

Value Creation Framework

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What is Value?

- ◆ Liquidation Value
- ◆ Operational (Going Concern) Value
- ◆ Historical Value
- ◆ Replacement Value
- ◆ Others Methods (Interlinked to the above)
 - Relative Value
 - Contingent Claim Valuation (... will explain later ... please ask)



Valuation of a asset or resource or organization 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
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

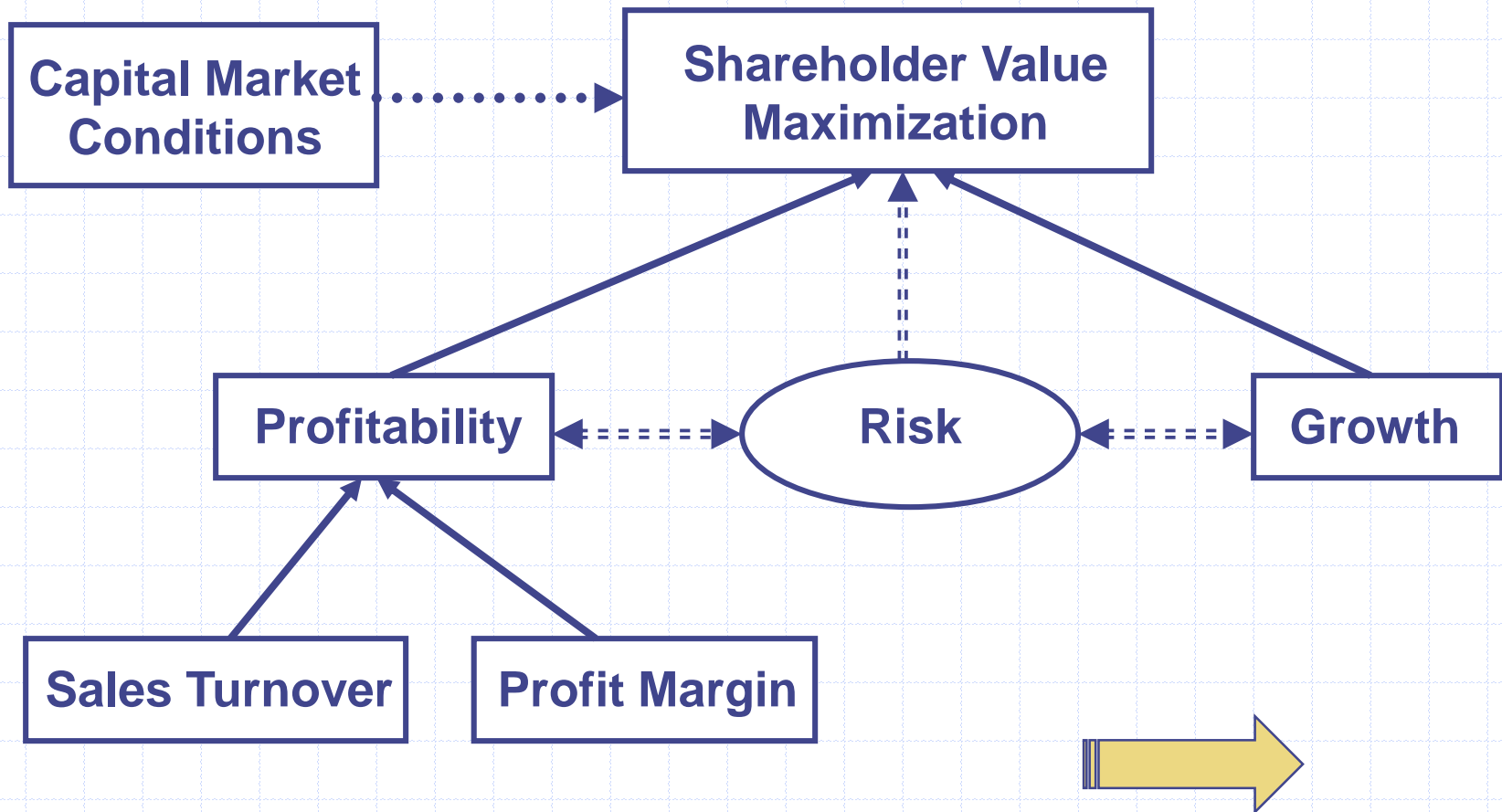
Importance of Market Value

◆ 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 2,462 and P/BV ratio is 3.9

◆ Colgate Palmolive (India)

Market Price is 1,474 and P/BV ratio is 21.5

◆ Tata Steel

Market Price is 299 and P/BV ratio is 0.5

◆ Footwear Industry

Bata India ... Market Price is 865 and P/BV is 7.9

Relaxo Footwear Market Price is 673 and P/BV is 3.7

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

◆ Kaushalya Infrastructure

Market Price is 5 and P/BV ratio is 0.1

Shall we value some firms ...

