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Chair of Financial Economics
Institute for Banking and Finance
Prof. Dr. Felix Kübler

Bachelor Thesis

Supervisor: Marlon Azinovic

Equity Valuation Using Multiples - Performance Analysis of Selected Stocks

Author: Markus Geissler

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Abstract

The multiples valuation approach, which is part of the relative valuation methods, is regularly used to assess current share prices within the market. The question is to whether the data used in those assessments can also be sufficient for building a successful investment strategy. In the following study, a multiple-based investment strategy is formed and tested on the Swiss equity market. The main objective is to find out if the application of the newly formed framework is capable of achieving recurring excess returns compared to the market. Based on the price-to-earnings (P/E), price-to-book (P/B), and enterprise value-to-earnings before interest, taxes, depreciation, and amortization (EV/EBITDA) multiples, seven distinct portfolios are created from the historical components of the SMI Expanded Index. The results of the portfolio analysis for the period from 2005 to 2018 show that none of the portfolios is able to beat the market consistently. However, on a long-term basis, overall performance measurements indicate that some of the portfolios can generate excess returns. For example, the combined P/E and P/B portfolio yields two and a half times the cumulative market return. Although the outlined investment approach constitutes a useful preselection tool for identifying promising investment opportunities, it cannot be used without further assessments.

Executive Summary

The intrinsic value of a company can be assessed with the help of fundamental company analyses. If an estimate is below the current market price, the company in scope has a favorable price-value ratio and is considered undervalued in the market. Value investors attribute an increased return potential to these investments, as they assume that the market price will adjust to the true company value over time. In practice, however, instead of thorough fundamental analysis models, low multiple values are often associated with undervalued but promising companies. This study examines the prospects of success of a value investment strategy derived from the multiples valuation method.

In order to be able to measure the success and the application suitability of the newly created strategy, a portfolio analysis is carried out on the Swiss equity market. Based on the two possible multiple-based investment techniques, namely the screening approach and the method of comparables, a total of seven distinct portfolios are formed. The annual returns of the portfolios, as well as the return of the SMI Expanded Index as the selected market proxy, are compared in the thirteen periods from the end of June 2005 to the end of June 2018.

The results of the empirical analysis show that the annual portfolio returns are much more volatile, and none of the portfolios outperforms the market return every year. Considering the overall performances, only two out of seven monthly rebalanced and annually restructured portfolios considerably beat the market. Removing the monthly rebalancing increases the returns of most portfolios so that five out of seven portfolios have an annualized return that is at least 1% above that of the market proxy. While the highest annualized return of 10.87% is achieved by a combined price-to-earnings (P/E) and price-to-book (P/B) portfolio, the SMI Expanded Index only yields an annualized return of 6.09% during the same period. Furthermore, contrary to other related research, the performances of portfolios constructed using forward-looking multiples are below expectations.

Due to its weaknesses such as inconsistency and variability, the investment approach analyzed in this study poses only a supporting tool for identifying promising investment opportunities. In order to be able to conclusively evaluate whether a proposed investment is a truly attractive investment or whether its low multiple value is justified, further analyses need to be conducted on that specific company.