ACT349 Sep 10, 2014 lectures:

P/E ratio and discounted cash flow example analysis of ASOS, Sep 2013

Stolen from
http://ftalphaville.ft.com/marketslive/2013-09-17/
who stole it from Morgan Stanley Research.

ACT349 Examinability of this document:
Specifics on graphs and ASOS etc not examinable. Relationship between one-year P/E comparisons and multi-year discounted cash flow analysis under the effects of high assumed growth rate is an examinable concept.

Disclaimer:
This is not investment advice. Keith Sharp has no idea whether stocks mentioned here are overvalued or undervalued by the market. Commentators in this material are making guesses and would be too rich to bother working as commentators if their past guesses had been mostly right. Same for instructors. It’s possible to lose all your money making investments in stocks, derivatives, real estate, commodities etc etc.

11:48AM

BE While on retail, that leads us nicely into Asos.

BE Which definitely has market share.

BE About 1% globally, apparently.

BE What it also has is a £4bn market cap.

BE And Morgan Stanley's rather excellent retail team has been trying to make sense of that.

BE Spoiler: they can't.

PM hehehehe

PM (btw its http://www.matchesfashion.com/ — correcting earlier link)

BE Course, dangerous game downgrading Asos. It just keeps going up, no matter what.

BE Had a sensible retail analyst bemoaning that fact the other day. Trying to value it is pointless. Just keep buying because there's always going to be another mug to pay more.

BE However, Morgan Stanley stick their collective necks out on this one.

ASOS PLC (ASC:LSE): Last: 4,848, down 514 (-9.59%), High: 5,295, Low: 4,815, Volume: 489.36k

BE

> *We remain fans of ASOS and its potential to be a winner in online clothing. Nothing has shaken our confidence in the long-term story, and we anticipate the company issuing a strong trading update later this week (with sales likely to be up more than 40% year on year).*

PM blimey

BE

> *However, the share price has increased by 158% over the last 12 months, despite consensus earnings forecasts over that period having fallen by 5%. As a result, the company is now trading on more than 35x 2017e earnings.*

Comment from KeithSharp: it's saying Price/Earnings ratio is >35, using 2017 estimated earnings

BE

> *We have tried 10 different ways to justify the current share price but none seems plausible. We are acutely aware of the drawbacks of turning negative on a hyper-growth stock in the middle of a bull market. We have, therefore, looked for ways to justify raising our price target to somewhere close to the current share price. However none of the 10 approaches we tried stood up to much scrutiny.*

BE Note: ten different valuation models. We'll come back to that.

BE

> *We downgrade to Underweight, though raise our price target to 4000p. Although we are comfortable raising our price target to 4000p (by assuming higher sales growth), this still represents 23% downside from the current share price. On valuation grounds alone, therefore, we move to Underweight, leaving us out of line with the consensus view.*

PM This is great stuff

BE It is, and here are the ten models as briefly as possible.

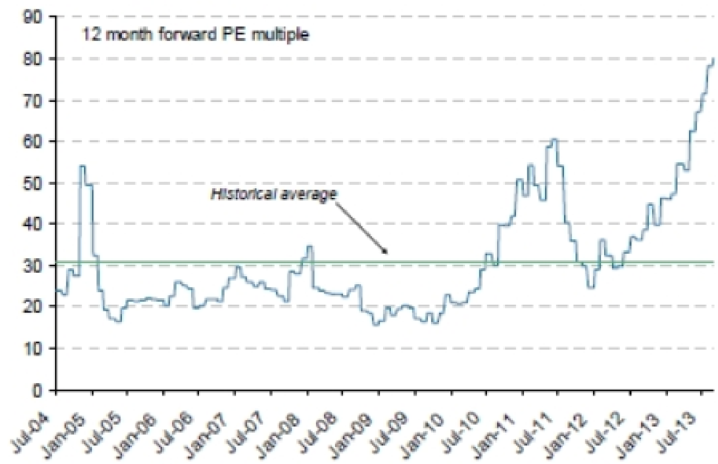
BE So .....

BE 1. Against history, it looks expensive.

