

Fundamental Analysis of Stocks

Fundamental Analysis of a business involves analyzing its financial statements and health, its management and competitive advantages, and its competitors and market.

Financial Statements

- **Income Statement:** Shows whether or not a company made a profit.
- **Balance Sheet:** Shows a companies current financial position. This shows the total worth of a company.
- **Cash Flow:** Shows the flow of cash for a company and how much cash it has on hand.

Income Statement

Income Statement
For the Three Months Ending March 31, 2006

	Year to Date	
Revenues		
Landscaping Fees	\$ 20,075.00	99.50
Finance Charge Income	100.00	0.50
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Total Revenues	20,175.00	100.00
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Cost of Sales		
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Total Cost of Sales	0.00	0.00
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Gross Profit	20,175.00	100.00
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Expenses		
Auto Expense	2,200.00	10.90
Commissions and Fees Exp	6,000.00	29.74
Dues and Subscriptions Exp	600.00	2.97
Insurance Expense	250.00	1.24
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Total Expenses	9,050.00	44.86
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Net Income	\$ 11,125.00	55.14
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Balance Sheet

- Must balance
- $\text{Assets} - \text{Liabilities} = \text{Owner's equity}$

	Starting	Month 1	Month 2	Month 3
Assets				
Current				
Cash	\$3,000	\$1,699	\$1,891	\$787
Accounts Receivable	\$0	\$8,500	\$17,567	\$19,323
Inventory	\$2,000	\$4,750	\$5,225	\$5,748
Other Current Assets	\$1,850	\$1,850	\$1,850	\$1,850
Total Current Assets	\$6,850	\$16,799	\$26,532	\$27,708
Long-term				
Long-term Assets	\$11,000	\$11,000	\$11,000	\$11,000
Less depreciation	\$0	\$183	\$367	\$550
Total Long-term Assets	\$11,000	\$10,817	\$10,633	\$10,450
Total Assets	\$17,850	\$27,615	\$37,166	\$38,158
Liabilities and Capital				
		Month 1	Month 2	Month 3
Current Liabilities				
Accounts payable	\$0	\$9,202	\$7,610	\$8,441
Current Borrowing	\$0	\$0	\$13,000	\$12,500
Other Current Liabilities	\$0	\$0	\$0	\$0
Total Current Liabilities	\$0	\$9,202	\$20,610	\$20,941
Long-term Liabilities	\$10,000	\$9,864	\$9,730	\$9,597
Total Liabilities	\$10,000	\$19,065	\$30,340	\$30,538
Capital				
Paid-in Capital	\$0	\$0	\$0	\$0
Earnings	\$0	\$700	\$1,476	\$2,270
Retained Earnings	\$7,850	\$7,850	\$7,850	\$7,850
Total Capital	\$7,850	\$8,550	\$9,326	\$10,120
Total Liabilities and Capital	\$17,850	\$27,615	\$39,666	\$40,658
Net Worth	\$7,850	\$8,550	\$6,826	\$7,620

Cash Flow

	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Next
Income Statement														
Sales	1,212	1,655	1,666	1,777	1,698	1,625	845	474	631	858	702	215	86	600
Direct Costs	1,113	1,490	1,519	1,621	1,549	1,482	771	432	575	782	640	196	78	547
Gross Profit	99	166	147	156	149	143	74	42	56	76	62	19	8	53
Indirect Costs	69	70	70	70	70	70	70	70	70	70	70	70	70	70
Net Profit	30	96	77	86	79	73	4	(28)	(14)	6	(8)	(51)	(62)	(17)
Cash Flow														
Starting Cash	(1,401)	(1,470)	(1,534)	(1,856)	(1,994)	(1,950)	(1,799)	(1,128)	(277)	51	(154)	(261)	114	546
Plus Cash In														
From Sales	1,144	740	1,270	1,537	1,691	1,730	1,700	1,448	947	606	649	762	619	305
Other	10	10	10	10	10	10	10	10	10	10	10	10	10	11
Total Cash In	1,154	750	1,280	1,547	1,701	1,740	1,710	1,458	957	616	659	772	629	316
Less Cash Out														
Direct Costs	1,123	714	1,512	1,595	1,567	1,499	948	517	540	731	676	307	108	430
Indirect Costs	69	70	70	70	70	70	70	70	70	70	70	70	70	70
Other	31	30	20	20	20	20	20	20	20	20	20	20	20	20
Total Cash Out	1,223	814	1,602	1,685	1,657	1,589	1,038	607	630	821	766	397	198	520
Ending Cash	(1,470)	(1,534)	(1,856)	(1,994)	(1,950)	(1,799)	(1,128)	(277)	51	(154)	(261)	114	546	341

