



Business Risk

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Business Risk Factors - Explained

Macro

- Does the monetary policy restrict currency availability?
- Are the company's cash flows affected by FX volatility?
- Is there a stable government?
- Has the country defaulted on any of its debt commitments
- What is the regulatory framework of the country?
- Are there tariffs or onerous taxes?
- Access to natural resources, human resources, infrastructure?
- Consumer spending level?

Industry

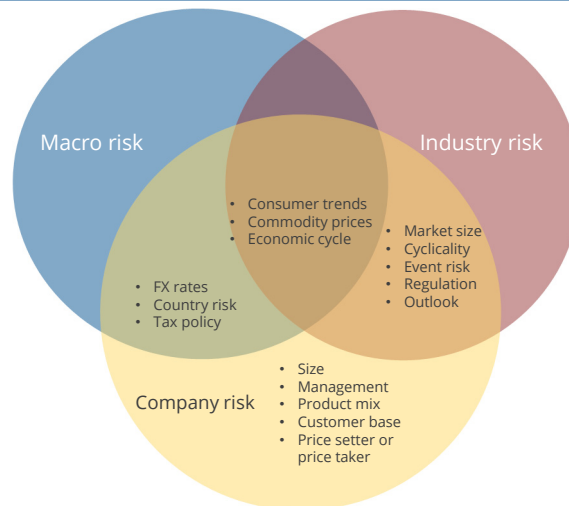
- Do people still want to buy the products or are there replacements/disrupters?
- Can increases in commodity prices be passed on to the consumer?
- Is the industry cyclical, seasonal?
- How big is the market. Is it big enough for everyone?
- What events might affect industry (e.g. war, terror, climate change?)
- Will any industry regulations have a negative affect?
- What is the general economic outlook for the industry

Company

- Size matters! Larger companies can withstand economic shocks far better
- Do you trust the management team? Do they set realistic goals and deliver on them?
- Is the product mix diverse enough if a major product line suffers?
- Does the company have a large customer base or a small group of high value customers?
- Is the company a market leader, fast follower or lagging behind the competition?
- Are its products differentiated?
- Are the shareholders expectations aligned?

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Intersection of Business Risk Factors



Could anything happen that would specifically affect the ability of the industry and/or company to generate operating cash?

Business Risk – Operating Country

Australia	AAA
USA	AA+
France	AA
Japan	AA-
Ireland	A+
Slovakia	A
Malaysia	A-
Thailand	BBB+
Spain	BBB
India	BBB-
Indonesia	BB+
Paraguay	BB
Bangladesh	BB-
Sri Lanka	B+
Barbados	B
Egypt	B-
Greece	CCC
Ukraine	CC
Argentina	SD

Source: S&P

If the company's operations are mainly located in one country the sovereign will normally be the ceiling rating

Sovereign ratings will impact the country's corporate ratings

Business Risk – Industry Dynamics

High risk

Transportation, homebuilders and developers, metals and mining, Oil and gas refining, technology hardware and semiconductors

Medium risk

Agribusiness, building materials, aerospace and defense, media and entertainment, retail and restaurants

Low risk

Pharmaceuticals, REITs, railroads, logistics, transportation infrastructure,

Competition

Technological change

Regulatory change

Substitution risk

Cyclical

Barriers to entry

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Drivers of Value

- Consider the market's view of the future prospects of a business

Growth

Margins



HIGHER valuation driven by high growth and margins

Risk



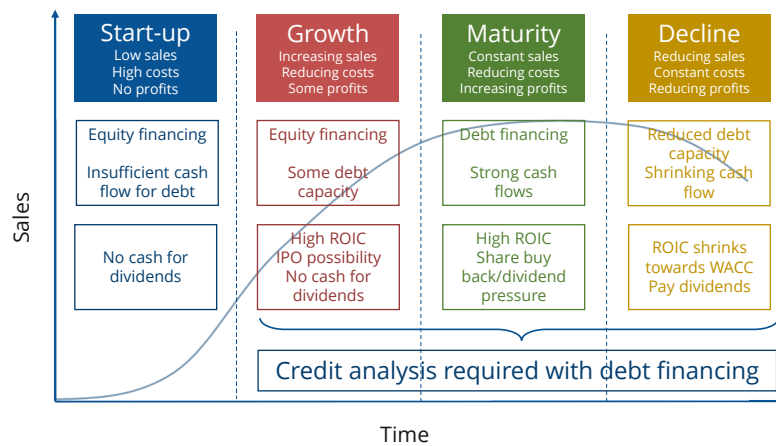
LOWER valuation associated with lower growth

- What do each of these really mean for a business?

