

A group of students in a computer lab working at their desks. The image is faded and serves as a background for the slide.

Ch. 3 Introduction to Industry and Company Analysis

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INTRODUCTION

Company analysis is the analysis of an individual company, and it requires understanding a company's industry and identifying its peers.

- An **industry** is a group of companies offering similar products and/or services, whereas a **sector** is a group of related industries.
- A **principal business activity** is a source from which a company derives a majority of its revenues and/or earnings.
- A **peer group** is a group of companies that are engaged in similar business activities, and whose economics and valuation are influence by closely-related factors.

USES OF INDUSTRY ANALYSIS

Understanding a company's business and business environment

- Stock selection
- Credit analysis

Identifying active equity investment opportunities.

- Security selection
- Industry or sector rotation

Portfolio performance attribution

- Performance attribution
- Industry or sector selection

<RRG>



APPROACHES TO IDENTIFYING SIMILAR COMPANIES

Products and/or services supplied

- Similar products and/or services
- Industry and sector classification
- A company's principal business activity

Business-cycle sensitivities

- **Cyclical companies** have profits correlated with the overall economy
- **Noncyclical companies'** performance is independent of the economy

Statistical similarities

- Groups based on correlations of security returns
- Based on historical returns, but relationship may not continue in the future
- May associate firms based on chance or may exclude important relationships

SECTORS

Basic Materials and
Processing

Consumer
Discretionary

Consumer Staples

Energy

Financial Services

Health Care

Industrial/Producer
Durables

Technology

Telecommunications

Utilities

91) Actions ▾ 92) Community 93) Settings

<Search BI> Exam

- 1) BI: All Research
- 2) My Favorites
- Sectors
 - 3) Communications >
 - 4) Consumer Discretionary >
 - 5) Consumer Staples >
 - 6) **Energy** >
 - 7) Financials >
 - 8) Health Care >
 - 9) Industrials >
 - 10) Materials >
 - 11) Technology >
 - 12) Utilities >
- Topics
 - 13) Credit >
 - 14) Government >
 - 15) Litigation >
 - 16) ESG >
 - 17) Economics >
 - 18) Strategy/Index/ETF >
 - 19) Special Reports >

91) Actions ▾ 92) Community

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- 1) <BI: All Research
- 2) **Energy**
- 3) Oil, Gas & Coal
- 4) Coal
- 5) **Crude Oil Production**
- 6) Drilling & Support
- 7) Integrated Oils
- 8) Liquefied Natural Gas
- 9) Midstream Oil & Gas
- 10) Nat Gas Production
- 11) Oil & Gas Services ...
- 12) Oil & Nat Gas E&P
- 13) Refine & Markt
- 14) Renewable Energy
- 15) Biofuels
- 16) Solar Energy Equip...
- 17) Wind Energy Equipm...
- 18) Special Reports
- 19) OPEC

91) Actions ▾ 92) Directory 93) Settings

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Crude Oil Production Dashboard (BI OILSN)

- Research
 - Dashbd Home
 - Companies
 - Industry
 - Credit
 - Government
 - Litigation
- Data Library
 - Market Share
 - Macro
 - Industry
 - Company
 - Earnings
 - Valuation
 - Credit
 - Government
 - Pricing
 - Shale Plays
 - RigData
 - M&A Data
 - Contributors
- Monitor
 - News/Research
 - Events
 - Comp Sheets

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Critical Themes

- 1) Rough Road For Capital
- 2) Here We Go Again: Hur
- 3) Energy Sentiment: Pro
- 4) Behind the Data: Nat G

Most Recent | More >>

- 5) Different Views Add to
- 6) Floating Crude and Pro
- 7) Global Crude Oil Market
- 8) E&P M&A to Rest as Sur
- 9) Oil Industry's Canary in
- 10) Oil Imbalances, Straine
- 11) Updated Mexico Crude C
- 12) Gulf Coast Storms Not a
- 13) Harvey Below Category
- 14) SAGD Project by Project
- 15) SAGD Drilling Drives Oil

CLASSIFICATION SCHEMES

Commercial industry classification schemes

- Produced by private enterprises, such as analysis firms and financial services firms.

Governmental industry classification schemes

- Produced by government agencies
- Goal: facilitate comparisons over time and across companies

INDUSTRY CLASSIFICATION SCHEMES

Global Industry Classification Standard (GICS)

- Developed by Standard & Poor's and MSCI
- Classifies companies for developing and developed countries
- Based on business activity, classifies each company into a sector, industry group, industry, and sub-industry

Russell Global Sectors (RGS)

- Classifies companies by products and services
- System has sectors, sub-sectors, and industries.

Industry Classification Benchmark (ICB)

- Developed by Dow Jones and FTSE
- Classifies companies by source of revenues
- System has supersectors, sectors, subsectors, and industries

GOVERNMENTAL INDUSTRY CLASSIFICATION SCHEMES

International Standard Industrial Classification of All Economic Activities (ISIC)

Statistical Classification of Economic Activities in the European Community (NACE)

Australian and New Zealand Standard Industrial Classification (ANZSIC)

North American Industry Classification System (NAICS)

