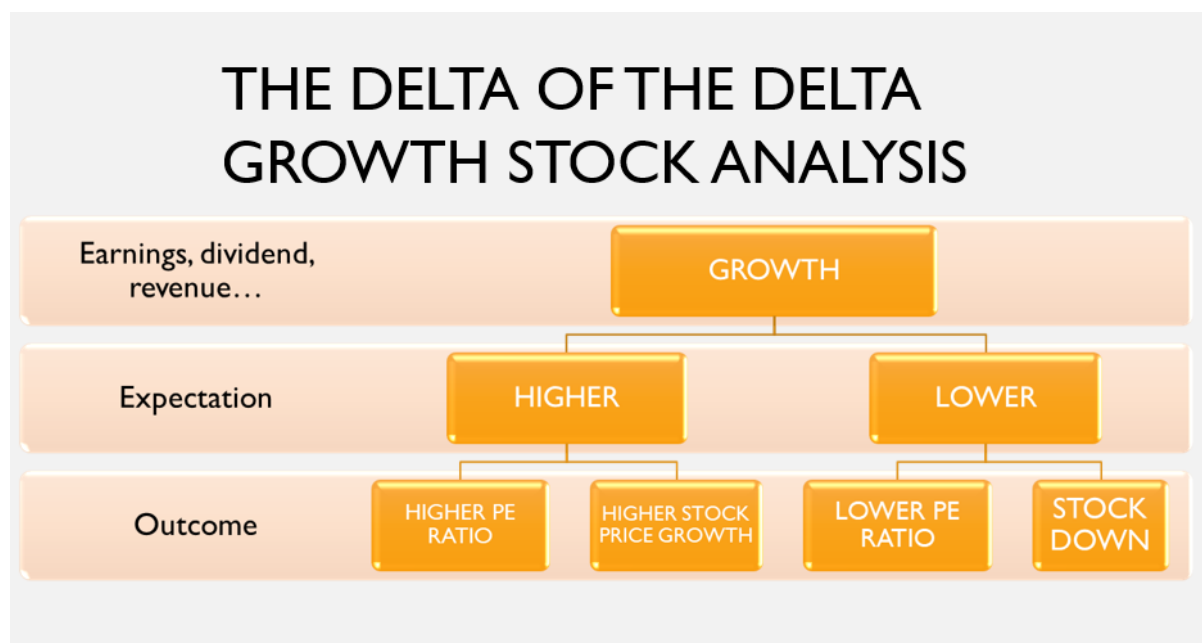


How to Analyze Growth Stocks – The Simple Delta of the Delta Tool – Visa Growth Stock Example

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A tool that is extremely important when it comes to growth stocks analysis is the delta of the delta. We will use Visa as a growth stock example and by the end of the article you will have another valuable tool when it comes to assessing the risk and reward of an investment, in this case a growth stock. The following chart explains the growth stock analysis we will discuss and what you'll fully master by the end of the article.



Growth stocks - The decade of growing valuations

The last decade has been the decade of growth stocks. The Nasdaq index is up almost 6 times over the last decade.

Nasdaq Composite
INDEXNASDAQ: .IXIC

+ Follow

8.654,05 +37,87 (0,44%) ↑

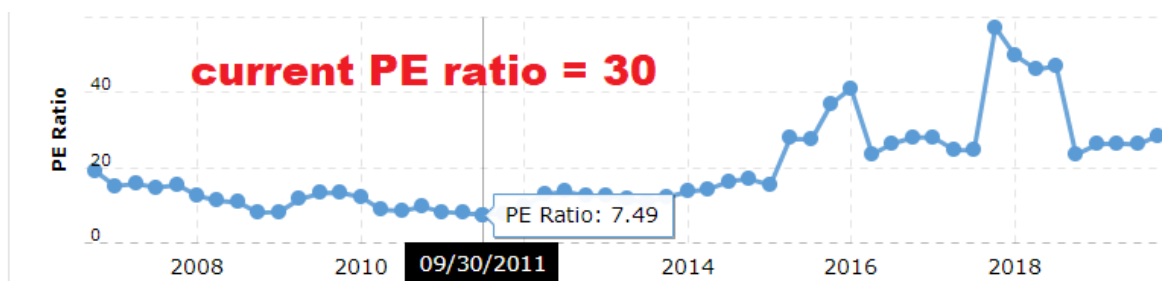
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1 day 5 days 1 month 6 months YTD 1 year 5 years Max



That is an amazing performance and tech businesses, growth stocks, did perform really well over the past decade. However, did those businesses perform as well as their respective stock prices?