Let's ignore the numbers for now and understand the qualitative drivers of each

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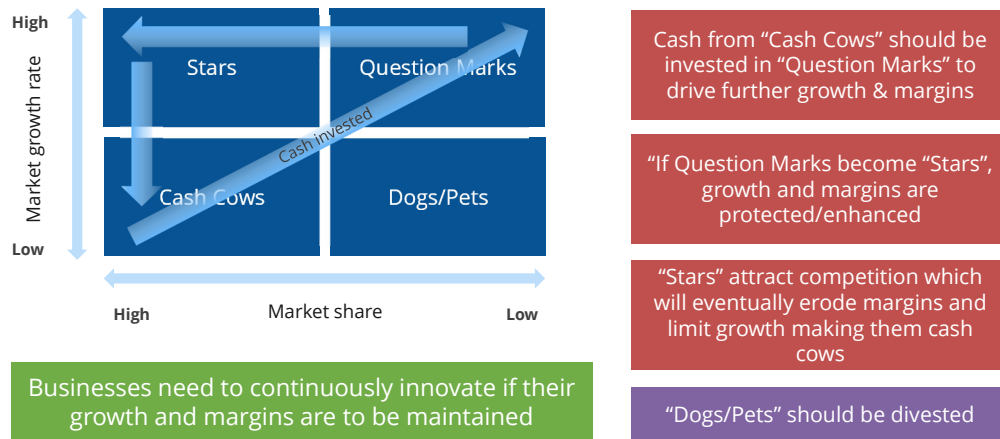
Company Lifecycle - Explained

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BCG Matrix

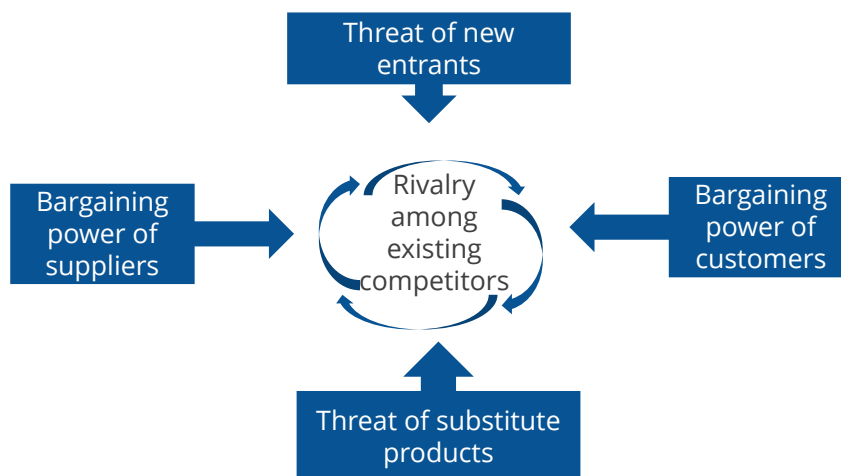
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BCG Matrix - Explained



