

Value Investing Seminar #4

Relative Valuation

November 25th, 2018

Jeff Jones

President, CIMG

Jake Gardner

VP of Investment Research, CIMG



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INVESTMENT MANAGEMENT GROUP

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CIMG Board of Directors

Jeff Jones, President



HARRIS ASSOCIATES

**Goldman
Sachs**



VULCAN
VALUE
PARTNERS

Year: Senior

Hometown: Mountain Brook, Alabama

Major: Mathematics & Economics

Semesters in CIMG: 7

Internship Experience:

2018 – Equity Research Intern – *Vulcan Value Partners*

2019 – Equity Research Summer Analyst – *Goldman Sachs*

Full Time:

2020 – Research Associate – *Harris Associates*

CIMG Board of Directors

Jake Gardner, Vice President of Investment Research



Year: Senior

Hometown: Baltimore, MD

Majors: Finance, Economics

Semesters in CIMG: 7

Internship Experience:

2019 – Investment Banking Summer Analyst – *Bank of America*

2018 – Internal M&A/Strategic Planning Intern – *Regions Financial*

Full Time:

2020 – Investment Banking Analyst – *Bank of America*



Value Investing Seminars

Culverhouse Investment Management Group

Schedule of VIS

Date	Topic
Nov. 4 th	Intro to Value Investing- <i>Overview, Warren Buffet, Ben Graham, strategy, margin of safety</i>
Nov. 11 th	Accounting- <i>Financial statements, cash vs. accrual, profit, margins, growth</i>
Nov. 18 th	Intrinsic Valuation- <i>DCF analysis, present value, discount factors, enterprise vs. equity value</i>
Nov. 25 th	Relative Valuation- <i>Selecting comparable universe, multiples, P/E, EV/EBITDA</i>

Overview

- Designed to provide a comprehensive overview on:
 - ▶ Value Investing strategy
 - ▶ Opportunities at UA
 - ▶ Accounting knowledge
 - ▶ Financial statement analysis
 - ▶ Practical valuation concepts

Value Investing Opportunities at UA



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Value Investing Opportunities at UA

Culverhouse Investment Management Group

CIMG Overview

- **Student-run investment fund** managed by select students at The University of Alabama, with oversight from the school's Fitzpatrick Endowed Professor of Value Investing, John Heins
- **Value-based, equity-only** investing philosophy to actively manage a portfolio worth over **\$600,000**
- Members are taught and practice a variety of **quantitative and qualitative analysis** techniques to value companies and make intelligent investment decisions
- The group prepares young professionals for careers in **equity research, investment banking, management consulting**, and other areas of the financial industry
- Recent CIMG alumni have placed at a variety of top-tier firms, including **Goldman Sachs, J.P. Morgan, Bank of America, Bain & Company, The Boston Consulting Group**, among others

CIMG's Values

- Intellectual Capacity
- Intellectual Honesty
- Intellectual Curiosity
- Intellectual Diversity
- Intellectual Creativity
- Intellectual Skepticism
- Tenacity, Drive, and Passion
- Humility
- Teamwork Skills
- Culture of Continuous Improvement
- Mentorship & Leadership Development
- Professionalism

CIMG's Vision

We, the Culverhouse Investment Management Group, aspire to be the premier undergraduate, student-managed investment fund at The University of Alabama, in the State of Alabama, in the Southeast, and in the nation.