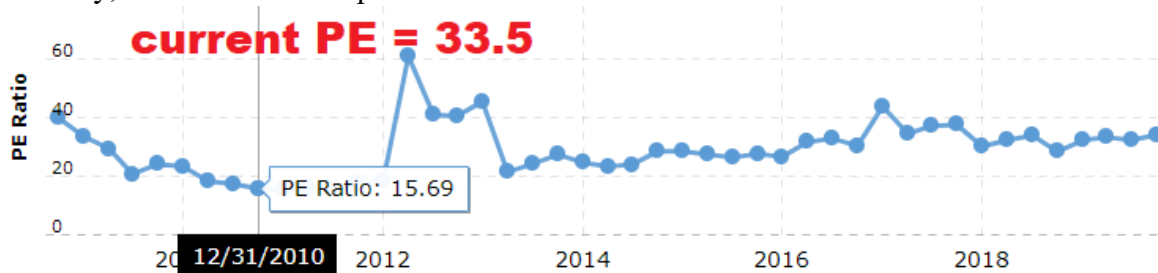
Microsoft's (MSFT) price to earnings ratio increased from 7.5 in 2011 to the current 30.



Source: [MSFT growth stock - Macrotrends](#)

Such an expansion in valuation means that investors' expectations considering growth have also been constantly growing in comparison to what they expected at the beginning of the decade.

Similarly, Visa's PE ratio expanded from 15.5 in 2010 to the current 33.5.



Source: [Visa growth stock - Macrotrends](#)

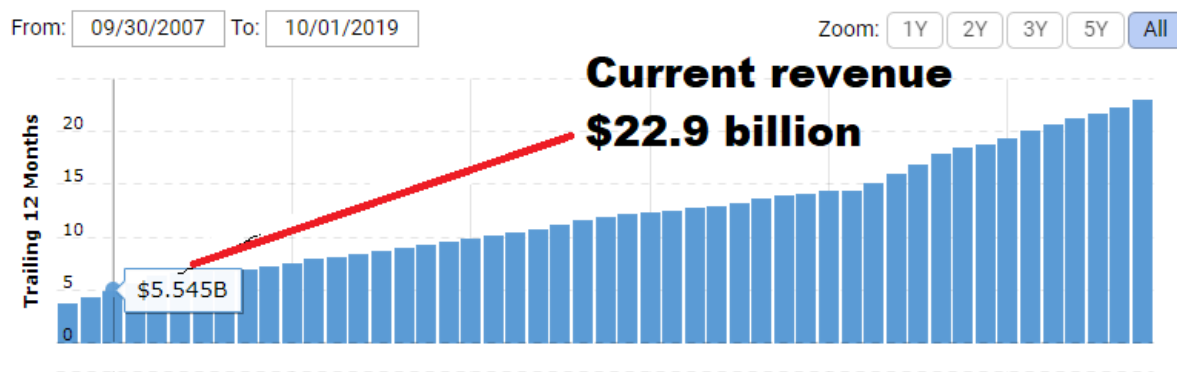
Such valuation expansions tell us that investors expect strong growth rates going forward that justify paying a relatively high price for a growth stock. The expectation of future growth, in combination with current growth, is what keeps the stock price going higher and higher as investors combine current strong business growth with even higher expectations of growth in the future. This leads to growing PE ratios and consequently constantly higher stock prices.

As investors, we have to look at the key factor that will influence future investment returns: the delta of the delta – the change in the growth. I have recently [analysed Visa stock](#) and it will serve as a great example for the application of this tool. Let me give you first a quick introduction to Visa's stock and then we'll apply the technique to make a Visa growth stock analysis.

