Techniques in Value Investing

Ralph Birt
Charles R. Blyth Fund
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Book Value
A company's book value is its total assets minus intangible assets and liabilities, such as debt. A company's book value might be more or less than its market value,

Companies that are trading less than or at there book value are considered to be undervalued. In today's market conditions, trading at 3-4x book value is usually a pretty fair valuation. The only problem is that many investors believe that this is too conservative a measure of the company's assets

Example: PSINet (Nasdaq: PSIX)

Market Price: $2.63 Book value/ share: $9.05 Price/Book Ratio: 0.29

- By our criteria, this stock would be considered undervalued
- With such a low price/book ratio, there is **probably** little downside risk with this stock

Debt/ Equity Ratio
This is an indicator of financial leverage. It is calculated by dividing long-term debt (such as bonds) by common stockholder equity. Stockholder equity is the claim that shareholders have against the firms assets and is calculated by subtracting total liabilities from total assets (TA- TL).

Generally value investors look for a debt/equity ratio of around 0.5, showing that the firm is not heavily leveraged, but different industries required different amounts of debt. Too much long term debt can slow a company's growth.

Example : **Teradyne, Inc. (NYSE:TER)**

Debt/Equity ratio = $8,948,000 / $1,153,032,000 = 0.01 < 0.50 → good value, reasonable leverage

Current Ratio
This is a measure of the liquidity of a company. It tells of the firm's ability to pay of short term debts. A higher current ratio means that the firm has a higher degree of liquidity. This information can be found on a firms balance sheet

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current Liabilities}}$$

Example : **Teradyne, Inc. (NYSE:TER)**

Current Ratio = $1,280,750 / $518,619 = 2.46,

- Value investors tend to look for a current ratio of at least 2
- Therefore, according to this criteria, TER has a good degree of liquidity

Net Current Asset Value

NCAV (working capital) = current assets (cash, accounts receivable, inventory) – current liabilities

NCAV / # of shares outstanding = NCAV / share

- Firms that are trading at are below their NCAV are consider to be extremely undervalued
- For practical purposes, it is very difficult to find a company to meet this criteria, so a low multiple may suffice