THE GLOBE AND MAIL
CANADA'S NATIONAL NEWSPAPER ▪ FOUNDED 1844 ▪ GLOBEANDMAIL.COM

A LITTLE EVA

Economic value added is notoriously difficult, admits Brian Schofield, but it's a more accurate assessment

Wednesday, October 13, 1999
Page 15

WORKING AS AN INVESTMENT BANKER IN 1993, Brian Schofield adopted a new technique called economic value added (EVA) to calculate a reasonable price for merger and acquisition candidates. EVA was originally developed by consultants Joel Stern and Bennett Stewart, of Stern Stewart & Co. in New York, as an internal management tool to measure return on capital and show graphically if a company's divisions were creating or destroying shareholder value. In addition to helping managers distinguish good performers from bad, the tool also served as a useful motivator and, later, as Schofield discovered, as a way to pick investments.

A painstaking procedure, EVA uses financial information to help managers apply capital in an efficient way to generate maximum value. In the process, and with a few mathematical tweaks, EVA measures a company's intrinsic market value. By comparing this value with its share price, a manager can determine if a company's stock is undervalued and then apply Benjamin Graham's advice to buy low and sell high.

Research departments in U.S. investment banks such as Goldman Sachs and CS First Boston provide EVA company analysis to institutional money managers. In Canada, Dan Lavallee at Union Securities Ltd. in Toronto has adopted a program of research and written company-specific reports using EVA to minimize the efforts required by fund managers to benefit from the technique.

"In determining value," says Schofield, now a principal of Sustainable Investment Group Ltd., "you can use EVA or you can use price-to-earnings, price-to-cash-flow or price-to-book value ratios and still call yourself a value investor." Schofield believes EVA provides a more accurate picture of a company's value than the more conventional ratios used in value investing. "Using these ratios is like playing volleyball with the net down," he says. That's because the income statement doesn't acknowledge the cost of raising equity capital, which takes the form of a return on investors' money. EVA does.

Using EVA to determine value, Schofield recently started the YMG Sustainable Development Fund as a joint venture with YMG Capital Management. Up and running since June, 1999, the fund hasn't been around long enough, under Ontario Securities Commission rules, to publish an assessment of its performance. But Schofield says a second fund, started in March, 1999, for institutional investors, has outperformed the TSE 300 and the S&P/TSE 60.

"It's a terrific technique for determining value in companies that aren't fully developed," says Schofield. "And it's good at the same time for big companies such as BCE and Stelco."

After applying EVA to about 130 candidates for investment, Schofield follows a procedure similar to other value investment managers, interviewing management and assessing each company's quality, then narrows the field to about 40 stocks. To determine when to sell a stock, Schofield uses EVA to set a target price, re-evaluated every quarter, that reflects the company's true inherent value.

"When the price comes within 20% of the target, the stock becomes a candidate for divestiture," he says. "If there's a stock in the same sector that's more undervalued, I'd sell the first stock and buy the second."

Schofield admits that EVA and its variations are "notoriously difficult to do, because they are very labour intensive. But in the long run," he says, "it's truly a more accurate assessment of value."

SCHOFIELD PICKS

MOORE CORP. "Moore has fallen from grace, but if you follow its EVA, it hasn't reached its optimum share price. It's a turnaround situation, with a target price of $23."

INTRAWEST "It's very undervalued at the moment. The company combines a leisure business, with golf and skiing, with real estate, including condominiums and some prestigious properties. Its cash-flow stream is smoother now than it was before when it focused on skiing, and it is suited to current demographics. I look for a target price of $40."

EMPIRE "The owners of Sobey's, which just bought the Oshawa Group and divested its interest in Hannaford for $27 a share in cash, Empire sells at $30 a share now, with a target price of $50."

FINNING "This Caterpillar distributor is based in Vancouver. Its business is a bit cyclical, and it ebbs and flows with mining and forestry, but it's now at $14 and I see it reaching $25."

MAGNA "While everyone watches Frank Stronach to see what he's going to do next, the company's values remain solid. It trades at $74, and I see it going above $100."

globeandmail.com and The Globe and Mail are divisions of The Globe and Mail Inc., 444 Front St. W., Toronto, Canada M5V 2S9

Phillip Crawley, Publisher