International Management Studies

Class 7

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Contents

I. Fundamental Approach

1. Top-down Approach
2. Bottom-up Approach

◆ 1. Overview of Each Approach

Aspect	Top-Down Approach	Bottom-Up Approach
Starting Point	Begins with **macro-level analysis**: global economy → region → industry → company.	Begins with **micro-level analysis**: individual companies → industry → economic context.
Focus	Economic trends, political environment, demographic shifts, monetary policy, and global cycles.	Company-specific fundamentals: earnings, management quality, innovation, competitive edge.
Goal	Identify **promising sectors and countries** first, then pick firms within them.	Find **undervalued or strong-performing firms**, regardless of macro conditions.
Used By	Asset allocators, global macro funds, economists, long-term investors.	Equity analysts, stock pickers, active fund managers.
Time Horizon	Often **long-term**; depends on economic and sector cycles.	Can be **short- or medium-term**, depending on company performance.

🔹 2. Top-Down Approach — Global Firm Examples

Example 1: BlackRock Global Allocation Fund

- **Process**: BlackRock's portfolio managers start by assessing **global economic trends** — such as inflation, interest rate expectations, and geopolitical risks.
- **Application**:
    1. If U.S. interest rates are expected to rise, they may **reduce exposure to U.S. bonds**.
    2. If Asia's GDP growth is forecasted to exceed global averages, they may **increase exposure to Asian equities**.
    3. Then they select firms within the chosen region — e.g., Samsung Electronics or TSMC in technology.
- **Result**: Portfolio is aligned with **macro-level conditions** before stock selection.

🔹 3. Bottom-Up Approach — Global Firm Examples

Example 1: Warren Buffett's Berkshire Hathaway

- **Process**: Focuses on individual companies' **intrinsic value** rather than macroeconomic forecasts.
- **Application**:
  - Buffett invests in firms like **Coca-Cola**, **Apple**, and **American Express** based on **earnings consistency**, **brand strength**, and **competitive moat**.
  - He often says, "I don't care if the next interest rate move is up or down."
- **Result**: Investments are based on **company fundamentals** such as management quality, ROE, and cash flow.

🔹 4. Hybrid or Blended Example — Real-World Combination

Example: T. Rowe Price Global Growth Fund

- Uses a "**Top-Down + Bottom-Up" hybrid**:
  1. Starts with **macro views** (which countries or sectors will benefit from growth or policy support).
  2. Then applies **bottom-up screening** for companies with strong fundamentals and earnings potential.
- For instance:
  - In the 2020–2023 period, they favored **semiconductor** and **AI** sectors (macro growth drivers),
  - But selected **NVIDIA**, **ASML**, and **AMD** based on micro-level metrics.

🔹 5. Summary: Key Distinctions

Dimension	Top-Down	Bottom-Up
Primary Driver	Macro conditions	Company fundamentals
Risk Focus	Country, policy, sector	Earnings, management, balance sheet
Example Firms	BlackRock, PIMCO, Vanguard Macro Funds	Berkshire Hathaway, Fidelity Contrafund
Advantage	Aligns with broad economic trends	Finds hidden gems or mispriced stocks
Disadvantage	May miss company-level opportunities	May ignore macro risks like recession or inflation

II. Industry Analysis

1. M. Porter’s five competitive forces


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
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
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

5. Rivalry Among Existing Competitors

Red Ocean vs Blue Ocean

Definition:

The intensity of competition among current firms in the industry.

Key Factors:

- Number of competitors
- Industry growth rate
- Product differentiation
- Fixed costs and exit barriers

Example:

- **Smartphone Market:**
  Intense rivalry between **Apple**, **Samsung**, **Xiaomi**, and **Google** drives innovation but compresses margins.
- **Automobile Market:**
  Fierce global competition among **Toyota**, **Volkswagen**, **Hyundai**, and **GM** in technology, design, and price.

◆ The Five Competitive Forces

1. Threat of New Entrants

Definition:

How easy is it for new firms to enter the industry and compete with existing players?

Key Factors:

- Economies of scale
- Brand loyalty
- Capital requirements
- Access to distribution channels
- Government regulation

2. Bargaining Power of Suppliers

Definition:

The power suppliers have to drive up prices or reduce the quality of inputs.

