What is meant by Relative Value?

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- Relative value is a method of determining value through comparison with similar assets or businesses

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- When approaching a relative valuation, the first major decision is the selection of the comparison assets
- This in itself can be a flawed process if the wrong assets are selected - and this is a subjective judgement

What is meant by Relative Value?

- The financial information of the selected comparator group is then used in conjunction with market price to identify a number of appropriate price related ratios
- One of the most frequently used is the Price Earnings Ratio - PER

What is meant by Relative Value?

- The PER is derived by dividing the stock price by the Earnings Per Share
- A company with a high PER is trading at a higher price per dollar of earnings than one with a lower PER

What is meant by Relative Value?

- Other ratios include;
  - Price to Free Cash Flow
  - Price to Enterprise Value
  - Price to Operating Margin
  - Price to Sales (useful for retail)
  - Price to Cash Flow (used in the Real Estate sector)

What is meant by Relative Value?

- The best way to apply this is to take a basket of comparable assets and derive a comparative range from the average, highs and lows of the basket
- You can also use sector and industry average figures for the comparator

What is meant by Relative Value?

- The Relative valuation tells you how a company's stock price is rated compared to its peers
- This is independent of the scale of revenues or profits
- You can compare a small company to a large company although this is not recommended.
- You should always try to compare similar sized companies with one another.

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