International Management Studies

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I. Asset Valuation

➤ Asset valuation is **the process of determining the worth or fair market value of assets**, which can include both tangible items like real estate, equipment stock and bond, and intangible items like patents, trademarks, and goodwill.

➤ This valuation is essential in finance and investment for various purposes, such as mergers and acquisitions, financial reporting, investment analysis, taxation, and loan collateral assessment.

Here are some common asset valuation methods: (Over Valued or Under Valued ?)

1. Market Approach

Comparable Sales Method: Valuing an asset by comparing it to similar assets recently sold in the market. This is often used in real estate. (eg: the price of apartments in Korea)

Multiples Method: Using financial ratios, like the price-to-earnings (P/E) or enterprise value-to-EBITDA (EV/EBITDA) multiple, to value a business or intangible assets, often applied in company valuations.

2. Income Approach

Discounted Cash Flow (DCF): Projects the future cash flows generated by the asset and discounts them back to the present value, reflecting the time value of money. This is widely used in valuing businesses and long-term investments.

Capitalization of Earnings Method: Applies to assets that produce a consistent income. It divides expected earnings by a capitalization rate, which reflects the required rate of return.

3. Cost Approach

Replacement Cost Method: Determines the cost to replace or recreate the asset with an equivalent one, used often for physical assets.

Adjusted Book Value: Adjusts the book value of assets by accounting for depreciation and other factors to reflect a more current value.

II. Fundamental Approach

➢Fundamental approaches to asset valuation focus on understanding the **intrinsic value of an asset** based on underlying financial and economic factors rather than just market prices.

➢This involves analyzing the asset's ability to generate future cash flows, growth potential, and risk, **which provides insights into its "true" value**.

1. Discounted Cash Flow (DCF) Analysis

This method calculates the present value of an asset's expected future cash flows. It projects the future cash flows and discounts them using a discount rate (often the weighted average cost of capital, or WACC) to reflect the time value of money.
DCF is widely used for valuing companies, projects, and investments that have predictable future cash flows, as it provides a detailed look at future earnings and profitability.

2. Dividend Discount Model (DDM)

The DDM is a type of DCF analysis specifically for valuing stocks. It assumes that a stock's value is the present value of all expected future dividends.
This approach is typically used for mature companies with stable dividend policies, where dividends are a reliable indicator of value.

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3. Residual Income Model (RIM)

- This model evaluates the value of an asset based on the residual income it generates, which is the income remaining after accounting for the opportunity cost of capital.

- RIM is useful when a company doesn't distribute dividends but has a reliable track record of income generation, as it highlights economic profit over just accounting profit.

4. Relative Valuation Models

- **Price Multiples (Comparable Analysis):** This involves comparing the asset to similar assets using financial ratios, such as price-to-earnings (P/E), price-to-book (P/B), or price-to-sales (P/S) ratios.

- Relative valuation is popular for valuing assets where similar market benchmarks are available, such as publicly traded companies in the same industry.

5. Asset-Based Valuation

- **Net Asset Value (NAV):** This method values a company by assessing the fair value of its total assets minus its total liabilities. It is particularly useful for investment funds or companies with significant tangible assets, such as real estate or manufacturing firms.

- **Liquidation Value:** This is an asset's estimated value if it were sold off quickly, typically used for distressed assets or companies.

. Earnings Power Value (EPV)

- EPV is based on the assumption that a company's value is directly related to its sustainable earnings power. This approach values the company by capitalizing its normalized earnings.

- It's useful for businesses with consistent earnings histories, focusing on their long-term ability to generate profit rather than just current financial metrics.

7. Economic Value Added (EVA)

- EVA is the residual income approach applied on a more granular level, assessing whether a company generates returns above its cost of capital. If a company earns more than its cost of capital, it creates value; if it earns less, it destroys value.

- EVA is commonly used for performance analysis, as it gives a straightforward view of whether management is creating or eroding shareholder value.

III. Top-down Approach

➢A **top-down approach** to evaluating the intrinsic value of an asset starts with a macroeconomic view, assessing the broader economy and industry before analyzing individual assets.

➢This method contrasts with the **bottom-up approach**, which focuses directly on individual asset fundamentals. Here are the main steps of the top-down approach:

Here are the key steps typically involved in a top-down analysis:

1. Macroeconomic Analysis

- **Economic Indicators:** Assess key economic indicators such as GDP growth, inflation rates, interest rates, and unemployment levels. These factors influence overall market conditions and investment sentiment.