Visa Growth Stock Analysis

Visa Stock (NYSE:V) is the ultimate compounder. Revenue keeps growing, earnings and cash flows too, that leads to constantly higher dividends while the market for Visa simply keeps increasing thanks to global economic growth.

Visa growth stock – revenue growth

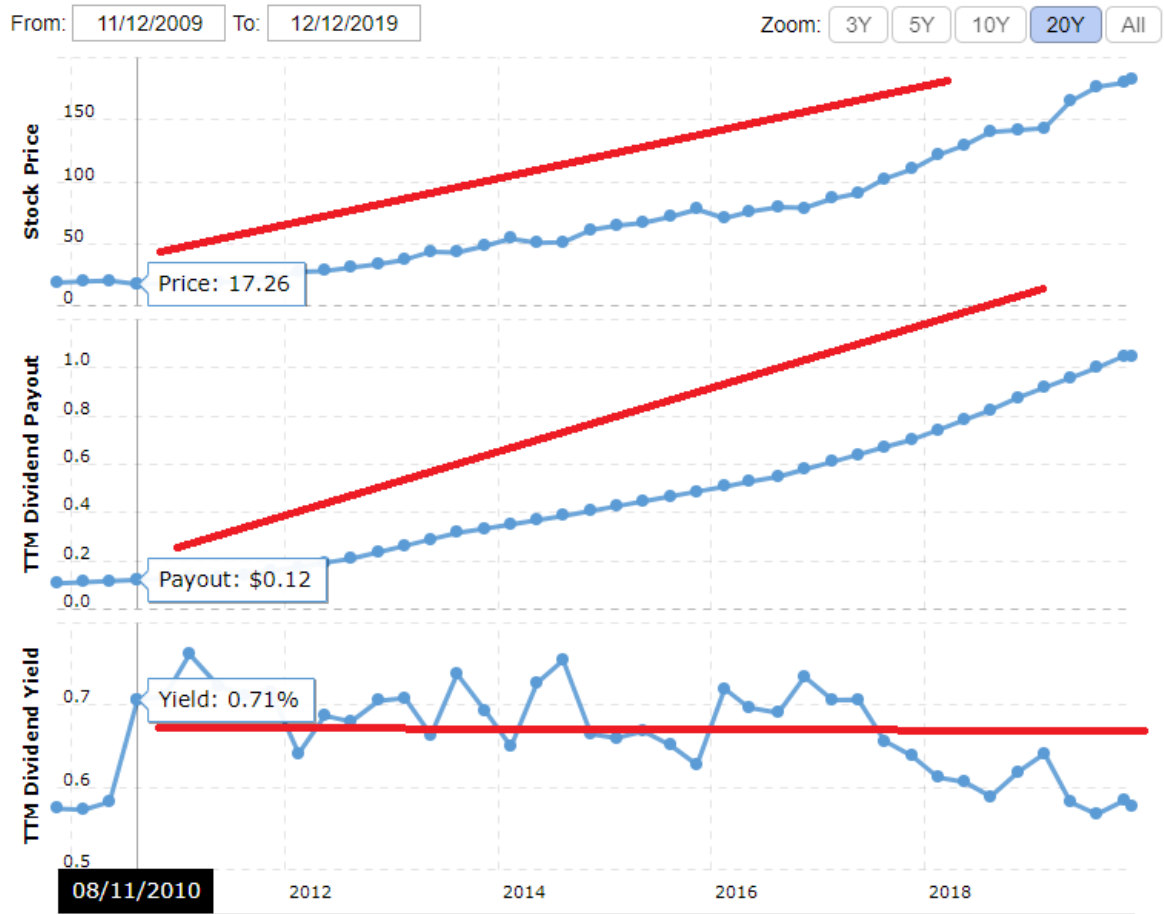


I have two bank accounts; one is Visa the other is MasterCard. I think if you open your wallet, you'll probably find a Visa card.