5-Jun-13	Price	BV	PIBV	EPS	P/EPS
Infosys Technologies	2462	628	3.9	158.8	16
Colgate Palmolive (India)	1474	69	21.5	36.5	40
Tata Steel	299	590	0.5	52.1	6
Bata India	865	109	7.9	27.1	32
Relaxo Footwear	673	181	3.7	37.3	18
Lawreshwar Polymers	6	23	0.3	1.0	6
Kaushalya Infrastructure	5	46	0.1	0.0	167

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 7.5
- ◆ *Note: After FY2006, Zee Tele has been split into Zee Entertainment, Zee News, and Zee Learning*

Shall we value some firms ...

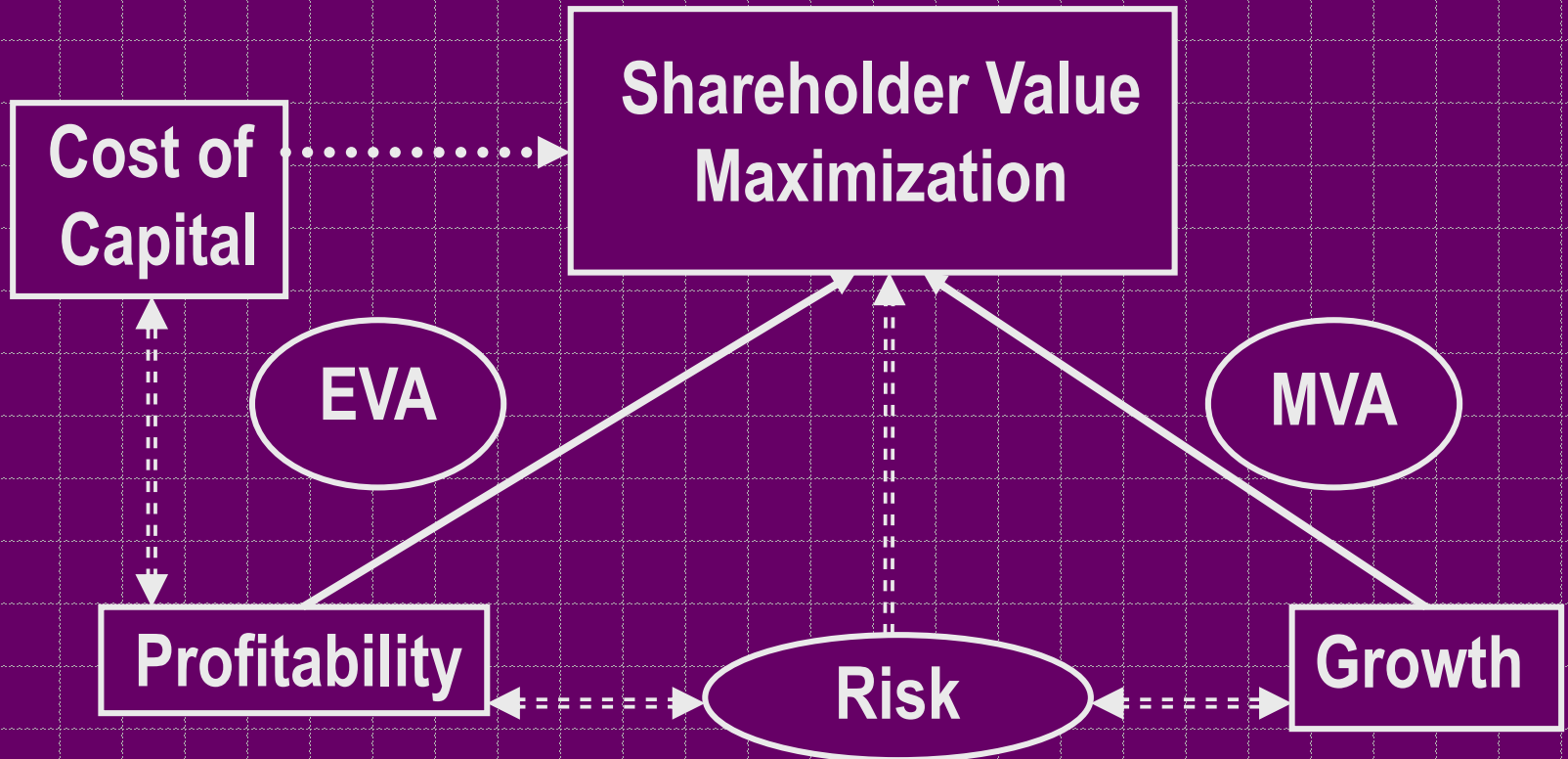
Conclusions:

- (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	GOVIND	TVS	BIRLA
Growth Measure (CAGR _{TA})	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

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)

Purpose of this discussion includes ...

