

Fundamental Analysis

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Learning Objectives

- Understand intrinsic value
- Interpret financial statements
- Use ratios and valuation
- Apply to real company

Fundamental Analysis

Overview

- What is fundamental analysis?
- Why it matters for investors
- Lecture roadmap

Fundamental Analysis

Overview

- Fundamental analysis evaluates a company's true economic value
- It focuses on financial data, business model, and future performance
- Investors use it to decide if a stock is under or overvalued

Intrinsic Value

- Intrinsic value is the real worth of a company based on future cash flows
- It depends on growth, profitability, and risk
- It cannot be observed directly, only estimated

Price vs Value

- Market price fluctuates
- Value is estimated
- Opportunities from mispricing

Price vs Value

- Price is what investors pay in the market today
- Value is what the company is actually worth
- Differences between price and value create opportunities

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Market Inefficiencies

- Behavioral biases
- Information delays
- Market sentiment

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Margin of Safety

- Protects against uncertainty
- Requires discount to value
- Core investing principle

Top-Down Approach

- Macro → Industry → Firm
- Useful for context
- Economic influence

Bottom-Up Approach

- Focus on firm specifics
- Ignore macro initially
- Common among investors

Qualitative Analysis

- Competitive advantage
- Management quality
- Business model strength

Three Financial Statements

- Income Statement
- Balance Sheet
- Cash Flow Statement

Income Statement Details

- Revenue, Costs, Profit
- Gross vs Operating vs Net
- Profitability insight

Income Statement Explained

- Shows company performance over a period
- Revenue - costs = profit
- Different levels: gross, operating, and net income

Balance Sheet Explained

- Shows financial position at a point in time
- Assets = what company owns
- Liabilities + equity = how assets are financed

Balance Sheet Details

- Assets, Liabilities, Equity
- Financial stability
- Liquidity vs solvency

Cash Flow Statement Details

- Operating cash flow
- Investing cash flow
- Financing cash flow

Cash Flow Statement Explained

- Tracks actual cash movement
- Operating cash flow shows core business strength
- Free cash flow is key for investors

Free Cash Flow

- Operating CF - CapEx
- Key valuation input
- Indicates flexibility

Ratio Analysis Overview

- Simplifies data
- Needs context
- Compare across time and peers

Profitability Ratios

- Net margin
- ROE
- ROA

Profitability Ratios

- Net margin shows profit per revenue unit
- ROE shows return to shareholders
- ROA shows efficiency of total assets

Liquidity Ratios

- Current ratio
- Quick ratio
- Short-term health

Liquidity Ratios

- Current ratio = ability to pay short-term obligations
- Quick ratio excludes inventory for stricter measure
- Low liquidity can lead to financial distress

Leverage Ratios

- Debt-to-equity
- Interest coverage
- Financial risk

Leverage Ratios

- Debt-to-equity shows reliance on debt financing
- Interest coverage shows ability to pay interest
- High leverage increases both risk and return

Efficiency Ratios

- Asset turnover
- Inventory turnover
- Operational performance

Efficiency Ratios

- Asset turnover measures sales efficiency
- Inventory turnover shows stock management
- Higher efficiency often means better operations

Valuation Ratios

- P/E ratio
- Price-to-book
- EV/EBITDA

Valuation Ratios

- P/E ratio compares price to earnings
- High P/E may indicate growth expectations
- Low P/E may signal risk or undervaluation

Valuation Overview

- Estimate intrinsic value
- Forward-looking
- Multiple approaches

DCF Method

- DCF values a company based on future cash flows
- Cash flows are discounted due to time and risk
- Small assumption changes can affect valuation

DCF Intuition

- Future cash flows
- Discount rate
- Time value of money

DCF Steps

- Forecast cash flows
- Choose discount rate
- Estimate terminal value
- Discount to present

DCF Limitations

- Sensitive to assumptions
- Requires judgment
- Range not single value

Relative Valuation

- Compares company to similar firms
- Uses multiples like P/E or EV/EBITDA
- Depends on correct peer selection

Relative Valuation

- Use peer multiples
- Fast and practical
- Depends on comparables

Dividend Model

- Present value of dividends
- Best for stable firms

Case Study: Apple

- Well-known company
- Strong ecosystem
- High margins

Apple Business Model

- Hardware + Services
- Recurring revenue
- Customer lock-in

Apple Financials

- Revenue ~400B
- Net income ~100B
- Strong cash flows

Apple Valuation

- P/E around 24
- Depends on growth expectations

Apple Risks

- Product cycles
- Competition
- Regulation

Case Conclusion

- Great company \neq great stock
- Depends on price

Common Mistakes

- Overreliance on ratios
- Ignoring cash flow
- Assuming growth

Framework Recap

- Business
- Quality
- Financials
- Valuation
- Decision

Final Takeaways

- Think critically
- Use multiple tools
- Focus on value vs price