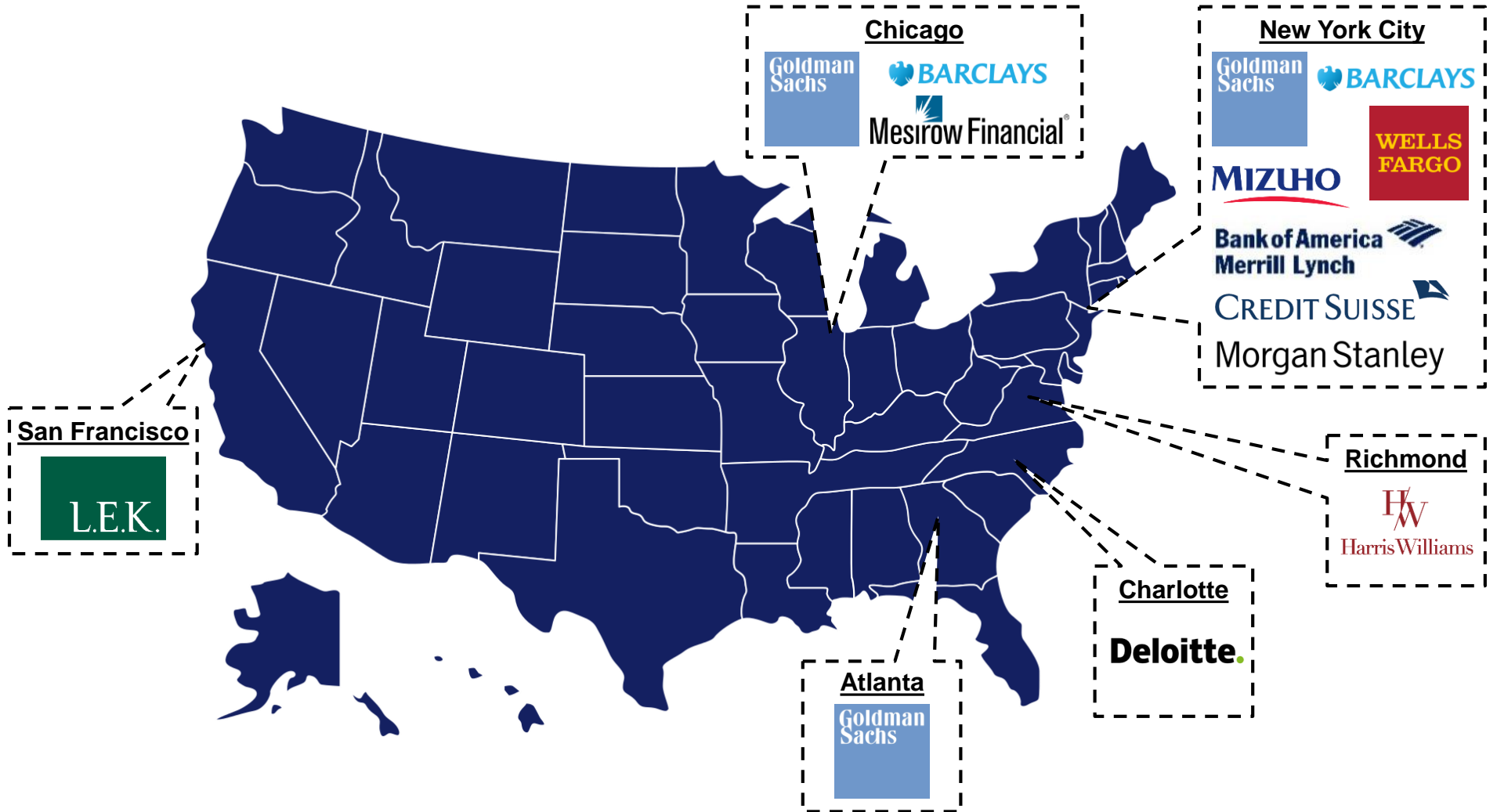


J.P.Morgan

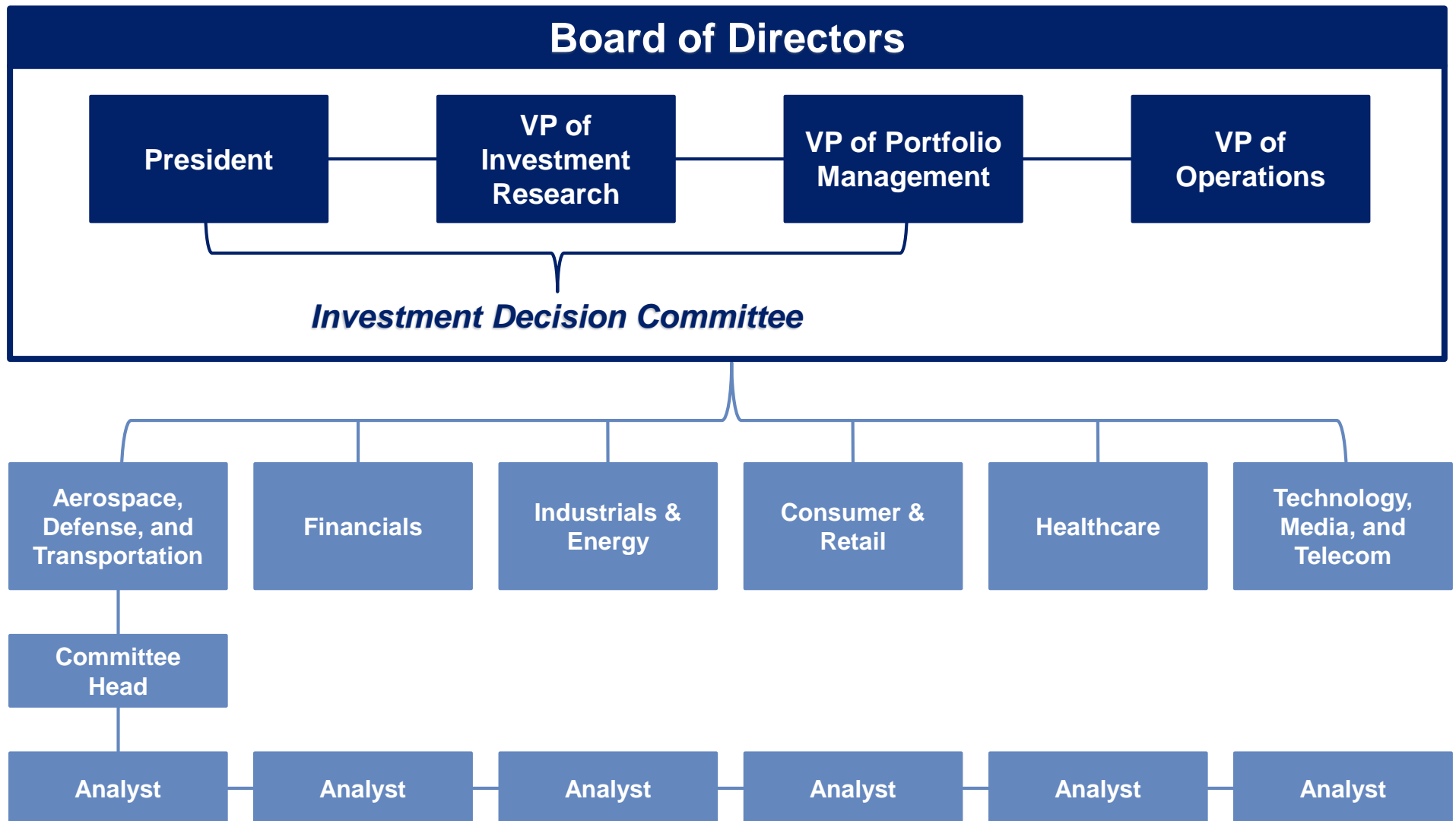
Bank of America
Merrill Lynch



2020 CIMG Member Full Time Placement



Group Structure



New Member Training Program Overview

- **8 weeks of intensive training covering the following topics:**
 - ▶ Week 1: Introduction to Research
 - ▶ Week 2: Financial Analysis
 - ▶ Week 3: Business & Industry Analysis I
 - ▶ Week 4: Business & Industry Analysis II
 - ▶ Week 5: Intrinsic Valuation I
 - ▶ Week 6: Intrinsic Valuation II
 - ▶ Week 7: Relative Valuation
 - ▶ Week 8: Review
- **The New Member Training Program curriculum focuses on teaching practical skills to make you a value-additive analyst in you committee on day one**
 - ▶ In 8 weeks, you will create all the materials necessary for a CIMG quality stock presentation
 - ▶ Weekly office hours with Committee Heads to aid in the creation of your pitch
 - ▶ Personal mentors to assist through the process
 - ▶ Mid- and end-of-program performance reviews
 - ▶ After 8 weeks, you will present your stock pitch with your mentor at a CIMG General Meeting
 - ▶ You will match with a committee at the end of the semester and join that team in the Spring

Faculty Advisor

John Heins, Fitzpatrick Endowed Professor of Value Investing



Email: jheins@culverhouse.ua.edu

Education: B.S., University of Pennsylvania; M.B.A., Stanford University

Current Roles:

President & Editor-in-Chief, Value Investor Media, Inc.

Previous Roles:

President & CEO, Gruner + Jahr USA Publishing

Senior Vice President, Personal Finance, AOL

Reporter, Forbes Magazine



Value Investing Opportunities at UA

Finance Major; Value Investing Specialization

