Uniwersytet Wrocławski

# Basic analysis

# 1. Methods of share analysis

- Basic analysis
- Portfolio analysis
- Technical analysis

# 1. Methods of share analysis

Basic analysis:

- deals with the basics of companies which company's operations are based on
- the more solid foundation the better prospects the company has and the more chances for sustainable and effective development

# 1. Methods of share analysis

Basic analysis:

- thus there are premises for the growth of company value
- by the fact that in the long term there is a significant correlation between the increase in the value of the company and the assessment of its shares on the capital market, popularity of this method is not surprising, for example among stock exchange investors

# 1. Methods of share analysis

Basic analysis:

- The cause of changes in stock prices is the change of the socio-economic situation in the company, with its partners and competitors, as well as the entire economic system.
- Therefore focuses on the information concerning the company and its widely understood environment.

# 1. Methods of share analysis

Stages of basic analysis:

- Macroeconomic analysis
- Sector analysis
- Situation analysis
- Financial analysis of the company
- Valuation of company’s shares

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# a. Macroeconomic analysis

- general assessment of the investing in the financial market attractiveness
- attractiveness depends on the economic situation, the economic policy and the risk of investment in the country
- global issues related to the political and economic situation in the world that can have an impact on the market in the country must be considered

# a. Macroeconomic analysis

Macroeconomic analysis uses he basic characteristics of the economy such as:

- GDP growth rate
- inflation rate
- the size of the budget deficit, etc.

# a. Macroeconomic analysis

Positive signals for the investor:

- higher than expected GDP growth,
- declining budget deficit,
- declining public debt,
- growth of favorable trade balance,
- an increase in the positive balance of payments,
- declining unemployment rate,
- reduction of interest rates by the central bank lowering the tax rates,
- reduction of economic interventionism,
- decline in the role of labor unions,
- decline in the significance of populist political parties,
- legislating legal acts resulting in greater labor market flexibility…

# b. Sector analysis

- Sector analysis aims to assess the situation in the sector and then to determine the position of the company in it.
- It’s looking for the leading sectors of the country's economy, which is offering the highest rate of profit or that create a greater supply of and demand for a particular product group.

# b. Sector analysis

Criteria of sector analysis:

- ROI in the sector
- the level of investment risk in a particular sector
- the sensitivity of the sector to cyclical factors (trade cycle)
- phase of the cycle in which the sector:
  - pioneering phase
  - growth phase
  - mature phase
  - phase of collapse

# c. Situation analysis

- It aims to establish the importance of the company in the sector and the market, as well as development prospects from the non-financial factors point of view

# c. Situation analysis

The subject of this analysis are:

- objects of the company and its degree of competitiveness (price and quality)
- the location and scale of operation of the company
- structure and quality of assets
- production capacity and distribution network
- qualifications of employees
- quality and management efficiency
- factors of success and failure within the SWOT

# d. Financial analysis of the company

- It applies to the considered company, with that taken into account here, financial condition, analyzed on the basis of, among others, financial statements.
- The financial statements include:
  - Balance
  - Profit and Loss Account
  - Cash Flow Account
  - Statement of changes in equity capital
  - additional information

# d. Financial analysis of the company

Balance:

- is a list of business assets and sources of financing of those assets (liabilities),
- assets are equal to liabilities and their value is given in the balance sheet at the beginning (opening balance) and end (closing balance) of the reporting period (accounting),
- the values are given for a specific moment in time, the balance sheet shows the economic variables statically

# d. Financial analysis of the company

Profit and Loss Account:

- It is based on the statement of income streams generated in the company from the sale of products and services as part of the commercial activities and revenue from the financial operations and cost of this activity
- economic variables are given for a period of time, that means it is dealing with the dynamic view
- summing up, profit and loss account reports the level of effectiveness of each activity and the overall financial result of the company

# d. Financial analysis of the company

Cash Flow Account:

- It shows the changes that have occurred in the individual components of assets and liabilities caused by cash flow
- analysis of cash flow allows to evaluate the degree of liquidity, effectiveness of collecting receivables and the ability to discharge liabilities by the company

# d. Financial analysis of the company

Statement of changes in equity capital:

- the aim is to provide information about:
  - changes in sources of funding equity of the company and their causes
  - profits remaining in company, perchance loss that requires coverage
  - costs and revenues, which as a basic error were included directly into equity capital, bypassing the profit and loss account

# d. Financial analysis of the company

Additional information:

- It provides in-depth information of the balance sheet, profit and loss account as well as the cash flow statement.
- properly drawn up should include relevant information and explanations that are necessary for a true and fair presentation of the assets and financial standing and the financial result in the financial statements.

