Finance – case study

Education

ASSIGN BUSTER

This paper seeks to prepare a private valuation for Teabucks, owned by Helen Troy, in the latter' effort to have an initial public offering as way tofinancethe company has planned expansion. This will therefore discuss several methods of valuation as a basis for advice to Helen Troy. Analysis however will be limited to available information given thecase studyand other necessary assumption in order to make the paper accomplish its purpose.

Valuation could be done using the P/E ratio of a company. What is given only is net income for Teabucks at $40 million and this formula would require still having total outstanding shares as basis for earning per share. Since the company is just organizing for IPO, no such figure could be used from the case facts. If assuming that the industry average of 35 P/E is applied to the company, this would produce a total market value for Teabucks at $1. 4. If 14. 0 million outstanding shares of stocks are assumed to be issued, the share value per share could be estimated at $100 per share for the purpose of the IPO.

To use the Price/Sales ratio, and assuming that the company is within the industry average of 20, the total market value of Teabucks could be computed by multiplying 20 by total revenues of $750 million to produce $15 billion market capitalization. If the same amount of 140 outstanding shares is assumed, the price per share of its stocks could be estimated at $1071. 4 per share.

To use capital assets pricing model (CAPM) to calculate the discount rate using value from a proxy firm, it could be assumed that company is as big as a regular player on the industry and therefore within the industry. To use the model requires cost of capital that involves the use of risk-free rate and risk premium as an added rate to compensate for the risk. There is also need to know market rates for similar firms in the industry to compute the risk premium (Brigham, E., and Houston, 2002). Given case, facts do not allow ready application. As an alternative, the industry P/E reciprocal is used here to estimate the cost of capital for the company. This could be estimated at 1/35 or 2. 86%. This cost of capital could be used discount future dividends that may be given by the company using the dividend discount model. Since there is no estimate of dividends available from the given facts, this method may not be applied without again making another assumption.

Price to cash flow ratio cannot be used for the company since there is no available cash flow from the given.

In selling its stock to market, the company could use selling via the Internet but there are registration and other requirements to be complied on what state or states should be targeted as market for investors in the initial public offering (Winmark Corporation, 2009).

It can be concluded that Teabucks could only offer its stock at the initial public offering at amounts computed using assumed outstanding shares of stocks to be issued. Teabucks' investors normally may value the new public company on the basis of what the company may be discounted cash values using a discount factor that represent the company's cost of capital to bring down the values to their present values but cash values are not available. This paper has instead found the application of P/E ratio and Price/Sales ratio as possible. The value per share will however be again dependent on the number of shares that will be issued and outstanding. Hence the primary thing to make valuation here is get the total market valuation of the company in terms of given earnings or net income and sales and divide each figure with estimated outstanding shares to be issued. By dividing the same market valuation, using net income or sales revenues, by the assumed outstanding number 140 million shares that will be issued, the stock value per share that could be used as basis for IPO within the range of $100 to $1071. 14 per share.

References:

Brigham, E. and Houston, J. (2002) Fundamentals of Financial Management, Thomson South-Western, US

Case Study – Regarding Teabucks

Winmark Corporation (2009) Internet Offering of Securities, {www document} URL, http://www. wbsonline. com/resources/internet-offerings-of-securities/, Accessed April 16, 2009