Valuation Models – Assignment II

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A company valuation is an objective search for a "true" or "fair" value. Valuing a company involves studying a set of procedures used to estimate the economic value of an owner's interest in the firm / organization. Valuation is used by market players to determine the price they are willing to pay or receive to consummate a sale.

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A BRIEF SYNOPSIS OF THE COMPANY

Sector: Technology

Industry: IT Consulting and Services

Current Market Price: $6.93

Indicator		Indicator	
Enterprise Value	973.31m	Beta	1.9
Enterprise Value/ EBITDA Multiple	2.48	P/Sales	0.3
Net Debt	139.60m	P/BV	0.67
Enterprise Value/ Total Market Cap	1.17	P/FCF	11.94
EBITD Margin (Avg)	14.5	ROA (Avg)	6.71
Net Profit Margin (Avg)	9.23	ROI (Avg)	8.95
EPS	6.98	ROE (Avg)	11.28

VALUATION OF THE COMPANY THROUGH VARIOUS MODELS

1. EARNINGS PER SHARE DISCOUNT MODEL:

Value of a company = EPS_1/ (Ke – g)

Where EPS = Earnings per Share

Ke = Cost of Equity

G = Growth

Having analyzed the financial statements for the company since the time of listing in 1998, it was observed that it has not paid any dividend till date. Hence, *valuation through the dividend discounting model or the two phase growth model may not be applicable.* It is due to this reason that we discount EPS to value the company.

EPS	Ke (Given)	Growth *	EPS1 = (EPS*(1+Growth)
6.98	14%	1.95%	**7.17**

*(Source:http://www.convergys.com/pdf/investor/annual_report_2003.pdf, http://www.convergys.com/pdf/investor/annual_report_2004.pdf, http://www.convergys.com/pdf/investor/annual_report_2005.pdf ,
http://www.convergys.com/pdf/investor/annual_report_2006.pd, http://www.convergys.com/pdf/investor/annual_report_2007.pdf, http://www.reuters.com/finance/stocks/ratios?symbol=CVG.N)*

** Growth was calculated based on Compounding Annual Growth Rate of revenues for the period 2003 – 2008*

Value per share as per EPS Discounting Model = $***59.07***

Note: The two stage EPS growth model may not be applicable in this scenario as a growth rate of 1.95% indicates that the company is already in the constant growth stage.

2. PRESENT VALUE OF GROWTH OPPORTUNITIES:

Having analyzed the financial statements for the company since the time of listing in 1998, it was observed that it has not paid any dividend till date. Hence, *valuation through this model or the two phase growth model may not be applicable.*

3. LIDUIDATION MODEL:

We analyzed the balance sheet of the company for the period 2003 – 2007 and noted that there were no reserves created for revaluation purposes. Also, most companies in the industry use property on leasing contracts and hence we can assume that the book value of the firm is the liquidation size of the company.

Net worth as per year ended 2007 = ***$1,521 Million.***

(Source:http://www.convergys.com/pdf/investor/annual_report_2004.pdf, http://www.convergys.com/pdf/investor/annual_report_2005.pdf, http://www.convergys.com/pdf/investor/annual_report_2006.pdf, http://www.convergys.com/pdf/investor/annual_report_2007.pdf)

The aforementioned figure indicates that in an exit scenario the common shareholders would realize $ 1,521 Million.

4. RELATIVE VALUATION/ PRICE TO BOOK VALUE METHOD:

Since Convergys is a mature company we use the Price to Book Value Method of valuing the company. Here, we multiply the Book Value of the company with the average Price to Book Value of its competitors.

Table 1: Price to book value ratio of competitors

IBM	Amdocs	APAC	Accenture Ltd.	Sykes Enterprise Incorporated	*Average*
4.21	1.47	2.5	8.98	1.81	***3.794***

(Source:http://www.convergys.com/pdf/investor/annual_report_2007.pdf, http://www.reuters.com/finance/stocks/ratios?symbol=IBM.N, http://www.reuters.com/finance/stocks/ratios?symbol=DXO.N, http://www.reuters.com/finance/stocks/ratios?symbol=APAC.N, http://www.reuters.com/finance/stocks/ratios?symbol=ACAN.N, http://www.reuters.com/finance/stocks/ ratios?symbol=SYKES.P)

Value of the firm as per the price to book value model = 3.794*$1,521 Million

Value as per P/BV model = ***$5,770 Million or $5.77 Billion***

Actual P/BV = 0.67

Value of firm using actual P/BV = 0.67*$1,521 Million = ***$1,109 Million or $1.109 Billion***

Using the Price to Book Value method may over value the stock of the company. This method is far more likely to provide an accurate reflection of market volatility and perceptions as compared to the discounted cash flow or the decision tree method. The relative valuation technique generally requires less information as compared to other methods. On the downside, due to its nature the relative valuation technique uses the several implicit assumptions. The results are accurate to the extent of the accuracy of the underlying assumptions.

This method may be particularly useful in valuing unlisted companies.