IDENTIFYING PEER GROUPS

Examine classification systems

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graph TD; A[Examine classification systems] --> B[Review subject company's annual report]; B --> C[Review company's competitors' annual reports]; C --> D[Confirm comparability with potential peers];
```

Review subject company's annual report

Review company's competitors' annual reports

Confirm comparability with potential peers

<RV>

ETH US Equity Output Settings Relative Valuation

Comp Source **GICS** Region **North America** Curr **USD**

Classification	Type	Metric	ETH	Low	Comp Range	High
1) Consumer Discretionary	Sector	Est P/E Current Yr	15.69	10.58		24.17
2) Consumer Durables & Apparel	Industry Group	Sales Growth Yoy...	-3.88	-22.30		136.60
3) Household Durables	Industry	EBITDA Margin (%)	10.31	-12.42		16.10
4) Home Furnishings	Sub Industry	Same Store Sales...	-6.40	-6.40		0.70

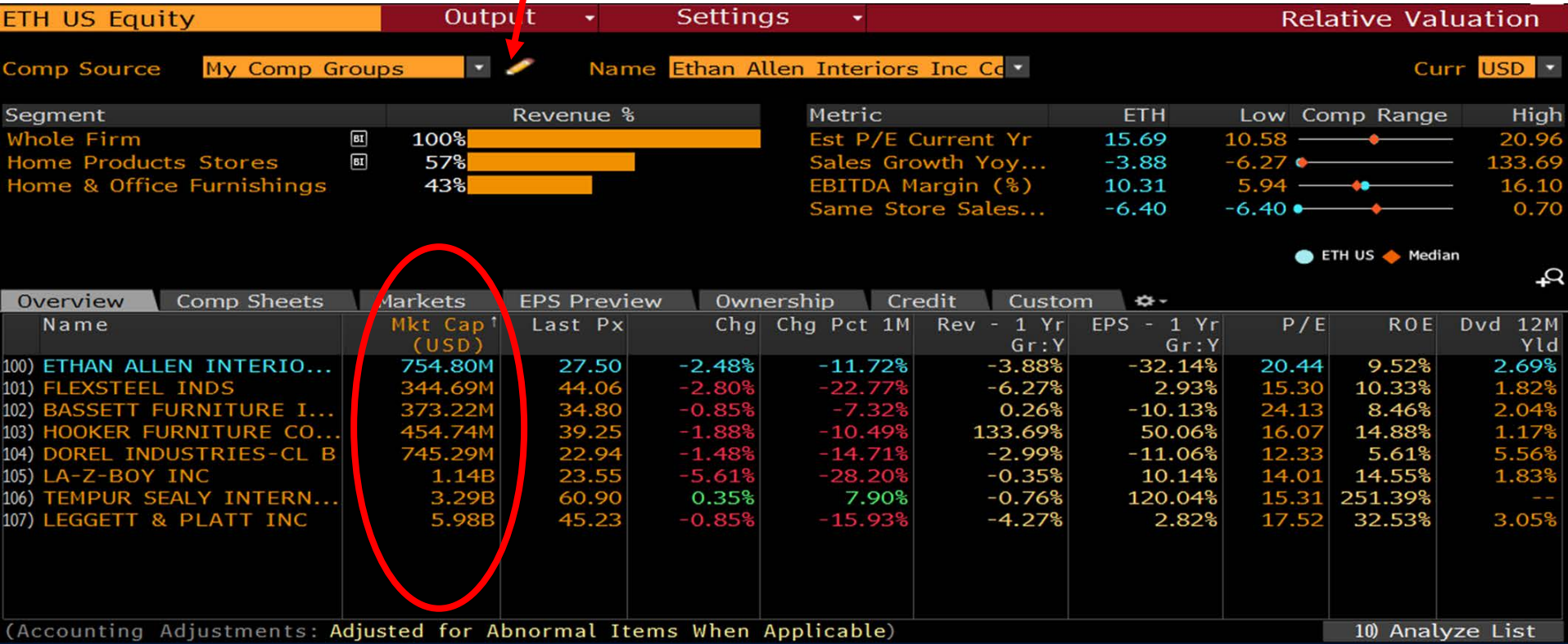
Showing Closest 15 Comps by Mkt Cap ● ETH US ◆ Median

Overview	Comp Sheets	Markets	EPS Preview	Ownership	Credit	Custom					
Name	Mkt Cap (USD)	Last Px	Chg	Chg Pct	1M	Rev - 1 Yr Gr:Y	EPS - 1 Yr Gr:Y	P/E	ROE	Dvd 12M Yld	
100) ETHAN ALLEN INTERIO...	754.80M	27.50	-2.48%	-11.72%		-3.88%	-32.14%	20.44	9.52%	2.69%	
101) LEGGETT & PLATT INC	5.98B	45.23	-0.85%	-15.93%		-4.27%	2.82%	17.52	32.53%	3.05%	
102) TEMPUR SEALY INTERN...	3.29B	60.90	0.35%	7.90%		-0.76%	120.04%	15.31	251.39%	--	
103) LA-Z-BOY INC	1.14B	23.55	-5.61%	-28.20%		-0.35%	10.14%	14.01	14.55%	1.83%	
104) DOREL INDUSTRIES-CL B	745.47M	22.95	-1.48%	-14.71%		-2.99%	-11.06%	12.33	5.61%	5.56%	
105) HOOKER FURNITURE C...	454.74M	39.25	-1.88%	-10.49%		133.69%	50.06%	16.07	14.88%	1.17%	
106) BASSETT FURNITURE I...	373.22M	34.80	-0.85%	-7.32%		0.26%	-10.13%	24.13	8.46%	2.04%	
107) FLEXSTEEL INDS	344.69M	44.06	-2.80%	-22.77%		-6.27%	2.93%	15.30	10.33%	1.82%	
108) DIXIE GROUP INC	70.15M	4.35	6.10%	-3.33%		-5.92%	-792.10%	--	-1.35%	--	
109) NOVA LIFESTYLE INC	34.45M	1.27	0.00%	-11.81%		3.01%	--	--	-1.76%	--	
110) LIVE VENTURES INC	19.88M	9.89	1.33%	-8.26%		136.60%	--	6.72	21.22%	--	
111) STANLEY FURNITURE C...	17.50M	1.16	2.65%	-5.69%		-22.30%	--	--	-8.49%	21.55%	

(Accounting Adjustments: Adjusted for Abnormal Items When Applicable)

10) Analyze List

<RV>



DESCRIBING AND ANALYZING AN INDUSTRY

- Analysts examine statistical relationships between an industry and business and economic variables