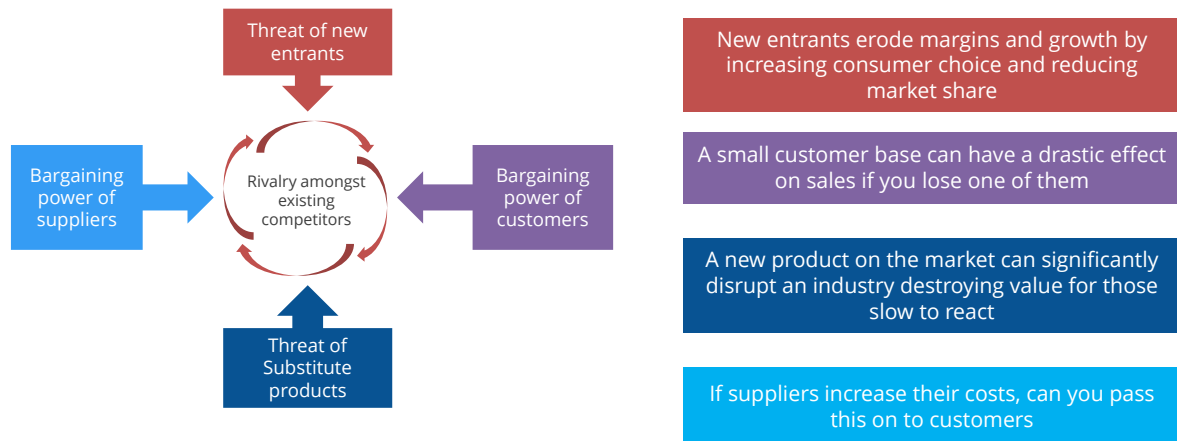
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Porter's Five Forces



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Porter's Five Forces - Explained



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Business Risk – Company Position / Peer Group Analysis

Company Name	Credit rating	Total Debt/EBITDA [LTM]	EBITDA Margin % [LTM]	Est. 2 Year Growth Rate %	Revenue LTM	
Wal-Mart Stores Inc.	AA	1.41	7.39	1.84	315,950.2	Diversity
Costco	A+	1.29	4.02	6.13	75,073.7	Price setter
Target Corp.	A	1.83	9.58	2.53	48,265.7	Product quality
The Kroger Co.	BBB	2.26	4.76	3.92	72,199.7	Execution
Flowers Foods, Inc.	BBB-	1.66	11.4	1.38	2,465.9	Management quality
Whole Foods Market, Inc.	BBB-	0.045	9.31	10.1	10,212.7	Market share
Ingles Markets, Inc.	BB-	3.87	6.27	1.21	2,568.4	Shareholder pressures
Smart & Final Stores, Inc.	B+	3.74	4.35	11.3	2,426.5	
SUPERVALU Inc.	B+	3.51	4.36	2.16	11,534.0	
The Pantry, Inc.	B+	3.57	3.93	-	4,260.7	
Safeway Inc.	B	1.97	4.2	-	23,634.6	
Tops Holding Corp.	B	6.09	5.26	-	1,656.4	
Fairway Group Holdings.	B-	18.1	1.78	3.16	535.8	

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Management Factor

Overall Qualities

- Accessible to insiders and outriders (credit and equity analysts)
- Transparent in discussing strategy and other activities, issues, problems
- Executes what has been discussed
- Rarely surprises anyone
- Trustworthy

Governance

- Aggressive corp culture
- Frequency of litigation
- High senior mgmt turnover
- Frequent changes in accounting policies

Operations

- Abrupt shifts in operating strategy
- Frequent restructurings, asset sales, layoffs
- Acquisitive

Financial

- Complexity of leverage/ capital structure
- High use of derivatives
- Aggressive in creating shareholder wealth

Estimating Business Risk – Part 1

Macro Risk factor	Low risk	1	2	3	4	5	6	High risk
Stable government	Stable							Unstable
Sovereign default	Never							Yes
Stable currency	Stable							Unstable
Combined macro Risk	Low macro risk							High macro risk

Industry factor	Low risk	1	2	3	4	5	6	High risk
Product popularity	Increasing							Declining
Commodity pressure	Pass on costs							Absorb costs
Cyclical industry	Non-cyclical							Highly cyclical
Market size	Large							Small
Event risk	Low							High
Regulatory risk	Unregulated							Highly regulated
Economic outlook	Good							Waning
Combined industry Risk	Low industry risk							High industry risk

Estimating Business Risk – Part 2

Company risk factor	Low risk	1	2	3	4	5	6	High risk
Combined macro risk	Low							High
Combined industry risk	Low							High
Size	Large							Small
Management team	Reliable							Unreliable
Product mix	Diverse							Small range
Customer base	Many and varied							Few and limited
Comparison with peers	Market leader							Small market share
Shareholder base	Aligned with management							Distracted by activists
Overall business risk	Low							High