



Intrinsic Value vs Value & Growth: What's the difference?

VALUE & GROWTH INVESTING:

The two investment styles – Value and Growth – have divided the investment world for over fifty years. The two styles have become not only schools of investment thought, but labels for indexes, portfolio managers and mutual funds. The major differences between the two styles are as follows:

- Value: considered “low-priced” relative to price to earnings (P/E), price to book (P/B), and price to sales (P/S) ratios
- Growth: considered “high-priced” relative to P/E, P/B, and P/S ratios.

However, these financial ratios only result in simplified math metrics and are used to create two style indexes. For example, the S&P 500 Value Index includes 1/3 of the companies of the S&P 500 that have the highest ratio for the Value Rank (low priced metrics). The Growth Index is created with a similar methodology.

It's easy to look at a stock with a low P/E ratio and believe that means it's “underpriced,” a bargain, and good investment. But it could have operation weakness, governance issues, management issues, shrinking earnings, growing competition and so on. Conversely, a rapidly growing company is not synonymous with increased returns, because future growth certainty is far lower since cash flow needed to justify its valuation will be realized far into the future.

INTRINSIC VALUE INVESTING:

Intrinsic value is defined as the “present value of discounted cash flow”. Intelligent investing can only be done when intrinsic value can be reasonably estimated. Thus, the essential underlying principles of Intrinsic Value Investing include:

- Viewing stocks as part ownership of a business
- Estimating *worth* which is far different than *market price*
- Knowing a company's economic moat and its sustainability
- Staying within the areas of competence
- Emotional discipline of not chasing returns and trying to predict price

At the end of the day, Intrinsic Value investing is the combination of value and growth; finding value based on future cashflow in business where future growth prospects can be reasonably estimated.

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Michael Anderson
Chief Investment Officer
Hi-Line Capital Management