

## **Value Investing**

Today's world is full of frenzied money making opportunists. The call for quick cash is never answered soon enough especially in an equity market that has gone through a correction and is not experiencing the colossal boom of years gone before. Value investors, however, are not singing the same sad song. They are not as concerned with the present state of the market or the economy. A value investor concerns himself with companies that are thought to be undervalued. He looks for companies that are capable of generating sustainable earnings.

The concept of value investing, though pioneered by Benjamin Graham, was brought to the forefront by William Buffet. Buffet has experienced tremendous success in this field and so, is held in high regard among value investors. A US\$10,000 investment in his famed Berkshire Hathaway in 1965 is now worth nearly US\$30 million in comparison to a US\$10,000 investment in the S&P 500 which is now worth only about US\$500,000.

Clearly, one of the most noteworthy observations in the example given is the time horizon in which the appreciation was achieved. The mission of value investing is not to provide overnight success...But in fact, long term success. This is why current market conditions are of little concern.

Warren Buffet's value investing method involves looking at the performance of the company by using various ratios in order to determine if the company is worth the investment. One analyzes the company's ratios such as its return on equity, debt/equity ratio and profit margin. Buffet typically considers only companies that have been around for at least 10 years and those that do not rely solely on a commodity.

In my analysis, I have chosen four companies, each of which I think qualify under the value investing method as having value and the ability to sustain and amplify this worth in the long term. The four companies are Neal & Massy (NML), Republic Bank Limited (RBL), RBTT Financial Holdings Limited (RBTT) and Guardian Holdings Limited (GHL). Though under individual ratio analysis, one company may not look favourable, the companies were considered under a holistic approach.

As can be seen from Table 1, the EPS of these companies has been steadily increasing over last five years. This is an indication that the companies have been consistently increasing their profits as the EPS is a measure of a company's overall profit per share and so suggests the likeliness to sustain this in the future. Though GHL's EPS was significantly higher in 2003, \$4.03 of this portion was due to a non recurrent item resulting from a gain on sale of RBTT shares and a mark to market adjustment on the residual investment in RBTT. All subsequent ratios and analyses of GHL are done without this non-recurrent item in order to demonstrate the Company's value. In addition, because GHL's year end is 31<sup>st</sup> December, the five year period analyzed was 2000 to 2004 instead of 2001 to 2005.

**Table 1**

Earnings per Share					
Year	NML	RBL	RBTT	GHL	
2000	-	-	-	1.09	
2001	1.51	2.60	1.20	1.35	
2002	1.85	2.79	1.42	1.14	
2003	1.90	3.67	1.69	6.25	
2004	2.43	4.16	2.35	3.00	
2005	2.80	5.09	2.68	-	

In examining, the Return On Equity (ROE), one would also find, on average a steady ROE which is a measure of a stockholder's return on his investment. This ratio reveals the rate at which shareholders are earning interest on their shares. Hence, a good return on equity would indicate the company's ability to sustain their profits while being able to reward the shareholders.

As is shown in Table 2, RBTT and NML have a fairly stable ROE while RBL's have been slowly increasing since 2002. GHL on the other hand does not look so favourable under this ratio as their return on equity declined steadily from 2000 to 2003.

**Table 2**

Return on Equity %					
Year	NML	RBL	RBTT	GHL	
2000	-	-	-	22.04	
2001	15.46	19.08	22.75	18.89	
2002	18.08	15.00	22.25	16.63	
2003	16.95	17.66	22.47	14.98	
2004	18.84	17.91	25.85	18.52	
2005	18.73	19.61	22.04	-	

The debt to equity ratio for GHL however shows steady decline over the five year period under review (See Table 3). This ratio shows the proportion of debt to equity that the company is using to finance its assets. Therefore, a low or declining debt to equity ratio would indicate that the company has been successfully managing their debt and should be able to sustain this going forward. RBTT's debt to equity ratio declined steadily from 2002 to 2005 while that of RBL and NML was generally steady for the period under review.

**Table 3**

Debt to Equity Ratio					
Year	NML	RBL	RBTT	GHL	
2000	-	-	-	9.18	
2001	1.51	7.02	9.64	6.35	
2002	1.35	5.44	11.76	6.61	
2003	1.08	6.71	10.42	3.62	
2004	1.08	6.61	9.74	3.37	
2005	1.00	6.51	8.23	-	

**Table 4**

<b>Profit Margin Ratio %</b>					
<b>Year</b>	<b>NML</b>	<b>RBL</b>	<b>RBTT</b>	<b>GHL</b>	
<b>2000</b>	-	-	-	15.00	
<b>2001</b>	6.47	33.58	36.09	15.65	
<b>2002</b>	6.43	35.39	29.06	12.08	
<b>2003</b>	6.05	37.59	28.30	13.26	
<b>2004</b>	7.08	32.97	31.89	15.90	
<b>2005</b>	7.01	33.56	33.10	-	

The profit margin ratio which is a ratio of a company's profit in relation to its revenue indicates how well the company is executing its business. It is a direct indication of how much of the revenue is retained as profit attributable to shareholders. Hence, a historically favourable profit margin would demonstrate the company's ability to sustain and enhance their profit in the future.

While NML's profit margin ratio is much lower than the other companies, their profit margin ratio has been slowly increasing from 2002 to 2005. On average RBL has a good but somewhat inconsistent ratio while RBTT has been increasing since 2002. GHL's profit margin ratio ranges from 12.08 per cent to 15.90 per cent. (See Table 4)

An analysis of market value to book value is shown in the following Table 5.

**Table 5**

<b>Company</b>	<b>Book Value per share</b>	<b>Market Value per share as at 25/01/06</b>	<b>Ratio of Market Value to Book Value</b>
RBL	28.37	87.75	3.09
RBTT	12.51	37.99	3.04
NML	15.42	44.38	2.88
GHL	15.68	31.10	1.98

This ratio indicates the relation between the market value per share of the company and the book value per share. A high market to book ratio would indicate that a company is overvalued while a low market to book ratio would indicate that the company is undervalued. A ratio of 5 would be considered high, 3 would be average and less than 2 would be low. One can therefore see from the table that RBL's, RBTT's, and NML's ratio would be considered average while GHL's would be deemed as low. This aspect alone shows that these companies do in fact have room for growth.

In addition, all of these companies have been public for at least ten years. Longevity is an important factor as this measure testifies that the company had made it through several business cycles and so is able to stand the test of time.

Table 6 shows a summary of the result from the historic analysis.

**Table 6**

	<b>COMMENT</b>			
	<b>NML</b>	<b>RBL</b>	<b>RBTT</b>	<b>GHL</b>
<b>Earnings per share</b>	increasing	increasing	increasing	fairly increasing
<b>Return on equity</b>	fairly stable	slowly increasing since 2002	Fairly stable	unfavourable
<b>Debt to Equity</b>	generally steady	generally steady	decreasing	decreasing
<b>Profit Margin Ratio</b>	low but slowly increasing	high but somewhat inconsistent	average to high but increasing	average but somewhat inconsistent
<b>Market Value to Book Value</b>	average	average	average	low

In conclusion, following the rules of value investing, the companies highlighted show that they do in fact have value. Even though, due to present market conditions, it may not be openly prevalent, it is evident that these are companies that have long term potential and should be considered part of any long term portfolio. The companies chosen were for illustrative purposes only and is by no means an exhausted list.