Understanding Equities

Presented by
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Analyst certification and required disclosures can be found at the end of document
What is a stock

• Represents an ownership share in a corporation
• Stocks are traded on exchanges all over the world—the largest is the New York Stock Exchange
• Stocks are identified by their ticker symbols. Apple Computer’s ticker symbol is AAPL
• Common Stock:
  – Holders elect board of directors and vote on corporate policy
  – A company may or may not pay dividends on common stock
  – In a bankruptcy or liquidation, common stockholders are the last to share in the company’s remaining assets
• Preferred Stock:
  – Generally receives a fixed level of dividends
  – Senior to Common Stock regarding asset claims
  – Generally does NOT vote on corporate matters
Why do people buy stocks?

2011 year-end Value of $1,000 Invested in Stocks & Bonds in 1959

Source: Bloomberg
We do not recommend buying stock in this!
Why do companies issue stock?

Needs money to grow

What a single unit could become with investor money and a good business plan
How companies access investment capital

- Borrow $$$ From a Bank–Debt
- Friends & Family–Equity (aka Stock)
- Social Media Executive
- Venture Capital/Private Investors–Equity (aka Stock)
We DO NOT recommend this approach for raising money
How do stocks trade once a company becomes a public company?

Most stocks are traded on exchanges, which are places where buyers and sellers meet and decide on a price.

Some exchanges are physical locations where transactions are carried out on a trading floor, such as the New York Stock Exchange (NYSE).

Other exchanges are virtual, composed of a network of computers where trades are made electronically which are called over-the-counter markets. NASDAQ is among the most popular of these over-the-counter markets.
Why do stock prices change?

• Supply & Demand

• Corporate Earnings

• Good/Bad News Flow

• Investor Sentiment

• World Events

• Some Reasons Completely Defy Logic—“Buy The Rumor & Sell The News”
What does “The Market is Up” or “The Market is Down” mean?

What is an index?

• **Dow Jones Industrial Average (DJIA)**
  – it is a basket of 30 leading publicly-traded companies that trade on the New York Stock Exchange
  – includes companies such as General Electric, Walt Disney, Exxon Mobil and Microsoft

• **Standard & Poor’s 500 (S&P 500)**
  – The S&P 500 is a basket 500 publicly-traded companies chosen for
  – Generally considered a better representation of the U.S. stock market
  – Apple Computer is largest company in the S&P 500 by market value

• **Nasdaq Composite**
  – The NASDAQ is a basket of more than 3,000 publicly-traded companies
What is with all the wild animal talk on Wall Street

Bulls believe the market is going up and buy stocks ‘long’. They make $$ when the market goes up.

Bears believe the market is going down and sell stocks ‘short’. They make $$ when the market goes down.
The oldest adage on Wall Street

- Bulls Make Money
- Bears Make Money
- Pigs Get Slaughtered
There many ways to invest in stocks, including

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<td>• Buy individual companies such as Apple, IBM, Pepsi</td>
<td>• A professionally collection (or portfolio) of stocks. An example is the Fidelity Magellan Fund</td>
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<td>• Self-directed purchasers or professional broker—i.e. UBS</td>
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How Do We Value Stocks?
How are stocks valued? There a number of valuation techniques including

- Return on Invested Capital (ROIC)
- Price/Earnings Ratio (P/E)
- Discounted Cash Flow
- Price/Book Value Ratio (P/B)
Valuing stocks—some words to live by

- Price & Value are two very different concepts
- A low stock price does not necessarily imply a cheap stock
- Valuation should be considered on a stand-alone basis as well as compared to a company’s peers
- A stock should not be considered cheap just because its price declined
- A low P/E ratio does not necessarily imply a cheap stock
Buying what you know is not a guaranteed strategy

Well Priced Business Networking IPO

Valuation matters!!!!!

Poorly Priced Social Networking IPO
Appendix

Supplemental Section
More Detailed Description of Previous Sections
Appendix: What is a stock?