BE

Exhibit 7

ASOS is trading on more than 2.5x its historical PE at an all-time high…



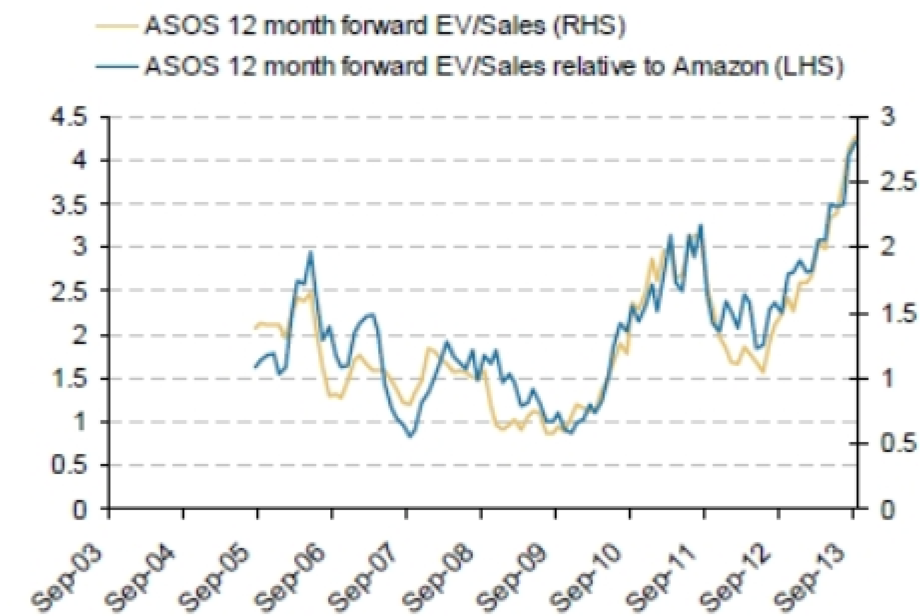
Source: DataStream, Morgan Stanley Research

BE 2. Against Amazon, it looks expensive.

BE

Exhibit 11

ASOS is trading on c.3x the EV/Sales multiple of Amazon



Source: Thomson Reuters, Morgan Stanley Research

Comment from Keith Sharp: EV=enterprise value, Investopia.com says <<A measure of a company's value, often used as an alternative to straightforward market capitalization. Enterprise value is calculated as market cap plus debt, minority interest and preferred shares, minus total cash and cash equivalents>>

