicated as they seem to be.

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Year Ended December 31,		
	2015	2016	2017
Net product sales	$ 79,268	$ 94,665	$ 118,573
Net service sales	27,738	41,322	59,293
Total net sales	107,006	135,987	177,866
Operating expenses:			
Cost of sales	71,651	88,265	111,934
Fulfillment	13,410	17,619	25,249
Marketing	5,254	7,233	10,069
Technology and content	12,540	16,085	22,620
General and administrative	1,747	2,432	3,674
Other operating expense, net	171	167	214
Total operating expenses	104,773	131,801	173,760
Operating income	2,233	4,186	4,106
Interest income	50	100	202
Interest expense	(459)	(484)	(848)
Other income (expense), net	(256)	90	346
Total non-operating income (expense)	(665)	(294)	(300)
Income before income taxes	1,568	3,892	3,806
Provision for income taxes	(950)	(1,425)	(769)
Equity-method investment activity, net of tax	(22)	(96)	(4)
Net income	$ 596	$ 2,371	$ 3,033
Basic earnings per share	$ 1.28	$ 5.01	$ 6.32
Diluted earnings per share	$ 1.25	$ 4.90	$ 6.15
Weighted-average shares used in computation of earnings per share:			
Basic	467	474	480
Diluted	477	484	493

See accompanying notes to consolidated financial statements.

Cash and Cash Equivalents

"Cash is king" is an old saying among value investors, and for a good reason. When you're buying a company with a lot of cash, that's a good sign that the business is healthy and can pay off debt as well as any sudden expenses.

On a balance sheet, this is called cash and cash equivalents. Strictly speaking, this isn't just cash but also short-term investments that can be sold quickly. Just like how having a savings account is a good idea, it's a good sign to see a company with a comfy cash balance sitting on its books.

With that in mind, you'll want to look at the company's current market cap and compare the two. Usually, a business's cash is just a fraction of its market cap. However, the higher this proportion is, the more likely a company is undervalued right now.

For example, Apple (AAPL) currently has around $195 billion in cash on hand. Every time you buy shares of Apple, you're indirectly buying a small portion of this $195 billion fortune for yourself. With so much cash on hand, you can be certain that Apple isn't at risk of going out of business anytime soon.

Book Value and Market Cap

Market cap or market capitalization is just a company's total price tag. When you read the financial news and stumble across a headline that says, for example, "Apple is Worth $2 Trillion," they are referring to market cap. The exact formula for market cap is the current share price multiplied by the total number of shares.

However, you don't want to just look at the market cap all the time. You'll also want to consider other metrics as well. Just like having a strong cash reserve is a good sign, another healthy sign is that its debt is relatively low.

Some businesses might look like they have a lot of assets, which helps bump up their market cap. However, if most of it is from liabilities, like loans, that's actually not a good sign. Think of it this way. You can look rich by borrowing a lot of money, racking up credit card debt, and buying all sorts of fancy things. But that doesn't mean you have a high net worth; it just means you have a lot of credit. It's the same thing with businesses.

That's why a lot of investors look at a company's book value. The book value is just the difference between a company's total assets and total liabilities. Back to our previous example, your "book value" is like your net worth.

Total Assets - Total Liabilities = Book Value

In other words, if a company were to be liquidated, the book value is how much there would be leftover when everything's been sold off, and all debts paid.

We can also compare a company's book value to the market cap. The higher the book value is compared to its market cap, the more likely the stock is undervalued.

Let's look at a real-life example.

Value Stock Example: Kinross Gold (K)

Assets		
Current assets		
Cash and cash equivalents	**$ 1,210.9**	$ 575.1
Restricted cash	**13.7**	15.2
Accounts receivable and other assets	**122.3**	137.4
Current income tax recoverable	**29.9**	43.2
Inventories	**1,072.9**	1,053.8
	2,449.7	1,824.7
Non-current assets		
Property, plant and equipment	**7,653.5**	6,340.0
Goodwill	**158.8**	158.8
Long-term investments	**113.0**	126.2
Investment in joint venture	**18.3**	18.4
Other long-term assets	**537.2**	572.7
Deferred tax assets	**2.7**	35.2
Total assets	**$ 10,933.2**	$ 9,076.0

Gold mining stocks can be pretty cheap, especially since gold prices are up so much. Kinross Gold has seen its cash position more than double from last year to $1.2 billion, around 11% of its $10.9 billion market cap.