Ratios

- Used to Compare Strengths and Weaknesses of Different Companies
- Type
 - Price to Earnings(P/E)
 - Price to Book
 - Price to Sales
 - Gross Profit Margin
 - Return On Equity
 - Current
 - Debt to Assets

P/E Ratio

- =Price/Earnings Per share
- Indicates growth in a company
- A high P/E ratio can mean greater growth
- Companies that are not growing do not have a P/E ratio

Price To Book

- $\text{Price} / (\text{Total Tangible Asset} - \text{Liabilities})$
- A high P/B ratio can mean that a stock is undervalued.
- Commonly used to compare banks
 - Higher P/B expect more value from a given set of assets



Price To Sales

- =Per Share Price/ Revenue per share
- Lower P/S means investors are paying less for each sale
- Used to calculate performance
- More indicative of a stocks performance because sales are less easy to manipulate than other areas such as earnings



Gross Profit Margin

- $$= (\text{Revenue} - \text{Cost of Goods Sold}) / \text{Revenue} \times 100$$
- Evaluate efficiency
- Used to compare different companies.
- Discount Retailers have a lower Gross Profit Margin because they can operate at tiny margins

Return on Equity

- $\text{Return on Equity} = \frac{\text{Net Income} - \text{Preferred Dividends}}{\text{Average Common Stocks Equity}}$
- Measure Profitability of Stocks

Current

- =Current Assets/Current Liabilities
- Measures Liquidity: ability to pay short term liabilities

Debt To Assets

- =Total Debt/Total Assets
- Measure Leverage: How much a company relies on debt for its financial needs
- Can help determine risk



EPS = Net Earnings/Outstanding Shares

- Tool of comparison
- Companies within the same industry
- 3 types of EPS
 - Trailing EPS (only actual EPS)
 - Current EPS
 - Forward EPS
- This tool alone doesn't tell you if it's a good stock to buy.

Project Earnings Growth (PEG)

- $PEG = P/E / (\text{projected growth in earnings})$
- Important things to note about PEG
 - It is about year-to-year earnings growth
 - It relies on projections, which may not always be accurate.

Dividend Payout Ratio (DPR)

- Measurement of what a company pays out to investors in the form of dividends
- $$\text{DPR} = \frac{\text{Annual dividends per share}}{\text{Earnings Per Share}}$$
- Must compare this ratio in context of the company or industry.
- If it is a growth company expect little to none, however if the company is in a mature industry with little growth we are expecting a high DPR.

Dividend Yield

- Key metric of value investors
- Dividend Yield – $\frac{\text{annual dividend per share}}{\text{stock's price per share}}$
- Typically a more established company will have a consistent dividend yield, which is important to note.

Understanding Book Value

- The question to ask is...
- How much is a company worth and is that value reflected in stock price?
- $\text{Book Value} = \text{Assets} - \text{Liabilities}$
- Typically $\text{Market Value} > \text{Book Value}$

So what can we take from all these tools?

- Is there a single “tell all” figure?
- They serve as benchmarks when looking at the entire picture of a stock to determine the worth of potential investments.

Management

- Share a sense of ownership in the company
- Long-term view
- Board of outsiders that can objectively measure the performance of management
- An often overlooked factor is the view of shareholders whether short-termed or long-termed investors

Questions??