

DRAFT

Darden Capital Management Research Fundamentals

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Research Fundamentals – Overview

- ◆ Idea generation
- ◆ Company research
- ◆ Industry analysis
- ◆ Investment thesis
- ◆ Valuation
- ◆ Other considerations
- ◆ The pitch

- ◆ Appendix – Resources

Idea Generation – Sources

- ◆ Companies in the news
 - WSJ, Bloomberg, Barron's, Forbes, etc
- ◆ Investment-specific websites
 - Seeking Alpha, Stock Guru, Magic Formula, etc
- ◆ Previous employers and / or clients
- ◆ DCM's stock "Watch list"

**Transform an idea into an investment opportunity
through good research.**

Company Research – Public Info

- ◆ Review the following
 - Public Filings – most recent 10-K, 10-Q, and annual report (www.sec.gov or Investor Relations)
 - Transcripts from earnings releases (Investext)
 - Recent press releases (Investor Relations)
- ◆ Compare actual versus expected performance
- ◆ Conduct a SWOT Analysis on the business

**Identify a company's strategy, key business drivers,
and value proposition.**

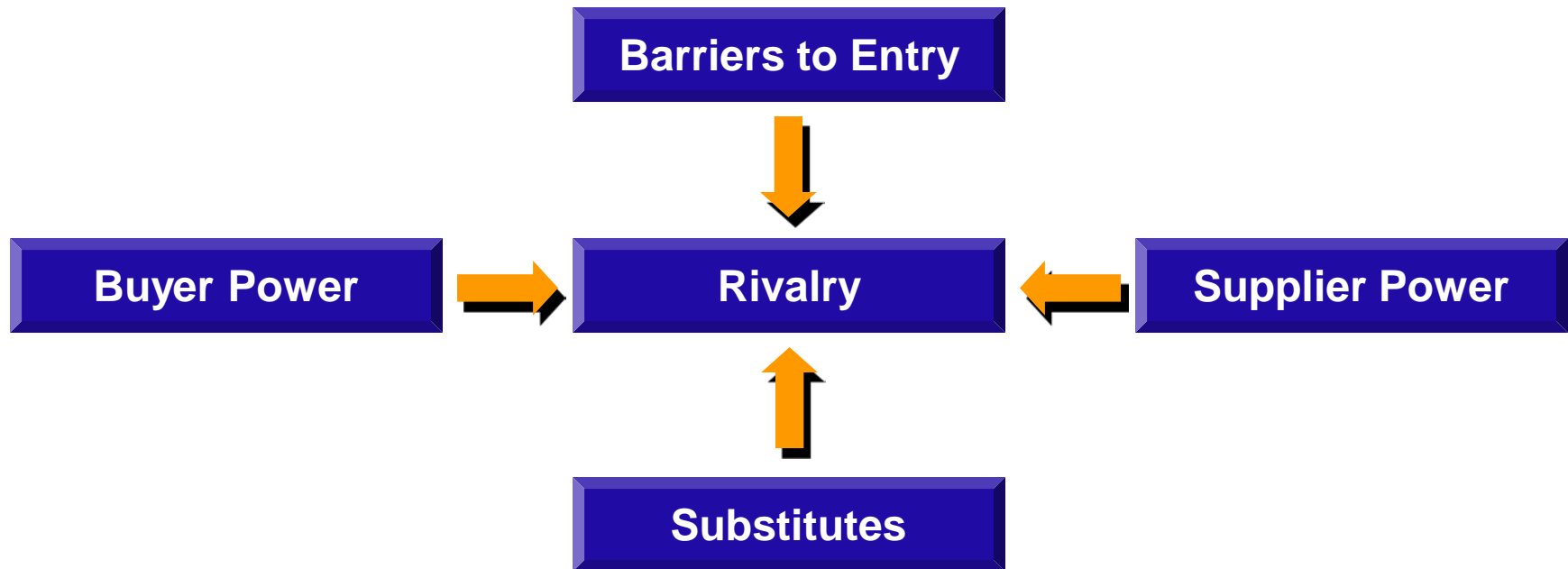
Company Research – Sell-Side View

- ◆ Use sell-side Analyst reports (Investext) for the following:
 - Business / industry overview
 - Competitive analysis
 - Earnings summaries
- ◆ Identify similarities and differences in opinion, especially between the most bullish and bearish analysts

**Understand the consensus view but think critically
to develop your own opinion.**

Industry Analysis – the Basics

- ◆ Examine major industry trends, both past and expected future
- ◆ Identify key competitors
- ◆ Conduct a Porter’s Five Forces Analysis on industry



Industry Analysis – Comparables

- ◆ Evaluate competitive position vis-à-vis relevant comparable companies (“comps”)
- ◆ Identify “best in breed”
- ◆ Compare operating and financial metrics versus comps
 - Sales / earnings growth
 - Profitability (gross margin, EBITDA margin)
 - ROE, ROIC, ROA
 - Free Cash Flow (and how it’s used by the companies)
 - Relevant valuation multiples (P/E, EV/EBITDA, PEG, etc)

Investment Thesis

- ◆ Develop an investment thesis
- ◆ Test and re-test assumptions throughout research process
- ◆ Evaluate the key risks to your thesis and identify any risk mitigation or hedging techniques (e.g., pair trades, options, etc)
- ◆ Quantify the results of your research

Valuation – Multiples

- ◆ Market multiple approach – measure of relative value
 - Apply trailing and forward multiples to relevant firm-specific operating statistics (e.g., P/E, EV/EBITDA, PEG)
 - Use comparable companies to identify disparities between market pricing and value (justify discounts and premiums)
- ◆ Precedent transaction multiples
 - Similar concept as market multiple approach
 - Remember that these multiples typically include premiums (i.e., for synergies, control, etc), which may not apply to standalone valuations

Valuation – Discounted Cash Flow

- ◆ Discounted Cash Flow – the value of the firm is the present value of all future cash flows
 - Cash Flows – estimate Free Cash Flows (FCF) over the planning period (i.e., until the firm reaches a point that it no longer improves margins and asset utilization)
 - Terminal Value – at the end of the planning period, the value of all future FCF
 - Perpetuity growth approach
 - Terminal multiple approach
 - Discount Rate – discount all future FCF at the appropriate rate to account for specific business and financial risks
- ◆ Sensitize your model for a range of operating scenarios

Valuation – Set a Target Price

- ◆ Use the various Valuation methodologies to arrive at your best estimate of the firm's equity value
- ◆ Explain disparities between your view and the market's view
- ◆ Identify a catalyst that will unlock value
- ◆ Make an investment recommendation (Buy, Hold, Sell) with a Target Price

Other Considerations

- ◆ Insider transactions
- ◆ Institutional holders
- ◆ Short interest
- ◆ Regulatory issues

The Pitch

- ◆ Use the common DCM research template to organize your thoughts
- ◆ Synthesize qualitative and quantitative research – the two are necessarily intertwined
- ◆ Discuss both investment merits and key risks
- ◆ Consider events / scenarios that would change your investment thesis
- ◆ Anticipate questions and concerns of DCM Portfolio Managers

Appendix – Resources

- ◆ Darden Library
 - Website with links to the following
 - Investext: sell-side research, earnings transcripts
 - Hoover’s Online: company information
 - Factiva: news search
 - S&P Industry Surveys (hard copies)
 - Value Line Investment Surveys (hard copies)
- ◆ Bloomberg Terminal
- ◆ Second Year Students