Visa Stock Growth Performance

When you look at what Visa did in the past, it is simply amazing. Over the last decade, revenues more than tripled, net income quadrupled and the dividend was increased by a factor of 10.

Visa growth stock – dividend growth



With such financial metrics, the only outcome for a stock is to skyrocket.

Visa stock growth – stock price performance

Visa Inc
NYSE: V

+ Follow

180,60 USD -1,30 (0,71%) ↓

Closed: 5 Dec, 05:26 GMT-5 · Disclaimer
Pre-market 181,29 +0,69 (0,38%)

1 day 5 days 1 month 6 months YTD 1 year 5 years Max



Open	182,66	Div yield	0,66%
High	182,80	Prev close	181,90
Low	180,47	52-wk high	187,05
Mkt cap	389,62B	52-wk low	121,60
P/E ratio	33,97		

Visa stock analysis and valuation

On the other hand, Visa's stock also comes with a high valuation and low dividend. The whole game with Visa stock is that it has to continue to grow and compound for the stock price to keep growing. As soon as the growth slows down, there will be a big hit for the stock too.

Fortunately for Visa stock holders, the company just keeps on giving and giving. They have a low dividend payout ratio of around 20% because they can reinvest capital at rates above 20%.

Visa stock profitability

Key Ratios

Profitability	Growth	Cash Flow	Financial Health	Efficiency Ratios											
Margins % of Sales					2010-09	2011-09	2012-09	2013-09	2014-09	2015-09	2016-09	2017-09	2018-09	2019-09	TTM
Revenue					100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
COGS					20.42	19.76	20.54	20.38	18.75	18.39	18.33	17.69	18.71	18.13	18.13
Gross Margin					79.58	80.24	79.46	79.62	81.25	81.61	81.67	82.31	81.29	81.87	81.87
SG&A					19.95	17.64	16.40	14.76	13.66	12.64	13.62	13.02	12.51	11.99	11.99
R&D					—	—	—	—	—	—	—	—	—	—	—
Other					3.29	3.13	3.20	3.37	3.42	3.56	3.33	3.03	2.97	2.86	2.86
Operating Margin					56.34	59.46	59.87	61.49	64.16	65.40	64.73	66.25	65.80	67.03	67.03
Net Int Inc & Other					1.17	2.10	-38.69	0.13	-3.35	-0.60	-11.60	-2.55	-3.66	-2.25	-2.25
EBT Margin					57.51	61.56	21.18	61.61	60.81	64.81	53.12	63.70	62.14	64.78	64.78
Profitability					2010-09	2011-09	2012-09	2013-09	2014-09	2015-09	2016-09	2017-09	2018-09	2019-09	TTM
Tax Rate %					36.09	35.54	2.95	31.38	29.60	29.65	25.22	42.71	19.56	18.84	18.84
Net Margin %					36.78	39.73	20.51	42.12	42.68	45.48	39.31	35.23	48.24	52.57	52.57
Asset Turnover (Average)					0.25	0.27	0.28	0.31	0.34	0.35	0.29	0.28	0.30	0.32	0.32
Return on Assets %					9.03	10.71	5.72	13.06	14.55	16.02	11.37	9.80	14.49	17.04	17.04
Financial Leverage (Average)					1.34	1.31	1.45	1.34	1.41	1.35	2.35	2.49	2.43	2.48	2.48
Return on Equity %					12.31	14.19	7.91	18.21	19.97	22.05	20.79	23.76	35.65	41.83	41.83
Return on Invested Capital %					12.48	14.27	7.91	18.21	19.97	22.05	13.93	15.05	23.34	26.52	26.52
Interest Coverage					65.42	177.75	—	—	—	—	19.76	21.77	21.92	—	—

Source: [Visa Stock Morningstar](#)

The company has all what you can dream about when it comes to investing; growing revenues, a high margin, high return on invested capital alongside constantly growing distributions to shareholders. Apart from the dividend, the number of Visa stock outstanding fell from 3 billion to 2.2 billion over the last 10 years. That is almost 30% less than the number of Visa stocks outstanding in 2009!