	Years ended	
	December 31, 2020	December 31, 2019
Revenue		
Metal sales	**$ 4,213.4**	$ 3,497.3
Cost of sales		
Production cost of sales	**1,725.7**	1,778.9
Depreciation, depletion and amortization	**842.3**	731.3
Reversals of impairment charges - net	**(650.9)**	(361.8)
Total cost of sales	**1,917.1**	2,148.4
Gross profit	**2,296.3**	1,348.9
Other operating expense	**186.5**	108.5
Exploration and business development	**92.5**	113.5
General and administrative	**117.9**	135.8
Operating earnings	**1,899.4**	991.1
Other income - net	**7.4**	72.7
Finance income	**4.3**	7.9
Finance expense	**(112.6)**	(107.9)
Earnings before tax	**1,798.5**	963.8
Income tax expense - net	**(439.8)**	(246.7)
Net earnings	**$ 1,358.7**	$ 717.1

Additionally, the company is reporting a profit (that's also growing) in comparison to last year.

Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	**$ 479.2**	$ 469.3
Current income tax payable	**114.5**	68.0
Current portion of long-term debt and credit facilities	**499.7**	-
Current portion of provisions	**63.8**	57.9
Other current liabilities	**49.7**	20.3
Deferred payment obligation	**141.5**	-
	1,348.4	615.5
Non-current liabilities		
Long-term debt and credit facilities	**1,424.2**	1,837.4
Provisions	**861.1**	838.6
Long-term lease liabilities	**46.3**	38.9
Other long-term liabilities	**102.4**	108.5
Deferred tax liabilities	**487.8**	304.5
Total liabilities	**$ 4,270.2**	$ 3,743.4

INDICATORS OF AN **UNDERVALUED STOCK**

Looking at Kinross's book value (remember, assets minus liabilities), we see that Kinross is doing pretty well also. Its book value comes down to $6.6 billion, meaning it's "net worth" as a business is quite high.
Overall, Kinross looks like a solid value stock right now, and other investors seem to agree as well. Kinross has seen its stock price soar more than 55.3% over the past 12 months.

HOW TO FIND A **POTENTIAL GROWTH STOCK**

REVENUE GROWTH

Whereas value stocks are more focused on cash, debt, and book value, growth stocks are more focused on revenue growth. However, it shouldn't come at the expense of profitability.

A good growth company should see strong revenue growth. However, be careful if a company's expenses are growing faster than its revenues. When all a company cares about is growth, but don't care about how much it costs, it's a recipe for disaster. A lot of times, companies will try to show off their growing revenue figures to impress potential investors. However, that's not a good business model in the long-term.

Instead, a healthy company should be able to grow its sales without having to increase its expenses in the process drastically. Look at the cost of goods sold (COGS) as well as other expenses.

If these expenses are growing in proportion to revenue growth, then this is sustainable. If expenses are doubling or tripling while revenue is growing less than that, then you have a problem.

EARNINGS PER SHARE (EPS) GROWTH

When you take a company's net income or profit, divide it by its outstanding shares, the number you get is called the earnings per share (EPS). There's a reason why we look at EPS in addition to net income. While a company might seem to have a great profit, if there are too many outstanding shares from issuing too much stock, it would push down its EPS.

Net Income/Total outstanding shares = Earnings per share (EPS)

In general, you don't want to see a company issuing out new stock often. While it's a way to raise some quick cash, it ends up diluting the equity of existing shareholders and pushing down stock prices.

When looking for growth stocks, we want to find companies that are growing their EPS consistently every year. That means that not only is a company profitable, but it's not diluting their outstanding shares either.

