Follow Warren Buffet's advice on investing in the stock market

Investing in stocks without understanding what is going on is like betting in a casino.

Warren Buffet, called by many as the 'Greatest investor alive today' has always been open about the way he invests. Pouring over his speeches, I have developed this checklist to help you gain an insight into Warren Buffet's approach.

There are over twenty points to note. If you can only handle five questions then this is my take:

1. Do you know how the company's money is made?
2. Is there a high threshold for new entrants meaning that the company is sparred from fierce price wars?
3. Has the management demonstrated a high degree of integrity, intelligence, and energy?
4. Is the company conservatively financed with a below industry average debt to equity ratio?
5. Is the CEO home grown? Outstanding organisations grow their own CEOs.

Investment checklist incorporating Warren Buffet's advice	**Each 'No' should be a concern**
Checking the market timing for investment	
1. Is the investment company, Berkshire Hathaway (Warren Buffet's investment vehicle) buying stocks at the moment? This is a good sign that the market is under-priced.	□ Yes □ No
2. Is the 'Shiller price earnings ratio for the S&P top 500' below 20? The number of years' earnings it will take, at the existing level, to recoup the investment.	□ Yes □ No
3. Has the stock market / company been temporarily punished for a specific risk that is not a long-term risk?	□ Yes □ No

When evaluating a prospect investment

Capital and clarity of business	
4. Is the company conservatively financed with a below industry average debt to equity ratio?	□ Yes □ No
5. Do you know how the company's money is made? (Never invest in a company you do not understand how they make their money)	□ Yes □ No
6. Is there a high threshold for new entrants meaning that the company is sparred from fierce price wars? (e.g., it is difficult for a new drink company to compete with Coca Cola)	□ Yes □ No

7. Does the company have favorable long-term prospects?	□ Yes □ No
Assets	
8. Can current operations be maintained without a large reinvestment in plant and equipment? (This will require looking at the annual accounts, a task investors should be doing.)	□ Yes □ No
9. Is the value of intangible assets (goodwill) less than 40% of capital employed (shareholders' funds plus all borrowings)?	□ Yes □ No
Management	
10. Has the management demonstrated a high degree of integrity? (Wikipedia is a good source of any company scandal)	□ Yes □ No
11. Does the Board and CEO come across as rational? (Read the Chairman's and CEO's report in that last three annual reports. Any signs of outrageous optimism and over confidence is an indicator of potential failure)	□ Yes □ No
12. Is management candid with shareholders? (evidence in the past of open disclosure to the shareholders when there have been problems)	□ Yes □ No
13. Is the CEO home grown, arriving at the company before being made CEO? Parachuting a CEO from outside is a key sign of a poor leadership culture. Outstanding organisations grow their own CEOs.	□ Yes □ No

Earnings	
14. Does the business have a consistent history of organic revenue growth (growth excluding any acquisitions)?	□ Yes □ No
15. Is the return on equity (shareholders' funds) adequate? This is what shareholders' funds have made in the year.	□ Yes □ No
Liquidity	
16. Can the organisation pay its current liabilities? Look at the last balance sheet and calculate this ratio that should be >1.25 $$\frac{\text{cash at bank} + \text{marketable securities} + \text{trade receivables balance}}{\text{current liabilities balance}}$$	□ Yes □ No
17. Are there less than 50 days of sales in debtors? Look at the last balance sheet and P/L and calculate this number that should be <50 $$\frac{\text{Revenue per day (annual sales /365)}}{\text{trade receivables balance (on the balance sheet)}}$$	□ Yes □ No
Sensitivity	
18. Is the company diversified so that no one overseas market is over 30% of its revenue?	□ Yes □ No
19. Has the business been free of a major merger in the last three years? (Wikipedia is a good source. Many merger failures come out of the woodwork within three years of the merger so be warned.)	□ Yes □ No

Some extra steps if you have the time

Other points worth investigating if the information is available	
20. Is the company free to adjust its prices because of lack of competition and no governmental regulation?	□ Yes □ No
21. Is the company protected from the impact of big swings in exchange rates, commodity prices, freight charges?	□ Yes □ No
22. Does the company own land and buildings that could be sold?	□ Yes □ No
23. Has the company created at least one dollar of market value for every dollar of earnings retained over the last five years? (Use sites like LSE.co.uk)	□ Yes □ No
24. Are the profit margins better than the industry average? (its main competitor could be a better buy, use simplywall.st))	□ Yes □ No
25. Has the company less than 3000-7000 full time staff? I believe a smaller company has a better chance of being nimble, having a consistent culture and operating with integrity.	□ Yes □ No
26. Is the CEO's salary at least 50% of their total remuneration? Look at the last three year annual reports at the executive pay section s If bonuses and share options are greater than 50% of their total package their integrity will be surely challenged.	□ Yes □ No
27. Has the company been free of any ownership by a private equity firm in the last ten years? (Private equity firms have a track record of destroying the income producing assets. Search Wikipedia)	□ Yes □ No