**Fundamental Analysis**

Fundamental analysis typically refers to a method of analyzing and evaluating equities, though it may also apply to any kind of security. A whole slew of data including, but not limited to, financial statements, economics, health, management, interest rates, production, earnings, competitive advantages, competitors and many other qualitative and quantitative factors are considered. What is the company’s revenue? Is it growing? Are they even making a profit? Are they in or paying off debt? What are their turnover rates? Does management take care of employees? All of this to determine a numerical intrinsic value for the security that can be compared with its current price so as to determine whether or not it is overvalued or undervalued. Fundamental Analysis is often (mistakenly) directly contrasted with Technical Analysis.

Fundamental data: Beta

Price to Earnings

This measure is very popular. It consists of finding a company whose price-earnings (P/E) ratio is low compared to others of its kind. To find the price-earnings ratio, divide the stock's current price by its earnings per share.



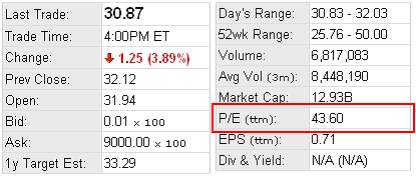
If a stock is selling for $35 now and its earnings last year were $7 a share, the P/E ratio would be 5 (35/7=5). That means for every $1 the stock earns, investors are currently willing to pay $5. However, investors also pay for future earnings. If the same $35 stock is expected to earn $9 a share next year, then the P/E ratio would be 3.89 ($35/$9 = 3.89). The idea is to find stocks with a significantly lower P/E ratio than others in its category. That category could be almost anything, from an industry group (i.e.; financial stocks) to high-yield securities, or many others.

The following video shows the difference between PE vs PEG:

PE vs PEG

**In the following Screens, ABC's P/E Ratio is 43.60 whereas XYZ's P/E Ratio is much lower.**

**ABC**



**XYZ**

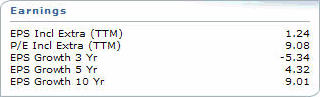


The P/E ratio has some flaws. If the company has losses or breaks even, then there are no earnings to compute. Also, companies in a cyclical industry, or which have a small capitalization, are likely to be less stable which cause their values to fluctuate too much from day to day, week to week or month to month, for P/E values to be a reliable measures. Highly volatile equities, such as Internet stocks, are a breed apart. Most of them lose money, so it is impossible to compute a P/E ratio. Yet popular expectations are so high that they have sold for prices way above the market anyway.

Earnings Per Share

Earnings per Share (EPS) is calculated by dividing net income by the weighted average common shares outstanding. It is used in fundamental analysis for valuation purposes. This calculation works well when looking at the past, but if an analyst wants to look at the future, they need to calculate EPS based on the expected outstanding shares in the future.

Many times financial statements will present two types of EPS calculations. One for primary earnings and the other for fully diluted earnings. Fully diluted EPS includes all common-stock equivalents, such as warrants and options, and assumes full exercise and conversion. This calculation provides the maximum dilution. When comparing EPS between companies and within sectors, be sure to use the same EPS calculation, otherwise you will be making comparisons between apples and oranges. The same is true when calculating the Price/Earnings Ratio (P/E). The P/E includes an EPS number in its calculation. The P/E is one of the most widely used valuation tools for the price of a stock. Therefore, when doing your own analysis, make sure you are using the same EPS numbers for each company in your P/E calculations.



Cashflow

Cashflow is an important measure of a business for investors because it is a way of determining a company's ability to pay dividends and more. Generally, cashflow is defined as the net income (the difference between how much the company sold and how much it spent during a particular time frame, typically one quarter) of a business, plus depreciation (an accounting method which spreads out the cost of a fixed asset over several years) plus the value of other non-cash assets such as intangible assets, including copyright patents, trademarks, licenses, goodwill and franchises.

Companies, like people, need cash to keep going. Corporations need money to pay dividends, of course. But they also need it to pay for all the goods and services they use, as well as making capital improvements (things you can touch or feel, like buildings, machinery and computers), and paying operating costs (wages, raw materials, gas for company cars, and electricity).

Companies with a high level of debt have to pay a significant amount in interest to service that debt. If an opportunity suddenly appears, perhaps to buy a strategically located piece of land or a company that would help the company in some way, cash-poor companies may not have the money to make the deal. Most important, perhaps, is that during “hard times”, the fortunes of a company with a cash cushion are likely to have a higher probability of making it through. Companies, which have cash to make it through the down periods, are in a good position to make clear-headed judgments and keep their enterprise afloat.

One proponent of Cashflow Analysis is Robert L. Renck, Jr., managing director of R.L. Renck & Co., who uses a surplus cashflow analysis. That approach adds together pretax income (how much money the company takes in before it starts paying taxes) and depreciation. Then it subtracts capital expenditures, which is the money companies spend to buy or improve capital assets, which again are those things you can lay your hands on such as computers, machinery or buildings.

Kenneth Hackel, founder of Systematic Financial Management, New Jersey, scours stocks for companies that can pay off their entire debt entirely from free cashflow. That figure is arrived at by taking, for the current year, the amount of cash left over after taxes, then adding the sum of all the fixed assets - the company's property used in running the business but which won't be sold off, such as furniture, machinery, computers - which have depreciated for that year, plus other non-cash expenses such as amortization and depreciation. Then subtract all capital expenditures and any increase in working capital, which is the money left over, by subtracting the liabilities from the assets.