- Analysts develop forecasts, often developing scenario analyses
- Analysts may examine **strategic groups**, which are companies that share similar business models or specific market segments.
- Analysts often classify an industry based on its stage in the industry **life cycle**.
 - The **experience curve** is a representation of how the direct cost per unit of a good or services produced or delivered declines as a function of cumulative output.

<BICO>

The screenshot shows a Bloomberg terminal interface. At the top, it displays market data for ETH US Equity, including a price of 227.05 / 30.25T, a volume of 360, and a 2x1 leverage indicator. Below this, the report title 'Ethan Allen Interiors Primer' is visible, along with a navigation menu where 'Company' is selected. A profile picture of Seema Shah, a BI Industry Analyst, is shown. The main content area features a section titled '1. BI 2017 Midyear Outlook: Consumer Hardlines, North America' with a detailed paragraph of text. To the right of the text is a 'Table of Contents' with two columns: 'Performance & Valuation' (listing Peer Performance and Peer Valuation) and 'Topics' (listing Housing & Economy, Consumer Credit, Omnichannel Grows, Store Monetization, and Capital Allocation). At the bottom, a list of companies is partially visible: Home Depot, Lowe's, Ulta, Bed Bath & Beyond, Pier 1 Imports, Williams-Sonoma and GNC.

ETH US \$ G1 Market Msg:R. Exchanges 227.05 / 30.25T 2x1
Prev 27.50 Vol 360
ETH US Equity 66) Send 98) Actions Bloomberg Intelligence Company Primer
[BI]

Ethan Allen Interiors Primer

BI Consumer Hardlines, North America Dashboard | BI »

1) Company 2) Industry

 Seema Shah | BIO »
Team: Retail
BI Industry Analyst

1. BI 2017 Midyear Outlook: Consumer Hardlines, North America

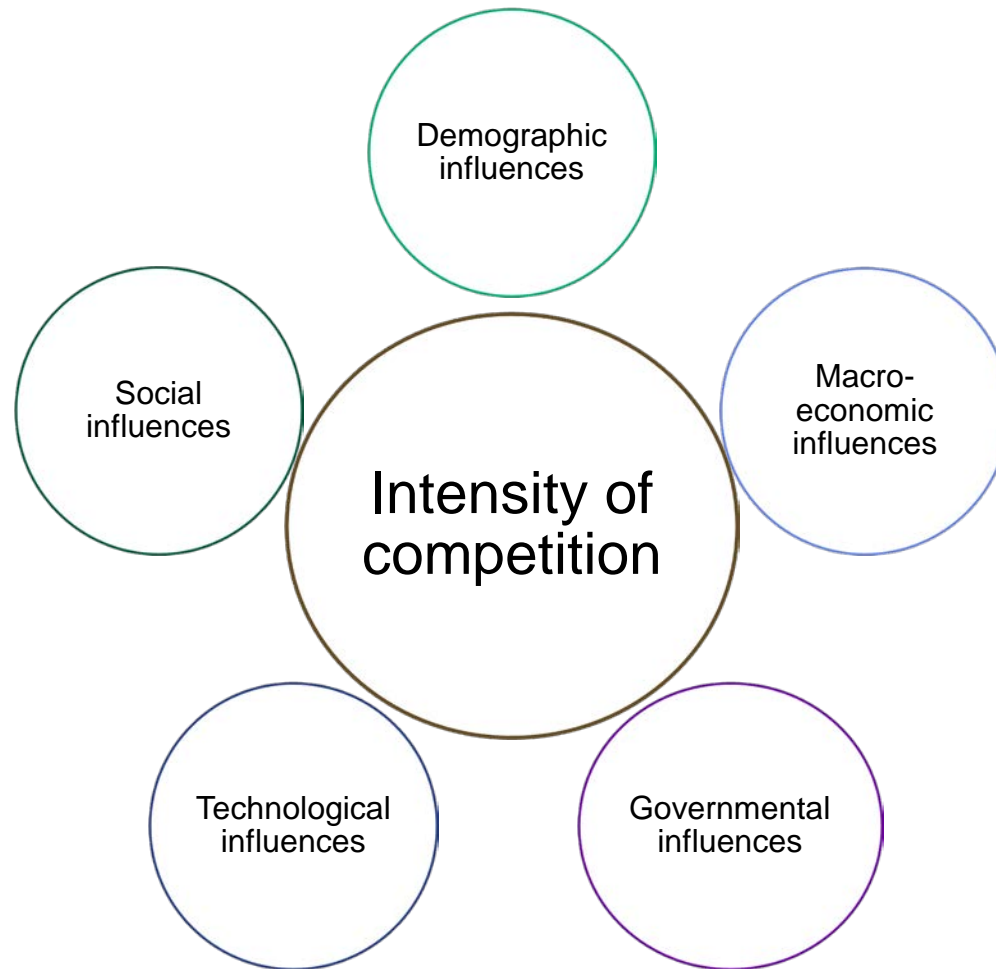
(Bloomberg Intelligence) -- Consumer hardline retailers face ongoing turbulence in 2017 as they try to balance volatile macroeconomic factors with secular industry trends. The companies are increasingly dependent on expanding online penetration and experiential retail to drive traffic and sales, with any gains offset by promotions, technology spending and competition -- particularly from Amazon.com. Housing sales may moderate due to rising interest rates that could shift spending to renovations, while unseasonable weather compresses demand.

Home Depot, Lowe's, Ulta, Bed Bath & Beyond, Pier 1 Imports, Williams-Sonoma and GNC, among