However, it would help if you also looked at whether a company's EPS is growing compared to other competitors in the sector. If EPS growth is stronger than its other rivals, then that's a sign a company is growing its market share.

If that's not happening, then this might not be that great of a growth stock. In general, prime growth stocks are companies that have an advantage compared to the rest of their industry but still haven't reached their full potential yet in terms of size.
Let's look at a real example below;

Growth Stock Example: Nio (NIO)

Key Financial Results
(in RMB million, except for per ordinary share data and percentage)

	2020 Q4	2020 Q3	2019 Q4	% Change[iv]	
				QoQ	YoY
Vehicle Sales	6,174.0	4,266.8	2,683.9	44.7%	130.0%
Vehicle Margin	17.2%	14.5%	-6.0%	270bp	2320bp
Total Revenues	6,641.1	4,526.0	2,848.3	46.7%	133.2%
Gross Profit/(Loss)	1,141.9	585.8	(253.8)	94.9%	549.9%
Gross Margin	17.2%	12.9%	-8.9%	430bp	2610bp
Loss from Operations	(931.4)	(946.0)	(2,826.2)	-1.5%	-67.0%
Adjusted Loss from Operations (non-GAAP)	(871.2)	(896.7)	(2,774.9)	-2.9%	-68.6%
Net Loss	(1,388.6)	(1,047.0)	(2,864.6)	32.6%	-51.5%
Adjusted Net Loss (non-GAAP)	(1,328.4)	(997.8)	(2,813.4)	33.1%	-52.8%
Net Loss Attributable to Ordinary Shareholders	(1,492.2)	(1,187.9)	(2,893.8)	25.6%	-48.4%
Net Loss per Ordinary Share-Basic and Diluted	(1.05)	(0.98)	(2.81)	7.1%	-62.6%
Adjusted Net Loss per Ordinary Share-Basic and Diluted (non-GAAP)	(0.93)	(0.82)	(2.73)	13.4%	-65.9%

Electric vehicle makers have been exploding in popularity, and Nio (NIO) has been at the forefront of this trend. As you can see, revenue growth has been tremendous, more than doubling in just a year. It's a similar story with revenues as well.

Like a classic growth stock, Nio is reporting some large losses, over a billion per quarter, but you can see it's improving over last year. You'll also notice that Nio's gross margin is improving as well, a good sign that the company is becoming more financially efficient.

(Revenue - Cost of Goods Sold) /Revenue = Gross Margin

Net losses per share are getting better as well. Compared to last year's $2.73 loss per share, Nio currently is reporting just $0.93. If losses per share were getting worse, then we would be worried that this revenue growth isn't sustainable.

Nio might not be profitable, but it's growing incredibly fast. This year alone, shares surged from around $2.37 to over $43.35.

Before I share with you some red flags I've typically noticed in companies, you need to understand what's healthy for that particular industry. You can't compare a company from one sector that's growing quickly to another that's more established.

You need to compare apples to apples, not apples to oranges.

Let's take what we've learned so far and look at an example. Tell me, do you think this stock is a good investment right now?

CRISPR Therapeutics AG
Condensed Consolidated Statements of Operations
(Unaudited, In thousands except share data and per share data)

	Three Months Ended December 31,	
	2020	2019
Revenue:		
Collaboration revenue	$ 194	$ 77,016
Grant revenue	176	—
Total revenue	$ 370	$ 77,016
Operating expenses:		
Research and development	82,365	48,762
General and administrative	25,766	17,271
Total operating expenses	108,131	66,033
(Loss) Income from operations	(107,761)	10,983
Total other income (expense), net	575	19,563
Net (loss) income before income taxes	(107,186)	30,546
Benefit (provision) for income taxes	147	(4)
Net (loss) income	(107,039)	30,542
Foreign currency translation adjustment	37	29
Unrealized loss on marketable securities	14	—
Comprehensive (loss) income	$ (106,988)	$ 30,571
Net (loss) income per common share - basic	$ (1.50)	$ 0.53
Basic weighted-average common shares outstanding	71,282,096	57,395,839
Net (loss) income per common share - diluted	$ (1.50)	$ 0.51
Diluted weighted-average common shares outstanding	71,282,096	60,233,927

Revenues are down from $77.0 million in Q4 2020 to just $194,000 for Q4 2020. Expenses have gone up substantially, and the company went from reporting a profit last year to seeing a massive $107 million loss. Do you think this is a good investment?