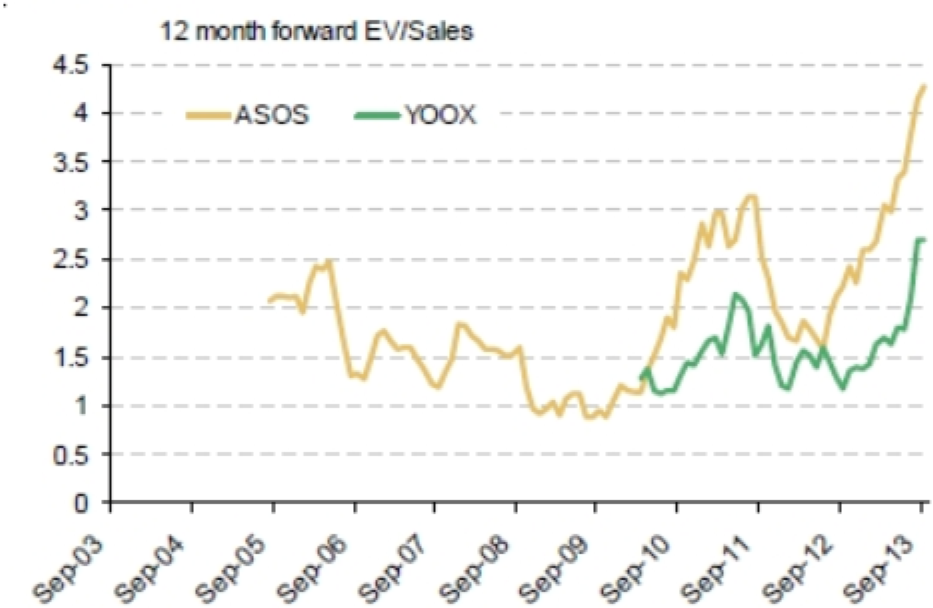
BE

3. Against Yoox, it looks expensive.

BE

Exhibit 16

ASOS is substantially more expensive than YOOX on EV/Sales…



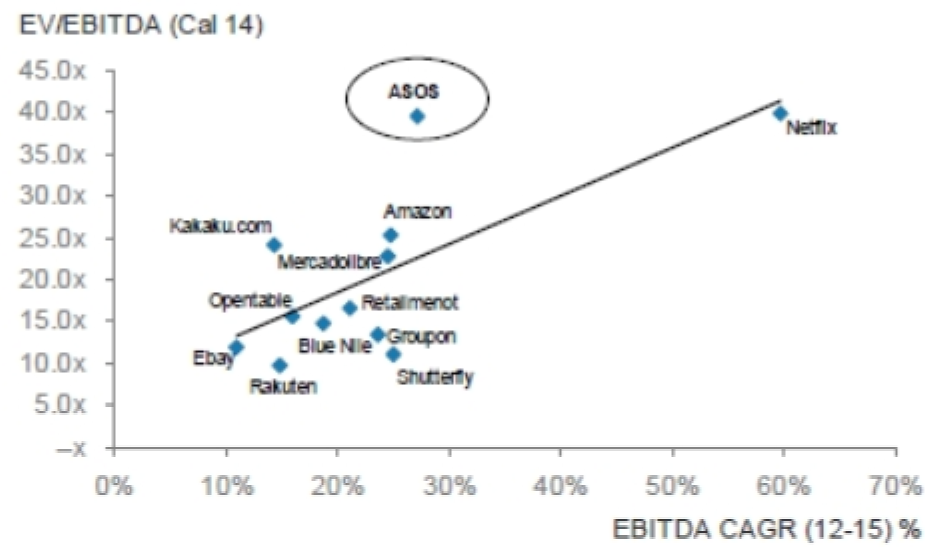
Source: Thomson Reuters, Morgan Stanley Research

BE 4. Against all the other listed retailers, it looks expensive.

BE

Exhibit 18

ASOS is the most expensive on EV/EBITDA of the global eCommerce companies covered by Morgan Stanley…



Source: Thomson Reuters, Morgan Stanley Research estimates

Comment from Keith Sharp: EBITDA = ~~Earnings Before I Tricked Da Auditor~~ Earnings Before Interest, Tax, Depreciation and Amortization. CAGR=Compound Annual Growth Rate

BE 5. Against the rest of the web, it looks expensive.

