

P R I S T I N E

Industry and Company Analysis - II

- Differentiation between various types of company stocks
- Earnings per share(EPS) and earnings multiplier

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Sample Material

Differentiation between various types of company stocks ^{Imp} PRISTINE

- Good companies may be not so good stocks, if expensive (as seen currently). Hence, the need to understand valuations.
- Growth Company Vs. Growth stock
 - Growth company: Returns (risk adjusted) are higher in new projects.
 - Growth stock: is one which outperforms other stocks (rapidly growing earnings).
 - Growth companies growth may be factored in and may give poor returns.
- Defensive Company Vs. Defensive Stock
 - Defensive Company: Relatively immune to downturn. Low Business risk and moderate financial risk (Utility, FMCG).
 - Defensive stock: is one which will not decline as much as overall market declines.
- Cyclical Company Vs. Cyclical Stock
 - Cyclical Company: Earnings follow business cycle. High levels of fixed assets and leverage.
 - Cyclical Stock: Betas > 1 . Will outperform market in down & up turns.

Differentiation between various types of company stocks

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- Speculative Company Vs. Speculative Stock
 - Speculative Company: Assets are risky with potential for high payoffs. Ex: Diamond miners, oil explorers, Dot Coms etc.
 - Speculative stock is one which is overpriced and has high probability of low returns and low probability of high returns (Ex: Capital goods, RE in India).
- Growth Stock Vs. Value Stock
 - Growth Stock: High earnings growth rate Vs. lower ones. Based on P/E or P/B criteria. Growth firms have high P/Es.
 - Value stocks: have low P/Es, low P/Bs and higher dividend yields.

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- EPS is arrived at by forecasting the Sales and the profit margin of the company.
EPS = [Sales (EBITDA%) – Depreciation – Interest] * (1 – Tax Rate)
- Two ways to determine appropriate P/E ratio:
 - Macro: Company P/E ratio is estimated by comparing it to industry and market P/E ratios.
 - Micro: Using the formula derived in DDM.
 - Estimate projected dividend payout ratio (D/E)
 - Estimate ROE : $k = RFR + \beta (R_{\text{market}} - RFR)$
 - Estimate growth rate: $g = \text{Retention Rate} * ROE$ (Retention rate = 1 - D/E)
 - Estimated P/E = $(D/E) / (k-g)$
- CONCLUSION: The intrinsic value arrived at above should be compared with the market price and then a decision should be made whether the stock should be purchased or not...