Visa Inc Class A V | ★★

Financials

	2010-09	2011-09	2012-09	2013-09	2014-09	2015-09	2016-09	2017-09	2018-09	2019-09	TTM
Revenue USD Mil	8,065	9,188	10,421	11,778	12,702	13,880	15,082	18,358	20,609	22,977	22,977
Gross Margin %	79.6	80.2	79.5	79.6	81.2	81.6	81.7	82.3	81.3	81.9	81.9
Operating Income USD Mil	4,544	5,463	6,239	7,242	8,150	9,078	9,762	12,163	13,561	15,401	15,401
Operating Margin %	56.3	59.5	59.9	61.5	64.2	65.4	64.7	66.3	65.8	67.0	67.0
Net Income USD Mil	2,966	3,650	2,144	4,980	5,438	6,328	5,991	6,699	10,301	12,080	12,080
Earnings Per Share USD	1.00	1.29	0.79	1.90	2.16	2.58	2.48	2.80	4.42	5.32	5.32
Dividends USD	0.13	0.15	0.22	0.33	0.40	0.48	0.56	0.66	0.82	1.00	1.00
Payout Ratio % *	12.5	11.6	40.9	14.7	17.5	19.2	23.4	23.6	19.1	18.5	18.8
Shares Mil	2,956	2,828	2,712	2,624	2,523	2,457	2,414	2,395	2,329	2,272	2,272
Book Value Per Share * USD	9.07	9.92	9.82	10.64	11.07	11.79	11.28	11.31	12.58	13.26	13.14
Operating Cash Flow USD Mil	2,691	3,872	5,009	3,022	7,205	6,584	5,574	9,208	12,713	12,784	12,784
Cap Spending USD Mil	-241	-353	-376	-471	-553	-414	-523	-707	-718	-756	-756
Free Cash Flow USD Mil	2,450	3,519	4,633	2,551	6,652	6,170	5,051	8,501	11,995	12,028	12,028
Free Cash Flow Per Share * USD	0.83	1.24	1.50	0.72	2.75	2.49	1.80	3.42	4.81	4.94	—
Working Capital USD Mil	5,236	5,739	3,832	3,487	3,556	5,518	6,267	9,029	6,911	7,555	—

* Indicates calendar year-end data information

Visa's growth comes from their strong moat that is also reflected within their extremely high net profit margin of 50%.

Visa stock business performance

Fiscal Fourth Quarter 2019 Results

<i>in billions, except percentages and per share data</i>	Q4 2019 (Ended September 30, 2019)	
	USD	YoY Change
Net Revenues	\$6.1	13%
GAAP Net Income	\$3.0	6%
Non-GAAP Net Income ⁽¹⁾	\$3.3	18%
GAAP Earnings Per Share	\$1.34	9%
Non-GAAP Earnings Per Share ⁽¹⁾	\$1.47	21%

⁽¹⁾ Non-GAAP Net Income and Non-GAAP Earnings Per Share exclude special items in the current and prior fiscal years.

- Growth in underlying business drivers remained strong
- Returned \$2.7B of capital to shareholders in the form of share repurchases and dividends
- The board of directors increased Visa's quarterly cash dividend by 20% to \$0.30 per share

Note: Refer to the accompanying financial tables in the press release for further details and a reconciliation of the non-GAAP measures presented.

Source: [Visa Stock Investor relations](#)

Visa stock growth outlook

The outlook is simple when it comes to Visa stock. For as long as the company can keep growing earnings at 15% per year, the stock will follow. The management expects the company to continue to grow earnings in the mid-teens range.

