

Kohler terminal value

[Economics](#), [Financial Markets](#)



Both approaches (used to come up with the value of the Kohler Company) are greatly impacted by the assumptions made by both the company and the dissenting shareholders.

The use of the Market approach has shown that the value of the company varies greatly depending on the comparable companies. If Masco (which is the largest comparable company) is included, the value goes to nearly \$3.7 B and excluding it causes the value to go down to \$1.2 B. Moreover, depending on the discount for lack of liquidity and control, the value of the company could decrease considerably. Then, in the market approach there are two variables that affect the value of the company; comparable peers and the discount for lack of liquidity and control.

In the Free Cash Flow (FCF) approach, the two variables that makes the value diverge is the Beta and the discount (liquidity and control) used. In this specific scenario the Beta impacts the WACC considerably due to the high weight of the cost of equity. For example, a difference of 4 points in the WACC raises the value of the company more than 150% [Table 7].

It is interesting to see that in order to arrive at Kohler's initial valuation of \$58K per share; a 65% discount is needed in both valuation approaches. Also, Masco's exclusion is required under the Market approach while the high Beta is required under the FCC approach. The factor created by the division of standard deviations of industry peers and the deviations from different markets increases or decreases Beta considerably. (More details about this factor are discussed later in the paper.) Conversely, according to the

dissenting shareholders, in order to arrive at \$273K per share a 0 % discount and the inclusion of Masco and low Beta is needed.

In the settlement, Kohler may use two simple methods to resolve the claim. The first would be a Weight Adjusted Value method, which consists of taking the weighted average of the proposed settlement values times the confidence level. The second method is to calculate the book value of the company using the formula $(\text{Assets} - \text{Liabilities}) / \# \text{ of shares}$ (Intangibles are not excluded). The results of these two methods indicate that The Kohler Company should be indifferent between going to trial and settling for \$120K per share.

Finally, the suggested settlement price should be adjusted to reflect the possibility of an increased tax liability Kohler may have with the IRS. Using a weighted average, the new settlement price is around \$150K per share.

Company Overview Kohler is a recognized international manufacturer of plumbing products, home furnishings, generators and engines. It also owns and operates hospitality and real estate Businesses. Kohler has been a private company, predominantly owned by the Kohlerfamily since its founding in 1887. Market Approach

Because Kohler is privately held the market value needs to be ascertained by the implied value determined by using a multiples approach based on the trading value of Kohler's comparable industry peers. Table 1 shows the relevant multiples for Kohler's peer group. Depending on what multiples are used to value Kohler the estimation varies considerably. Table 2

demonstrates the range of these values. If Masco, with its generally high multiples, is excluded from the analysis the valuation would be roughly \$1.2B.

On the other extreme if Kohler's value is based on Masco's benchmark, the value leaps to nearly \$3.7B. A strict average of the peer group would yield a value of \$1.6B. Our best guess of value is closer to \$2B based on the peer average being averaged with Masco's profitability multiples as we feel that the fundamentals of Kohler and Masco are closely matched. These estimates do not include any discounts for the lack of liquidity or control that the shares are characterized by. Table 3 shows the value per share given a \$2B market value and various discounts applied.

Based on the market multiples approach it appears that Kohler takes a much more conservative approach to not only valuation but to the discounts that should be applied to the stock given his relative illiquidity and lack of controlling stake in the enterprise. From their perspective the value is the historically modest dividend and the long range growth of the business. Given their approximation of a share price of \$54,000 that would suggest they excluded Masco as an outlier if they used a multiples approach and they used a discount of nearly 65% on the value of the shares to address their limitations noted previously. This would yield a value of roughly \$58,000 per share.

The dissenting Kohler shareholders, many of whom acquired shares for north of \$100,000 each, have a vested interest in a much more generous approach to the value of Kohler's shares. It appears they could be talking

one of two approaches in arriving to their \$273, 000 value per share. The first is that they could also assume a market value of roughly \$2B for Kohler, and not acknowledge any need to discount the shares. This would yield an estimate of \$274, 100 per share. The other approach could be that this estimate was derived from the multiples values using Masco as a fellow industry leader with higher margin products and strong differentiation and acknowledging the need to discount the share value for lack of liquidity and control. Based on the Masco benchmark and a 25% discount the value would be roughly \$279, 000 per share.

Free Cash Flow Approach Kohler's Free Cash Flow (FCF) model is developed using the Non-Cash Working Capital Approach, a correlated Beta and an EBITA that excludes both interest income and expense. The Non-Cash Working Capital is used because of the consistency each year in Kohler's forecasted working capital. [Table 4]

Secondly, in order to make the FCF model more accurate, a correlation between the company financials and its main competitors is used. Table 5 displays this correlation. The correlation is then multiplied by a factor which is defined by the division of the standard deviation of Kohler's competitor and the standard deviation of the market (US Equity Market). Lastly, an average of each of these factors is performed and the Kohler's Beta is found. [Table 5]

The Beta in this case significantly affects the Weight Average Cost of Capital (WACC) since the weight of Kohler's cost of equity is about 82% and the

remaining 18 % tied to the cost of debt [Table 6]. The calculated WACC using this beta is 14. 19%.

If Beta is calculated using a different standard deviation, other than the US Equity Market, the results will vary drastically. For example, using a standard deviation of a highly correlated distribution of stocks that includes 3 kitchen & bath companies and 3 engine & generator companies, the Beta will decrease from 2. 67 to 1. 52. Then, the new WACC would be 10. 40%[Table 5]. Just this difference in Beta would make the per share value of the stock go from \$164K to \$251K with 0 discount (due to the lack of control and liquidity), and from \$ 57K to \$ 88K with 65 % discount [Table 7].

Kohler is most likely using a relatively high WACC and high discount to come up with a \$58K value per share. As it is shown in Table 8, using a WACC of 14. 19% and a discount of 65% for liquidity and control of the stock arrives at \$57K per share.

On the other hand, the dissenting Kohler shareholders have probably used a much more generous approach to the value of Kohler's shares. It appears they could be using a WACC close to 10% and not discount (liquidity and/or control) or a WACC of 8% and 30% discount to arrive at their \$273, 000 value per share.