Table of Contents

Performance & Valuation	Topics
◆ Peer Performance	◆ Housing & Economy
◆ Peer Valuation	◆ Consumer Credit
	▲ Omnichannel Grows
	▲ Store Monetization
	▲ Capital Allocation

FRAMEWORK FOR INDUSTRY ANALYSIS



EXTERNAL INFLUENCES ON INDUSTRY GROWTH, PROFITABILITY, AND RISK

- Macroeconomic influences include the level of production, interest rates, availability of credit, GDP growth, and inflation
- Technological influences include new products that change how companies do business and enhance productivity
- Demographic influences include the distribution of consumers by age, location, and gender
- Governmental influences include tax rates and regulations
- Social influences include how people work and spend.

<WACC>

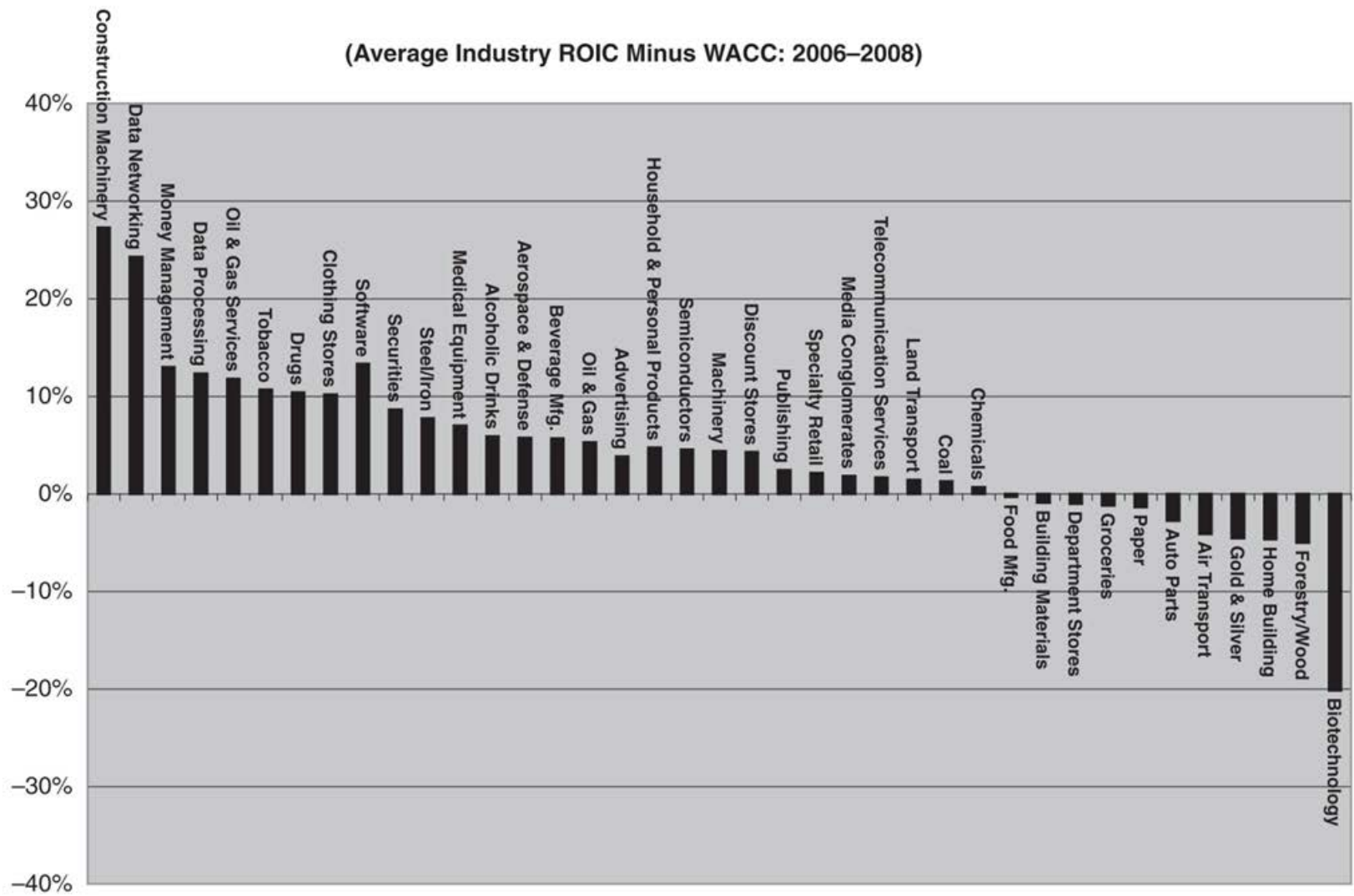
DD US \$ ↓ 82.55 -0.21 N82.55 / 82.57T 3x1
 At 10:05 Vol 123,960 O 82.84N H 82.9216D L 82.37N Val 10.241M

DD US Equity 1) Create Report 2) Output to Excel Weighted Average Cost of Capital
 EI du Pont de Nemours & Co Period MR 2017 Q2

Cost of Capital - Current Market Value				Capital Structure (Millions of USD)		
	Weight	Cost	W x C			
3) Equity	83.5%	8.2%	6.8%		Market Cap	70,029.0 83.5%
4) Debt Cost (A-T)	16.2%	2.3%	0.4%		ST Debt	3,473.0 4.1%
5) Preferred Equity	0.3%	4.2%	0.0%		LT Debt	10,086.0 12.0%
WACC			7.2%		Pref. Eqty	237.0 0.3%
					Total	83,825.0 100.0%

6) History		Economic Value Added (Millions of USD)	
WACC	EVA	ROIC	EVA Spread
		7) Net Operating Profit	3531.00
		8) Cash Operating Taxes NOPAT	-67.03 3598.03
		9) Total Investment Capital Capital Charge	24018.00 1733.98
		Economic Value Added	1864.05
		ROIC	14.98%
		EVA Spread	7.76%

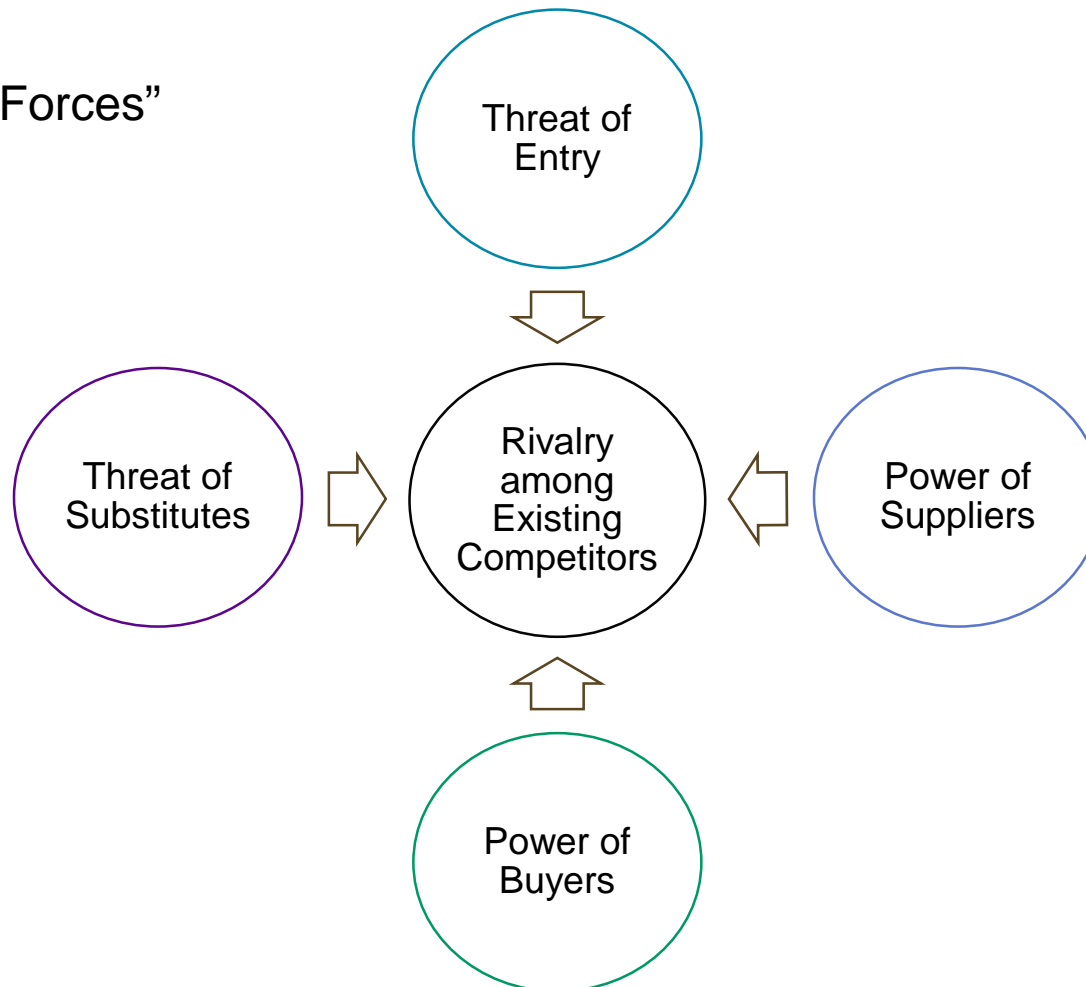
EXHIBIT 3 Some Industries Create Value, Others Destroy It



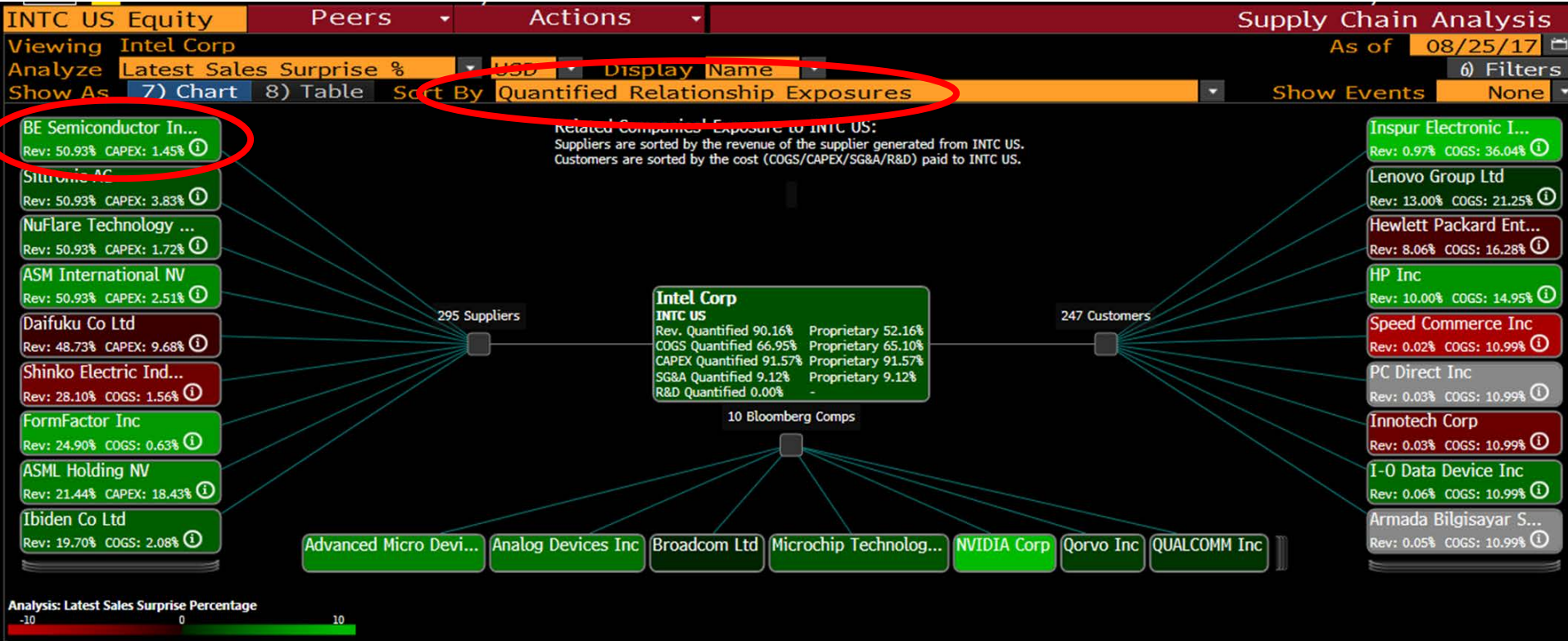
Source: Morningstar, Inc.

STRATEGIC ANALYSIS OF AN INDUSTRY

Porter's "Five Forces"
Framework



<SPLC>



- BE Semiconductor In...
Rev: 50.93% CAPEX: 1.45%
- Siltronic AG
Rev: 50.93% CAPEX: 3.83%
- NuFlare Technology ...
Rev: 50.93% CAPEX: 1.72%
- ASM International NV
Rev: 50.93% CAPEX: 2.51%
- Daifuku Co Ltd
Rev: 48.73% CAPEX: 9.68%
- Shinko Electric Ind...
Rev: 28.10% COGS: 1.56%
- FormFactor Inc
Rev: 24.90% COGS: 0.63%
- ASML Holding NV
Rev: 21.44% CAPEX: 18.43%
- Ibiden Co Ltd
Rev: 19.70% COGS: 2.08%

Related Companies' Exposure to INTC US:

Suppliers are ranked by the revenue of the supplier reported from INTC US

