Understanding the Factors Affecting Share Prices

2 December 2014
Disclaimer for presentations

- This presentation is intended to provide a general overview for information and educational purposes only and is not a comprehensive treatment of the subject matter. The information is provided generally without considering specific circumstances and should not be regarded as a substitute for professional advice. The Investor Education Centre (“IEC”) has not advised on, passed on the merit of, endorsed or recommended any of the products/services or types of products/services referred to in this presentation. Readers/Audiences should seek professional advice if they consider necessary.

- The IEC endeavours to ensure that the information contained in this presentation is accurate as of the date of its presentation, but the information is provided on an "as is" basis and the IEC does not warrant its accuracy, timeliness, or completeness. The IEC has no obligation to update this presentation as law and practices change. In no event shall the IEC accept or assume any liability (including third party liability) nor entertain any claim for any loss or damage of any kind howsoever caused arising from or in connection with the use of or reliance upon this presentation (including whether caused by the IEC’s negligence or any error or omission in information or otherwise).

- Examples and case studies provided in this presentation are for educational purposes only. All background information, characters and situations created for the examples and the case studies are fictitious.

Copyright for presentations

- The Investor Education Centre (“IEC”) is the owner of the copyright and other intellectual property rights in this presentation. This presentation (in whole or in part) may not be reproduced or distributed, or used for commercial purposes, without the prior written permission of the IEC.

Copyright © 2014 Investor Education Centre. All rights reserved.
• Supported by the four financial regulators and the Education Bureau

• Aims to improve financial literacy in Hong Kong

• Equip the general public with skills and knowledge to make informed financial decisions and manage their money wisely

• Provide comprehensive, credible and impartial financial information, tools and education resources
Some basics...

- Two forms of capital: Equity (share) & Liability (debt/loan)
- A share represents some ownership in a company.
- Ownership in a company entitles a shareholder to:
  - Receive dividend (part of the company’s profit)
  - Vote on major issues of the company
  - Receive money in case of sale of company/business/assets (e.g. M&A, liquidation)
  - Others
Some basics...

- Shareholders have lower priority claim on a company’s assets than lenders:
  - Interest paid before dividend
  - Debts/Loans repaid first in case of company restructuring or liquidation. Shareholders get residual money

- Share price reflects the economic value of these entitlements

- Share price reflects EXPECTED FUTURE
Investors estimate the value of dividend stream and expect a future share price.

Share price is driven by estimation of dividend and expected future share price, i.e. “return”
About Share Price…

- Return

Single Period Holding Period Return (HPR) = \[ \frac{CF_1 + (P_1 - P_0)}{P_0} \]

where HPR : Holding Period Return
P_1 : Ending Price
P_0 : Beginning Price
CF_1 : Cash Flow (Dividend) during Period One

Component 1: Income

\[ \frac{CF_1}{P_0} \]

Component 2: Capital Appreciation

\[ \frac{(P_1 - P_0)}{P_0} \]
About Share Price…

Risk

- Most investors are risk averse, thus prefer “Steady Eddie” to “Volatile Joe”
- Investors demand higher return for stocks with volatile business performance
About Share Price…

Stock valuation

- Common matrixes: price/earnings ratio (P/E), price/book ratio (P/B)
- P/E: If earnings/per share = $1, share price = $12, P/E = $12/$1 = 12x
- Factors affecting valuation of stock:
  - Business prospects / growth
  - Profitability
  - Size of company
  - Stability and predictability
  - Management quality and corporate governance
Factors Affecting Share Prices

- Supply vs Demand

<table>
<thead>
<tr>
<th>Scenario</th>
<th>share price</th>
</tr>
</thead>
<tbody>
<tr>
<td>buying power &lt; selling power</td>
<td>↓</td>
</tr>
<tr>
<td>selling power &gt; buying power</td>
<td>↑</td>
</tr>
</tbody>
</table>

- Why buying power ≠ selling power?
  - Different investors have different estimates
  - Different investors require different returns
  - Investor-specific reasons, e.g. liquidity needs
Factors Affecting Share Prices

- Market
- Profitability
- Corporate Activities
- Others

Share Price
Factors Affecting Share Prices

Share Price

Profitability
Profitability – Company Performance

- Improved Profitability (Sales / Costs)
- Competition (Business / Capital Market)
- Corporate Governance
- Red Flag
Profitability – Macro Factors

- General Economy / Business Environment
- Government (Political / Legal / Economics)
- Overall Political Environment
- Social Changes
- Costs of Input
- Sector Business Prospects
Factors Affecting Share Prices

Market

Share Price
Market – Macro

- Market Liquidity
- Market Interest Rate
Market – Intermediaries

- Addition to / Removal from Stock Index
- Investment rating by research analysts
Market – Investors

- Movements by Substantial Investors
- Market Sentiment
- Speculation
- Insider Trading
- Stock Manipulation
- Derivative Products
Factors Affecting Share Prices

Corporate Activities

Share Price
Corporate Activities

- Unexpected Dividend Payout / Change in Dividend Policy
- Ex-dividend
- Scrip Dividend / Bonus Share
- Share Split / Consolidation / Buy-back
- Privatization
- Mergers and Acquisitions
- Spin-offs
Factors Affecting Share Prices

Share Price

Others
Others

- Natural disasters
Visit the IEC website www.hkiec.hk
Thank you