Bernstein Bank

Basics of Fundamental Analysis

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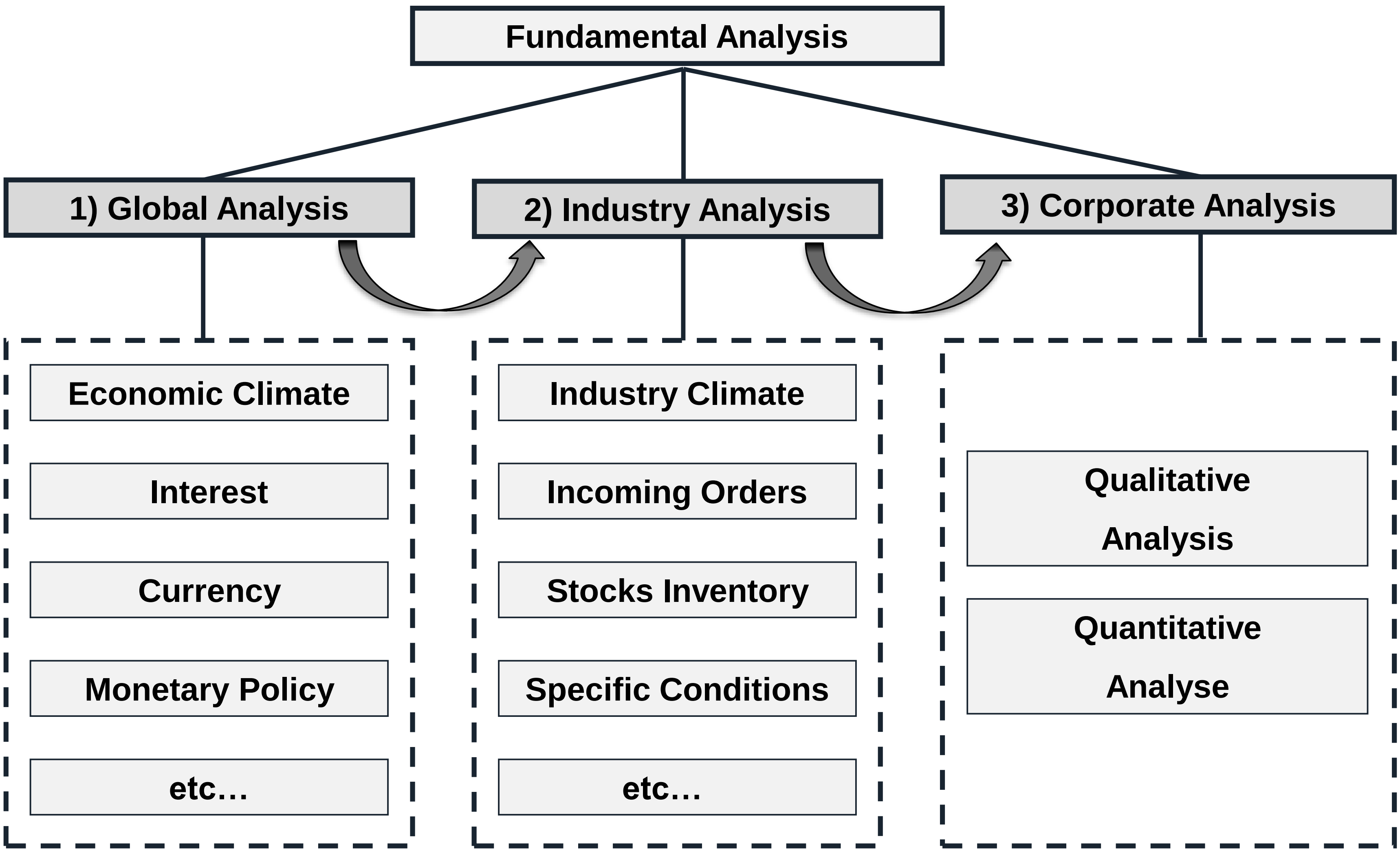
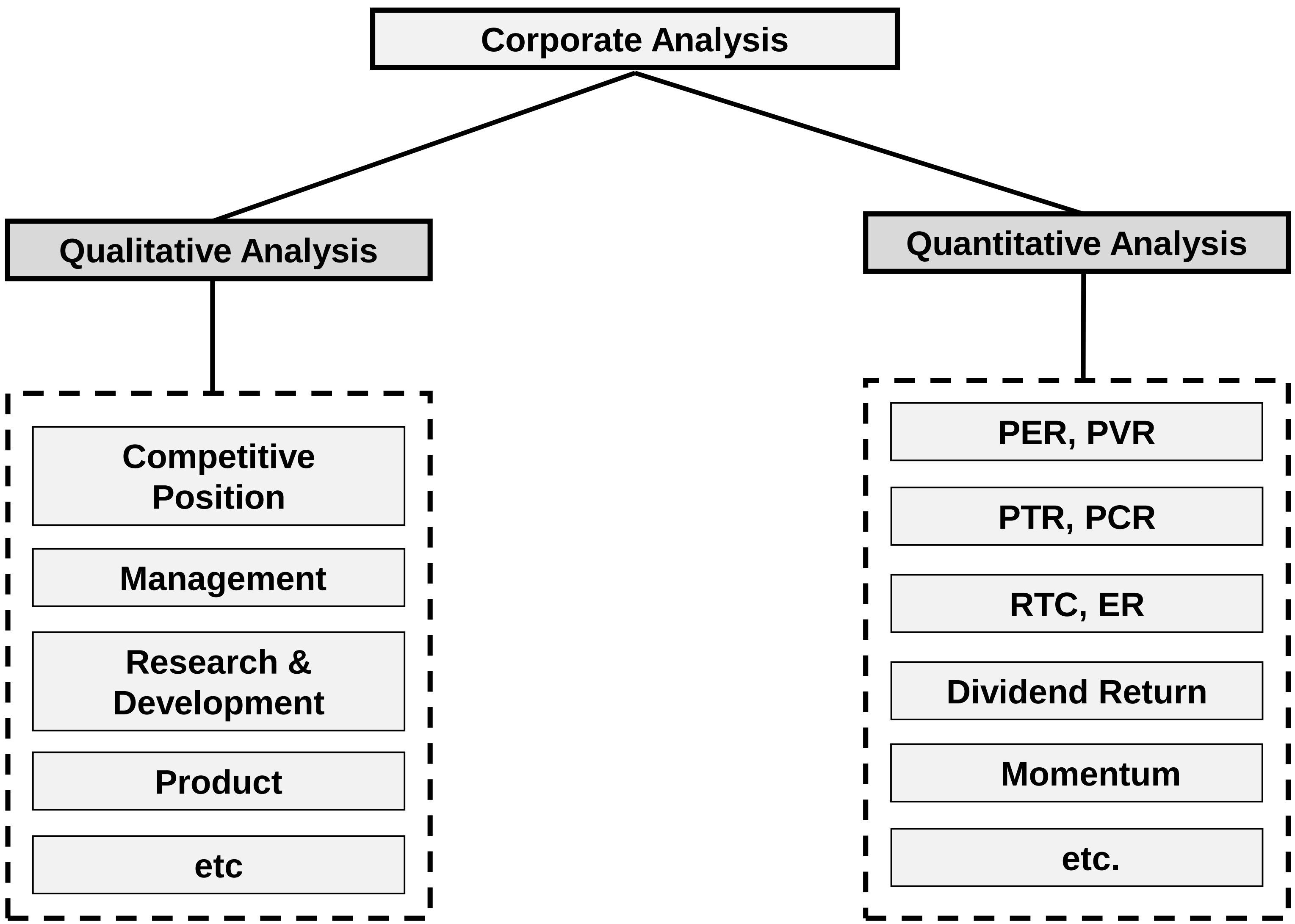
Background: Fundamental Analysis