Relationship Details

Supplier BE SEMICONDUCTOR(BESI NA)
Source 2016 Q4 Bloomberg Estimate
Origin INTC US's 2015 A Company Financials

	Percent	Value
BESI NA's Revenue		
Revenue in USD	50.93%	51.10M
INTC US's Cost		
CAPEX in USD	1.45%	51.10M

Close

- Advanced Micro Devi...
- Analog Devices Inc
- Broadcom Ltd
- Microchip Technolog...
- NVIDIA Corp
- Qorvo Inc
- QUALCOMM Inc

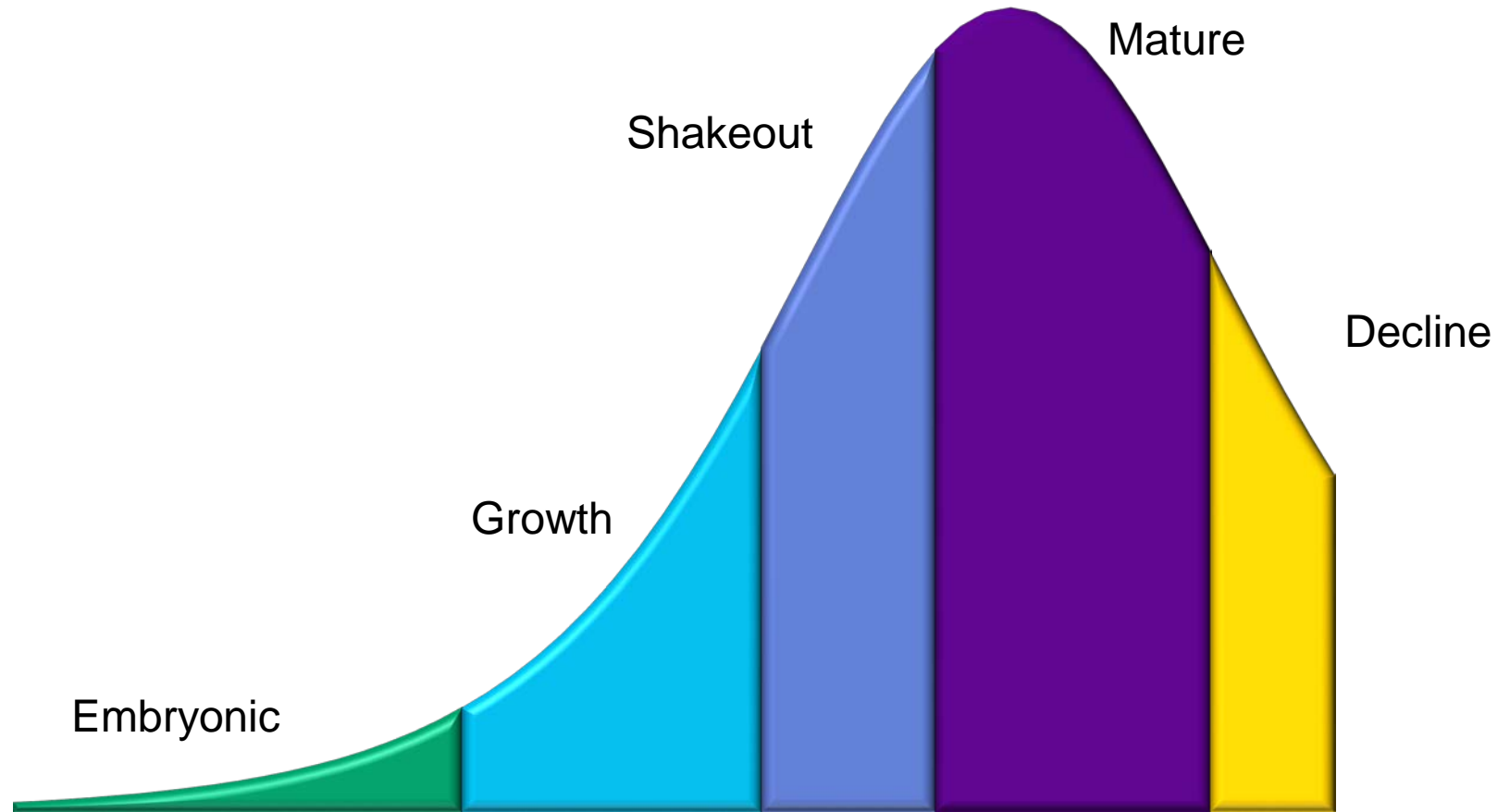
FACTORS AFFECTING PRICING POWER AND PRICE COMPETITION

- **Barriers to entry** are obstacles or hurdles that limit or restrict the entry of new competitors in the market
 - These barriers keep or discourage new entrants, hence reducing competition
- **Industry concentration** is the degree to which some companies may dominate the industry in terms of market share.
 - Generally, the more concentrated an industry, the less competitive it is
- **Industry capacity** is the maximum amount of a good or service that can be supplied in a given time period
 - The more limited the capacity, the greater the companies' pricing power
- **Market share stability** is the degree to which market shares change over time
 - The more stable the market shares, the less competitive the industry

EXHIBIT 4 (Continued)

Concentrated with Strong Pricing Power	Concentrated with Weak Pricing Power
Integrated Shippers (UPS, FedEx, DHL International) US Railroads (Burlington Northern) US Defense (General Dynamics) Heavy Construction Equipment (Caterpillar, Komatsu) Seaborne Iron Ore (Vale, Rio Tinto) Confections (Cadbury, Mars/Wrigley) Credit Card Networks (MasterCard, Visa) Custody & Asset Administration (BNY Mellon, State Street) Investment Banking /Mergers &Acquisitions (Goldman Sachs, UBS) Futures Exchanges (Chicago Mercantile Exchange, Intercontinental Exchange) Canadian Banking (RBC Bank, TD Bank) Australian Banking Tobacco (Philip Morris, British American Tobacco) Alcoholic Beverages (Diageo, Pernod Ricard)	Consumer Electronics (Sony Electronics, Koninklijke Philips Electronics) PCs (Dell, Acer, Lenovo) Printers/Office Machines (HP, Lexmark) Refiners (Valero, Marathon Oil) Major Integrated Oil (BP, ExxonMobil) Equity Exchanges (NYSE, Deutsche Börse Group)
Fragmented with Strong Pricing Power	Fragmented with Weak Pricing Power
