

Relative Value

Relative Value is an important concept for the serious stock analyst. It tells whether based on historical prices **and earnings**, a stock is priced too high, just about right or is selling at a discount.

[Remember that price by itself is not a reliable indicator. Since, over the long-term, **earnings drive the price of the stock**, we must look at historical earnings data as well as historical stock prices.]

An RV of 100% indicates that the stock is fairly valued. If the RV is 130%, the stock is selling at 1.3 times its fair value [said to be selling at a “premium” of 30%.] An RV of 80%, means that it is selling a discount of 20%.

In theory, with RVs [like price-to-earnings ratios — PEs], the lower, the better. However, the saying “If it looks too good to be true, then it is just that—too good to be true, “ certainly applies here.

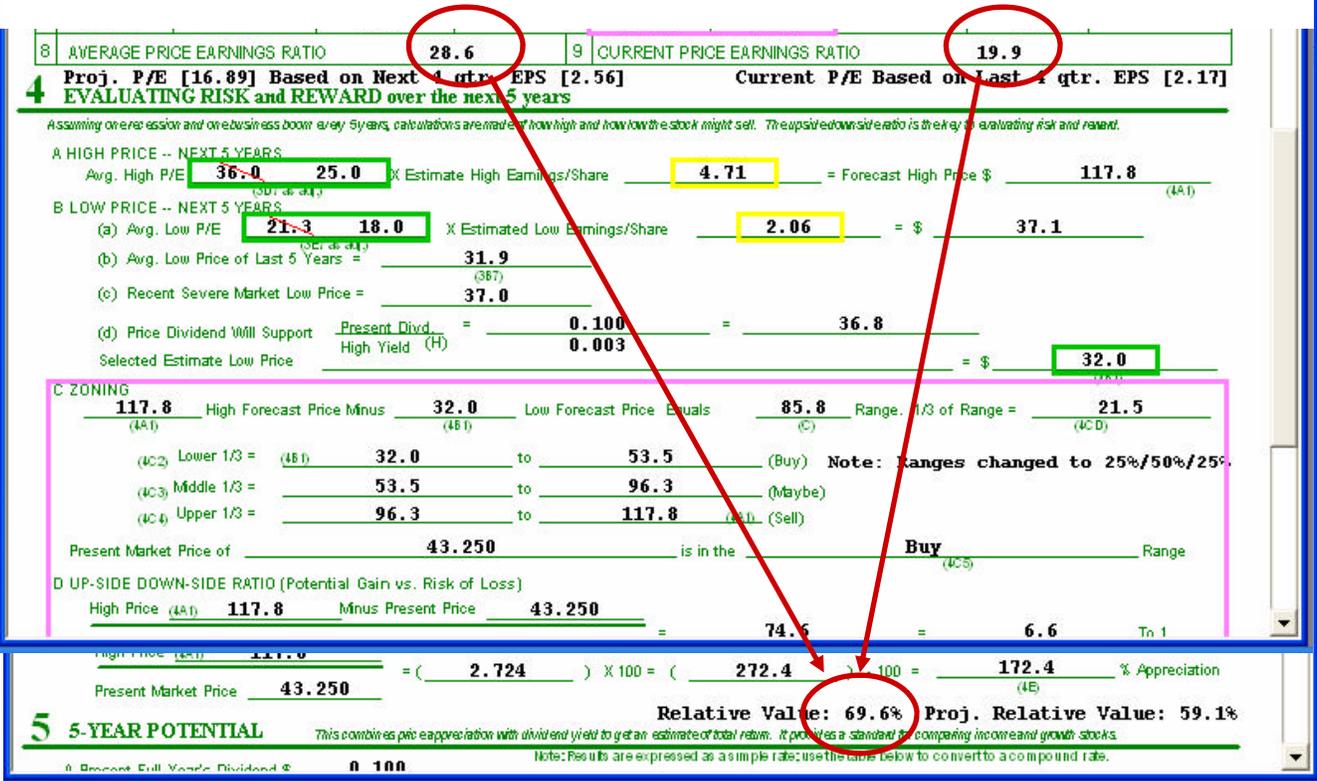
When RVs get below about 75%, scrutinize the company’s fundamentals carefully. These fundamentals include profit margins, return on equity, cash flows, consistency of EPS and sales, sales and EPS growth rates, etc. About 90% of the time, you will find that the market has rightly punished the stock’s price, because of problems with the fundamentals listed above.

About 10% of the time, you will find that the fundamentals are sound and that the market has unfairly punished the stock price. However, make sure you think the fundamentals will remain strong before contemplating a purchase.

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In fact, re-accomplishing the SSG is in order before purchasing this “battered-down” company.

The SSG graphic below show where Toolkit gets the data to compute the RV.



From SSG, Part 3, row 9, find current PE 19.9

From SSG, Part 3, row 8, find historical PE 28.6

Divide top figure by bottom figure = .696 = 69.6% = RV

In theory, the lower the figure, the better, but beware of low RVs, since, like very low PEs, it could signal something wrong in the company. **Look for 80% - 120%.**