

# Value Creation Framework

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→ Please note that all slides are compilations from various books and presentations.

→ Views expressed herein are personal.

→ They are only with the sole purpose of good class discussion.

# FM2 Course ...

- ◆ Reasonable understanding of Accounting and Financial Management I
- ◆ Expectations from the course
- ◆ Who can avoid attending sessions?
- ◆ Who can ask questions?
- ◆ All ... preferably the ones who have not understood
- ◆ Class Discipline – Timeliness, Mobiles, etc.

# What is Value?

- ◆ Liquidation Value
- ◆ Operational (Going Concern) Value
- ◆ Historical Value
- ◆ Replacement Value
- ◆ Relative Value (interlinked with above)



Valuation of a asset or resource depends on two key issues:

- (a) Whose perspective are you looking at?
- (b) What is the purpose of valuation?

# Ram needs your help ...

Year 2001

- ◆ He has Rs 40 Million of Investible Funds ...
- ◆ Decides to invest in Real Estate ...
- ◆ Picks Four Cities ...
- ◆ Ahmedabad, Boston, Chennai, and Delhi
- ◆ Picks an apartment worth Rs 10 Million in each place

City	A	B	C	D
Investment in 2001	10	10	10	10

Which City-Apartment (or Investment) of Ram has created value?

City	A	B	C	D
Investment in 2001	10	10	10	10

# Jargons in Corporate Context ...

Corporate Context	A	B	C	D
Networth of the Firm (or BVPS)	10	10	10	10
Profit After Tax (PAT) in 2010	0.4	1.3	0.1	0.5
Market Capitalization in 2010	34	11	21	7
Market Cap-to-Rent Ratio	85	8.5	210	14
Market Cap-to-Investment Ratio	3.4	1.1	2.1	0.7



# Jargons in Corporate Context ...

Corporate Context	A	B	C	D
Book Value per Share	10	10	10	10
Earnings Per Share (EPS) in 2010	0.4	1.3	0.1	0.5
Market Price (MP) per Share in 2010	34	11	21	7
P/E Ratio	85	8.5	210	14
P/BV Ratio	3.4	1.1	2.1	0.7

