

“The average long-term experience in investing is never surprising, but the short-term experience is always surprising. We now know better than to focus not on rate of return, but on the informed management of risk.” - Charles Ellis

NSE at a glance
(For week ended November 10th)

Index:	36,325.86	-13.27%
Cap:	N7.97trn	-13.37%
Volume:	1.09 billion	+10.43%
Value:	N7.19bn	-14.8%



Analysing Offer Prospectus for effective investing 5

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Profit and Loss Statement: This is the financial statement that summarizes the income, costs and expenses incurred during a specific period - usually a fiscal quarter or year. These records provide information that shows the ability of a company to generate profit by increasing revenue and reducing costs. The P&L statement is also known as a "statement of profit and loss", an "income statement" or an "income and expense statement".

The statement of profit and loss follows a general format that begins with an entry for revenue and subtracts from revenue the costs of running the business, including cost of goods sold, operating expenses, tax expense and interest expense. The bottom line (literally and figuratively) is net income (profit).

Calculating a company's profit margin is a great way to gain insight into these and other aspects of how well a company generates and retains money.

Take note that the important data to refer to is "profit after taxation but before extraordinary items." The profits derived after taking into account extraordinary items can sometimes be misleading as they can disguise a bad year. For example, the company may have disposed of assets like land, buildings or shares to realise an extraordinary gain in order to boost a low profit year performance.

Many of the profitability ratios such as return on equity (ROE), return on assets (ROA) have already been discussed as part of balance sheet ratios. Listed below are more ratios particularly relating to returns on company shares.

1. Earnings per share (EPS)

EPS serves as an indicator of a company's profitability. It is derived by dividing the Profit after tax (PAT) by the total number of shares outstanding of a Company.

$$EPS = \frac{\text{Profit after tax}}{\text{No. of company's issued shares}}$$

2. P/E Ratio

The price-earnings ratio is one of the most popular fundamental factors used by investors to determine the attractiveness of an asset's current value and whether the current price level makes for a good buying opportunity. It is derived by dividing the prevailing market price of equity by the earnings per share (EPS).

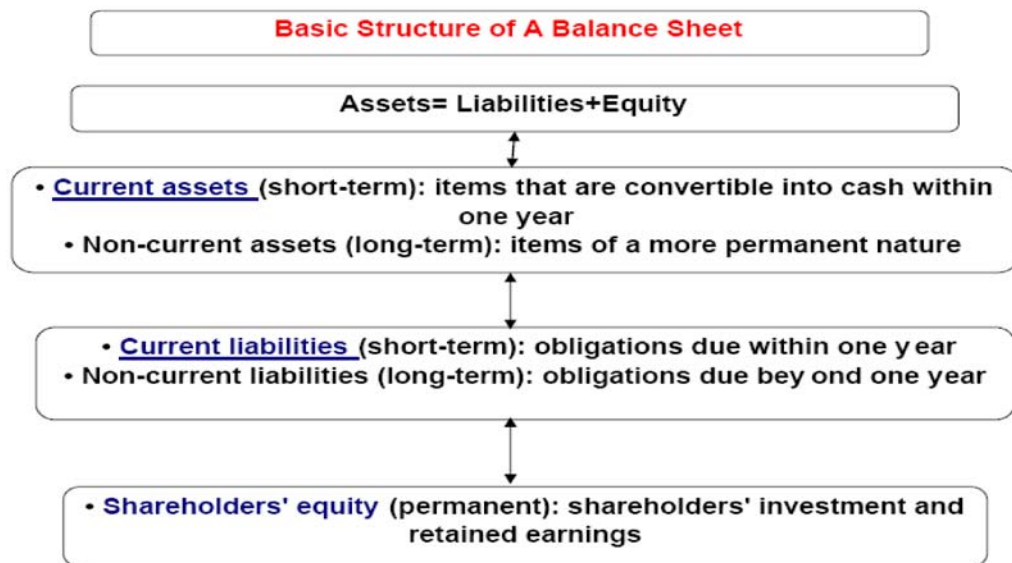
$$P/E \text{ Ratio} = \frac{\text{Market Price per Share}}{\text{Earnings per Share (EPS)}}$$

If a company is currently trading at N50 a share and earnings over the last 12 months were N2.0 per share, the P/E ratio for the stock would be 25.0. This is considered to be very high.

