# LECTURE 8

**Chapter 13**

***Asset / Equity Valuation***

***Different Measurements of Valuation***

## Net Book Value

The main features, of net book value, include:

- Net book value equals the total equity shown on the balance sheet derived from total assets minus total liabilities.
- It reflects total issued equity adjusted for the effect of historical retained earnings, divided payments, and repurchase of stock.
- It is based on accounting conventions – generally accepted accounting principals (GAAP) which reflect the valuation of individual groups of assets, and, more influentially over time, the measurement of retained earnings derived from recording of individual revenues and expenses from income statement.

The main advantages and disadvantages of net book value as an analytical measurement are:

- Net book value is a historical accounting measurement, reflecting all of the weakness endemic in accrual accounting as a measurement of historical cash flows. Further, it does not measure the impact of value future cash flows.
- Net book value is nevertheless used extensively as a measurement of valuation. For example, certain types of companies are valued and analyzed by comparing market value to book value (e.g. banks and other financial institutions). This reflects the importance, which the market places on underlying value (primarily liquidation value) of the assets of the firm.
- Net book value, sometimes referred to as net worth or equity, is also an important measurement since it is the basis for most loan agreement financial covenants, and provides lenders with the requisite trigger in their agreements in the event of deterioration in book value below a certain point. For lenders, therefore, net book value is an important measurement of value.

## Market Value

Market Value has the advantage over Book Value because it starts to reflect not just historical earnings, but future earnings discounted back to value today.

Many factors contribute to the market value of a company and different types of buyers may use different formulas for determining the price they are willing to pay the company. Whatever formula one may use, almost everyone takes into account in some way other factors which may or may not be quantified, such as the market conditions, specific industry characteristics and firm specific issues/opportunities such as reputation of the current or past management. Each of these factors must be weighed for every company and in some cases one factor may weigh more heavily than all of the others combined.

There are a lot of methods of calculating the Market Value of a corporation, depending on if the firm is privately or publicly owned. This chapter will focus on four of the methods that are used today by bankers, Wall Street analysts, Mergers and Acquisitions specialists and Private Equity Firms. These methods are:

1. Using the Stock Market
2. Using EBITDA Multiples of comparable companies
3. Using Comparative Transactions
4. Using Discount Cash Flow Method

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