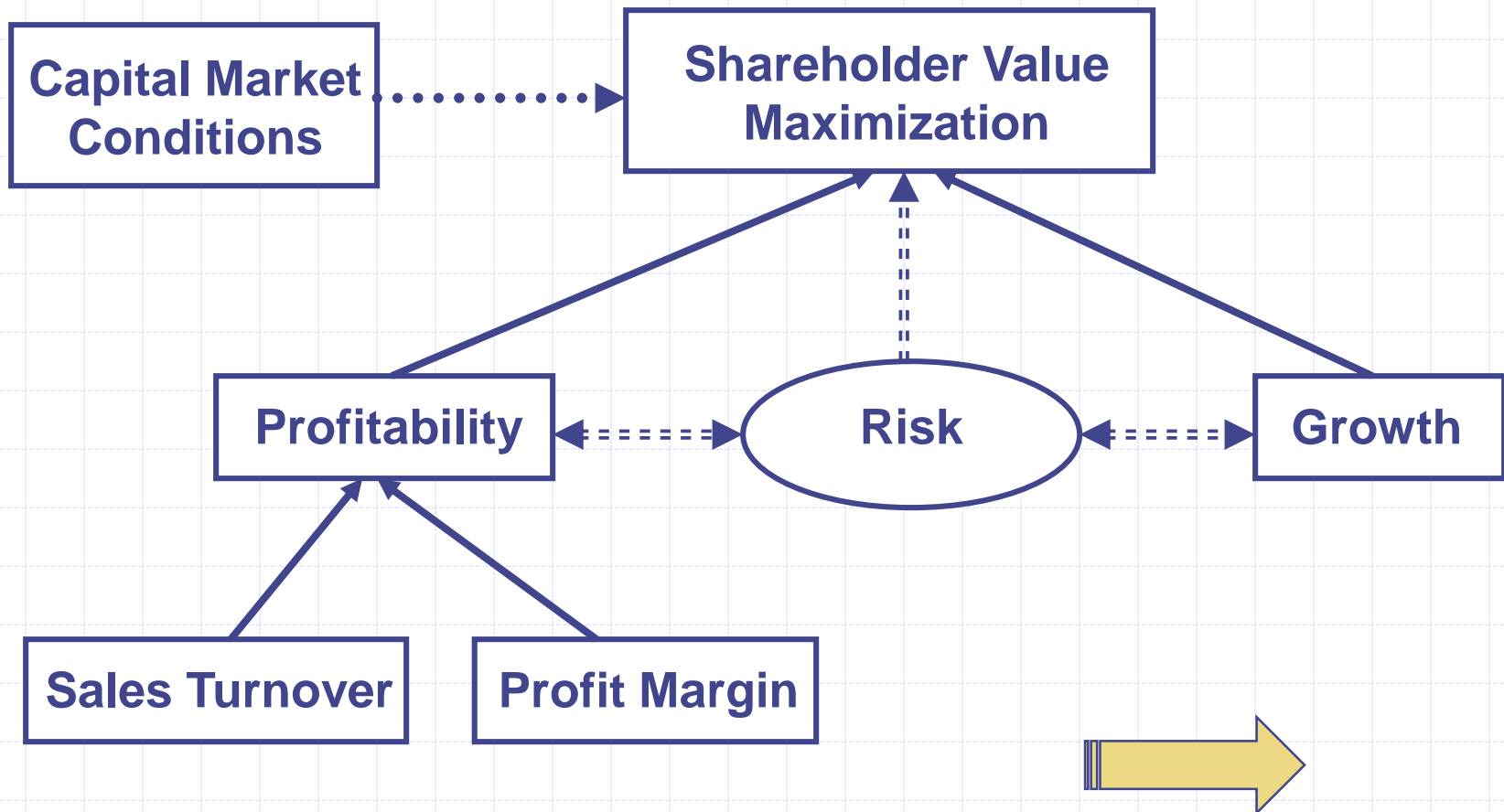
# Importance of Market Value

◆ Factors influencing market value or shareholder(s) value

- Profitability
- Growth
- Risk
- Capital Market Conditions

◆ Can we put this in a framework and find measures?

# Valuation Framework ...



**Source:** Ram Kumar Kakani, Doctoral Dissertation '*Financial Performance and Diversification Strategy of Indian Business Groups*', Indian Institute of Management Calcutta, 2001.

# Value Maximization Measures

- ◆ If 'n' is the number of equity shares
- ◆ Earnings Per Share (E.P.S.) =  $PAT/n$
- ◆ Market Capitalization = (Market Price per share) x n
- ◆ Book Value of Equity (BV) =  $NW/n$
- ◆ Price-to-Earnings Per Share (P/E Ratio)  
= Market Price per Share/EPS = Market Capitalization/PAT
- ◆ Price-to-Book Value Per Share (P/BV Ratio)  
= Market Value per Share/BV per share  
= Market Capitalization/Net Worth

# Shall we value some firms ...

## ◆ Infosys Technologies

○ Market Price is 2,525 and P/BV ratio is 8.1

## ◆ Colgate Palmolive

Market Price is 690 and P/BV ratio is 43.4

## ◆ Maruti Suzuki

Market Price is 1,453 and P/BV ratio is 4.5

## ◆ Tata Motors

Market Price is 785 and P/BV ratio is 3.0

## ◆ Kilburn Chemicals

Market Price is 45 and P/BV ratio is 0.9

## ◆ Shree Rama Multi Tech

Market Price is 7 and P/BV ratio is  $< 0.1$

# Shall we value some firms ...

07/01/2010	Price	BV	P/BV	EPS	P/EPS
Infosys	2525	311	8.1	105.9	24
Colgate Palmolive	690	16	43.4	25.5	27
Maruti Suzuki	1453	323	4.5	55.7	26
Tata Motors	785	271	2.9	30.6	26
Kilburn Chemicals	45	50	0.9	4.3	11
Shree Rama Multi-Tech	7	64	0.1	na	#####

# Shall we value some firms ...

## ◆ Zee Telefilm (in 1999, 2002, and 2010)

- Dec-1999 was period when stock market was on a bull run especially for IT and Media sectors ... then (?)
- Profitability (+, −, and 0)
- Growth (+, −, and 0)
- Risk (−, −, and 0)
- Capital Market Conditions (+, −, and 0)

◆ Result: Prices moved from 1900 to 70 to 250-300

◆ P/BV moved from 22 to 0.7 to 6-7

◆ *Note: In 2006, Zee Tele was split into Zee Entertainment and Zee News*

# Shall we value some firms ...

## Conclusions:

- (a) The relationship between value and the underlying financial factors works;
- (b) The relationship is stable over time; and
- (c) It is important to fully understand the business dynamics