Key Factors:

- Number of suppliers
- Uniqueness of input
- Cost of switching suppliers
- Supplier concentration vs buyer concentration

Example:

- **Apple and TSMC:**
  TSMC (Taiwan Semiconductor Manufacturing Company) is a dominant chip supplier for Apple's iPhones and Macs. Its **limited competition** and **technological leadership** give it strong bargaining power over Apple.
- **Automobile industry:**
  Suppliers of rare materials (e.g., lithium for EV batteries) hold strong positions over companies like **Tesla** or **Ford**.

3. Bargaining Power of Buyers

Definition:

The power of customers to affect pricing and quality.

Key Factors:

- Buyer concentration
- Price sensitivity
- Product differentiation
- Availability of alternatives

Example:

- **Retail Industry (Walmart):**
  Walmart's huge purchasing scale allows it to **pressure suppliers** (like P&G, Unilever) for lower prices — demonstrating **high buyer power**.
- **Luxury Brands (Louis Vuitton, Rolex):**
  Consumers have **low bargaining power** because products are unique, differentiated, and brand-driven.

4. Threat of Substitute Products or Services

Definition:

The possibility that customers switch to products outside the industry that fulfill the same need.

Key Factors:

- Availability of alternatives
- Relative price-performance
- Switching costs

Example:

- **Beverage Industry:**
  For **Coca-Cola**, substitutes include coffee, tea, energy drinks, and even bottled water. Consumers can easily switch, which keeps Coke's pricing under pressure.
- **Transportation Industry:**
  Airlines face substitution from **high-speed rail** (e.g., China's CRH, Japan's Shinkansen) on short routes.

IV. Company Analysis

1. Relative Valuation
2. Absolute Valuation

♦ 1. Overview

Valuation is the process of estimating what an asset or company is **worth**.

There are two main approaches:

Approach	Main Idea
Absolute Valuation	Determines the *intrinsic value* of a company based on its **fundamentals** — cash flows, growth, and risk.
Relative Valuation	Compares a company's value to that of **similar firms** using market multiples like P/E, P/B, or EV/EBITDA.

2. Absolute Valuation (Intrinsic Value Approach)

Definition:

Absolute valuation estimates a company's *true value* based solely on its own expected performance — **not** on how peers are priced in the market.

Key Models:

1. **Discounted Cash Flow (DCF)**
   - Estimates future cash flows and discounts them back to present value using a required rate of return.
   - Formula:

$$\text{Value} = \sum_{t=1}^{n} \frac{CF_t}{(1+r)^t}$$

2. **Dividend Discount Model (DDM)**
   - Used when firms pay stable dividends (e.g., utilities, consumer staples).
3. **Residual Income Model (RIM)**
   - Focuses on accounting profits in excess of required equity returns.

Example: Apple Inc. (AAPL)

- Suppose analysts forecast Apple's **free cash flow (FCF)** to grow 5% annually and discount it at 8%.
- Using DCF, Apple's *intrinsic value* might be **$210 per share**, while its current market price is $200.
- ⇒ Since intrinsic value > market price → **Apple is undervalued**.

Advantages:

- Based on fundamentals, not market mood.
- Useful for long-term investors.

Limitations:

- Requires many assumptions (growth rate, discount rate).
- Sensitive to small input changes.

🔸 3. Relative Valuation (Comparative or Multiples Approach)

Definition:

Relative valuation compares a firm's value with similar companies using **valuation ratios (multiples)** derived from market prices.

Common Multiples:

Multiple	Formula	Use
P/E Ratio	Price ÷ Earnings per share	Profitability measure
EV/EBITDA	Enterprise Value ÷ EBITDA	Useful for cross-company comparison
P/B Ratio	Price ÷ Book value per share	Asset-based industries
P/S Ratio	Price ÷ Sales	High-growth or early-stage firms

Example: Tesla vs. Toyota

Firm	Price	EPS	P/E Ratio
Tesla	$250	$3.0	83x
Toyota	$180	$9.0	20x

- Tesla's **P/E (83x)** is much higher than Toyota's **20x**, meaning the market prices Tesla as a **high-growth firm** relative to its peers.
- Investors might decide Tesla is **overvalued** compared to industry norms unless future growth justifies it.

