



## OPS Winners & Sinners

Reported Earnings Per Share Are Less Reliable Than Cash Flow Per Share For Predicting Future Stock Prices

**By Michael Markowski**

Rising earnings per share (EPS) lulls investors into a false sense of security. Enron, Sunbeam, Fruit of the Loom and many other companies reported "record EPS" quarters shortly before filing for bankruptcies. The contradiction left their shareholders confused and dazed.

The autopsies we performed on these companies indicated that each of them was generating negative OPS (Operating-cash-flow Per Share) or overall negative cash flow per share at the same time that they were announcing record positive EPS figures. Reporting cashless EPS levitated their shares to at or near all time highs.

Naturally we have conducted much research on the perils of investing in those companies having cashless EPS. But recently we finished a study, which compares the stock price performance of those companies where EPS was greater than OPS against those companies where OPS was greater than EPS.

The study was done over a 37 quarter period beginning December 31, 1995 and ending on March 31, 2005. What we found was quite revealing. Those companies that had OPS exceeding EPS numbers significantly outperformed those that had greater EPS than OPS in all categories making it a clean sweep for OPS.

During the test period there were 1,575 companies where annualized positive EPS exceeded positive OPS for at least one quarter. A \$10,000 investment into a portfolio of these companies appreciated to \$15,216. Conversely, a portfolio consisting of the 2,830 companies having positive OPS, which was greater than positive EPS for at least one quarter appreciated to \$22,659.

What was the sweet spot? Interestingly, there were 912 companies that had positive OPS while at the same time had losses or negative EPS. A portfolio consisting of these Cinderella stocks appreciated to \$33,188. Finally, even a comparison of those companies with negative OPS and EPS metrics heavily favor OPS as the winner. A \$10,000 portfolio consisting of 3,934 companies that had negative OPS, which exceeded their negative EPS or losses declined to \$5,810 by the end of the test period. On the other hand a portfolio of those companies where negative EPS exceeded negative OPS appreciated to \$12,005.

In conclusion this study and all of our studies since 2002 overwhelmingly support the fact that OPS and the other cash flow metrics that StockDiagnostics.com tracks are significantly more reliable than EPS for predicting stock price performance.

Using the cash flow is king approach, my picks to outperform the market are **Merge Technologies** (Nasdaq:MRGE-15.95), **NovaMed** (Nasdaq:NOVA-4.86) **Transact Technologies** (Nasdaq:TACT-8.65) and **United Online** (Nasdaq:UNTD-11.60). Two stocks that should be avoided are **Office Max** (NYSE:OMX-31.55) and **General Motors** (NYSE:GM-31.05).

*Michael Markowski is the founder of StockDiagnostics.com and utilized its CFFO (Cash Flow from Operations) and OPS (Operational cash flow Per Share) metrics to predict the bankruptcies of several large companies and Sear's serious credit problems. StockDiagnostics.com publishes current and historical cash flow metrics on over 8,000 companies.*

