

New Straits Times, Business Times – Thursday, October 12, 2023

UNDERSTANDING A STOCK'S INTRINSIC VALUE

BASICS OF FUNDAMENTAL INVESTING

FUNDAMENTAL investing, or fundamental analysis, is a common way to look at stocks when deciding whether to invest in them.

In fundamental analysis, you're looking at the reasons why stocks have a given value.

The fundamentals — like balance sheets and industry health — are everything in fundamental investing.

With fundamental analysis, your goal is to attempt to tease out a stock's intrinsic value rather than figure out if it will go up or down.

Many long-term investors tend to favour fundamental analysis to better understand if their company will do well for years or decades to come.

Fundamental investing is an approach to stock selection based on analysing a company's intrinsic value by assessing its financials, management, industry position, and economic outlook.

It's about evaluating a company's underlying fundamentals to determine its true worth and potential for future growth.

Fundamental investing involves in-depth analysis of a company's financial statements, including the income statement, balance sheet, and cash flow statement.

These documents provide essential information about a company's revenues, expenses, assets, liabilities, and cash flows over a specific period.



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Financial Statement Analysis

An income statement examines a company's revenues, expenses and profitability.

Key metrics include revenue growth, gross and net profit margins, and earnings per share.

Balance Sheet

Reveals a company's assets, liabilities, and equity. Key metrics include working capital (current assets to current liabilities), debt levels (gearing), and shareholder equity.

Cash Flow Statement

Highlights cash inflows and outflows. Key metrics include operating, financing and investing cash flows, cash brought forward and cash carried forward.

Ratio Analysis

Price-to-Earnings Ratio compares a company's market price per share to its earnings per share, indicating investor expectations regarding future earnings growth.

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Price-to-Book Ratio

Compares a company's market price per share to its book value per share, reflecting its net asset value.

Debt-to-Equity Ratio

Measures a company's leverage by comparing its debt to equity, providing insights into financial risk (the gearing ratio).

Return on Equity

Evaluates a company's profitability by measuring its return on shareholders; equity investment.

Dividend Yield

Indicates the annual dividend income as a percentage of the stock price, reflecting the return to shareholders through dividends.

Earnings Quality and Growth Prospects

Assess the sustainability and consistency of a company's earnings, focusing on recurring revenue, profit margins, and growth trends over time.

Analyse industry trends, competitive positioning, market share, and product/service innovation to gauge the company's growth potential.

Management and Leadership

Evaluate the competence, experience, and integrity of the company's management team

and board of directors.

Assess the company's corporate governance practices and alignment of executive incentives with shareholder's interests.

Economic/Industry Analysis

Consider macroeconomic factors such as interest rates, inflation, and overall economic health to anticipate the impact on the company and its industry.

Analyse industry dynamics, competitive landscape, regulatory environment, and technological advancements that could influence the company's growth and profitability.

Determine the intrinsic value of the company based on the analysis of financials, growth prospects, and market conditions.

Compare the intrinsic value with the current market price to identify undervalued or overvalued stocks.

Risk Management

Assess and mitigate risks associated with the company's operations, industry, competition, and broader economic factors.

Diversify the investment portfolio to spread risk and enhance overall returns.

Long-Term Investment Horizon

Emphasise a long-term investment approach, aiming to hold stocks for extended periods to benefit from the company's

growth and value appreciation.

Fundamental investing is about making informed decisions based on a thorough understanding of a company's financial health, market position, growth potential and management quality.

It requires a disciplined and patient approach, focusing on the long-term value and sustainability of investments.

As mentioned, several parameters have an impact on the fundamental analysis of a stock.

Some minority shareholders may be overwhelmed by the number of parameters that have a bearing on a stock's intrinsic value. But not all parameters are created equal.

It is at such times that we are reminded of a gentleman called Pareto to whom the Pareto Principle is attributed to.

It states that for many outcomes, roughly 80 per cent of consequences come from 20 per cent of causes (the "vital few").

Other names for this principle are the 80/20 rule, the law of the vital few or the principle of factor sparsity.

And so, adopting the Pareto principle approach, maybe 20 per cent of the parameters will result in an 80 per cent chance of success.

The task then is to determine what comprises the 20 per cent.

The writer is chief executive officer of Minority Shareholders Watch Group.