

On The “Value” Of Valuations of Companies Whose Shares Are Listed On the TASE

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(December 2003)

Abstract

The financial issues discovered in public corporations such as Enron in the US and in other financial markets triggered concerns regarding financial experts' objectivity in evaluating firms. This argument was raised by the IOSCO, which recently published guidelines for financial research analysts designed to ensure that such valuations are objective as possible. In this work, we discuss the challenges involved in firm valuation in general, and we specifically examine the roles and contributions of financial and valuation analysts, in particular. The challenge in firm valuation stems from the need to address theoretical and empirical problems that are related to financial statement analysis, the formation of expectations concerning a firm's future earnings, and its capital costs, among other things. Why are valuations of listed firms performed? Are such valuations evidence of the market's inefficiency? In this work we study the added value of valuations of public firms based on a sample of 44 companies whose values were assessed by analysts on the occasion of a transaction that occurred outside regular trading on the stock exchange. Each of the valuations was thoroughly examined using alternative valuation methods that differ from those used by the analysts. Each was reconstructed using a retrospective analysis of actual data. Main findings were: 1) The difference between firms' valuation and market value was 29% on average; 2) Nonetheless, share prices do not rise in response to publications of valuation results; 3) This difference is influenced mainly by firms' structure of control and is independent of the valuation method, the firm's economic sector, or the liquidity of the listed securities; 4) These findings are also supported by a retrospective analysis of analysts' projections, according to which we found a systematic upward bias in the firms' estimated cash flows and cost of capital. These findings indicate that valuations hold little added value for the public of outside investors, and that the investor public appreciates the fact that valuations embody a control premium and therefore are designed mainly for controlling shareholders. From this perspective, trading in shares on a stock exchange reflects share value for the marginal investor and does not include the control premium reflected in transactions for which the valuation was commissioned.

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