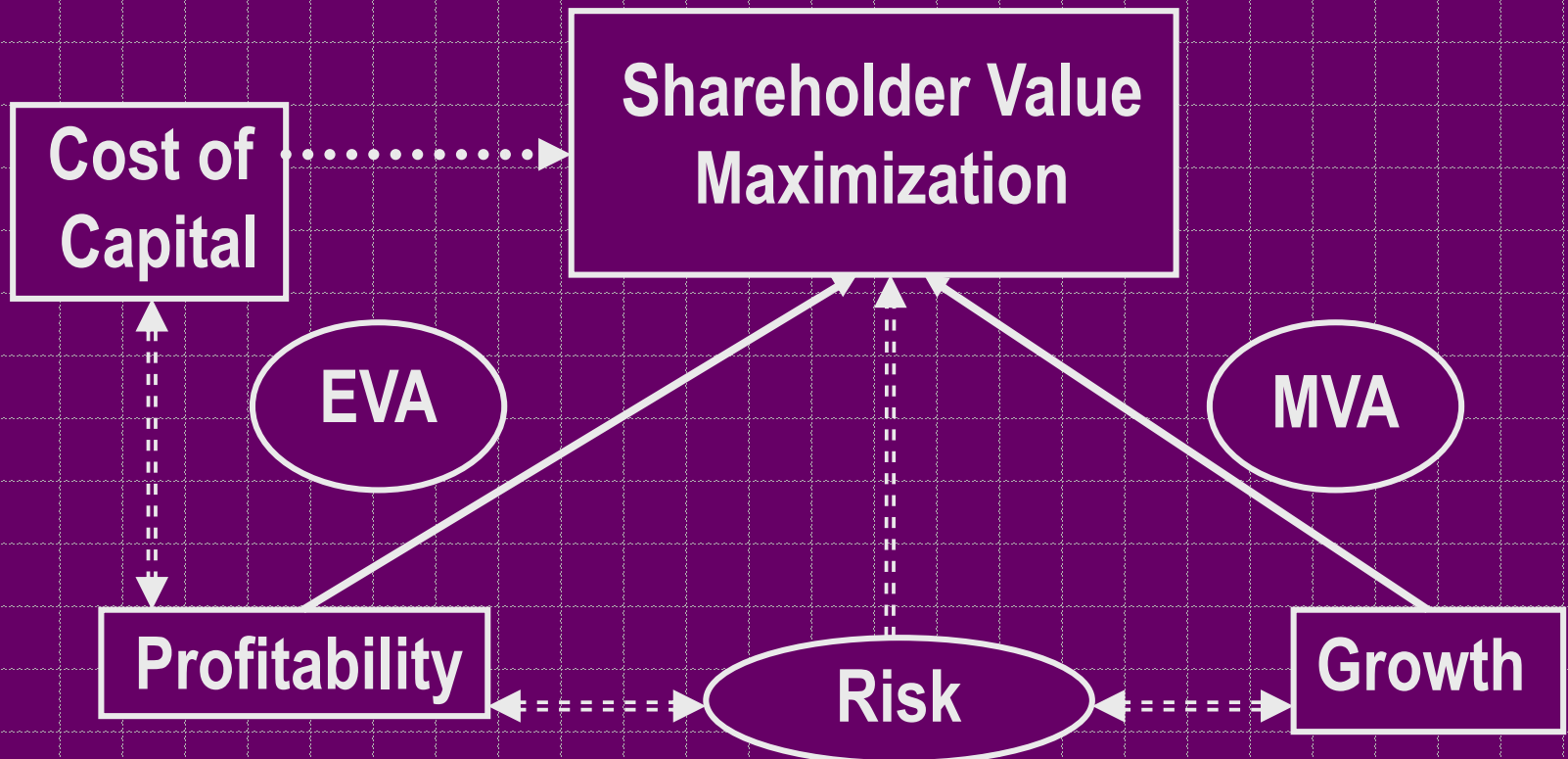
# Indian Tyre Sector

Performance Measure	Apollo Tyres	Falcon Tyres	TVS Srichakra	Vikrant Tyres
Growth Measure (CAGR <sub>TA</sub> )	12.56	11.10	18.72	32.43
Profitability Measure (ROA)	9.80	9.48	15.58	7.90
Profit Margin Measure (NPM)	3.36	2.51	5.30	2.83
Asset Utilization Measure (STA)	1.53	1.97	2.15	1.44
Risk Measure (VROA)	0.11	0.22	0.11	0.33
Market-to-Book Value Ratio	1.03	0.40	1.44	0.83
Tobin's Q Ratio (approximate)	0.84	0.62	1.05	0.77
Sales	1323	99	140	377
Market Capitalization	291	7	30	46

**Note:**

1. Data Source for Computation: CMIE-PROWESS
2. Time Period of Study is FY 1997-2000 (mean of 4 years)

# Can you connect this to Costs or EVA ...



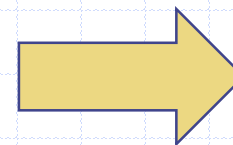
→ Market Capitalization = EVA + Present Value  
(of Future EVAs) ...

→ Market Capitalization = EVA + MVA ...

The Four Different Categories		Example
EVA Positive	MVA Negative	?
EVA Positive	MVA Positive	?
EVA Negative	MVA Positive	?
EVA Negative	MVA Negative	?

## Remarks

EVA Positive	MVA Negative	Firms not able to adjust to environment changes
EVA Positive	MVA Positive	
EVA Negative	MVA Positive	Firms with value accumulation or future dependent
EVA Negative	MVA Negative	Organizations with a different goal (not SVM)



# FM2 Course Outline

- ◆ Readings: Course Notes; Class Material;
  - Lower Level: Gitman; VanHorne & Wachowicz
  - Normal Level: RWJK, BMAM
- ◆ Evaluation Components:
  - Mid-term; Surprise Quiz; Take Home Assignment; Class Participation; Group Work; End-term;
- ◆ Take Home Assignment has already been detailed
- ◆ Ask doubts ... otherwise we will proceed fast