Visa stock earnings outlook

Financial Outlook for Fiscal Full-Year 2020

	GAAP Nominal-Dollar Basis	Foreign Currency Impact	Acquisition Impact	Adjusted Constant-Dollar Basis ⁽¹⁾
Annual Net Revenues Growth	Low double-digit	1% – 1.5% decrease	~0.5% increase	Low double-digit
Client Incentives as a % of Gross Revenues	22.5% – 23.5%			22.5% – 23.5%
Annual Operating Expense Growth ⁽²⁾	Mid-single-digit	1% – 1.5% decrease	3% – 4% increase	Mid-to-high single-digit
Effective Tax Rate	19% – 19.5%			19% – 19.5%
Annual Diluted Class A Common Stock Earnings Per Share Growth ⁽³⁾	Mid-teens	1% – 1.5% decrease	~1% decrease	Mid-teens

- ⁽¹⁾ Adjusted financial outlook is on a constant-dollar basis and excludes acquisitions, investment gains/losses and the non-GAAP special item in fiscal full-year 2019. We believe presenting this adjusted outlook provides investors with additional insight into our expected operating performance for fiscal full-year 2020.
- ⁽²⁾ Annual adjusted operating expense growth is derived from non-GAAP full-year 2019 operating expenses of \$7.6 billion, which excludes \$0.4 billion impact of the non-GAAP special item.
- ⁽³⁾ Annual adjusted diluted class A common stock earnings per share growth is derived from adjusted full-year 2019 earnings per share results of \$5.40, which excludes the impact of investment gains/losses (~\$0.04 increase) and the non-GAAP special item (~\$0.12 decrease).

Source: [Visa Stock Investor relations](#)

Visa growth stock investment analysis

When it comes to investing, it all depends on growth. If there is an economic halt, Visa's traffic and profitability could stagnate for a while and consequently the stock would stagnate too. Visa is definitely a business that compounds, but I would say fairly priced given the PE ratio of around 30. If earnings continue to compound at 15% per year, the PE ratio on the current price will be just 15 in 5 years and just 7.5 in 10 years. The stock price will consequently grow alongside earnings growth at a constant valuation.

Visa earnings analysis

VISA EARNINGS

CURRENT EPS = \$5.32
Stock price = \$180
PE RATIO = 33

If earnings grow at 15% - earnings in 5 years =
\$10.70
PE RATIO of 16.82

If earnings grow at 15% - earnings in 10 years =
\$21.52
PE RATIO = 8.36

So, the questions are:

- Will Visa continue to grow as fast for a long time?
- What happens if Visa's growth is in the low teens or in the high teens?

The answers to the questions will be given by the delta of the delta tool that looks at the change in the growth rate.

[The change in the growth rate – the delta of the delta growth stock analysis tool](#)

For example, if Visa's growth, that is expected to be at 15% going forward, falls down to 10% per year, everything would change from an investing perspective. This is counterintuitive because 10% yearly growth is still amazing, but it might not be what is baked into the stock price.

If Visa's earnings grow 10% over the next 5 years, earnings per share would grow from the current \$5.32 to \$8.71 and not to \$10.70 as it would be the case with 15% growth.

VISA EARNINGS, DELTA OF THE DELTA

CURRENT EPS = \$5.32

Stock price = \$180

PE RATIO = 33

If earnings grow at 10% - earnings in 5
years =

\$8.71

likely PE RATIO = 20

Likely stock price in 5 years

=

\$174

You might think how this doesn't really make a great difference. Well, the change in growth makes all the difference. The market is willing to pay a price earnings ratio of 33 for 15% yearly growth. If the growth falls to 10% and the growth trend is slowing down, the market might want to pay a price to earnings ratio of just 20 for that. Thus, in five years, earnings per share of \$8.71 with a PE ratio of 20 would lead to a stock price of \$174, a stock price close to current levels. This would mean investors would look towards zero returns in the coming 5 years, despite the fact that the company is still growing at 10% per year.

The same works on the upside too. If Visa manages to grow at 20% per year, earnings per share would go from \$5.71 to \$14.2 over the next 5 years and the market would probably value the stock with a PE ratio of 40 and the stock price would reach at an incredible \$568.