- The fundamental analysis of a stock company does not only involve the research and evaluation of economic data and information (= micro-analysis), but also of the economic market and macro-economic framework conditions (macro analysis).
- On the basis of this assessment the attempt is made to give a forecast of the future market development.
- The aim is to select financial instruments that are valued as favorably as possible and at the same time offer promising perspectives. Ultimately, this involves the determination of concrete entry signals.
- For example, in order to be able to forecast the development, i. e. the future profits of a listed company, it is necessary to take into account a broad spectrum of fundamental data.


Fundamental Analysis
1) Global Analysis
2) Industry Analysis
3) Corporate Analysis
Economic Climate
Interest
Currency
Monetary Policy
etc…
Industry Climate
Incoming Orders
Stocks Inventory
Specific Conditions
etc…
Qualitative Analysis
Quantitative Analyse


Corporate Analysis
Qualitative Analysis
Quantitative Analysis
Competitive Position
Management
Research & Development
Product
etc
PER, PVR
PTR, PCR
RTC, ER
Dividend Return
Momentum
etc.

- However, the resulting measurement values are only meaningful and comparable if the companies' balance sheets are prepared in accordance with uniform rules.

Price-Earnings-Ratio (PER)	**Return on Total Capital (RTC)**
Price-Value-Ratio (PVR)	**Equity Ratio (ER)**
Price-Turnover-Ratio (PTR)	**Dividend Return (DR)**
Price-Cashflow-Ratio (PCR)	**Momentum (M)**

Corporate Analysis as part of Fundamental Analysis

Fundamental Analysis

Global Analysis → **Industry Analysis** → **Corporate Analysis**

- Business analysis distinguishes qualitative from quantitative analysis. The quantitative business analysis is based on the conventional balance sheet analysis.

- In this context, the quotients of the respective company data are compared in order to evaluate different companies. The respective quarterly or annual reports of the public limited companies serve as a basis.

- Subsequently, the most important key figures of the quantitative company analysis in terms of calculation and meaningfulness will be explained in more detail.

Price-Earnings-Ratio

- The PER results from the division of the current price by the consolidated net income per share.

$$\textbf{PER} = \frac{\textbf{Share Price}}{\textbf{Earnings per share}}$$

- The price/earnings ratio can be interpreted as a price/performance ratio, since it indicates the ratio of the share price to a company's earning power.

- A PER of 10 or lower is generally considered favorable. The opposite is the case with a value over 20.

Price-Value-Ratio (Market-to-Book-Ratio)

- PVR puts the price of a share in relation to its proportional book value. For this purpose, the price of the stock corporation is divided by the book value per share.

$$\textbf{PVR} = \frac{\textbf{Share Price}}{\textbf{Book Value per Share}}$$

- The market-to-book-ratio indicates the value that theoretically every shareholder is entitled to. A PVR of less than 1 would mean that you receive a larger share of equity than was actually paid for it.

Price-Turnover-Ratio

- The PTR results from the quotient of share price and turnover.

$$\textbf{PTR} = \frac{\textbf{Share Price}}{\textbf{Turnover per Share}}$$

- In contrast to the Price-Earnings-Ratio, the Price-Turnover-Ratio is not based on the profit, but on the revenue, i. e. the income generated by the company.

- PTR is problematic because it ignores the profitability of a company. On the other hand, it helps to determine a fair price for public limited companies that are (still) incurring losses. PER is not appropriate for these companies, as there are no profits yet.

Price-Cashflow-Ratio

- The PCR is calculated from the quotient of the share price and cash flow per share.

$$\text{PCR} = \frac{\text{Share Price}}{\text{Cashflow per Share}}$$

- The Price-Cashflow-Ratio provides information on the share price in relation to the company's liquidity: it is a measure of the development of a company's profitability.
- Generally speaking, a PCR of seven is considered a fair assessment.

Return on Total Capital

- Profit and interest expenses are added together to calculate the RTC in order to maintain the profit actually generated. The result is divided by the total capital and the resulting quotient is multiplied by one hundred.

$$\mathbf{RTC} = \frac{\textbf{Profit + Interest}}{\textbf{Total Capital}} \mathbf{x\ 100}$$

- The RTC (= percentage value) shows how efficiently and profitably the company acted during the calculation period.

- This key figure is of great relevance because it says a lot about the quality of the management of the examined joint-stock company: it provides information about how a company uses the available capital to generate profit.

Equity Ratio

- To calculate the equity ratio, equity is divided by total capital and the result is multiplied by 100.

$$\mathbf{ER} = \frac{\textbf{Equity Capital}}{\textbf{Total Capital}} \times 100$$

- This key figure sets a company's equity as a percentage of its total capital and is therefore an important indicator for the financial stability of a company.

- The higher the ER, the higher the stability and independence and thus the creditworthiness of the company.

Dividend Return

- The dividend return (= dividend yield) results from the division of dividend and stock market price.

$$DR = \frac{\textbf{Dividend}}{\textbf{Share Price}} \times 100$$

- The dividend is paid to all shareholders of the referring company. The amount will be decided on an annual basis at the annual general meeting and then distributed.
- The dividend yield is primarily based on the company's profit. For DAX companies, the average dividend yield is between 2% and 3%.

Momentum

- Momentum is calculated by dividing current growth rates by the corresponding increase in previous periods.
- Increasing earnings momentum, based on percentage earnings growth, means an annual increase in percentage earnings growth rates.

$$\textbf{Momentum} = \frac{\textbf{Profit growth for the current period}}{\textbf{Profit growth in the previous period}}$$

- Momentum measures the dynamics of profit growth and thus also allows an assessment of the long-term profit perspective.
- Shares with a high profit momentum are called growth shares on the stock exchange.

Summary

- The key figures of the fundamental analysis allow conclusions to be drawn as to whether a share is worth an investment and how the company should be assessed in comparison with other market players.

- All the key figures mentioned above come together in this context. One indicator alone is not very meaningful.

- Against this background, fundamental analysis should not be used as the sole criterion for decision-making.

- The technical analysis can be a useful supplement. This applies in particular to timing!

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Thank you for your Interest

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