

Relative Value



Mini Investment Class by the OKI Tri-State Chapter

Presented at OKI Annual Meeting 2011 by
Marge Daniels, *Director, OKI Tri-State Chapter*

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NATIONAL ASSOCIATION OF INVESTORS CORPORATION
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It's All Relative

- ▶ Definition of Relative Value
- ▶ Definition of Projected Relative Value
- ▶ Choosing a good time to buy or sell
- ▶ Warnings and Watch Outs

Many Definitions

- ▶ Fund managers compare price/earnings, price/book, or price/sales with a benchmark and then make a decision.
- ▶ Relative Strength is dividing the performance of one stock by the performance of an index or of another stock.

P/E's are part of RV

Think about the company's P/E

The Average P/E is a sort of signature P/E – a measure of the normal enthusiasm that investors have for this company.

Stock prices are driven over the long term by earnings.

Deviations in P/E, not caused by earnings, will tend to seek its normal or signature level.

Historically, P/E's have ranged from 6-25

There are Many RV Definitions

▣ SSG SECTION 3

- ▣ Current P/E Ratio divided by the co's historical 5-year average P/E Ratio

▣ VALUE LINE

- ▣ Basic P/E = price divided by last 6 mo earnings plus next 6 mo estimated earnings.
- ▣ Relative P/E compares the P/E of a co with the median of estimated P/Es of all other co in VL

SSG Section 3

3 PRICE, PRICE/EARNINGS RATIO and DIVIDEND ANALYSIS

		CURRENT PRICE		31.850	52-WEEK HIGH		36.5
	Fiscal Year	High Price	Low Price	EPS	High P/E	Low P/E	
1	2006	19.8	13.1	0.81	24.4	16.2	
2	2007	23.3	18.2	1.06	22.0	17.2	
3	2008	23.6	13.8	1.09	21.7	12.7	
4	2009	26.6	19.5	1.21	22.0	16.1	
5	2010	36.5	21.3	1.67	21.9	12.8	
6	AVERAGE		17.2		22.4	15.0	
AVERAGE P/E RATIO		18.7		PROJECTED P/E RATIO		16.2	
CURRENT P/E RATIO		18.0		PEG RATIO		1.5	
RELATIVE VALUE		96.3		PROJ. RELATIVE VALUE		86.7	



Value Line

ORACLE NDQ-ORCL				RECENT PRICE	27.60	PIE RATIO	11.9 (Trailing: 12.4 Median: 17.0)	RELATIVE PIE RATIO	0.86						
TIMELINESS	2	Raised 12/31/10	High:	46.5	35.0	17.5	14.0	15.5	14.5	19.8	23.3	23.6	25.1	32.3	31
			Low:	21.5	10.2	7.3	10.6	9.8	11.3	12.1	16.0	15.0	13.8	21.2	21
SAFETY	1	Raised 5/22/09	LEGENDS												
TECHNICAL	4	Lowered 8/12/11	— 15.0 x "Cash Flow" p sh												
BETA	.95	(1.00 = Market) Relative Price Strength												
			3-for-2 split 3/99												
			2-for-1 split 1/00												

How to Use Relative Value

- ▶ Buy company whose RV is less than 110%
- ▶ Sell if RV is less than 85%
- ▶ Use the whole SSG to make your decision.
- ▶ Check financial news, the company web site, investor relations.

Projected Relative Value

- ▶ Projected P/E Ratio divided by the 5 year average P/E Ratio
- ▶ SSG uses the future earnings which YOU estimated at the bottom of page 1.
- ▶ Don't buy a co with Projected RV above 100%
- ▶ Get suspicious if it's below 80%.

What does RV Mean?

- ▶ If less than 100%, the stock would be undervalued.
- ▶ We strive to purchase stocks whose current P/E is not much above the average or better yet is somewhat below it.

Cautions and Watch Outs

- ▶ Interest rates
- ▶ Inflation
- ▶ Competition
- ▶ Industry Trends
- ▶ Cyclical companies
- ▶ Emerging companies
- ▶ Irrational Market
- ▶ Dividing an unrealistic current P/E by an equally unrealistic Average P/E gives a useless Relative Value

Two Cycles to Keep in Mind

Life cycle of the business

P/Es are higher when estimated growth rates are high

Growth rates decline as a company matures

The business cycle of the economy

Average P/Es are highly correlated with inflation rates.

Inflation

Inflation is an investor's worst enemy.

Multiples move opposite to interest rates and inflation.

Red Flags

▣ Disappointing Qtr Results

- Actual loss or not meet analysts expectations

▣ Sales Growth

- Flattening?

▣ Pretax Profit Margins

- Down for 2-3 quarters?

▣ EPS growth

- Is growth rate for last 4 quarters above industry avg?