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By Ignacio B. Gimenez

Investment Basics: Book Value

The recent release of strong GDP data has spurred market interest in sectors that are seen to benefit the most from an accelerated economic growth. Among these are banks and property stocks. True enough, they have been faring extraordinarily well in the market during the past several weeks.

A query we keep getting from our readers and investors is if these stocks are still reasonably priced following the recent share price runup. To answer this, let us discuss the concept of book value, a basic metric used to determine the valuation of these stocks.

Price to Book Value

Book value refers to the stockholders' equity or total assets minus total liabilities. In other words, it is what is left to shareholders when a company is disposed and its debts are paid off. The source of this data is the audited balance sheet, ideally the latest one in order to get the most updated valuation.

By dividing the book value by the number of outstanding shares, we derive the book value per share which becomes relevant when we measure it up to the share price. This gives rise to the price/book value (P/BV) multiple which is indicative of a stock's relative valuation when compared against its peers, the industry average or the market average. A stock is said to be cheap if its multiple is lower than its peers or the industry and market averages, and vice versa. **But this is not a straightforward rule.** There could be some reasons why a stock is trading at a lower multiple. These include:

1. Valuation of the assets. Note that the balance sheet records the values at cost. We have to determine therefore if these values still hold true by looking at their market values. If the market value turns out to be higher, then we will derive a higher book value and lower P/BV multiple. The opposite is also true.

2. The quality of assets. Are the receivables still collectible? Are the values for property, plant and equipment updated or are these overstated given their current state? Can we derive similar salvage value for these assets when sold? Do intangible assets (such as goodwill) mean anything to the buyer if the company is sold? Is the land bank of a property company still suitable for development or has it diminished in attractiveness due to changes in circumstances such as accessibility, invalidity of titles, etc? If we answer negatively to these questions, then these assets may have to be written off or reduce their values. This will eventually diminish the overall book value. In contrast, companies with good asset quality are accorded higher valuation multiples by the market.

3. Efficiency in employing the assets for profitability. A company may have a high book value but the market does not look well on company management which is not efficient in utilizing assets to generate the most returns.

Adjusted book value

Another variation of the book value is the adjusted book value (ABV). This is most relevant when valuing banks because it takes into account the following:

1. the extent of non-performing loans (NPLs) or non-performing assets (NPAs) and the adequacy of the related loss or bad debt provisioning. There are global standards as to the extent by which banks should provide for potential losses on bad debts.
2. any reflation or deflation in the value of its property assets
3. any deferred tax assets or liabilities

Higher loan-loss provisioning, the deflation in the value of property assets and deferred tax liabilities bring down the ABV of a bank stock. The opposite is also true.

In a booming economy when most companies or bank creditors are presumably doing well, we may have to consider a lower loan-loss provisioning. Also, there exists the possibility of disposing property assets at higher market prices given the strong demand. On both counts, the ABV should be higher. In contrast, when the economy is bad, adjustments will tend to bring down the ABV.

Net asset value (NAV)

Another term use in lieu of book value is Net Asset Value or NAV. The two are actually synonymous. However, in the context of evaluating property companies, analysts usually take into account any actual or potential price appreciation for land and other property assets. This is in relation to developments within the location or the development plans for the said property. In this instance, NAV is no longer just assets minus liabilities but the market value of assets minus liabilities. A case in point is the Fort Bonifacio Global City. Land values in the area have appreciated significantly given all the development that has taken place as compared to about a decade ago when it was utilized primarily for military purposes.

The following are the book values of selected listed banks and property stocks.

Book Values of Selected Stocks	BV/share (P)	Price (P)	P/BV (x)
Banks			
Asiatrust	14.1	13.25	0.94
BPI	24.9	71.50	2.87
BDO	26	71.00	2.73
CHIB	414.2	930.00	2.25
EIB	0.27	0.56	2.07
MBT	37.84	74.00	1.96
PNB	43.1	62.50	1.45
PSB	33.4	65.00	1.95
RCB	29.4	36.00	1.22
SECB	40.14	84.50	2.11
UBP	38.73	63.00	1.63
Property Companies			
Ayala Land Inc	4.43	18.25	4.12
Belle Corporation	0.79	1.80	2.28
C&P Homes Inc	2.49	4.05	1.63
Cebu Holdings Inc	1.76	4.60	2.61
Cityland Development Corp	2.33	2.85	1.22
EDSA Properties Holdings Inc	3.44	3.20	0.93
Empire East	1.75	0.92	0.53
Fil-Estate Land	3.35	1.28	0.38
Filinvest Land	1.89	2.34	1.24
Highlands Prime Inc	1.13	2.95	2.6
Megaworld Corp	1.74	4.20	2.42
Philippine Realty and Holdings Corp	0.51	0.75	1.48
Robinsons Land Corp	7.41	20.25	2.73
SM Development Corp	2.86	5.60	1.96
SM Prime	3.75	14.25	3.8

Sources: Technistock Company data. Book value s as of 31 Mar 2007 Share prices as of 22 June 2007

Just as in any investment house or stockbrokerage research group, we in Philequity have our own computations for ABVs of banks and NAVs for property companies. These computations impute certain assumptions and subjective considerations. Notwithstanding these adjustments, book value can still be a useful valuation tool given that it is straightforward and it removes the subjectivity that comes with ABV and NAV computations. In future articles, we will delve more thoroughly on computing for ABVs and NAVs.

For inquiries and comments, you can email us at gime10000@yahoo.com or research@philequity.net.