Be Your Own Value Investor

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- While this is not a comprehensive step by step guide to becoming a value investor, I want to share with you a simple structure you can apply to making a value investment assessment of any stock or company

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- Step 1 Return on Equity
- How has the company performed?
- Look at the historical results over the past 10 years
- Compare its performance to its main competitors

- ROE = Net Income / Shareholders' Equity

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- Step 2 Debt to Equity Ratio
- You are looking for a low D/E ratio
- Returns should be generated by the excellence of the business and not financial engineering
- Use the second equation for more rigorous analysis

- Debt to Equity = Total Liabilities/Shareholder Equity
- Long Term Debt/Shareholders Equity

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- Step 3 Profitability
- You are looking for a min 5 year track record of steadily increasing earnings
- Margins should also be high and higher than competitors - think Michael Porter and Sustainable Competitive Advantage for the reasons why

- Profit Margin = Net Income / Net Sales

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- Step 4 Public Track Record
- You want to have access to 10 years of public financial information which public companies have to disclosed
- The search is for a strong track record but where the company is under valued by the market
- You can build your intrinsic analysis on solid foundations

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- Step 5 - Competitive Advantage
- One filter you should apply is to ensure that the company products have strong USPs = Unique Selling Propositions
- This also means avoiding commodity products and services as well as actual commodities (such as oil and gas) where products have no distinguishing characteristics

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- Step 6 Intrinsic Value vs Market Value
- Now and only now should you ask about the price of the stock
- Is is cheap?
- Is there a Margin of Safety of at least 30% between your intrinsic valuation and the market price

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- This final steps means you need to have done your intrinsic value analysis properly and in detail
- This includes a DCF and working out the WACC

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- A good way to reality check this is to consider the liquidation value or book value of the company to the intrinsic value
- The intrinsic value should be higher as it does not include intangible assets

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- Let me leave you with a couple of Warren Buffet quotations

- Rule 1 - Don't Lose Money
- Rule 2 - Never forget Rule 1
- "If a business does well, the stock eventually follows"
- "Our favourite holding period is forever"

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