The Value Investing concentration provides students with a strong foundation for examining the critical aspects of investing decisions, including generating good ideas, conducting fundamental business and industry research, analyzing financial statements, and credibly estimating what businesses and companies are worth. The focus is on practical applications. Students will be prepared for a broad range of business careers, including investment management, investment banking, private equity, management consulting, corporate business development, corporate finance and entrepreneurship. The Value Investing concentration is restricted to Finance majors only.

Value Investing Concentration		Hours
AC 444	Financial Analysis – Investing	3
FI 417	Value Investing Principles	3
FI 418	Advanced Value Investing	3
Total Hours		9

Intrinsic vs. Relative Valuation



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Three Major Forms of Valuation

Intrinsic

1. Discounted Cash Flow

- **Most accurate in theory**
- **Highly assumption dependent**
- Works best for mature, stable companies
- Less useful for high growth companies
- More inputs does not always equate to greater accurate
- Sometimes simpler is better
- Not relevant in all industries (commercial banking, insurance, REITs)

Relative

2. Public Comparables

- **Logical and practical to compare what similar companies are selling for**
- Multiples used and valuation ranges vary by industry
- Best when ample market data is available
- **No company is exactly alike, discrepancy in choosing the comps universe**

3. Precedent Transactions

- Time is a key consideration
- The more recent, the more relevant the transaction is for comparison
- Usually highest valuation because buyer pays a premium to acquire 100% of an entire company
- Price or multiples of smaller transactions are not always disclosed

Three Major Forms of Valuation

Intrinsic

1. Discounted Cash Flow

1. Project out future free cash flows
2. Calculate discount rate or WACC
3. Discount the future FCFs to the present
4. Calculate and discount a terminal value
 - ▶ Perpetuity growth method (Gordon Growth Model) **OR**
 - ▶ Terminal multiple
5. Sum the PV of FCFs and the TV
6. Walk the bridge from EV to equity value