- ◆ Perspectives of Valuation vis-à-vis the unit of our analysis i.e., the firm
- ◆ Understand the factors driving Market Capitalization; and the way they do it
- ◆ Link EVA, MVA, NPV and Capex to the Valuation of the Firm

Figure 1.1: A Simple View of a Firm

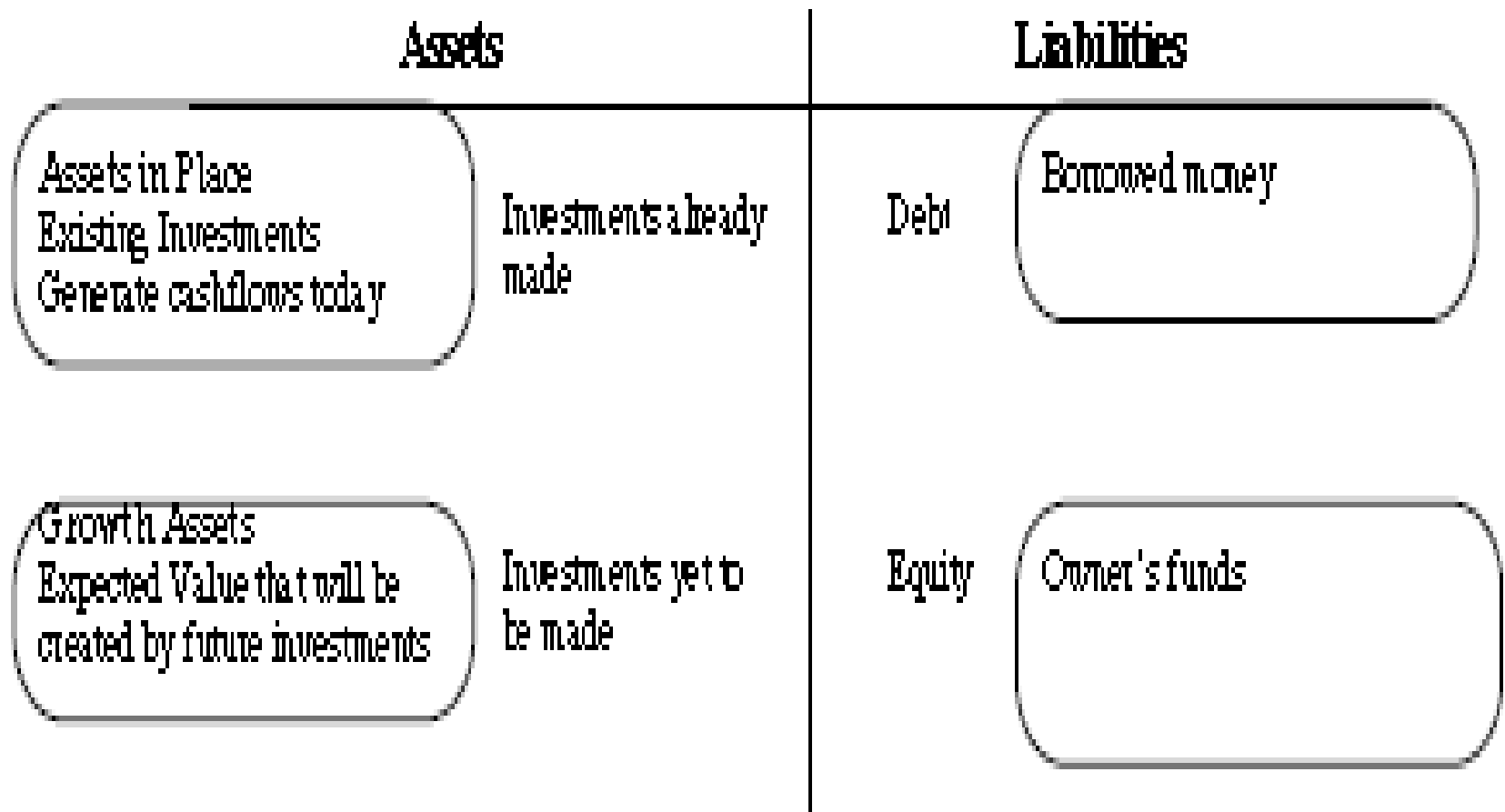


Figure 1.1: A Simple View of a Firm