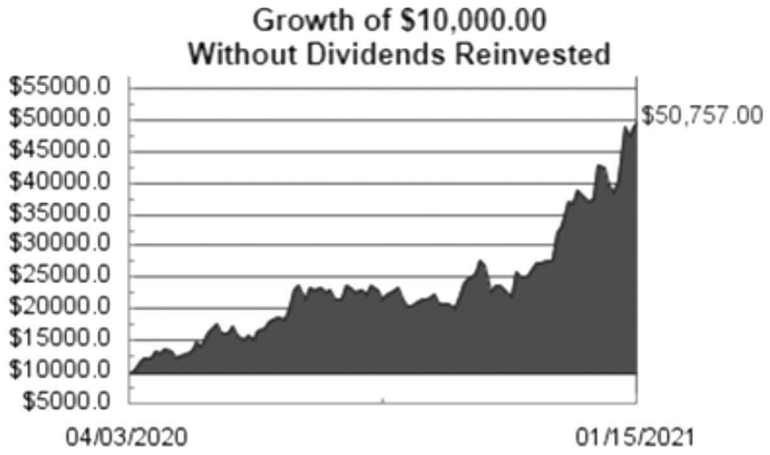
CRISPR Therapeutics AG
Condensed Consolidated Balance Sheets Data
(Unaudited, in thousands)

	As of	
	December 31, 2020	December 31, 2019
Cash	$ 1,168,620	$ 943,771
Marketable securities	521,713	—
Working capital	1,622,361	930,441
Total assets	1,827,966	1,066,752
Total shareholders' equity	1,664,234	939,425

Yet somehow, cash is up to over $1.2 billion! The company's market cap is around $9.8 billion right now, or around 12.2% of its total market cap. Proportionally, that's more than some of the most cash-flush companies on the market, like Apple.
So, what's going on here? Do you think this stock is a good investment?

As it turns out, CRISPR Therapeutics is up 328.1% over the past year. It's also one of the hottest growth stocks in the biotech world right now.

Between Apr. 3 2020 and Jan. 15, 2021, a $10,000 investment in CRISPR would have made you over $50,757.00 - in just nine months!



This is a good example of why you need to look at the broader industry to understand how a stock is doing, not just look at its financial statements. CRISPR is a leader in the gene-editing market, which is a tiny but rapidly growing biotech market. What's more, if you look at the rest of its competitors, CRISPR's financial situation is actually better than its peers.

In the world of early-stage biotech stocks, most aren't profitable until their drug candidate receives regulatory approval. Normally, that's not a good sign, but in the biotech world, that's normal. At the same time, clinical-stage biotech stocks tend to have lots of cash on their balance sheets in order to survive until then.

Always ask yourself, "Is what I see typical for this industry?" Know what's normal for that sector, and always compare a company to its peers.

Warning Sign #1: Diluting Shares

Share dilution is one of the biggest threats any long-term investor faces. Always look at a management team to see if they have a history of diluting their company's stock. Companies sometimes issue new stock to raise funds, which occasionally is a good move, like if they want to make a major acquisition. However, issuing new shares not just pushes down the stock's price, but it lowers the ownership proportion of a current shareholder.

Even if a company is doing great financially, repeated share dilution can completely erase any gains a stock normally would have seen. Sometimes, companies offer new shares to a company's shareholders that it's trying to buy out. Be sure to look at a company's acquisition history and whether it has a history of doing all-stock deals or not.

AURORA CANNABIS INC.