- **Monetary Policy:** Analyze the stance of central banks (e.g., interest rate policies, quantitative easing) as these decisions can impact liquidity and asset prices across the board.

- **Fiscal Policy:** Consider government spending and taxation policies that can affect economic growth and sector performance.

2. Sector (Industry) Analysis

- **Industry Trends:** Identify which sectors are expected to perform well based on the macroeconomic environment. For instance, during an economic expansion, consumer discretionary and technology sectors might outperform.

- **Competitive Positioning:** Evaluate the competitive landscape within the chosen sectors, including market share, barriers to entry, and potential disruptors.

- **Regulatory Environment:** Consider the impact of regulations and policies specific to sectors, as these can significantly influence profitability and risk.

3. Market Analysis

- **Market Sentiment:** Gauge investor sentiment through market trends, news, and investor behavior. This can include analyzing stock market trends, capital flows, and volatility measures (like the <u>VIX index</u>).

- **Comparative Analysis:** Compare sector performance relative to the overall market to identify potential undervalued or overvalued areas.

4. Company Analysis

- **Fundamental Metrics:** Once a promising sector or industry is identified, analyze individual companies using fundamental metrics such as revenue growth, profit margins, earnings per share (EPS), and return on equity (ROE).

- **Valuation Ratios:** Apply valuation methods (like P/E ratio, P/B ratio, or DCF analysis) to assess whether the specific companies are undervalued or overvalued relative to their peers or historical averages.

5. Intrinsic Value Estimation

- **Risk Assessment:** Evaluate the risk factors affecting the asset, including business risk, financial risk, and market risk. Adjust the valuation models accordingly (e.g., using a higher discount rate for riskier investments).

- **Sensitivity Analysis:** Conduct sensitivity analyses to understand how changes in key assumptions (like growth rates or discount rates) affect the intrinsic value.

6. Investment Decision

- **Final Evaluation:** Based on the intrinsic value derived from the analysis, decide whether to invest in the asset. Compare the calculated intrinsic value with the current market price to identify potential investment opportunities (e.g., undervalued assets).

Advantages of the Top-Down Approach:

- **Holistic View:** Provides a broader perspective by considering the overall economic landscape before focusing on specifics.

- **Identifying Trends:** Helps investors identify macroeconomic trends and sector opportunities that may influence asset prices.

Disadvantages:

- **Potential Overlook of Specifics:** May neglect company-specific factors that could significantly impact value.

- **Complexity in Analysis:** Requires extensive data and understanding of various economic and market indicators, making it complex and time-consuming.

The top-down approach is particularly useful for investors looking to align their strategies with macroeconomic conditions and to identify sectors poised for growth, ultimately leading to more informed investment decisions.

IV. Analysis of An Industry

➤ Analyzing an industry for investment purposes requires understanding its competitive landscape, growth prospects, risks, and economic cycles.

➤ Here (in the following pages) are some proven methods for conducting a thorough industry analysis:

1. Porter's Five Forces Analysis

- This framework assesses an industry's competitive dynamics by evaluating five key forces:

  o **Threat of New Entrants:** Identifies how easy it is for new competitors to enter the market, which can dilute profitability.

  o **Bargaining Power of Suppliers:** Analyzes how much influence suppliers have on costs and pricing, affecting margins.

  o **Bargaining Power of Buyers:** Evaluates customer influence on pricing, which can impact an industry's revenue stability.

  o **Threat of Substitutes:** Assesses the risk of alternative products or services that could reduce demand.

  o **Competitive Rivalry:** Examines the intensity of competition within the industry, impacting pricing and profitability.

This analysis helps investors understand how attractive or challenging an industry may be in terms of competitive pressures.