Relative

2. Public Comparables

1. Select a comparable universe of companies considering 3 criteria...
 - ▶ Industry, financials, geography
2. Determine which multiples are most applicable
 - ▶ EV/EBIT, EV/EBITDA, P/E, EV/Sales most common
3. Take an average, median, 25th and 75th percentiles
4. Apply those ranges to the appropriate value driver
5. If an EV multiple, walk the bridge to equity value

3. Precedent Transactions

1. Select a set of previous transactions involving similar companies considering 4 criteria...
 - ▶ Industry, financials, geography, **TIME**
2. Determine which multiples are most applicable and are readily available
 - ▶ EV/EBIT, EV/EBITDA, P/E, EV/Sales most common
3. Take an average, median, 25th and 75th percentiles
4. Apply those ranges to the appropriate value driver
5. If an EV multiple, walk the bridge to equity value

Enterprise vs. Equity Value



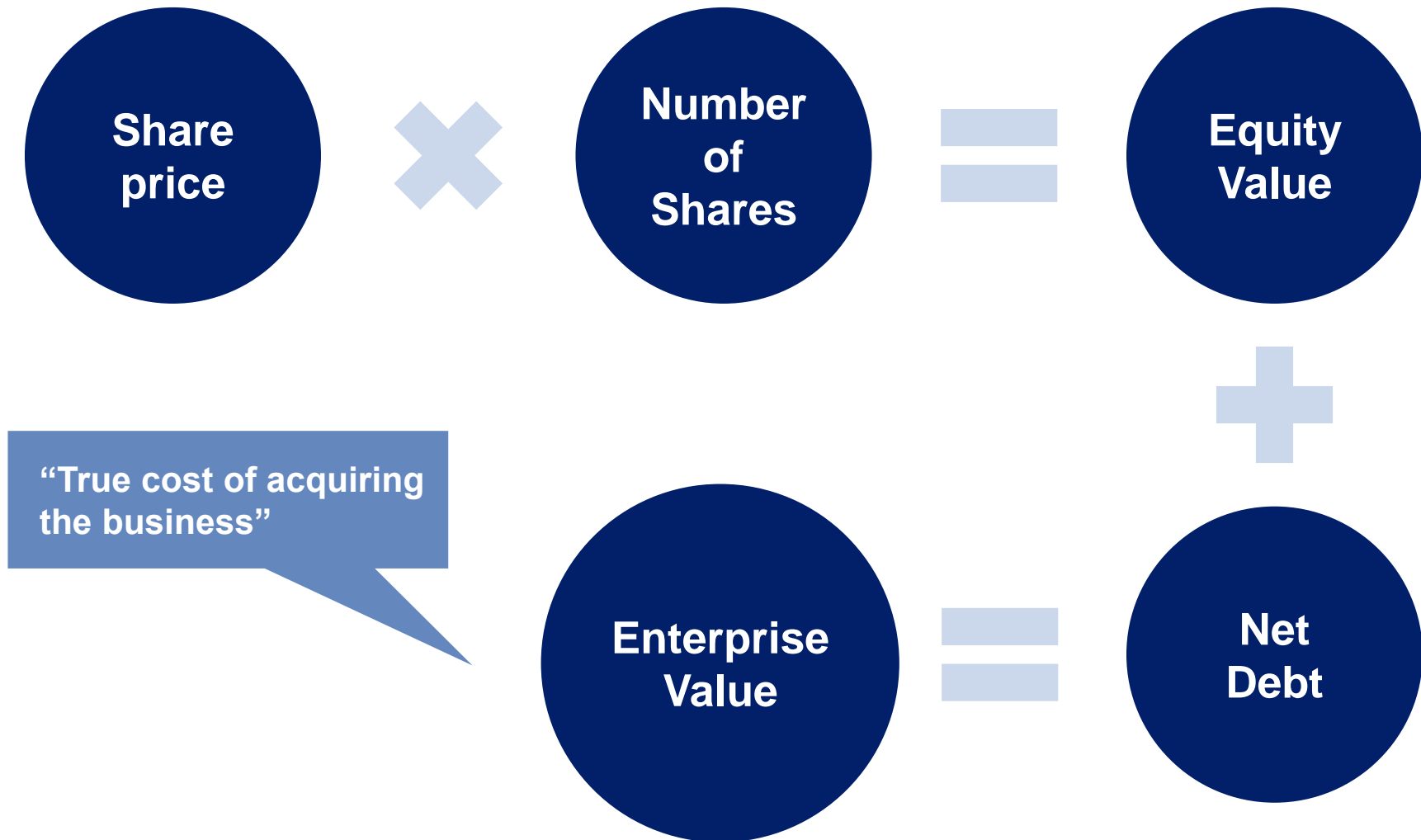
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Equity Value



