



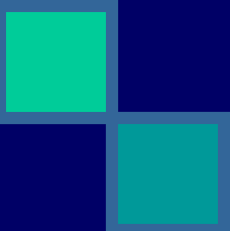

# VALUE CREATION FRAMEWORK

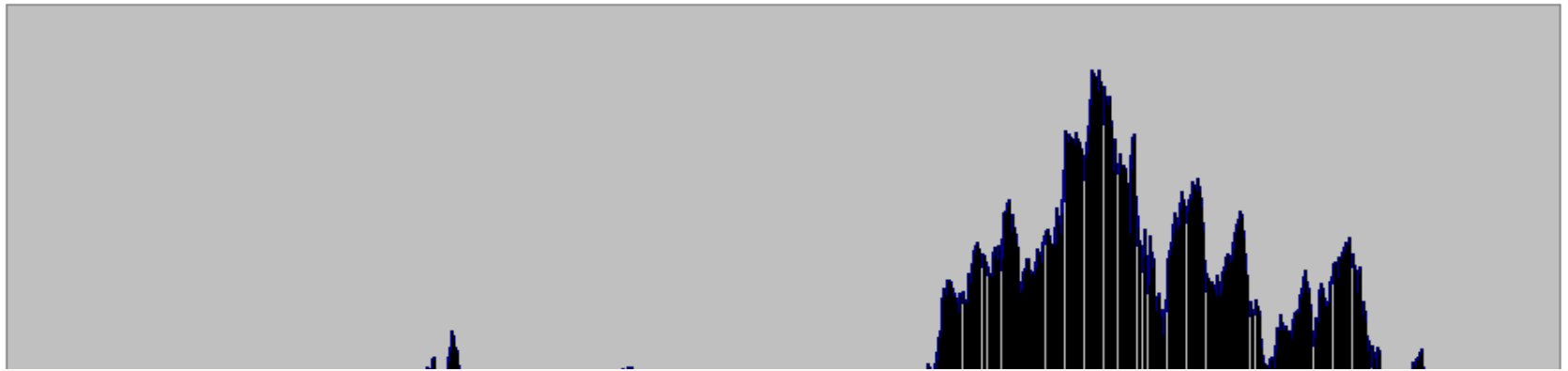


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# What is Value?

- 
- Liquidation Value
  - Operational (Going Concern) Value
  - Historical Value
  - Replacement Value
- 



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 ...
- Amsterdam, Boston, Chennai, and Dubai
- Picks an apartment worth Rs 10 Million in each place

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

# Which Flat (or Investment) of Ram has created value?

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

# Jargons in Corporate Context ...

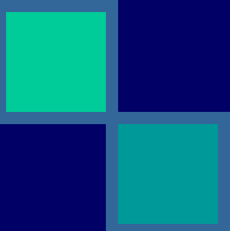

<b>Corporate Context</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>Networth of the Firm</b>	10	10	10	10
Net Income in 2006	0.2	1	0.1	0.5
Market Capitalization in 2006	34	11	21	8
<b>Market Cap.-to-Net Income Ratio</b>	170	11	210	16
<b>Market Cap.-to-Net Worth Ratio</b>	3.4	1.1	2.1	0.8

# Jargons in Corporate Context ...

<b>Corporate Context</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
<b>Book Value (BV) Per Share</b>	10	10	10	10
<b>Earnings Per Share (EPS)</b>	0.2	1	0.1	0.5
<b>Market Price (MP) Per Share</b>	34	11	21	8
<b>P/E Ratio</b>	170	11	210	16
<b>P/BV Ratio</b>	3.4	1.1	2.1	0.8