Alternatively, if another company whose share price is N20 has an EPS of N2.0, then the P/E ratio is 10. This can be considered more acceptable for investors. However, stocks having P/E ratios below 10 present better 'buy' options since it means it would take investors less number of years to recoup their investment.

A Company with good and stable financial and dividend payment track record could have a high price-earning ratio while a poorly performing Company would likely record a low price-earning ratio.

A low P/E ratio could be a sign that the given asset is undervalued and a potentially good investment at current levels. Conversely, a relatively high P/E value is used to suggest that investors will need to pay a high amount for the company's earnings, which can then be used to suggest that the asset is relatively expensive



and that it may be a good idea to wait for a better entry.

3. Dividend Yield

Dividend is the part of earnings (if declared) that is paid to the shareholders as their share of the profit of the Company for period. Dividend is not compulsory to be paid. The entire profit after tax can be ploughed back for the growth of the Company.

Dividend Yield (DY) is the ratio of dividend per share to the market price of an equity. It is however, usually expressed in percentage. For instance, if Company A paid a Dividend of N2.00 per share and market price of the share of the



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Company is N10.00, then the Dividend Yield is calculated thus:

$$DY = \frac{\text{Dividend per share}}{\text{Market Price of the share}} \times 100$$

$$= \frac{2}{10} \times 100 = 20\%$$

The usefulness of this is that it enables one to compare with interest rate on Savings and Deposits in the bank. A high dividend yield will attract investment into the stock market.

Financial Forecast

Future financial information usually covers forecasts on the following:

- Turnover;
- Pre-tax profit before minority interest;
- Pre-tax profit after minority interest;
- Profit after tax; and

- Gross and net dividend rates/amount.

The PO company will usually supply bases/assumptions or justifications for the forecast figures. Examine this closely to determine if the forecast is reasonable or merely a daydream. In addition, always bear in mind that forecasts are not prophecies of how well the company would be performing in the future. So, do not get too carried away by optimism.

From the forecast profit, and the offer price of the shares of the IPO company, you would be able to compute the prospective price-earnings multiple of the IPO company. The

INVESTORS' EDUCATION

Taking action on declining stocks

Every stock market investor has been confronted with the dilemma of making decisions about stocks that have declined in value. These decisions are tough because they are composed of several problems.

The first problem is forcing you to make a decision at all.

In addition, when deciding whether to sell a declining stock, you may be confronted with conflicting advice. Some will advise you to "average down" by buying more shares. Others will suggest you should never let a loss become a large loss, so always sell if the stock has declined some predetermined amount.

Irrespective of what dilemma you find yourself, the age-old common sense of buying low and selling high should remain applicable. Although it is the most elementary principle of trading, yet few stock investors follow it consistently. On the contrary people do exactly the opposite and suffer losses. Most investors jump on to buying a stock as its price is shooting up. As it happens in most cases, the price falls the moment they buy and continues to fall further to their great bewilderment till they lose their heart and sell out the rest of the stock presumably to prevent further losses. Therefore the secret of making profits is determined 100% by the time of your entry into the stock market. Buy a good stock when its price is low and wait patiently for it to rise.

An intelligent investor must understand that every 'fall hath a rise' and its opposite

price earnings multiple, together with a qualitative analysis of the PO company, can be used to assess whether or not the issue/offer of the shares of the IPO company is comparable to the share prices of already listed companies of similar business or nature.

You should also look out for a segment analysis of turnover and profits by subsidiary/associated companies, products/services and markets/geographical locations for both the historical and forecast financial information.

Shareholders, Directors and Management - Who are the people running the show?

The prospectus should provide adequate information on the following groups:

Substantial shareholders and promoters of the IPO Company, including the names and shareholdings of individuals behind the IPO Company;

Board of directors including their representation and details of each director's qualification, experience and area of responsibility, and whether they are executive or non-executive directors; and

Key management staff below the level of directors, detailing their qualification, experience, and areas of responsibility

Go through the list of shareholders, directors and management to enable you get an idea of the level of their management expertise and experience.

... To be continued next week