Price checklist

Having covered various aspects related to business, growth and management, the next step is to distil all of them to ascertain whether there is reasonable Margin of Safety in the current purchase price of the stock. The following questions aid the process.

Q20 Has the financial model been done with estimates for at least 3 years?

Objective:

All the narrative regarding the company under consideration will need to finally be translated into numbers in order to take an investment view on the same. A financial model is the bridge between the narrative and the numbers.

What to look for:

A robust financial model on a company should have the following essential elements –

- Revenue model – Capturing how exactly the company makes up its topline, including volume and price realization details, where available
- Cost model – Capturing the cost structure of the company, including unit costs where available
- P&L Statement including relevant margins – Gross Margin, EBITDA margin, PAT Margin
- Balance Sheet
- Cash flow
- Key ratios – mainly RoE, RoCE, Debt-equity, Payout ratio, Working capital cycle, etc
- All of the above should carry estimates for the next 3 years at least.
- Valuation basis – P/E, EV/EBITDA (EV stands for Enterprise Value), Discounted Cash Flow, Sum of Parts (in case of multiple businesses meriting separate valuation methodologies).