Asset Management (BlackRock, Fidelity) For-Profit Education (Apollo Group, DeVry University) Analog Chips (Texas Instruments, STMicroelectronics) Industrial Distribution (Fastenal, W.W. Grainger) Propane Distribution (AmeriGas, Ferrellgas) Private Banking (Northern Trust, Credit Suisse)	Consumer Packaged Goods (Procter & Gamble, Unilever) Retail (Walmart, Carrefour Group) Marine Transportation (Maersk Line, Frontline) Solar Panels Homebuilding Airlines Mining (metals) Chemicals Engineering & Construction Metal Service Centers Commercial Printing Restaurants Radio Broadcasting Oil Services Life Insurance Reinsurance Exploration & Production (E&P) US Banking Specialty Finance

INDUSTRY LIFE CYCLE



CHARACTERISTICS OF INDUSTRIES

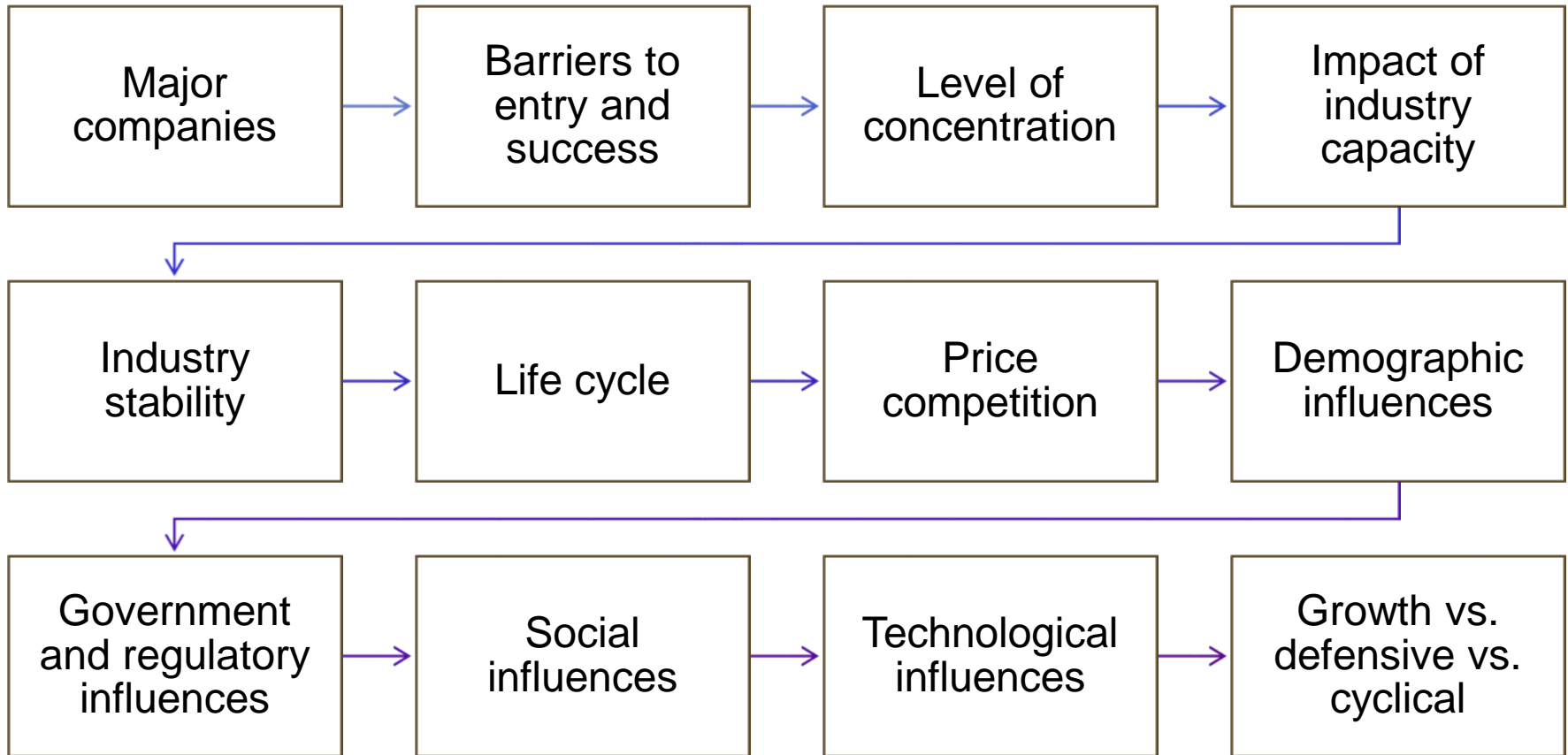


EXHIBIT 7 Elements of a Strategic Analysis for Three Industries

	Branded Pharmaceuticals	Oil Services	Confections/Candy
Major Companies	Pfizer, Novartis, Merck, GlaxoSmithKline	Schlumberger, Baker Hughes, Halliburton	Cadbury, Hershey, Mars/Wrigley, Nestle
Barriers to Entry/ Success	<i>Very High:</i> Substantial financial and intellectual capital required to compete effectively. A potential new entrant would need to create a sizable R&D operation, a global distribution network, and large-scale manufacturing capacity.	<i>Medium:</i> Technological expertise is required, but high level of innovation allows niche companies to enter the industry and compete in specific areas.	<i>Very High:</i> Low financial or technological hurdles, but new players would lack the established brands that drive consumer purchase decisions.

(continued)

	Branded Pharmaceuticals	Oil Services	Confections/Candy
Level of Concentration	<i>Concentrated:</i> A small number of companies control the bulk of the global market for branded drugs. Recent mergers have increased level of concentration.	<i>Fragmented:</i> Although only a small number of companies provide a full range of services, many smaller players compete effectively in specific areas. Service arms of national oil companies may control significant market share in their own countries, and some product lines are concentrated in the mature US market.	<i>Very Concentrated:</i> Top four companies have a large proportion of global market share. Recent mergers have increased level of concentration.
Impact of Industry Capacity	<i>NA:</i> Pharmaceutical pricing is primarily determined by patent protection and regulatory issues, including government approvals of drugs and of manufacturing facilities. Manufacturing capacity is of little importance.	<i>Medium/High:</i> Demand can fluctuate quickly depending on commodity prices, and industry players often find themselves with too few (or too many) employees on the payroll.	<i>NA:</i> Pricing is driven primarily by brand strength. Manufacturing capacity has little effect.
