Value Creation Framework

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What is Value?

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

Valuation of a <u>asset</u> or <u>resource</u> or <u>organization</u> 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 …
- ◆ Agra, 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	10	10	10	10
Proft 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?

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 2,970 and P/BV ratio is 5.7

◆ **Colgate Palmolive (India)**

Market Price is 1,332 and P/BV ratio is 32

◆ **Tata Steel**

Market Price is 359 and P/BV ratio is 0.7

◆ **Footwear Industry**

Bata India … Market Price is 784 and P/BV is 7.0

Relaxo Footwear Market Price is 674 and P/BV is 4.7

Lawreshwar Polymers Market Price is 6 and P/BV is 0.3

◆ **Shree Rama Multi Tech**

Market Price is 5 and P/BV ratio is < 0.1

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Shall we value some firms ...

| 9-Mar-13	Perception	Price	BV	P/BV	EPS	P/EPS
Infosys Technologies	3-4 Pluses	2970	518	5.7	166.7	18
Colgate Palmolive (India)	3 Pluses	1332	32	41.6	37.1	36
Tata Steel	0-1 Pluses	359	538	0.7	54.7	7
Bata India	3 Pluses	784	111	7.0	26.7	29
Relaxo Footwear	2 Pluses	674	144	4.7	41.8	16
Lawreshwar Polymers	2 minus	6	22	0.3	0.9	7
Shree Rama Multi Tech	3-4 minuses	5	?		2.0	3

Shall we value some firms ...

- Zee Tele (during years 1999, 2002, and 2013)
  - Year 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 220-240
- P/BV moved from 22 to 0.7 to 7.3
- *Note: After FY2006, Zee Tele has been split into Zee Entertainment, Zee News, and Zee Learning*

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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 is to fully understand the business dynamics

Can you connect this to Costs or EVA ...
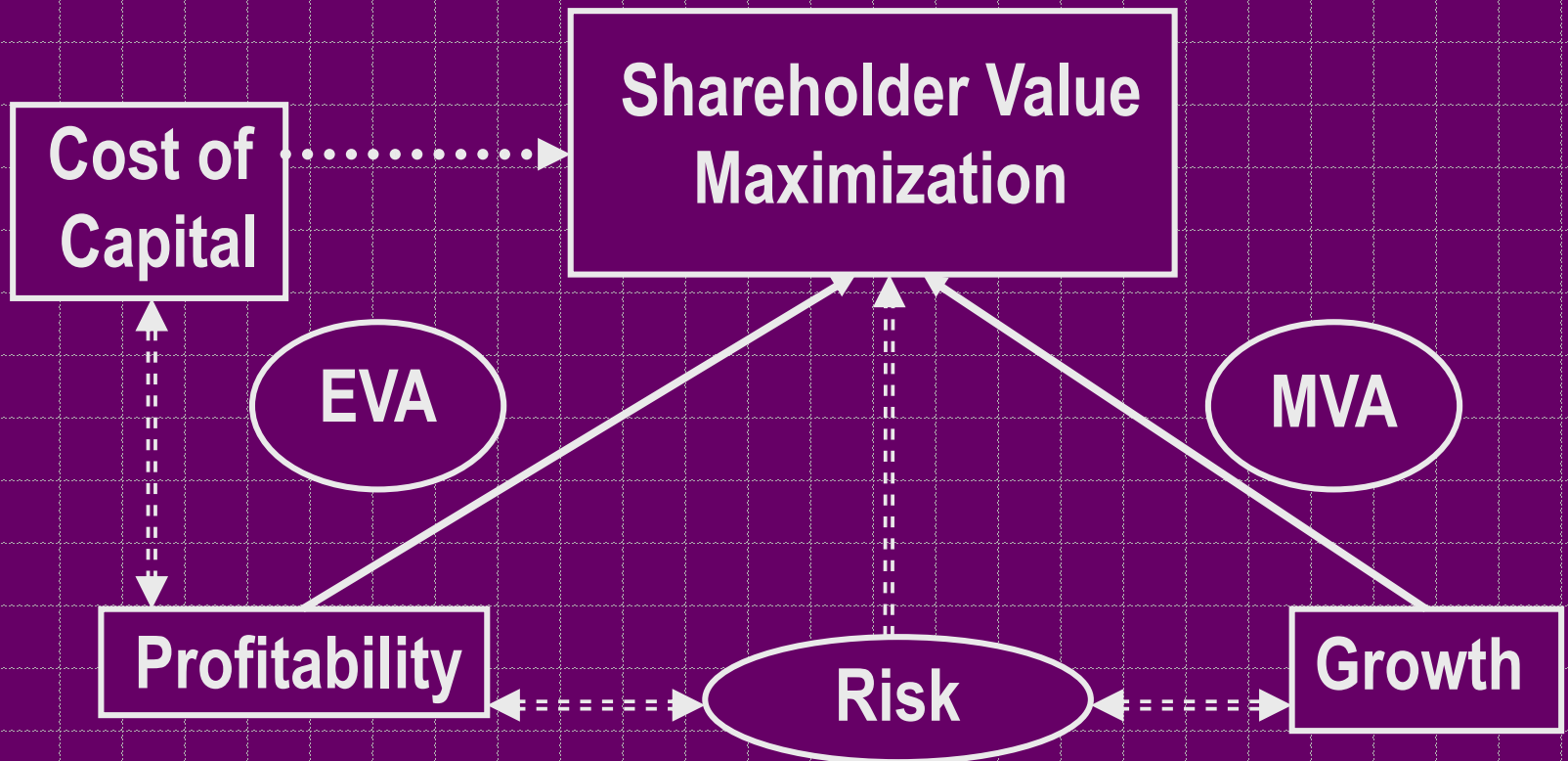
➔ Market Capitalization = EVA + Present Value (of Future EVAs) ...

➔ 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)

What could be done as part of 'Take Home Assignment' for Day 3

◆ **Similar questions that could be probed/answered (as part of First Session i.e., chapter 1 + 14 related)**

Looking at the relative importance of various components of Balance Sheet of your firm– discuss the type of Investment Decisions, Financing Decisions, & WCM Decisions dealt by your firm … write in your own words to the extent feasible.

◆ **Similar questions that could be probed/answered (as part of Second Session i.e., value drivers presentation)**

Can you use 'Shareholder Value Maximization' framework to discuss how your company performs on the same (along with 1-2 peers) … similar to what we did on Bata, Relaxo, Lawreshwar Polymers, etc.

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