VISA EARNINGS, DELTA OF THE DELTA

CURRENT EPS = \$5.32

Stock price = \$180

PE RATIO = 33

If earnings grow at 20% - earnings in 5
years =

\$14.2

likely PE RATIO = 40

Likely stock price in 5 years

=

\$568

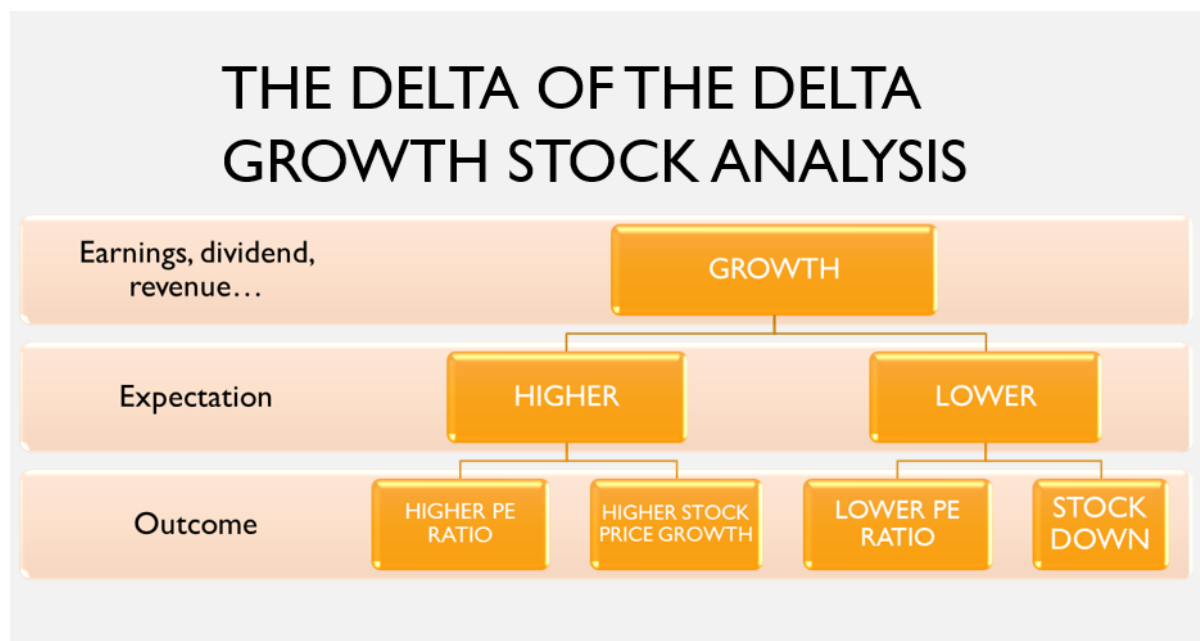
But this is the magic of growth stocks and when you analyze growth stocks, the key to watch is the change in the growth rate, i.e. the delta of the delta.

Growth stock analysis conclusion

The best way to apply the delta of the delta growth stock analysis tool is to use it for investment risk and reward analysis:

- What is the probability that Visa grows at 20%?
- What is the probability that we have a global slowdown over the coming 5 years and that Visa's growth falls to single digits?

The delta of the delta growth stock analysis tool gives you a range of what you can expect qua valuations, stock price targets and investment returns in relation to the growth rate.



Growth impact on stock price:

- 1) Growth matches expectations

If the growth matches the growth expectations, the stock price will likely grow at the same rate of the growth.

- 2) Growth rate beats expectations

If the growth rate beats expectations, the stock price will likely grow even faster as investors will give it an even higher price to earnings ratio in expectations of even higher earnings in the future due to faster growth. This is the case where Visa stock can easily grow from \$178 to \$568 over the next 5 years.

- 3) Growth rate below expectations

If the growth rate falls below expectations, all the exuberant feelings quickly turn cold, the market gives a much lower valuation to the stock and consequently the stock price can fall a lot. This is why investing in growth stocks is considered risky and why investors expect a high return when doing so.

I hope this helped to increase your tool box when it comes to investing. It is a simple technique but so important when it comes to assessing investment risks and rewards of a growth stock. If you wish to learn more, please check my [FREE Comprehensive Stock Market Investing Course](#) – did I mention it is FREE? It has many similar lectures, both in video and written form.

If you wish to look at the best stocks I find through research and analysis, take a look at my portfolios, check my [Stock Market Research Platform](#). There is a 28-day money back guarantee policy so even this can be FREE if you wish so.