nasi padang

in rupiah

hello Elona, today papa is going to teach you about how to buy a business, in stock market, but to simplify the rationale behind, i will use a simple business for an easier understanding.
so owning a share or stock, is actually owning a piece of the real business, let me give you a real life example of a simple restaurant business , in this case, Nasi Padang Restaurant.
now if a business is doing well, it generates a lot of income, people are willing to buy it at 2-3 or even 5 times the original capital that is required to set up the business.
however if the business is not doing well, or even losing money, people are not willing to buy it at the original capital used to set up the business. some are not interested at all with the business,
while others might still see some value, but will value it at 1/2 the original capital or even 1/3 or lower.

now let me explain more about

PBV - Price Book Value
ROE - Return on Equity
PER -Price Earning Ratio
DER - Debt Equity Ratio
and
MOS - Margin of safety

these are 4 basic financial ratios that is present in any businesses, and you will be well advised to take a look at these ratios and hope that they are healthy for you to even consider buying them

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example, Nasi padang business:

PBV-price book value

let’s say we have a business, in this case a nasi padang restaurant business that is worth 10 billion rupiah
asset = equity + liability
asset 10 billion = equity 7 billion + liability 3 billion
total number of outstanding shares = 1 million shares
(BV) book value of 1 share is 7000 (7 billion / 1 million shares) so the Price book value or PBV is 7000

liability of 3 billion , consist of short term and long term liability ,
short term is paying suppliers for food supplies. long term might include paying installment on property to the bank every month for the next 10 years.

income
total sales per year for nasi padang house
per year is 2.5 billion.

expenses
cost of good sold 500 million a year
selling general and administrative expenses 500 million a year
income before taxes 1.5 billion rupiah @ 20 % = 300 million
net income= 2.5 billion - 500 million COGS- 500 Million expenses - 300 million taxes = 1.2 billion

Example:

if a bicycle company has 4 billion rupiah of equity and 40 million of outstanding shares, how much is the price book value of each share ?
4 billion / 40 million = Rp 100 per share.

ROE (return on equity) is net income 1.2 billion / equity 7 billion = 17.1 %

so each share of nasi padang house (NAPA) is worth 7000 book value plus it earns 17 % every year, or 1190 per year ,

it's PER is 7000/1190 = 5.88

that means it takes 5.88 years for nasi padang to break even , at the current rate. which is really good , it has a low PER.
so the lower the PER, means the faster the business will break even at that price.
if the price earning ratio is 1, let's take this nasi padang example, it means share price of 7000 divided by 7000 in earning per share, it means, it will take the business one year to break even, which is fantastic.

Example:
if the bicycle company is worth 4 billion in equity , and it makes a profit of 1 billion a year, what is the ROE ?
you take 1 billion / 4 billion = 25%

roe is 25 percent for the bicycle company

DER debt equity ratio

so total liability over it’s equity which is 3 billion of liability over 7 billion of equity
which is 3/7 =42.85 % or 0.4285
DER of below 1, is usually a sign of a healthy company, apart from financial companies or contractor companies.
some of the best companies has no debt at all they are so good at earning money that they do not need to take on debt to expand. however they still will take on debts for tax reducing purposes.

Example:

if the bicycle company has liabilities, of 2 billion rupiah ,
what is its Debt to equity ratio ?

you take 2 billion of debt / 4 billion of equity = 0.5 or 50 % DER,

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how to value shares
one way of valuing shares is taking it’s pbv roe,
since its roe is 17 %, we can use pbv of 1.7 to estimate its share price, which is 11900.
if it’s roe is 20 % , we can use pbv of 2 to estimate its share price , which is 14000

another way of valuing share price is using PER ROE method (discount the per by 1-2 points from ROE)
if the ROE is 17 %, then per should be around 15
if the ROE is 20 %, then per should be around 18

which means at the current price of 7000 of per 5.88, it will be 7000/5.88x 15 = 17857
if the roe is 20 % , then 7000/5.88 x 18 = 21428

if ROE is super low, let’s say 5 percent, then 7000/5.88 x 4 = 4761 .

does this make sense ? a business that is not performing will be priced lower , because it doesnt generate enough return to justify the high price.
this is even lower than the book value of 7000 . because you might as well put your money in the bank and earn a risk free return of 6 % instead of earning 5 %.

Example:

so if the bicycle company book value is at 100, and it is selling in the market at 50 rupiah, is it cheap ? yes because it is 50 percent discount.

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valuing with PBV ROE method:
now lets take into account the ROE, which is 25 %, if we take the book value which is 100 x 2.5 (because ROE is at 25 percent) = Rp 250, so even if it is above book value of 100 let's say at 150,
the intrinsic value is still much higher at 250.

which is really good

valuing with PER ROE method:
earning per share is 1 billion rupiah of profit divided by 40 million shares which is 25 rupiah,
so it's PER will be at 100 rupiah , 100 / 25 which is per of 4, if the price is at 150 , then the per will be 150 / 25 = 6 ,
now with PER ROE valuation, we usually take 1-2 points of per , matching it with it's ROE, so if ROE is 25, then let's be conservative at PER 20-23 , which translates the price to
100/4 x 20 = 500 rupiah.

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if you were to buy this nasi padang shares on the stock market when the price is at 5000 rupiah, would you buy it ? of course you would , because the intrinsic value can range from 11900- 17857 ,
depending on which valuation method you use. you would have a **margin of safety** of 1-11900-5000= 6900 or 1-(5000/11900=48%)=52% , if you bought the share at 11900 then your margin of safety is 0 because 1- (11900/11900) =0 if you use the per valuation method then your margin of safety is much higher
1- (5000/17857=28 %)= 72 % **margin of safety.**

margin of safety is very important when buying stocks or business, or any assets that you wish to acquire,
because no on can predict a future, if economy picks up, then the business might pick up and sales will increase, but if the economy is down, the business might suffer and there is a possibility of declining sales by 50 percent or more, we have seen that during corona virus pandemic whereby millions of business worldwide goes bankrupt. so it is important to reduce your risk by employing the margin of safety concept.
example , let's say you are a property investor, say a land in BSD area is worth 10 million per meter square, would you pay 11 million or 15 million for it ? of

course not. you will pay maximum of 10 million if you really want it.
but using margin of safety, you will find someone who is desperately trying to sell their land due to unexpected emergency, so you try to bargain it for 5-7 million per meter square, thus giving you a 30-50 % margin of safety.
same thing with buying cars, especially second hand cars whom the seller is desperate to sell due to emergency reasons at below market rate.

Example:

if we look at the example above,
with PER PBV, the value we arrive at is 250 rupiah ,
so with the current market price of lets say 150 rupiah ,

we take 1- (150/250)= 0.4 or 40 percent MOS , so you have a margin of safety of 100 rupiah, or 40 percent Margin of safety from its intrinsic value of 250 rupiah .

with the PER ROE valuation we arrive at 500 rupiah ,
with the current market price of let’s say 150 rupiah ,

we take 1 - (150/500) = 0.7 or 70 percent MOS, so you have a margin of safety of 350 rupiah , or 70 percent margin of safety from it’s intrinsic value of 500 rupiah .