Finding the undervalued European stocks, an introduction to my strategy

Financial reporting provides information that is useful to present and potential investors in making rational investment, credit, and similar decisions. It should help to minimize the information asymmetry between management and investors.

Since Europe has adopted IFRS as financial reporting standards. The relevance of information has become priority. Following IFRS ''*relevant financial information is capable of making a difference in the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both. The predictive value and confirmatory value of financial information are interrelated''.*

Fair value estimates are one of the most important pillars of this relevance of information. According to IFRS fair value is defined as: *"The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date"*. IFRS uses three levels of fair value, in one of my following articles I will explain how fair value is calculated. The fair value on a reporting date is basically the value of the individual components of the company. How can an investor profit from this?

For example, we take a Dutch stock named Stern Groep (STRN: AEX). Stern is a listed Dutch automotive group. The fundamentals are shown below:

	2012	**2013**	**2014**	**2015**	**Average**
Turnover	942,51	924,62	903,64	1.101,34	968,03
Costs	947,60	916,39	899,89	1.082,53	961,60
EBIT	-5,09	8,23	3,75	18,81	6,42
Profit	-6,89	3,06	3,62	11,07	2,72

Balance sheet	**2012**	**2013**	**2014**	**2015**	**Average**
Fixed assets	330,41	340,76	359,26	339,97	342,60
Cash	0,75	0,68	1,64	0,61	0,92
Current assets	173,76	183,62	208,35	245,72	202,86
Total assets	504,17	524,37	567,61	585,70	545,46
Equity	133,96	138,32	140,57	150,78	140,91
Total debt	504,17	524,37	567,61	585,70	545,46

Information	**2012**	**2013**	**2014**	**2015**	**Average**
Shares outstandig (x 1000)	5.399,00	5.651,00	5.660,00	5.674,00	5.596,00
EPS	-1,28	0,54	0,64	1,95	0,46
DPS	0,00	0,21	0,00	1,00	0,30
CPS	0,88	2,15	2,56	3,76	2,34
Intrinsic value	24,81	24,48	24,84	26,58	25,18
Dividend Yield	0,00	1,42	0,00	5,52	1,74
Stock price and of the year	13,80	14,82	13,00	18,12	14,94

Over 2016 a profit between 1,95 and 2,50 per share is expected.

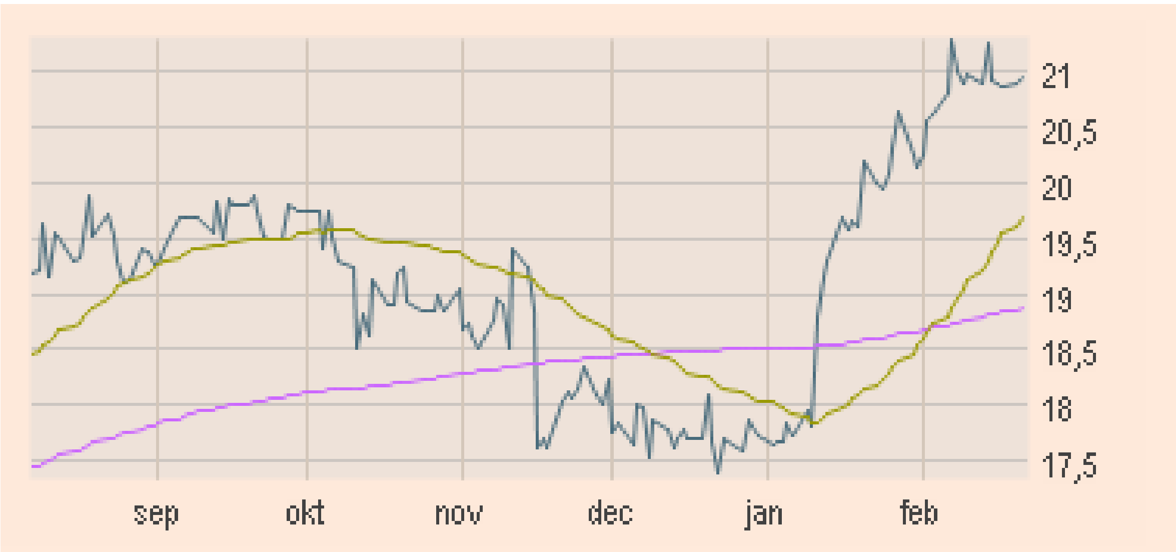
The intrinsic value of stern was end of 2015 26,58 and during the H1 of 2016 the intrinsic value was € 26,72, and the share price was € 18. What are the assets of Stern? Exactly cars, headquarters, dealer locations and cash. So in my opinion a few things could happen. 1) Stern could stop its business and sale everything which generates me around € 25 a share 2) a takeover by another party, which generates around € 25 -30 3) Stern could start a share buyback program.

On 11 January 2017 Stern announced its intention to start a buyback program. And therefore Stern is buying back shares of their own below intrinsic value. Therefore, Stern is adding a lot value for its shareholders.

> More Solutions and Services will be further explained in the 2016 Annual Report. The development of excess solvency in combination with the present dividend policy will also be addressed in the report. Currently, only the surplus solvency is available for distribution as dividend. The aim is to keep the cash dividend at its current level for the time being. When the excess solvency after dividend distribution has risen to over € 5 million, we will reserve the surplus for share buy-backs at prices of up to 75% of the most recently published net asset value per share (€ 27.13 on 30 September 2016). Under the authority granted by the General Meeting, repurchase of own shares can only be effected with the approval of the Supervisory Board.

Source: https://www.stern.nl/sterngroep/Press-releases/16216055/24999725/Stern-moves-to-more-Solutions-and-Services.html?publicationdate=True

An example if you have a company intrinsic worth €100 and valued €50 on the stock market with 100 share outstanding (IV of €1 per share and share price of € 0,50). The company announces to buy back €25 of shares. At the end the company has an intrinsic value of €75, and 50 shares outstanding therefore the intrinsic value grows to € 1,50 per share, also the EPS rises, and this is what is happening to Stern right now. Because less shares are on the market the earnings per share will rise and also the dividends have to be share with less shares. Stock prices have risen to €21 but there is room to €35 or above and profit of almost 100% with low risk. Also every year I receive a dividend of 5,6%.



Source: FD.nl

The low risk component is the main reason why I love stocks around their intrinsic value. When the market for the product my company is selling suddenly explodes. The company can simple decide to sell everything and I am only having a small loss. To quote Warren Buffet: *''Rule No.1: Never lose money. Rule No.2: Never forget rule No.1.''*

To conclude my buying criteria for my first stocks are:
Around or below intrinsic value (excluding goodwill)
Profitable
Understandable, which is reflected as easy to sell its assets
Paying dividends

Disclosure: Long Stern Groep