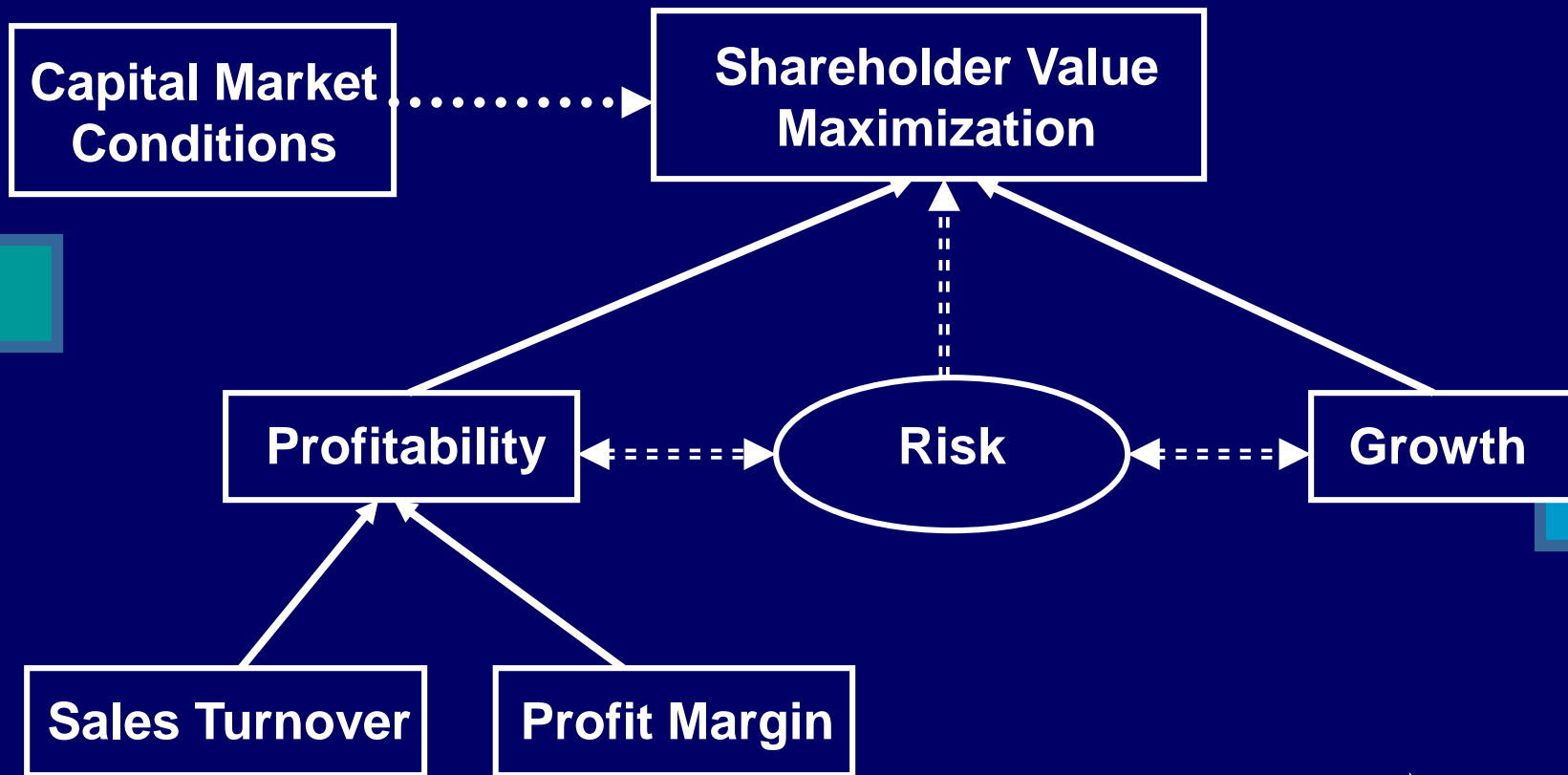


# Importance of Market Value

- 
- Factors influencing shareholder value
    - Profitability
    - Growth
    - Risk
    - Capital Market Conditions
  - Can we put this in a framework and find measures?
- 



# Valuation Framework ...



**Source:** Doctoral Dissertation, title '*Financial Performance and Diversification Strategy of Indian Business Groups*', Indian Institute of Management Calcutta, March 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 2,223 and P/BV ratio is 8.9

- Colgate Palmolive

Market Price is 395 and P/BV ratio is 19.8

- Tata Steel

Market Price is 482 and P/BV ratio is 2.7

- Essar Steel

Market Price is 36 and P/BV ratio is 1.1

- Shree Rama Multi Tech

Market Price is 6 and P/BV ratio is 0.1

# Shall we value some firms ...

27/11/2006

	Price	BV	PIBV	EPS	P/EPS
Infosys	2223	250	8.9	54.0	41
Colgate Palmolive	395	20	19.8	10.2	39
Tata Steel	482	176	2.7	62.5	8
Essar Steel	36	31	1.1	3.9	9
Shree Rama	6	64	0.1	-7.0	

# Shall we value some firms ...

- Zee Telefilm (in 1999, 2002, and 2006)
  - Dec-1999 was period when stock market was on a bull run especially for IT and Media sectors ... then (?)
  - Profitability (+, –, and –)
  - Growth (+, –, and –)
  - Risk (–, –, and 0)
  - Capital Market Conditions (+, –, and 0)
- Result: Prices moved from 1900 to 70 to 360
- P/BV moved from 22 to 0.7 to 7
- Similarly, we can do it for other firms ...

# Shall we value some firms ...

27/11/2006	Price	BV	P/BV	EPS	P/EPS
Infosys	2223	250	8.9	54.0	41
Colgate Palmolive	395	20	19.8	10.2	39
Tata Steel	482	176	2.7	62.5	8
Essar Steel	36	31	1.1	3.9	9
Shree Rama	6	64	0.1	-7.0	
Zee Tele	372	52	7.2	1.0	361

