



The Greatest Stocks of the Next Generation

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Todd Wenning
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Let me ask you a question.

Do you *miss* Circuit City?

Me neither. That's the question advertising guru Roy Spence asked when he visited Fool HQ, and it got me to thinking: Why do we feel this way? Why don't we care when stores like Circuit City or Linens 'n Things -- stores we all likely spent money in at one point or another -- go belly-up?

More than just numbers

Yes, they mismanaged their finances. But it turns out that was only a corollary to the real problem those companies faced.

At the end of the day, they lacked *purpose*. They lacked any defining characteristic that made consumers like you and me want to shop there. Without differentiation, we didn't much care whether we bought a comforter at Linens 'n Things or **Wal-Mart** -- it was who had the lowest price.

And, let's face it, competing with Wal-Mart on price has proven to be a losing game for countless retailers.

Why is that?

Wal-Mart can win on price time and time again because it has a well-defined purpose: "Saving people money so they can live better."

Even though this exact phrase didn't come about until years after the stores began, it was nevertheless founder Sam Walton's guiding principle from day one, and it has guided and directed every decision Wal-Mart has made to this day.

The mission is communicated in every Wal-Mart ad, in every store, and even on the top of the company's website. In the end, you may not choose to spend your money at its stores, but you can't avoid knowing that Wal-Mart is the company that's determined to save you money so that you can live better. Other successful blue chips that clearly define their purpose include **Procter & Gamble** (NYSE: [PG](#)) ("Improve the lives of the world's consumers") and **AT&T** (NYSE: [T](#)) ("Connecting people to their world, anytime, anywhere").

In his recently released book *It's Not What You Sell, It's What You Stand For*, Spence, whose agency helped companies as diverse as Wal-Mart, **Southwest Airlines**, and **John Deere** articulate their purpose, cited a study by Jim Collins and Jerry Porras that found that "organizations driven by purpose and values outperformed the market 15:1 and outperformed comparison companies 6:1."

Now, that's something I can warm up to as an investor.

A helping of purpose, please

When you think about it, privileging purpose makes sense.

The [greatest companies of our generation](#) all served an unmet market need with a product or service they were passionate about.

- **Starbucks** wanted to introduce gourmet coffee and espresso drinks to everyday Americans who had been accustomed to freeze-dried and bland coffee. Its purpose: "To inspire and nurture the human spirit -- one person, one cup, and one neighborhood at a time."
- **Google** exists "to organize the world's information and make it universally accessible and

useful." It has become a \$172 billion behemoth by combining simplicity, innovation, and functionality to allow Internet users to more quickly find what they are looking for on the Web.

- **Whole Foods** set out to "provide choices for nurturing the body, the community, and the planet" and brought organic food into the mainstream.

Each company, despite some natural bumps in the road, has converted its passion and purpose into superior shareholder returns since its IPO.

Why might this be? Another study, by Harvard Business School faculty members John Kotter and James Haskett, found that purpose-driven companies have other benefits as well.

1. Lower employee turnover -- keeps costs low.
2. Higher productivity -- leads to superior efficiency.
3. Better pricing power -- helps maintain profit margins.

In addition, a clear purpose helps us as investors evaluate the company's decision-making. For example, when Starbucks got involved in the 2006 movie *Akeelah and the Bee*, it was a wise time to reconsider your investment in Starbucks itself. The movie had nothing to do with selling coffee, so it was a clear sign that the company was running out of ideas and losing its focus as a business. I don't think it's a coincidence that 2006 marked the peak of Starbucks stock.

Finding companies with purpose

The greatest stocks of the next generation will be companies with a tremendous sense of purpose, led by passionate executives who are guided by that purpose and not solely by profits. The trick is finding them early in their growth cycles -- think Starbucks in the early '90s or Wal-Mart in the 1970s -- while they still have [room to grow](#).

Finding them is harder than you might think, what with the thousands of publicly traded companies out there declaring their purpose to be "maximizing shareholder value." Hey, I like maximizing shareholder value as much as the next investor, but I'm concerned with maximizing *long-term* shareholder value, and that requires a business purpose that can carry on for decades, not quarters.

Rather than beginning your search by paging through the thousands of publicly traded companies, looking for the ones with a good purpose, let's narrow it down a bit and start by looking for those with:

- Market caps less than \$5 billion.
- Consistent return on equity greater than 15%.
- Gross margins above 35%.
- Strong sales growth.

Here are seven ideas to get you started:

Company	Market Cap (in Millions)	Gross Margin	Return on Equity	3-Year Annualized Sales Growth
Amedisys (Nasdaq: AMED)	\$1,672	52.4%	20.5%	41.1%
Atwood Oceanics (NYSE: ATW)	\$2,191	61.2%	22.8%	23.9%
China Agritech (Nasdaq: CAGC)	\$328	40.5%	19.0%	31.6%
Boston Beer (NYSE: SAM)	\$664	50.3%	18.1%	14.1%
Ebix (Nasdaq: EBIX)	\$558	79.9%	36.7%	49.0%

Data provided by Capital IQ, as of Jan. 20, 2010.

Go the next mile

But a purpose alone isn't enough; you want a purpose-driven company with excellent management and strong business practices as well. To figure out if a given company fits the bill:

- **Read the company's annual report.** Does it have a simple and defined purpose that guides all the business decisions? What's the ultimate objective as a company? What greater good does it serve?
- **Read the SEC proxy filings.** How are executives rewarded? Is it based on short-term or long-term results? Is the CEO also a founder?
- **Read the financial statements.** Is the company financially strong enough to deliver on and spread its purpose?

These are all things that Motley Fool co-founder David Gardner looks for when recommending stocks for his [Motley Fool Rule Breakers](#) service. In fact, one of the stocks the team likes right now is the aforementioned, purpose-driven Google.

To hear more great ideas from David's *Rule Breakers* team, sign up for a free 30-day trial by [clicking here](#).

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Fool analyst [Todd Wenning](#) hopes you have a wonderful day. He owns shares of Procter & Gamble, a Motley Fool Income Investor pick. Wal-Mart Stores is a Motley Fool Inside Value selection. Ebix and Google are Motley Fool Rule Breakers recommendations. Atwood Oceanics, Starbucks, and Whole Foods Market are Motley Fool Stock Advisor picks. The Fool owns shares of Ebix and Procter & Gamble, and has one heckuva [disclosure policy](#).

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