http://www.theexaminernews.com/prudent-portfolio-a-lesson-from-shark-tank-understanding-a-companys-valuation/

Prudent Portfolio: A Lesson from 'Shark Tank:' Understanding a Company's Valuation

MAY 12, 2017 BY EXAMINER MEDIA

By Peter Chieco

Fans of the popular television show "Shark Tank" are familiar with the show's basic concept: in the hopes of obtaining financial backing, aspiring entrepreneurs pitch their unique new products and business ideas to hugely successful venture capitalists, or "sharks," who then judge the idea's merit and decide whether or not to invest in it.

Each episode is formulaic. After the hopeful entrepreneur makes his or her presentation, he or she will ask for a deal: Will a shark offer, say, $100,000 in return for a 10 percent share of the business? The sharks respond with detailed (often aggressive) questioning of the entrepreneur's assertions that the company is worth $1 million. What these investors are doing, in essence, is determining the true value of the company.

Evaluating a company or asset is essential, too, for real-life investment. Here are some parameters to help frame consideration of a company's value.

Earnings. A company's income statement may tell investors the story of how much revenue streams in and how much profit remains after all expenses. But current year (or quarter) earnings are not a guaranteed predictor of future results. What's the longer-term history of earnings? Are they stable or do they increase regularly?

New competition and advances in a given industry may greatly affect earnings. Think how digital cameras overtook traditional film models…and then cell phones began inching out many digital cameras.

Leadership. How long has the company's management been in place? Investors know that the imminent departure of a recognized company founder – for retirement, perhaps – could decrease a company's value. On the other hand, innovative young hires might increase profits by new branding, by changing to a more sustainable method of doing business, or by finding ways to decrease liabilities.

A Harvard Business Review study demonstrated that investors allocate about one-third of their decision making to quality of leadership. The researchers identified metrics designed to help investors evaluate a company. Some questions include personal proficiency: to what extent do leaders demonstrate the personal qualities to be an effective leader (e.g. intellectual, emotional, social, physical and ethical behaviors)?

There's also talent management: do leaders manage the flow of talent into, through and out of the organization? Specifying qualities such as these may help investors zero in on what's important to them.

Liabilities. How does a company finance its overall operations? What's the status of a company's short-term and long-term debt? Sharply increasing debt may suggest a risky situation. Is the company taking on new debt in order to expand? Or is the company refinancing existing debt because it cannot meet its financial obligations?

Intangibles. Even though they are not part of the typical numerical calculations, intangibles may hold sway over investors. Some of a company's intangible assets include its customer loyalty, brand recognition, intellectual property, strong sales force, social media presence or even its domain name.

Because of the recent run-up in stock prices since the election, many analysts are suggesting that equity prices are too high, i.e. overvalued in relation to corporate earnings. However, analysts at Morgan Stanley have explained that the combination of earnings and interest rates is a more accurate way to assess whether securities are under or overvalued. Under those considerations, it seems that prices represent fair valuations as well as the potential for additional upward movement in carefully-selected securities.

Detailed research into a given company's value may help direct the strategies of investors and financial advisers alike, giving them information that in the long run might decide if they sink or swim.

Peter Chieco is a financial adviser with the Global Wealth Management Division of Morgan Stanley in Greenwich, Conn. He can be reached at 203-625-4897.