Advantages:

- Simple and fast to apply.
- Reflects current market sentiment.
- Useful for comparing across similar companies or industries.

Limitations:

- Relies heavily on market pricing of peers — may mislead during bubbles or downturns.
- Hard to find *truly comparable* firms.

🔹 4. Key Differences at a Glance

Dimension	Absolute Valuation	Relative Valuation
Concept	Intrinsic, company-specific value	Market-based, comparative value
Basis	Firm's fundamentals (cash flows, dividends)	Peer multiples (P/E, EV/EBITDA)
Market Dependency	Independent of market prices	Dependent on peer pricing
Use Case	Long-term, intrinsic analysis	Quick comparison, trading or screening
Example Firm	Apple's DCF valuation	Tesla vs. Toyota P/E comparison
Key Tools	DCF, DDM, RIM	P/E, P/B, EV/EBITDA, P/S
Investor Type	Value investors	Relative or momentum traders

V. Financial Statements

1. Relative Valuation
2. Absolute Valuation

📘 1. The Four Primary Financial Statements

1. Income Statement (Profit and Loss Statement)

Purpose:
Shows the company's **revenues, expenses, and profit** over a specific period (e.g., quarterly or annually).

Key Components:

- Revenue (Sales)
- Cost of Goods Sold (COGS)
- Gross Profit
- Operating Expenses (SG&A, R&D)
- Operating Income (EBIT)
- Interest and Taxes
- Net Income (Profit)

Example:

- **Apple Inc. (FY2024)**
  - Revenue: $383 billion
  - Net Income: $97 billion

👉 *Tells how much money the company earned or lost.*

2. Balance Sheet (Statement of Financial Position)

Purpose:

Shows what the company **owns (assets)**, **owes (liabilities)**, and **its equity** at a specific point in time.

Basic Formula:

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

Key Components:

- **Assets:** Cash, Accounts Receivable, Inventory, Equipment
- **Liabilities:** Accounts Payable, Debt, Accrued Expenses
- **Equity:** Common Stock, Retained Earnings, Reserves

Example:

- **Samsung Electronics (2024)**
    - Assets: ₩460 trillion
    - Liabilities: ₩160 trillion
    - Equity: ₩300 trillion

👉 *Shows the firm's financial strength and solvency.*

3. Cash Flow Statement

Purpose:

Shows the **cash inflows and outflows** from operations, investing, and financing activities.

Three Sections:

1. **Operating Activities:** Cash from core business (e.g., collections from customers, payments to suppliers).
2. **Investing Activities:** Buying or selling assets (e.g., machinery, securities).
3. **Financing Activities:** Borrowing, issuing stock, paying dividends.

Example:

- **Tesla (2024)**
  - Cash from Operations: +$13 billion
  - Cash from Investing: −$9 billion
  - Cash from Financing: −$2 billion
  - Net Change in Cash: +$2 billion

👉 *Shows how well the company generates and uses cash.*

4. Statement of Changes in Equity (Retained Earnings Statement)

Purpose:

Explains **changes in owners' equity** over a reporting period.

Key Components:

- Beginning Equity
- Add: Net Income
- Less: Dividends Paid
- Add/Subtract: Other Comprehensive Income (e.g., FX gains, revaluation)

Example:

- **Coca-Cola (2024)**
  - Beginning Equity: $25 billion
  - - Net Income: $10 billion
  - – Dividends: $8 billion
  - Ending Equity: $27 billion

👉 *Shows how profits are retained or distributed.*

📘 3. Summary Table

Statement	Purpose	Focus	Example
Income Statement	Shows profitability	Performance over a period	Net Income = $97B (Apple)
Balance Sheet	Shows financial position	At a specific date	Assets = Liabilities + Equity
Cash Flow Statement	Tracks cash inflows/outflows	Cash movement	Tesla: +$2B cash change
Equity Statement	Shows changes in ownership equity	Changes in capital & retained earnings	Coca-Cola: +$2B net increase

📗 2. Supporting or Supplementary Statements

- **Notes to the Financial Statements** – detailed explanations, accounting policies, and assumptions.
- **Comprehensive Income Statement** – includes unrealized gains/losses (e.g., on securities, FX).
- **Segment Reporting** – financial results by division, geography, or product.