Industry Stability	<i>Stable:</i> The branded pharmaceutical market is dominated by major companies and consolidation via mega-mergers. Market shares shift quickly, however, as new drugs are approved and gain acceptance or lose patent protection.	<i>Unstable:</i> Market shares may shift frequently depending on technology offerings and demand levels.	<i>Very Stable:</i> Market shares change glacially.
Life Cycle	<i>Mature:</i> Overall demand does not change greatly from year to year.	<i>Mature:</i> Demand does fluctuate with energy prices, but normalized revenue growth is only mid-single digits.	<i>Very Mature:</i> Growth is driven by population trends and pricing.

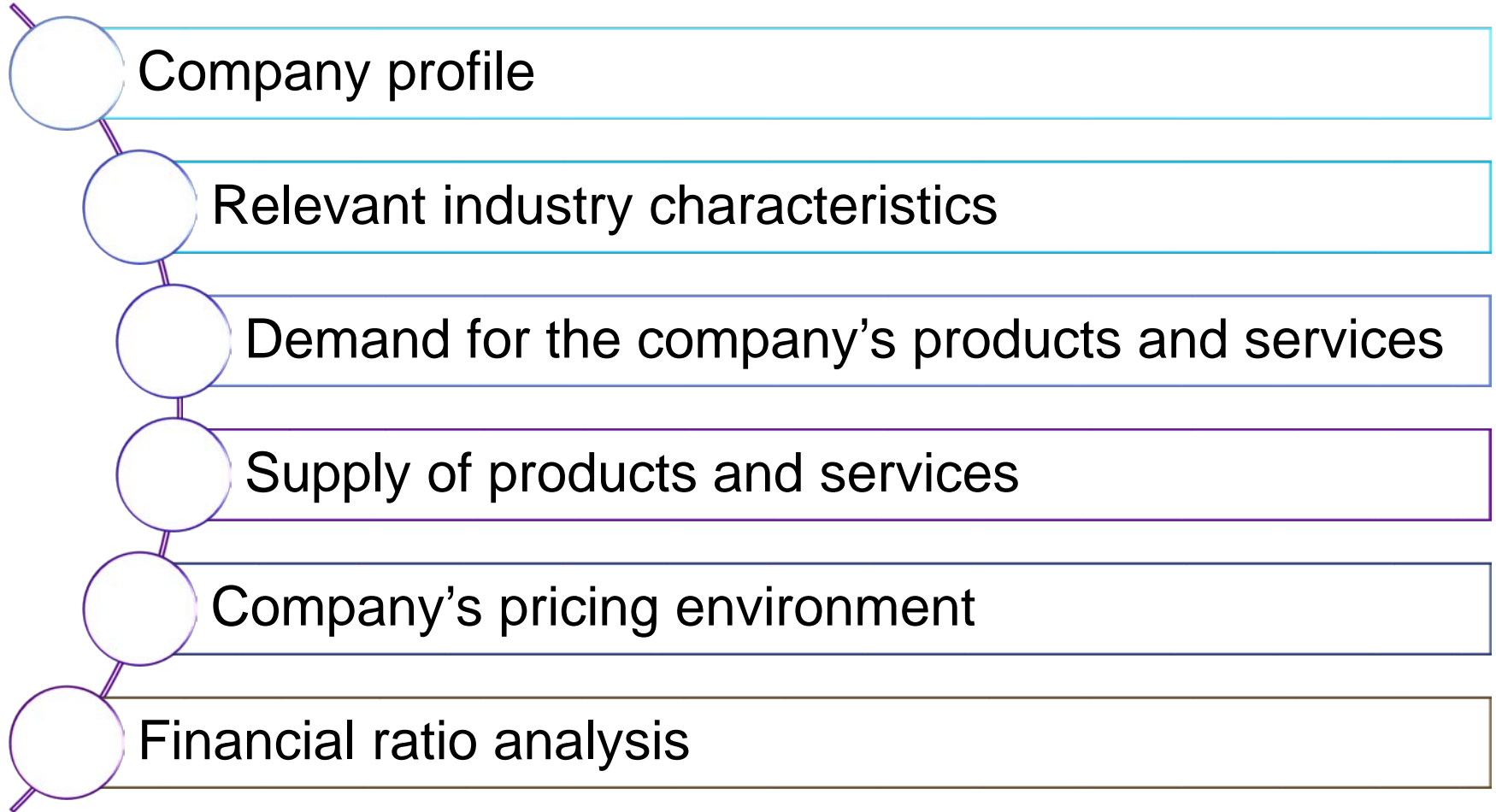
	Branded Pharmaceuticals	Oil Services	Confections/Candy
Price Competition	<i>Low/Medium:</i> In the United States, price is a minimal factor because of consumer- and provider-driven, de-regulated health care system. Price is a larger part of the decision process in single-payer systems, where efficacy hurdles are higher.	<i>High:</i> Price is a major factor in purchasers' decisions. Some companies have modest pricing power because of a wide range of services or best-in-class technology, but primary customers (major oil companies) can usually substitute with in-house services if prices are too high. Also, innovation tends to diffuse quickly throughout the industry.	<i>Low:</i> A lack of private-label competition keeps pricing stable among established players, and brand/familiarity plays a much larger role in consumer purchase decisions than price.
Demographic Influences	<i>Positive:</i> Populations of developed markets are aging, which slightly increases demand.	<i>NA</i>	<i>NA</i>
Government & Regulatory Influences	<i>Very High:</i> All drugs must be approved for sale by national safety regulators. Patent regimes may differ among countries. Also, health care is heavily regulated in most countries.	<i>Medium:</i> Regulatory frameworks can affect energy demand at the margin. Also, governments play an important role in allocating exploration opportunities to E&P companies, which can indirectly affect the amount of work flowing down to service companies.	<i>Low:</i> Industry is not regulated, but childhood obesity concerns in developed markets are a low-level potential threat. Also, high-growth emerging markets may block entry of established players into their markets, possibly limiting growth.
