Sector Wise, Which Method Is The Best Valuation Method?

Different valuation methods are preferred for valuation of companies in different sectors.

(a) Basic Materials – Cement and Steel

Steel & Cement represent basic/building materials. The sectors are cyclical (driven by expansion cycles). Being cyclical, in normal/bullish scenarios Comparables approach is best suited. However, in downturns it is better to shift to Asset based approaches to reflect maximum downside potential.

(b) Technology

Technology companies have very complicated business models where revenues are scattered & unpredictable, face constant threat of protectionism and so one simply cannot have a reliable long term forecast. Hence Comparables is chosen over DCF by most. However, we suggest the use of DCF in very bullish/bearish markets.

(c) Telecom

The Telecom sector has rich & abundant data availability to generate very reliable numbers over a 3-5 year horizon and the business model can be very easily broken down into a flow of numbers. For this reason it is recommended to use the DCF approach. However, many analysts use Comparables to provide short-term targets

(d) Retail

Although appearing to be simple, this is one of the most complicated sectors to value. The complexity is a result of distant breakeven, multiple formats, complex funding provisions (debt/lease/cash) and not-so-easily-quantifiable demand. This leads to a hybrid valuation approach often called SoTP Valuation.

(e) Healthcare

Like telecom, these sectors too can be very easily broken down into a logical flow of numbers resulting in a reliable medium-long term forecast. Hence DCF is a rational choice. However, asset based approaches are a must in bearish markets to determine worst-case scenario valuation.

(f) Infrastructure / Power / Oil & Gas

Infrastructure, Power and Oil & Gas together form the Core Sector. These sectors are primarily driven by government policy and funding, the details of which are clearly made available. Having distinct drivers along with rich data availability make it a perfect DCF candidate. Asset valuation should be used as a support

(g) Conglomerates

SoTP valuation is not an altogether different valuation methodology but just a combination of two or more traditional ones. The idea being, in case of a multi-business firm, certain business units may be better off valued using DCF while others may be valued using Comparables while some maybe valued with an asset based approach. The result of each shall be summed-up to determine the value of the firm as a whole. Sum Of The Parts (SoTP) can be used for multiple product lines, multiple business units or multiple subsidiaries. The choice of valuation for each unit must be based on strong rationale, rather than gut feeling (as discussed for the sectors above).