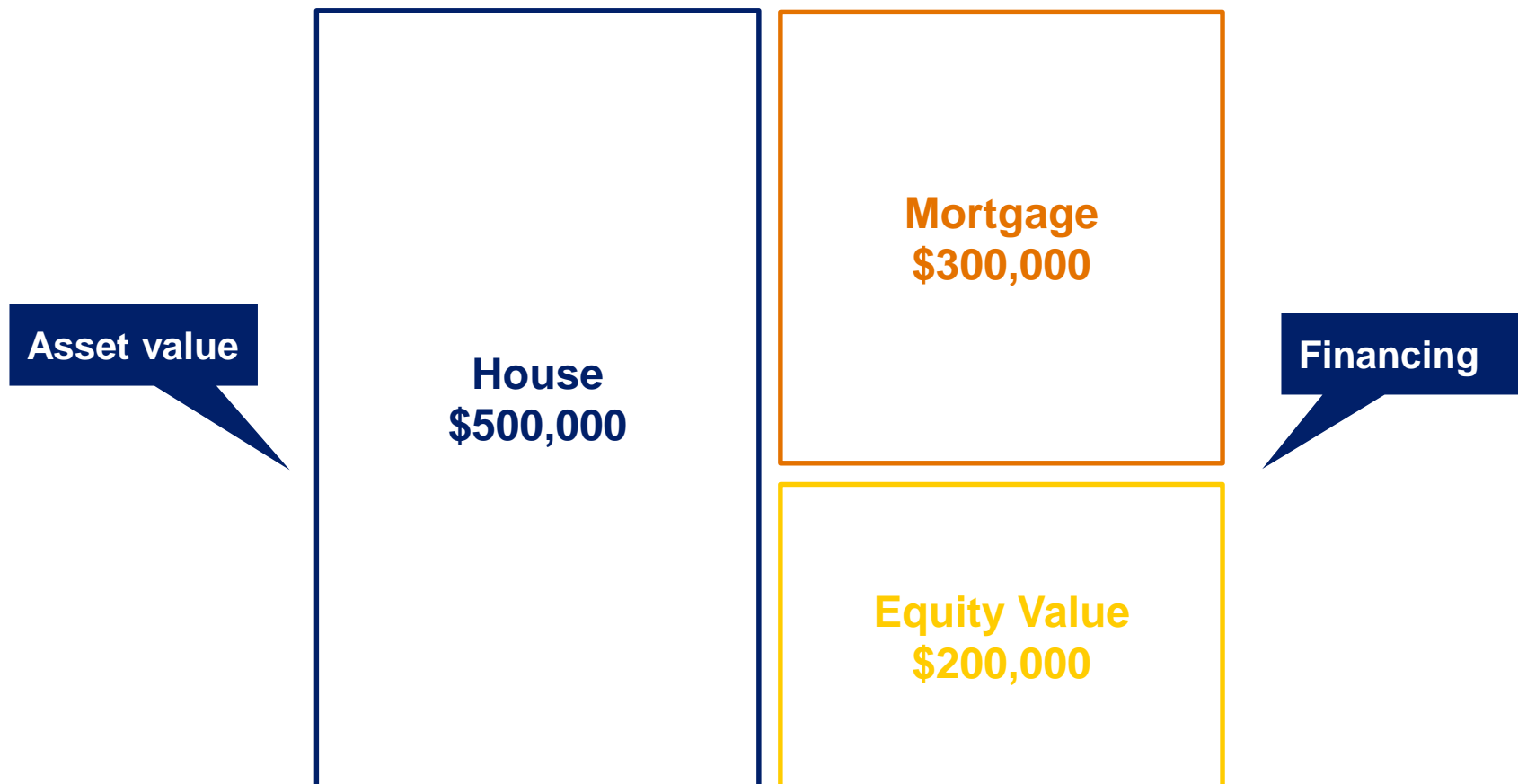
Also known as market value
or market capitalization