Social Influences	<i>NA</i>	<i>NA</i>	<i>NA</i>
Technological Influences	<i>Medium/High:</i> Biologic (large-molecule) drugs are pushing new therapeutic boundaries, and many large pharmaceutical companies have a relatively small presence in biotech.	<i>Medium/High:</i> Industry is reasonably innovative, and players must re-invest in R&D to remain competitive. Temporary competitive advantages are possible via commercialization of new processes or exploitation of accumulated expertise.	<i>Very Low:</i> Innovation does not play a major role in the industry.

EXHIBIT 7 (Continued)

	Branded Pharmaceuticals	Oil Services	Confections/Candy
Growth vs. Defensive vs. Cyclical	<i>Defensive:</i> Demand for most health care services does not fluctuate with the economic cycle, but demand is not strong enough to be considered “growth.”	<i>Cyclical:</i> Demand is highly variable and depends on oil prices, exploration budgets, and the economic cycle.	<i>Defensive:</i> Demand for candy and gum is extremely stable.

Note: “NA” in this exhibit stands for “not applicable.”

ELEMENTS OF A COMPANY ANALYSIS



SUMMARY

- Company analysis and industry analysis are closely interrelated.
- Industry analysis is useful for analyzing portfolio opportunities, strategies, and performance.
- There are commercial and governmental classification systems, although determining a company's peers is challenging because of different business activities even within defined industry groups.
- The analysis of the competitive environment of an industry includes Porter's five forces, assessment of barriers to entry, capacity, market share stability, and the industry's life cycle.
- External factors must be considered, including technology, demographics, government, and social factors.

SUMMARY, CONTINUED

- A thorough company analysis requires investigating the company's corporate profile, industry characteristics, demand for its products or services, supply of its products and services, pricing, and financial ratios.
- Spreadsheet modeling can assist the analyst in analyzing and forecasting revenues, income, and cash flows, as well as assessing the sensitivity of the analysis to the analyst's assumptions.