BE

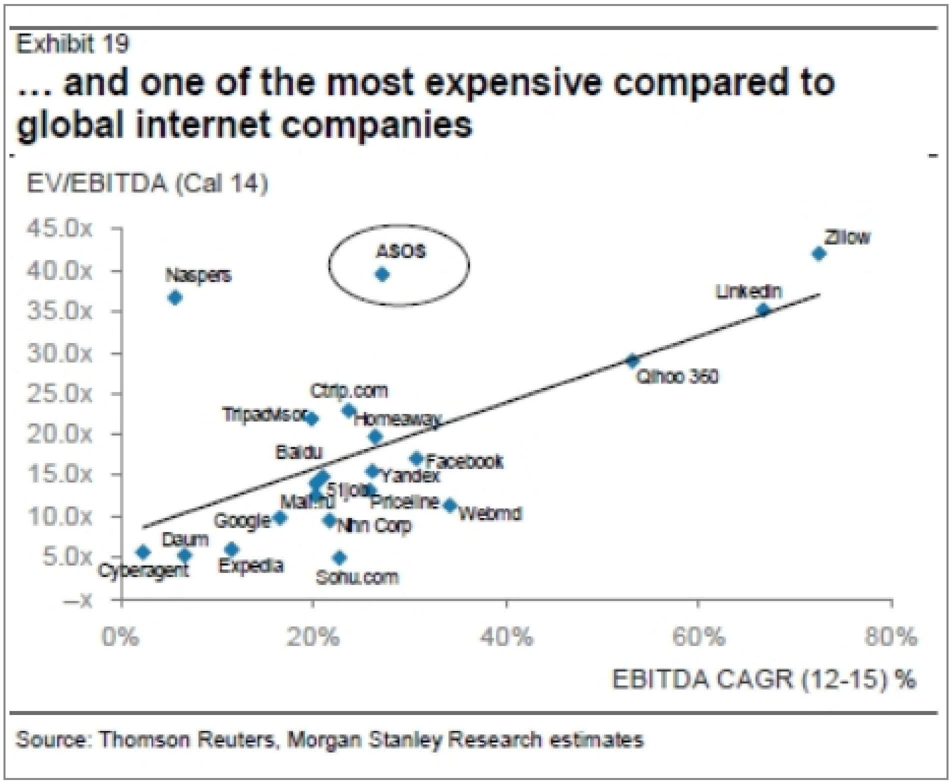


Exhibit 19

... and one of the most expensive compared to global internet companies

Source: Thomson Reuters, Morgan Stanley Research estimates

BE (Enough charts now.)

PM Ahh

PM I was enjoying those

BE But we're only halfway through. ....

BE 6. Against unlisted retailers such as Zalando, it looks expensive.

BE 7. Against H&M and Inditex, it looks expensive.

BE 8. Against the department store operators, it looks expensive.

BE 9. Top down, it looks expensive.

BE 10. Bottom up, it looks expensive.

PM hehehe

PM Brilliant

BE Just on that last one ... think we have room for one more chart.

BE Remember, market cap of £4.3bn.

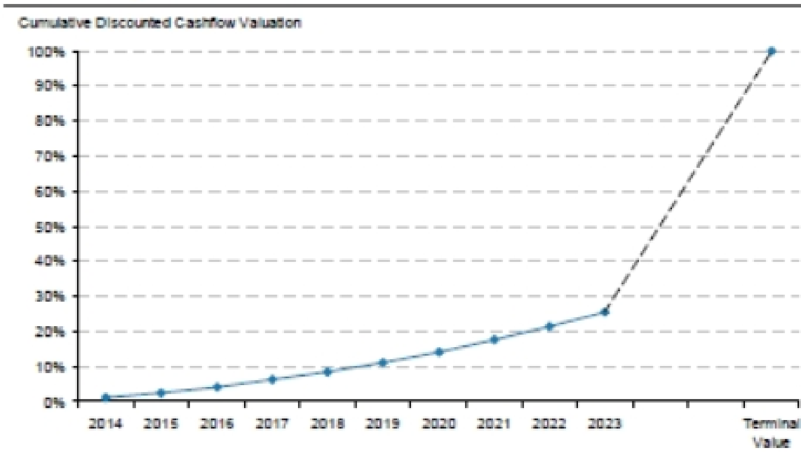
BE Annual free cashflow of ... err £25m

BE So the DCF (based on sensible growth/discount assumptions) looks a bit heroic too.

BE

Exhibit 33

In our DCF valuation, less than 9% of ASOS' value is delivered in the next 5 years, with 75% lying more than 10 years out



Source: Morgan Stanley Research estimates

BE Good, eh?

PM It's terrific

BE I do like Morgan Stanley's retail team. Even though I fell out with Geoff Ruddell in 2001-ish because it was my first week on the job and I didn't really understand what "off the record" meant.

BE Anyway. That.

11:58AM

*Comment from Keith Sharp: The <<err…….25 million>> is because that cashflow is laughably low compared with the market capitalization (stock price * number of stocks out there) of 4.3 billion. The market cap might turn out to be justified if growth is extremely high. Exhibit 33 is saying that the 'horizon value' (more than 10 years away) accounts for 75% of the discounted cash flow present value. This is no surprise when this stock ASOS is being valued on the assumption of extremely high growth rates g. Also no surprise that ASOS stock looks expensive compared with eg Amazon on current year earnings comparisons if the market is assuming much higher growth rates for ASOS than Amazon.*

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