RIVALRY AMONG EXISTING COMPETITORS:
- Number of competitors
- Diversity of competitors
- Industry concentration
- Industry growth
- Quality differences
- Brand loyalty
- Barriers to exit
- Switching costs

THREAT OF NEW ENTRANTS

THREAT OF NEW ENTRANTS:
- Barriers to entry
- Economies of scale
- Brand loyalty
- Capital requirements
- Cumulative experience
- Government policies
- Access to distribution channels
- Switching costs

BARGAINING POWER OF SUPPLIERS

RIVALRY AMONG EXISTING COMPETITORS

BARGAINING POWER OF BUYERS

BARGAINING POWER OF SUPPLIERS:
- Number and size of suppliers
- Uniqueness of each supplier's product
- Focal company's ability to substitute

THREAT OF SUBSTITUTE PRODUCTS:
- Number of substitute products available
- Buyer propensity to substitute
- Relative price performance of substitute
- Perceived level of product differentiation
- Switching costs

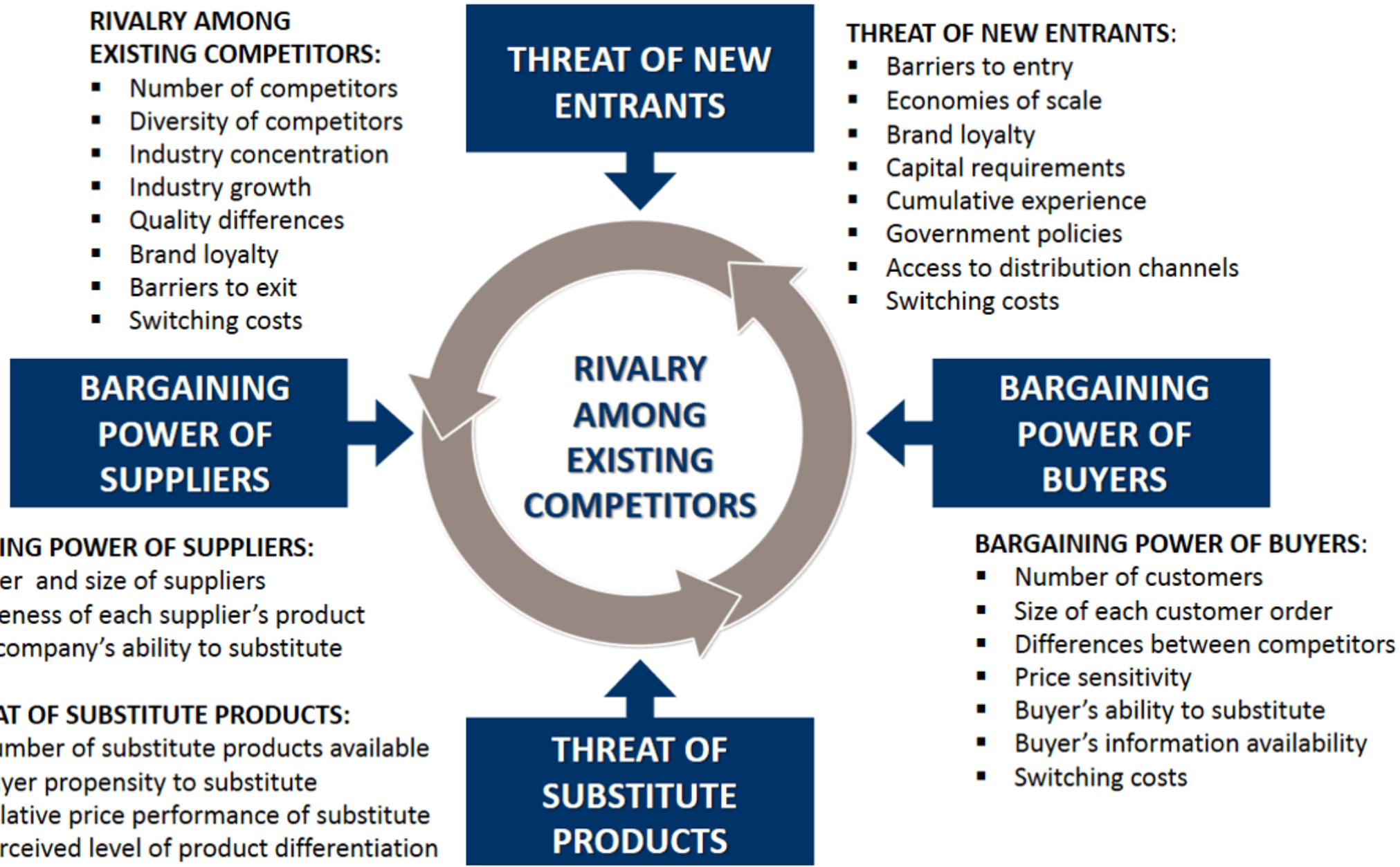**THREAT OF SUBSTITUTE PRODUCTS**

BARGAINING POWER OF BUYERS:
- Number of customers
- Size of each customer order
- Differences between competitors
- Price sensitivity
- Buyer's ability to substitute
- Buyer's information availability
- Switching costs

2. PESTEL Analysis

- PESTEL (Political, Economic, Social, Technological, Environmental, and Legal) analysis evaluates the external environment that affects an industry.

