NPTEL

Course Name: Security Analysis and Portfolio Management

Department: VGSOM, IIT Kharagpur

Instructors: Dr. Chandra Sekhar Mishra & Dr. Jitendra Mahakud

---

Session # 18 Company Analysis - II

Q.1: What are the favourable attributes of firms as suggested by Peter Lynch?

Ans.: As part of company selection for investment, the following favourable attributes are suggested by Peter Lynch.

1. Firm's product should not be faddish.
2. Firm should have some long-run comparative advantage over its rivals.
3. Firm's industry or product has market stability.
4. Firm can benefit from cost reductions.
5. Firms that buy back shares show there are putting money into the firm.

Q.2: What are the different tenets suggested by Warren Buffet and the questions to be asked as part of such tenets while choosing a company's stock to invest in?

Ans.; the following four broad tenets and associated questions/ advices are suggested by legendary investor Warren Buffet.

- Business Tenets:
  - Is the business simple and understandable?
  - Does the business have a consistent operating history?
  - Does the business have favorable long-term prospects?
- Management Tenets:
  - Is management rational?
  - Is management candid with its shareholders?
- Financial Tenets:
  - Focus on return on equity, not earnings per share
  - Calculate "owner earnings"

- Look for companies with high profit margins
- For every dollar retained, make sure the company has created at least one dollar of market value

- Market Tenets:
  - What is the intrinsic value of the business?
  - Can the business be purchased at a significant discount to its fundamental intrinsic value?

Q.3: Define Economic Value Added and Market Value Added

Ans.: Economic value added is the difference between net operating profit adjusted for tax and cost of capital (in absolute value). This is propagated by Stern and Stewart of New York as a better measure compared to accounting profit since it captures cost of capital. In its base form, it can be called as economic profit i.e. the profit earned over above the expectations of investors in terms of cost of capital.

Market value added is the difference between market value and book value of the firm. It is suggested that high EVA firms are likely to have high MVA. Similarly it is also suggested that MVA is the present value of future stream of EVA of a firm over the years.

Q.4: What are the factors that one should consider while analyzing global stocks?

Ans.: Besides the usual analytical tools, the following factors should be considered by one while analyzing global stocks.

- ✓ Availability of Data
- ✓ Differential Accounting Conventions (based on the country that the company belongs to)
- ✓ Currency Differences (Exchange Rate Risk)
- ✓ Political (Country) Risk
- ✓ Transaction Costs
- ✓ Valuation Differences