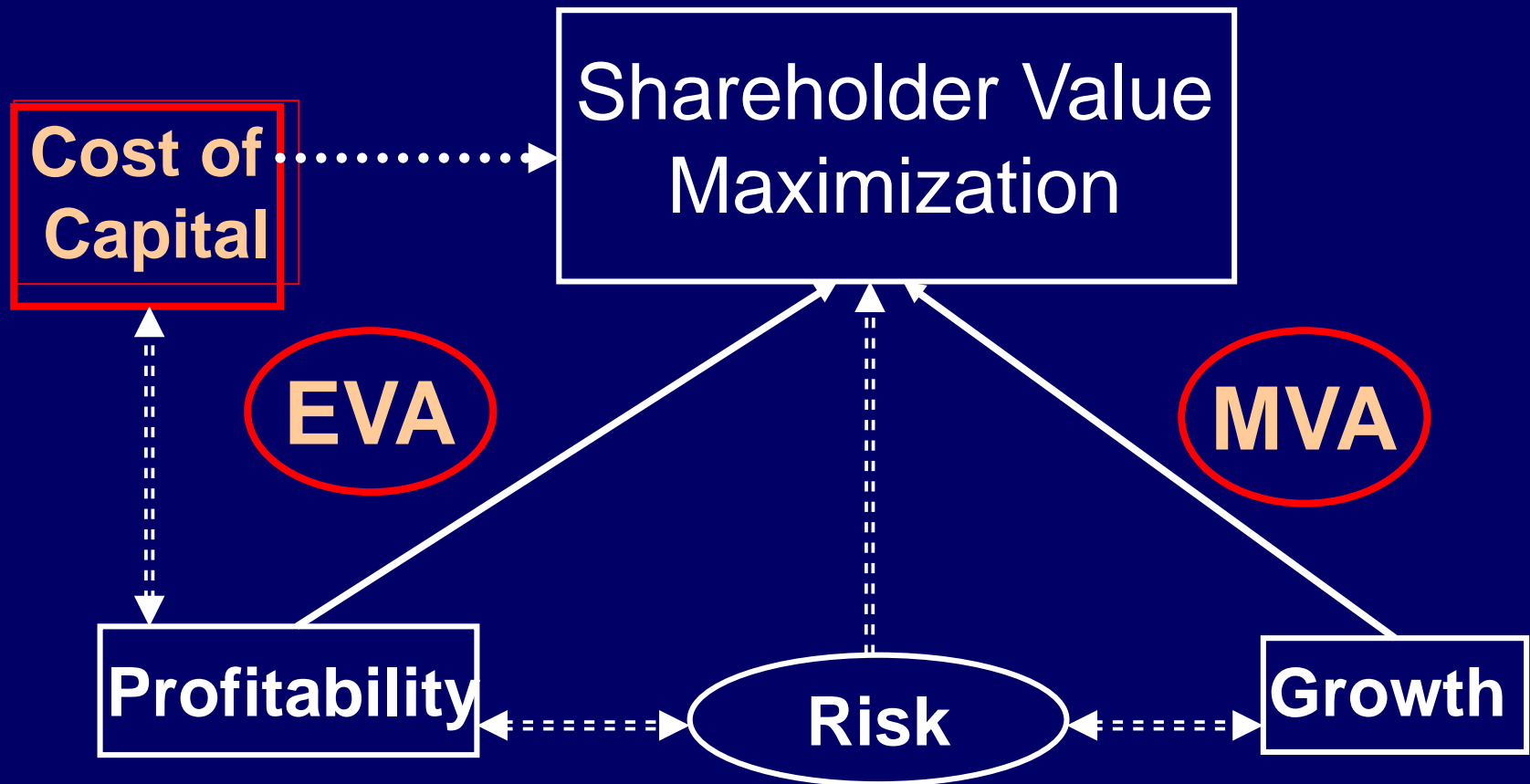
# India's Tyre Sector

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 we connect this to Costs or EVA ...

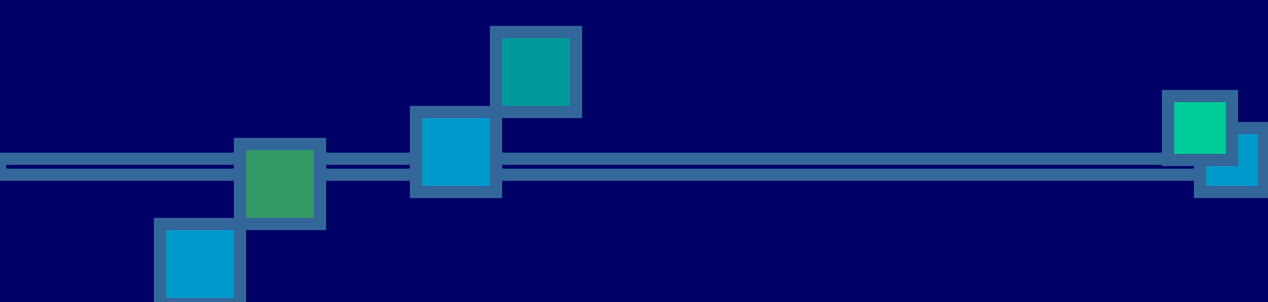




→ Market Capitalization = EVA + Present Value (of Future EVAs) ...

→ 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 was the purpose of this discussion?**

- **Accept Market Capitalization as the goal (of the firm)**
- **Understand the factors driving Market Capitalization; and the way they do it**
- **Link EVA, MVA to the Valuation of the Firm**
- **Next Session: Different Approaches to Valuation**