Enterprise Value

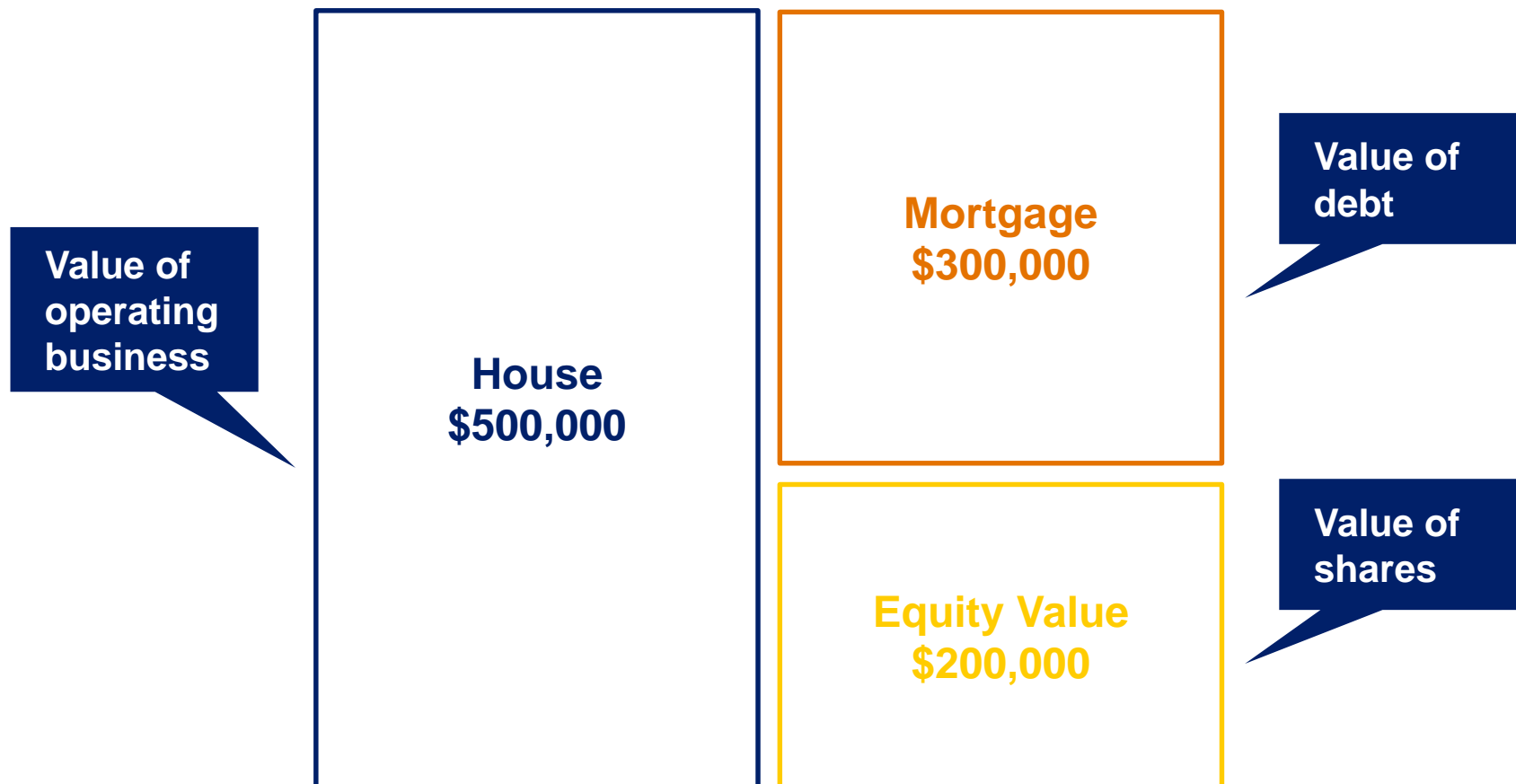


Enterprise Value

Asset value not affected by financing

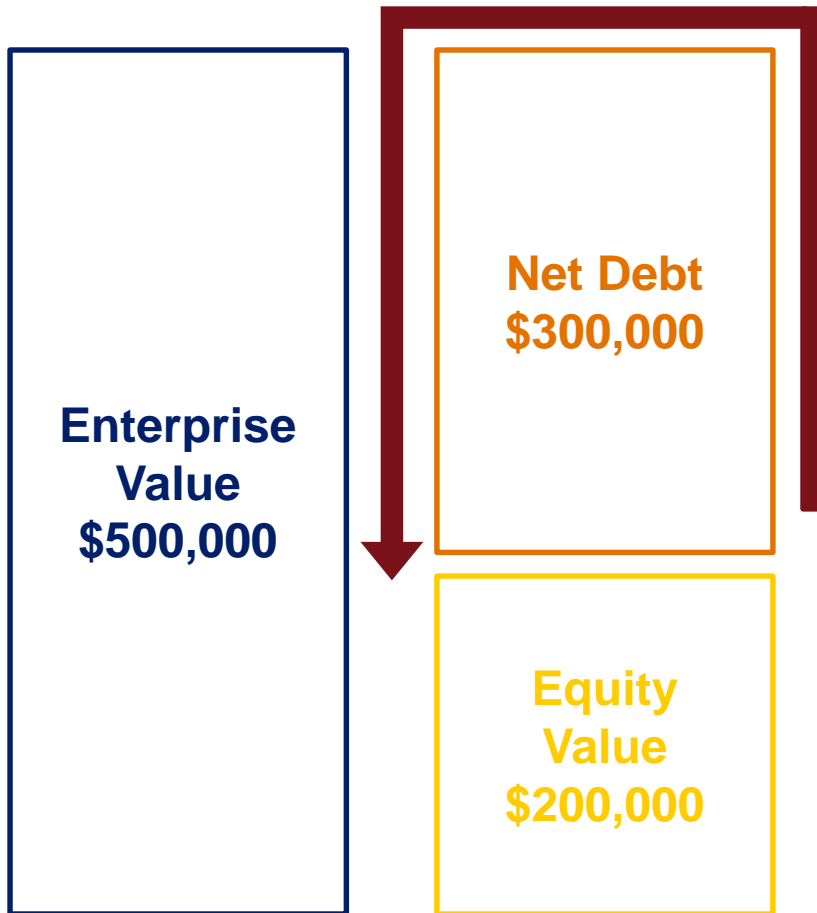


Two Versions of Value

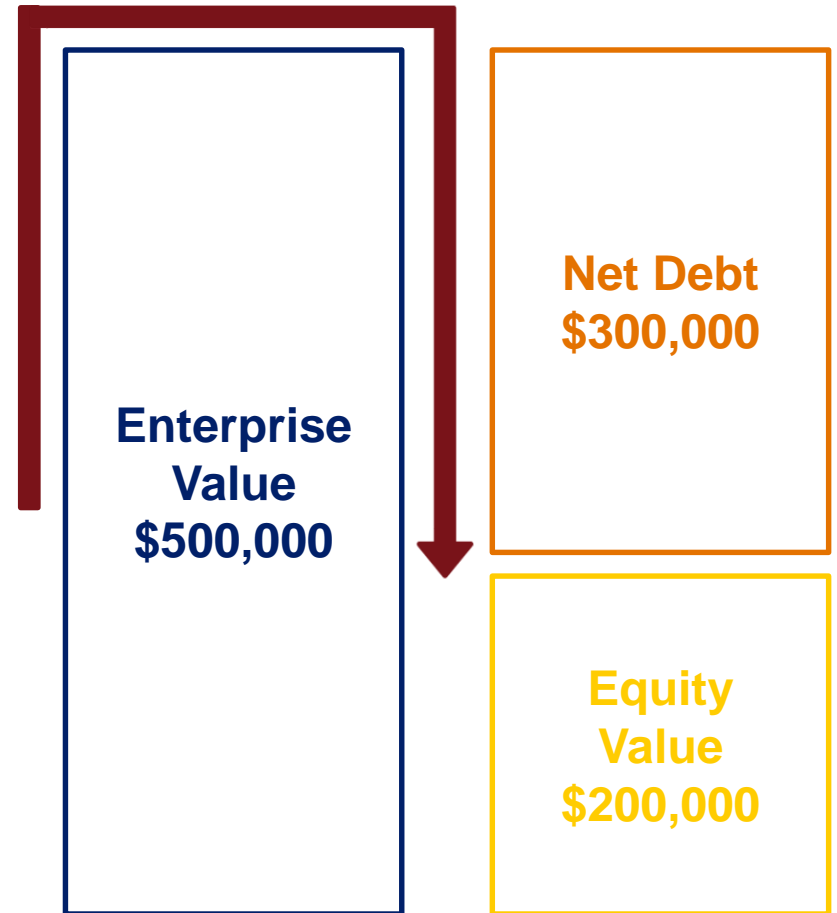


The Bridge

Equity Value → EV



EV → Equity Value



Calculating EV and Equity Value

Derive from bridge
OR
Calculate from multiples or DCF

Enterprise Value
\$500,000

Net Debt
\$300,000

Equity Value
\$200,000

Derive from bridge
OR
Calculate from share price

The Bridge

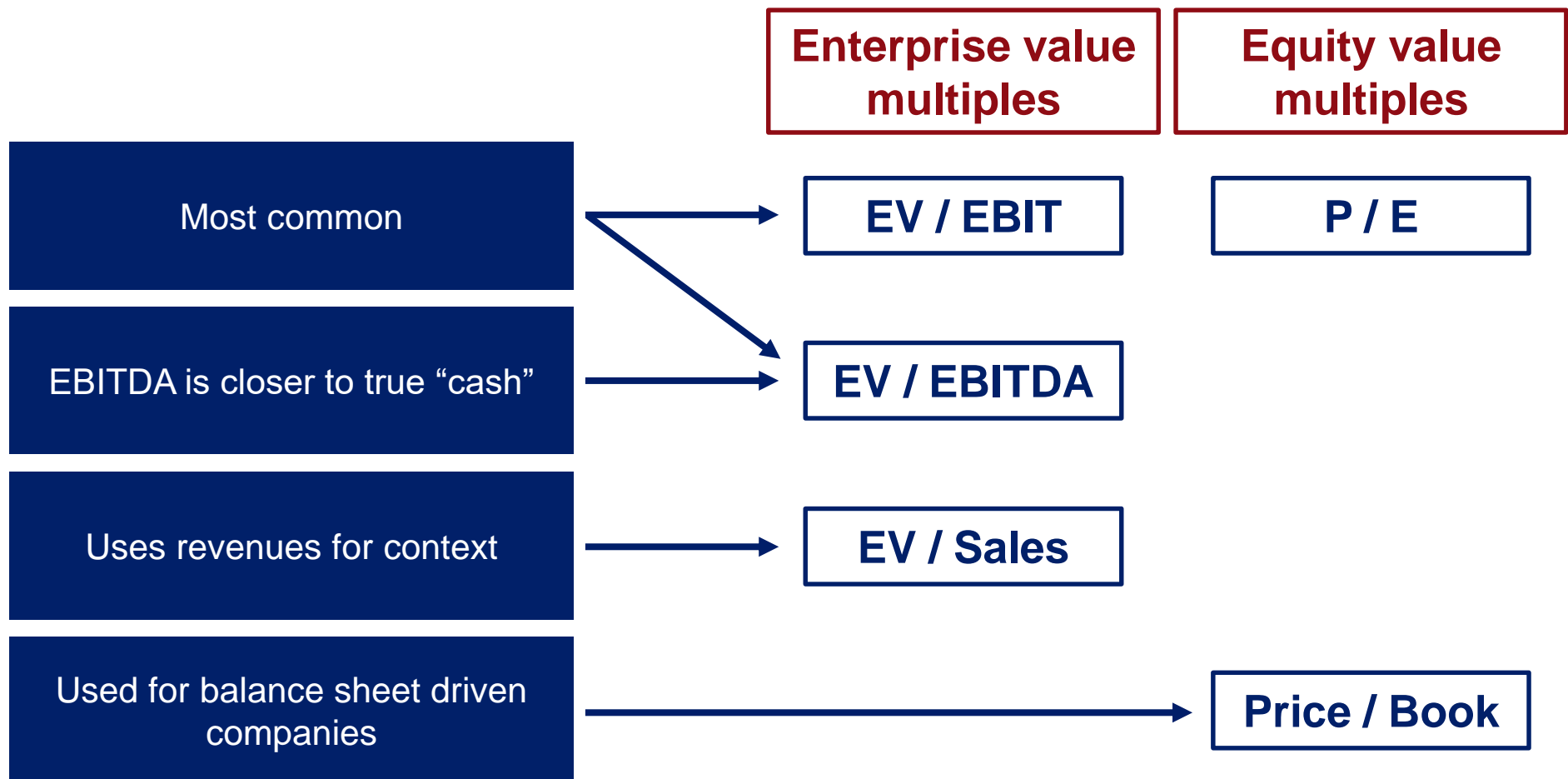
Enterprise Value	Equity Value
Operating assets less operating liabilities	Total assets less total liabilities
Operating focus	Ownership focus
Unaffected by financing decisions	Affected by financing decisions
Driven by: <ul style="list-style-type: none">• Company performance• Industry dynamics• General economic factors	Driven by: <ul style="list-style-type: none">• Company performance• Industry dynamics• General economic factors AND• Financing decisions

Multiples



