The Company Valuations Playbook – Foreword by James Clunie

Do stock valuations matter? We know that factors unrelated to valuation can be drivers of returns: themes, narratives and previous returns (momentum) can all dominate market behaviour, sometimes for years. Does this make stock valuations irrelevant, and valuation analysis redundant? For two reasons, I think not.

First, a series of rigorous, empirical studies show that 'value' stocks exhibit higher returns than 'not-value' stocks over the long-term. These studies, by necessity, use simple measures of 'value' for companies, such as the ratio of the net assets of a firm to its market capitalization; or the ratio of share price to reported earnings per share. Such research is numerous and holds up over different time periods and in different markets. Note that this applies over the long-term, not necessarily in the next week or the next three years.

The other reason is more subtle, philosophical even: the price you pay for an asset matters. It has to matter. If it didn't matter, what on earth are investment analysts doing? Sure, some analysis is associated with trading: short-term opportunities to profit around private information, or knowledge of the impending or likely trades of some other market participants. But this differs from investing. When investing for the long-term, the price you pay for an asset will determine the ultimate return you receive. And that's why valuation analysis is an important skill and process for an investor.

In this book, Charles Sunnucks leads us in a clear and methodical manner through the steps that an investment analyst is likely to take with an investment opportunity: qualitative perspectives, calculating straight-forward accounting ratios (over time and compared to a peer group) and then on to a discounted cash flow (DCF) analysis. DCF analysis is the theoretically correct, but not-easy-in-practice, method employed by analysts to estimate the intrinsic value of an asset.

Of special interest in this book are the sections on 'leveraged buyouts' and 'start-ups and early-stage companies' – topics of interest that are too often ignored in finance books. A separate section on the banking sector is included, which is both welcome and appropriate.
This book is not about day-trading, meme stocks or reacting to stock ideas touted on Twitter. That's for someone else to write. This is for those who wish to practice investment analysis as their occupation, whether it be in a professional or personal context. Of course, it's possible to go further still, using reverse-DCF analysis and scenario analysis to understand what assumptions are priced in to current share prices; or to undertake stochastic modelling, specialist sector metrics or more…but ultimately, these rely on the same fundamental principle: that an asset is worth the (estimated) present value of its future cash flows. Combining this with qualitative and accounting analysis, plus risk awareness, this book provides a solid foundation for any aspiring investor.

The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance