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CF968 Lecture 9 Summary

Like the running race, knowing one's finishing time is not enough to judge one's performance. The profitability is the same case in the stock market. Therefore, the problem is that how can investors evaluate one company's performance.

For example, a statement like 'the profitability of Tesco is 3.535 billion/year' does not make any sense without further information. Compare to the rest companies, Tesco has the 16th biggest profitability in FTSE 100. And in the same industry, Tesco is the most profitable company compare to Morrison (0.947 billion/year) and Sainsbury (0.827 billion/year). It seems like that Tesco is the most valuable company. But how much can an investor benefit from the company?

Earning per Share (EPS) is a measure portion of a company's profit allocated to each outstanding share of common stock. It is an indicator of its profitability, which tells investors the profitability on each share that they own. In the terms of EPS, Tesco has reported EPS of 29.2 and normalized EPS of 26.3 on 8.03 billion shares, while Morrison has 23.4 (reported EPS) and 23.5 (normalized EPS) on 2.5 billion shares and Sainsbury has 31.6 (reported EPS) and 28.8 (normalized EPS) on 1.88 billion shares. And from the history data, there is evidence showing that the EPS and profitability are positively correlated. Obviously, it is the higher the EPS the more that a shareholder can benefit from it. What do we miss here?

The missing part is the excluding of share price. Price/EPS Ratio is another measure that takes the share price into account, the lower the Price/EPS Ratio the better the share. Back to the Supermarket case, Tesco has a Price/EPS Ratio of 9.32 and Morrison and Sainsbury have 11.19 and 11.06 respectively. The Price/EPS Ratio takes all factors into account. It gives a general idea of if a company is over priced or under priced.

The $\frac{Price/EPS\ Ratio}{Earning\ Growth}$ (PEG) is a measure that counts a company's growth potential, the lower the better. Usually we are looking for those smaller than 1. Tesco has a 0.51 PEG and Morrison has a 1.40 PEG, while Sainsbury's forecasted EPS growth is negative. The reason that Tesco has a relatively low PEG may be that Tesco is a worldwide company, it has a vast number of superstores in various countries (some of them are developing counties, higher growth potential) which Morrison and Sainsbury have not.

Dividends are another important part to judge that if a company is worth to invest. It works like the coupon that pays regularly on bonds. This could be an important factor that long-term investors consider.

Operating margin, Debt, Cash Flow & liquidity are also considered as important factors in judging a company's performance; capital returns are also a very attractive factor to investors.

After knowing the metrics, we can rank the stock and find investment chances. Search the stock market, use the understanding financial metrics to rank stock and find attractive opportunities. This is called Stock Screening. And in trading, there are trends and patterns that tell you what action should be performed.