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EV vs. Equity Value Multiples



Multiples

Value consistent with value driver

How much investors pay in relationship to a value driver

Value		Value Driver		Multiple	
EV	1,000.0	EBIT	100.0	EV / EBIT	10.0x
Cash	100.0	Interest income	1.0		
Debt	(300.0)	Interest expense	(15.0)		
		Tax expense	(26.0)		
Equity	800.0	Net income	60.0	P / E	13.3x
No. shares	100.0	No. shares	100.0		
Price	8.0	EPS	0.60	P / E	13.3x

Public Comps



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Choosing the Public Comps Universe

Industry Classification

- *Same or similar industry*
- *Other industries with same characteristics*

Financial Criteria

- *Similar amounts of:*
 - *Market cap.*
 - *Revenue*
 - *EBIT, EBITDA*

Geography

- *Located in the same region*
- *Otherwise be wary of differing competitive dynamics, laws, business practices*

Choosing the Set of Precedent Transactions

Industry Classification

- *Same or similar industry*
- *Other industries with same characteristics*

Financial Criteria

- *Similar amounts of:*
 - *Market cap.*
 - *Revenue*
 - *EBIT, EBITDA*

Geography

- *Located in the same region*
- *Otherwise be wary of differing competitive dynamics, laws, business practices*

Time

- *Multiples can fluctuate drastically over time*
- *The more recent, the more relevant the multiples*

Implied Share Price Using Multiples

1

Select an appropriate range of multiples

2

Multiple * Driver = Implied EV

3

Walk the bridge to get implied equity value

4

Divide equity value by number of shares outstanding

5

Compare implied share price to current price

Next Week



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Value Investing Seminars

Culverhouse Investment Management Group

CIMG Applications

- Application date TBD
- Everyone that has attended a seminar and signed in will receive an email invitation to apply
- VIS slide decks will soon be uploaded to our website for your access
- Learn more at uacimg.com

Contact Information



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