

Considerations in Analyzing Your Company¹

Insiders

- Resignation of CEO, CFO, or auditors.
- The underwriter's analyst downgrades the company

Debt problems

- The company is burning through cash (cash burn rate). The question here is whether the firm will have trouble attracting additional funding. One way to calculate the number of quarters before a firm needs new financing is to divide a firm's cash + marketable securities by the change in cash that it reported in the last quarter. Since firms may spend more money in some quarters than in others e.g., seasonal businesses, you should calculate the average burn rate for the past four quarters in addition to the current quarter.
- Rating agencies downgrade the company or put the company on a credit watch. This worsens the situation because if the company issues new debt, the cost of debt will increase.

Profit problems

- Falling profit margins. This may be an indication that increased competition is forcing the company to either reduce prices or that the firm has difficulty in controlling costs. It could also be the result of a change in product mix.
- Analysts lower earnings estimates and/or company announces a large negative earnings surprise.
- Slower Sales growth and/or earnings growth. If a company is losing money, how long will it take to breakeven?
- Slower inventory turnover and/or accounts receivable turnover. Slower inventory turns could indicate either a loss of interest in the product or other suppliers of the product.

¹This section is from Christopher Graja, October 2000, "When to get out", Bloomberg, Personal Finance, pp. 66-74.

Strategic problems

- ❑ Company changes its business plan dramatically. Is management able to create synergies?
- ❑ Bad acquisition(s). Is a company able to make and integrate strategic acquisitions? How soon after the merger can a company's profitability increase?
- ❑ Bigger, stronger competitor enters the company's niche.
- ❑ A company's technology is replaced by a new one produced by a competitor, its "unique" product becomes a commodity, and/or the market adopts a new standard.
- ❑ A major new product is seriously and repeatedly delayed or the research and development department isn't producing new products. Innovation is necessary to maintain the status quo and to grow over time. Delaying a new product may result in a loss of market share.
- ❑ Regulatory problems
- ❑ Company isn't successful in building a brand name.