- A stock is an ownership share in a corporation. Each of these shares denotes a partial ownership of a company by a shareholder (also known as a stockholder). Stocks are traded on exchanges all over the world, the largest of which is the New York Stock Exchanges (NYSE). Stocks are identified by their ticker symbol. For example, Apple computer is identified as AAPL.

- **Common Stock**—Common stock represents ownership in a corporation. Common stockholders exercise control by electing the board of directors and voting on corporate policy. However, in the event of a bankruptcy or liquidation, common stockholders will not receive their money until all creditors and preferred stockholders have received their share of the company’s remaining assets.

- **Preferred Stock**—Preferred stock is a class of ownership of a company that has a higher claim on the assets and earnings of the company than common stock. Preferred stock generally pay a fixed level of dividends that take priority to common stock dividends. However, preferred stockholders generally do not have voting rights.
Appendix: Why do stock prices change?

- At the most fundamental level, supply and demand for a stock determines its price movements.
- A company’s earnings are a major factor impacting the demand level for a particular stock. A company with improving earnings is likely to attract more demand than those with poor earnings growth.
- Deciphering whether a given news item is positive or negative for a company can also influence the demand for shares, and hence the stock price.
- There are many other factors that can influence stock prices including investor sentiment (remember the tech bubble), economic factors, government action and international incidents (Japanese Tsunami, potential Greek defaults, terrorism).
- In short there are times that stock price movements will seem very logical and some times they will completely defy logic.
Appendix: What does “The Market is Up” or “The Market is Down” mean?

What is an index?

- **Dow Jones Industrial Average (DJIA)**
  - The DJIA is the oldest and single most watched stock index in the world. It is a basket of 30 leading publicly-traded companies that trade on the New York Stock Exchange. The DJIA includes companies such as General Electric, Walt Disney, Exxon Mobil and Microsoft.

- **Standard & Poor’s 500 (S&P 500)**
  - The S&P 500 is a basket of 500 publicly-traded companies chosen for, among other things, their market size, liquidity, industry grouping and economic significance. Given its size and diversity of companies, the S&P 500 is generally considered a better representation of the U.S. stock market. Apple Computer is largest company in the S&P 500 by market value.

- **Nasdaq Composite**
  - The NASDAQ is a basket of more than 3,000 publicly-traded companies listed on the NASDAQ stock exchange.
### Appendix: There many ways to invest in stocks, including

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<td>- A mutual fund is a collection (or portfolio) of stocks that is professionally managed by firms such as Fidelity and Franklin Templeton. An example is the Fidelity Magellan Fund</td>
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<td>- This can be done by you via a self-directed account or through a professional brokerage firm such as UBS</td>
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- **Return on Invested Capital (ROIC)**—How much profit is earned for each dollar of capital invested in the business. Net Operating Profit After Tax/Average Invested Capital

- **Price/Earnings Ratio (P/E)**—A company’s after-tax earnings are divided by the # of shares outstanding—$1,000,000/1,000,000 shares = $1/share in earnings per share (EPS). The current stock price is then divided by the EPS to calculate the P/E ratio–current stock price = $15. The P/E ratio is $15/$1 or 15x. A P/E ratio is usually compared to its projected earnings growth rate to get a sense on how the market is valuing the projected EPS growth. If the projected EPS growth is 15% and the P/E is 15x, the stock is trading at 1x its projected growth rate (this is called a PEG ratio)

- **Discounted Cash Flow**—The projected future free cash flows of the company are discounted back to their current value based on a rate that reflects the perceived level of risk for a particular company, industry and economic environment, among other things

- **Price/Book Value Ratio (P/B)**—If you take the total assets of a company and subtract their outstanding debt and other liabilities you are left with their Net Assets of Book Value. This figure is divided by the # of shares outstanding to get the Book Value Per Share (BVPS). The current stock price is then divided by the BVPS to calculate the Price/Book Ratio. Net Assets = $10,000,000 divided by 1,000,000 shares = BVPS of $10. Stock price of $15/$10 (BVPS) = a P/B ratio of 1.5x
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