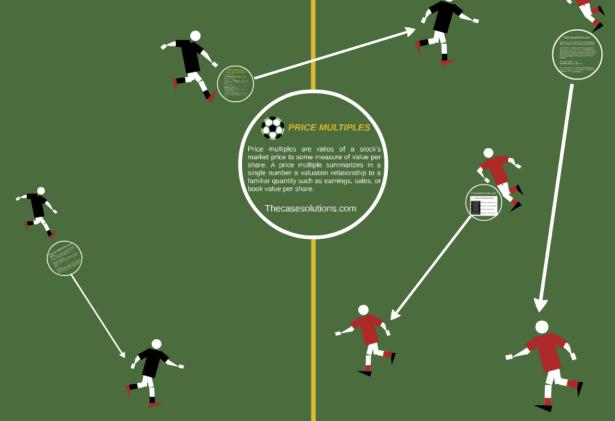


# Thecasesolutions.com Teuer Furniture (B): Multiples Valuation







- cost structures.

  Accounting issues related to revenue recognition can still alter sales.

  Price-to- Cash Flow (P/CF)

  Some items are not included, such as not cash revenue.







# Thecasesolutions.com Teuer Furniture (B): Multiples Valuation





GOAL



- Price-to-Sales (P/S)

   Sales do not always translate to profits which can leave out the cost component.
- cost structures.
   Accounting issues related to revenue recognition can still alter sales.

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Good mere to value time in districts.

Price to Cash Flow (PICE)

Cash Flow is a time meetic of a company's meatic in companion to centrings.

It is more difficult for managements to manipulate cash flow intends to be less violate time companion to centrings.



# PRICE MULTIPLES

Price multiples are ratios of a stock's market price to some measure of value per share. A price multiple summarizes in a single number a valuation relationship to a familiar quantity such as earnings, sales, or book value per share.

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In general, a price multiple ratio looks like this: **Price multiple = Price / Performance Metric** 

For example, Company XYZ has revenue of \$20,000,000 per year. It has 1,000,000 shares outstanding. Today, the company's stock price is \$20 per share. Using the formula above, we can calculate Company XYZ's price-to-revenue multiple:

Revenue multiple = \$20 / (\$20,000,000/1,000,000) = 1.0

In Company XYZ's industry, most companies trade at or below a 0.80 multiple, implying that Company XYZ is overvalued.

### POPULAR PRICE MULTIPLES

Price-to-earnings ratio (P/E)

· Stock price + earnings per share

Price-to-book ratio (P/B)

Stock price + book value per share

Price-to-sales ratio (P/S)

· Stock price + sales per share

Price-to-cash flow ratio (P/CF)

· Stock price + cash flow per share

### P/E ratio

The P/E ratio of a stock is a measure of the price paid for a share relative to the annual net income or profit earned by the company per share.

### P/E ratio Calculation

The P/E ratio calculation formula is as following: P/E ratio = Price per share / Annual earnings per share

## **Example**

Stock A is trading at \$100 and the earnings per share for the most recent 12 month period is \$5 then stock A has a P/E ratio of 20 (100 / 5).

### Price-to-book ratio

The price-to-book ratio measures a company's market price in relation to its book value. The ratio denotes how much equity investors are paying for each dollar in net assets.

## How it works/Example:

There are a couple ways to calculate book value, depending on the company. For purposes of this example, we'll assume that the best measure of book value is Total Assets - Total Liabilities. We'll also assume that the stock of Company XYZ is trading at \$6 per share and there are 100 shares outstanding.

#### Balance Sheet for Company XYZ Year ending December 31, 2009

**Assets** 

Cash 1,000
Accounts Receivable 500
Inventory 500
Total Current Assets 2,000

Liabilities

Accounts Payable 500
Current Long-Term Debt 500 **Total Current Liabilities 1,000** 

Long Term Debt 500 **Total Liabilities** 1,500

Owners' Equity 500

P/B ratio = Stock Price / Book Value per share

Book value: 2,000 - 1,500 = 500 (note that this is the same as owners' equity)

Book value per share: 500 / 100 = \$5

P/B ratio = \$6 / \$5 = 1.2

A P/B ratio of less than 1.0 can indicate that a stock is undervalued, while a ratio of greater than 1.0 may indicate that a stock is overvalued.

Please note that it is not always reasonable to calculate book value as Total Assets - Total Liabilities. Depending on the company's balance sheet, it might make sense to subtract intangible assets,goodwill, and/or preferred stock from the appropriate sections of the balance sheet.

#### Price-to-sales ratio

The price-to-sales ratio helps determine a stock's relative valuation.

The formula to calculate the P/S ratio is:

P/S Ratio = Price Per Share / Annual Net Sales Per Share

#### **How it works/Example:**

Let's assume Company XYZ reports net sales of \$5,000,000 and it currently has 500,000 shares outstanding. The stock is currently trading at \$20.

Sales per Share = (5,000,000/500,000) = 10

Price-to-Sales Ratio = 20/10 = 2

Now we want to compare XYZ to one of its competitors, Company ABC.

ABC also reports net sales of \$5,000,000 and it also has 500,000 shares outstanding. The stock is trading at \$100.

Sales per Share = (5,000,000/500,000) = 10

Price-to-Sales Ratio = 10/10 = 10

Investors in ABC are willing to pay \$10 for \$1 in sales, while investors in XYZ are willing to only pay \$2 for \$1 in sales. Any number of scenarios could explain this discrepancy, so it's important to know what makes ABC stock so much more appealing. If you could be good reason, perhaps stock XYZ isundervalued, and a good bargain.