Condensed Consolidated Interim Statements of Changes in Equity

Three months ended September 30, 2018

(Unaudited - Amounts reflected in thousands of Canadian dollars, except share amounts)

	Share Capital		Reserves		
	Common Shares	Amount	Share-Based Compensation	Compensation Options/ Warrants	Convertible Notes
	#	$	$	$	$
Balance, June 30, 2018	568,113,131	1,466,433	38,335	307	41,792
Shares issued for business combinations & asset acquisitions	384,033,926	2,655,341	75,490	19,556	—
Shares issued for earn out payments	—	10,094	—	—	—
Conversion of notes	20,994	86	—	—	(33)
Exercise of stock options	8,727,084	65,158	(41,875)	—	—
Exercise of warrants	906,156	4,046	—	(70)	—
Forfeited options	—	—	(341)	—	—
Share-based compensation	—	—	21,076	—	—
Change in ownership interests in subsidiaries	—	—	—	—	—
Australis Capital first tranche private placement	—	7,800	—	—	—
Australis Capital non-controlling interest reclass on loss of control	—	(6,348)	—	—	—
Spin-out of Australis Capital	—	—	—	—	—
Reclass gain from Australis Capital shares on derecognition upon spin-out	—	—	—	—	—
Comprehensive income (loss) for the period	—	—	—	—	—
Balance, September 30, 2018	961,801,291	4,202,610	92,685	19,793	41,759

In the above example, Aurora Cannabis' almost doubled its outstanding shares in only a quarter, just by using its stock to buy up other cannabis businesses. While revenue was skyrocketing in 2018, Aurora's stock has since plummeted in value from over $150 to less than $12 per share.

Warning Sign #2: Beware of Value Traps

Sometimes a stock is undervalued, but sometimes there's a reason why shares are trading so cheaply. There's a difference between buying a quality stock at a discount and buying a crummy stock at a fair price. Often, beginner investors will make the mistake of thinking a cheap stock must be a good deal, but that isn't' always the case.

These types of cases, which are called value traps, usually happen because an investor doesn't do enough research. While a company can look great on paper, you also have to look beyond the financial statements as well.

For example, sometimes a stock is trading incredibly cheaply because a major lawsuit was announced, or there was a previous scandal with the management team. None of these issues are reflected in a company's financial figures, but if you aren't paying attention, it could spell disaster for a company down the road. If you can't figure out why a company is trading super cheap, make sure there isn't some other reason, like a legal issue, that could be the cause.

Warning Sign #3: Industry-Wide Threats

When looking at a particular stock, you should also consider the general industry it's a part of. Are there any big tech innovations that could threaten it? How about any legal issues on the horizon that could change how it does business?

Blockbuster might have seemed like an undervalued stock back between 2005 and 2010. I might even have looked relatively normal compared to the industry. However, if you were aware of Netflix, you would have known that the entire video-rental industry was in for some trouble.

Entire industries could seem undervalued if you don't notice the looming threat coming over the horizon. As technology continues to evolve and accelerate in the 21st century, innovation is as much of a threat to old industries as it is an opportunity for new ones.

IN CLOSING

We've covered a lot of material in this eBook, and I want to commend you for getting to the end. You're now ready to start discovering undervalued stocks that have the opportunity to 5x, 10x or even 50x your initial investment. You can use the same strategy Warren Buffett, Philip Fisher, and many other legendary investors have used over the years to grow their wealth.

Both value investing and growth investing have the potential to grow your wealth exponentially. But to find these types of picks for yourself, you need to understand the difference between the balance sheet, income statement, and cash flow statement.

You also need to remember that value stocks and growth stocks require a different approach. What a good value stock will need to be undervalued is different from a potential growth stock. You also need to remember to look at the industry your company is in so you're comparing apples-to-apples.

And if you're interested in learning more about how to find undervalued stocks then check out a special bonus video I made for you here:

Click here to access the special bonus video.

In that video I'll show you a technique I like to use that gives me an unfair advantage when I look for undervalued stocks. It's something anyone can use but I'm still surprised how many traders aren't doing this.

It's a short video and it's my way of saying thank you for completing this ebook.

To your success,

Thomas Wood