# d. Financial analysis of the company

One of the basic tools of analysis of the financial statements is the ratio analysis, including:

- liquidity ratios
- debt ratios
- turnover indicators
- profitability ratios
- Indicators of market value

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# d. Financial analysis of the company

Liquidity ratios

- describe the company's ability to settle its current liabilities
- therefore they allow assessment of the solvency of the company
- the key indicators in this group include:
  - current ratio
  - quick ratio
  - cash ratio

# d. Financial analysis of the company

Debt ratios

- They show the extent to which the company's assets are financed by foreign or its own capital
- They show the structure of financing, and its effectiveness.
- Among this group we distinguish:
    - total debt ratio
    - debt to equity ratio
    - long term debt to equity
    - the coverage of assets to long-term liabilities ratio
    - times interest earned
    - the financial surplus coverage of liabilities ratio

# d. Financial analysis of the company

Turnover indicators:

- enable an assessment of the effectiveness of the use of resources owned by the company
- among the turnover indicators, the ones worth mentioning are:
  - total asset turnover
  - inventory turnover
  - receivables turnover

# d. Financial analysis of the company

Profitability ratios:

- They show the relationship of the profit earned by the company on the market and the resources involved.
- We can distinguish following indicators:
  - ROS - Return on sales
  - ROA - Return on Assets
  - ROE - return on equity
  - ROSE – return on staff employed

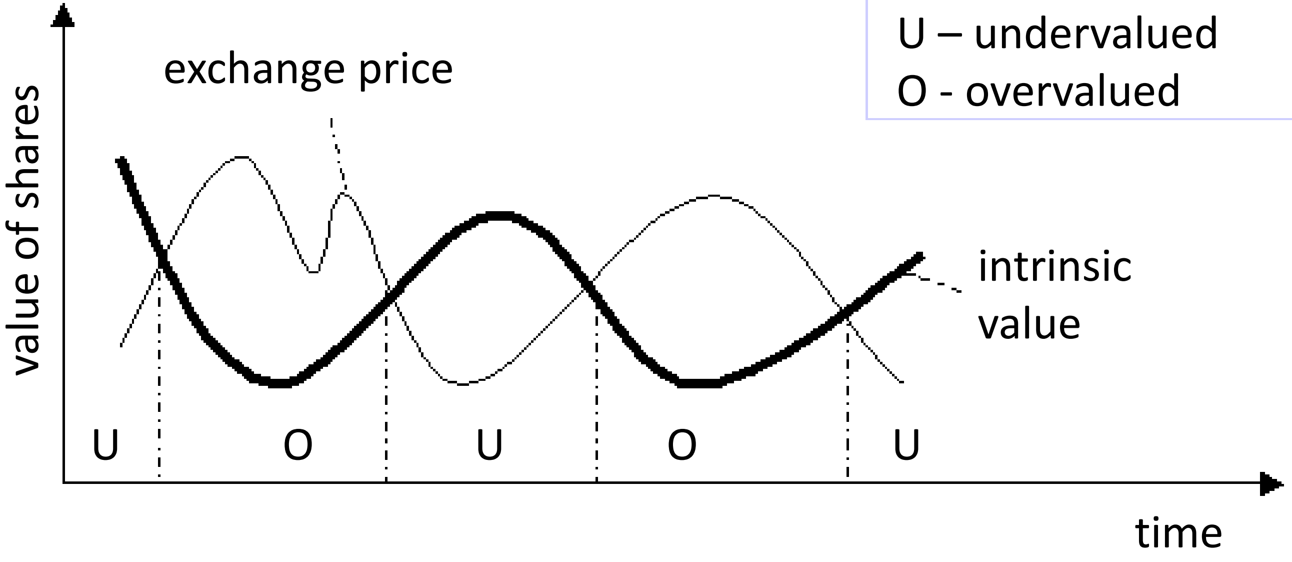
# d. Financial analysis of the company

Indicators of market value

- allow the board to find out what the investors think about the current results of the company and its prospects for the future
- among the indicators of the market worth mentioning we can enlist:
  - EPS - earnings per share
  - dividend yield
  - BVS - Book value per share
  - P/E - Price Earning Ratio
  - Dividend payout ratio

# e. Valuation of shares

Is used to evaluate whether the share is undervalued (the intrinsic value of the shares exceeds the market value)




Shares are:
U – undervalued
O - overvalued

# e. Valuation of shares

The basic approaches used in the valuation of the shares:

- book value method
- liquidation value method
- replacement value method
- multiples method
- Income method

# e. Valuation of shares

Book value method:

- According to the book value method, the value of the company results from the construction of the relevant balance sheet items - total assets reduced by liabilities.
- Alternatively, it takes into account the adjustments of assets and liabilities value.

# e. Valuation of shares

Liquidation value method:

- Relies on liquidation of the company.
- The enterprise value is calculated by adding the amounts resulting from the sale of company’s assets.
- Again, the result should be reduced by the value of the liabilities and costs of the liquidation of businesses and assets.

# e. Valuation of shares

Replacement value method:

- enterprise value is the amount of money that should be spent to duplicate the given company

# e. Valuation of shares

Multiples method:

- means the valuation of the analyzed company's shares with shares of another company;
- it is necessary to ensure that companies are comparable, work in the same sector;
- the most commonly used multipliers:
  - price / earnings
  - price / book value
  - price / sales
  - price / cash flow
  - dividend / price

# e. Valuation of shares

Income method:

- It uses a discounted cash flow.
- This means that the value of the company is the discounted value of its future income.