  - **Political:** Includes government policies, regulations, and political stability that could impact the industry.

  - **Economic:** Covers economic factors like inflation, unemployment, exchange rates, and interest rates that influence consumer demand and industry profitability.

  - **Social:** Examines cultural trends, demographics, and consumer behaviors that affect demand patterns.

  - **Technological:** Considers technological innovations that could either drive growth or disrupt the industry.

  - **Environmental:** Looks at environmental regulations and sustainability trends.

  - **Legal:** Includes industry-specific laws and regulatory changes that might impact operations.

- PESTEL analysis is especially helpful for understanding long-term industry dynamics and potential changes that might influence future growth.

3. SWOT Analysis (Strengths, Weaknesses, Opportunities, Threats)

- SWOT analysis assesses an industry's internal and external factors:

  - **Strengths and Weaknesses:** Focus on the industry's internal attributes, like technological capabilities, resource availability, and brand reputation.

  - **Opportunities and Threats:** External factors such as market expansion opportunities, regulatory threats, or economic shifts.

- This method provides a concise overview of where an industry stands in terms of competitive advantage and vulnerability

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4. Industry Lifecycle Analysis

- Industries typically progress through stages: **Introduction, Growth, Maturity,** and **Decline**.

- Understanding where an industry is in its lifecycle can guide investment decisions, as growth and profitability potential vary significantly across stages.

  - **Introduction:** High growth potential but high risk due to unproven market acceptance.

  - **Growth:** Rapid expansion, increasing profitability, and market share.

  - **Maturity:** Slower growth, stabilized profits, and increased competition.

  - **Decline:** Decreasing demand and profitability, often due to technological change or market saturation.

5. Financial Ratio Analysis

- Financial ratios, when applied to industry averages, offer insight into the financial health and profitability of an industry.

    o **Profit Margins:** Compare industry profit margins to understand cost structures and profitability.

    o **Debt Ratios:** Analyze debt levels to gauge financial stability, especially in capital-intensive industries.

    o **Return on Equity (ROE) and Return on Assets (ROA):** Evaluate overall efficiency and return generation.

    o **Price-to-Earnings (P/E) and Price-to-Book (P/B) Ratios:** Provide relative valuation insights, helping investors determine if the industry is overvalued or undervalued.

- Benchmarking these ratios against industry standards can identify performance trends and competitiveness.

6. Competitive Landscape Analysis

- Focus on identifying the key players, their market share, and competitive advantages within the industry.

    - **Market Share Analysis:** Highlights the dominant players and emerging competitors.

    - **Core Competencies and Differentiators:** Identify what sets leading companies apart, such as unique technology, brand loyalty, or cost advantages.

    - **Innovation and R&D Efforts:** Examine companies' commitments to innovation, which often dictate the industry's growth and resilience.

- Understanding these aspects reveals which firms are better positioned within the industry and can provide a competitive edge.

7. Supply Chain Analysis

- Analyzes the full supply chain from raw materials to end consumers to understand how materials, labor costs, and logistics impact the industry.

    - **Upstream Suppliers:** Evaluate key raw material providers and potential risks associated with supply concentration.

    - **Downstream Demand:** Assess customer industries to gauge demand stability.

    - **Operational Risks:** Look for supply chain bottlenecks, pricing power, and geographic dependencies.

- Supply chain analysis is especially critical for industries sensitive to input costs and logistical challenges, such as manufacturing, technology, and consumer goods.

8. Economic Cycle Sensitivity

- Assess how the industry performs during different phases of the economic cycle (expansion, peak, recession, and recovery).

- Industries like consumer discretionary or luxury goods are more cyclical, performing better in expansions and worse in recessions.

- Defensive industries, such as healthcare or utilities, tend to remain stable across cycles.

These methods (in the previous pages), used in combination, can give a comprehensive view of the industry's fundamentals, risks, growth potential, and strategic positioning, helping investors make informed decisions based on industry attractiveness and alignment with broader economic conditions.

V. Analysis of A Company or Stock

VI. Presentation on the Most Promising Industry

1. As a team, prepare to make a presentation on the most promising industry in the world in the five year span.