Multivariate Analysis of Relative Equity Valuation
Empirical testing of European Traded Stocks

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This paper draws on the literature of relative valuation of enterprises. The purpose of valuation using peer group multiples is to place equity value in relation to peers, who are considered as an alternative investment opportunity. A peer group is made of similar companies that do not necessarily operate in the same industry, but have similar profitability, liquidity and balance sheet structures. In addition to the usual common-size balance sheet and income statement items, industry norms are also used as the basis for forming valuation multiples. For this reason, the literature normally draws on peer groups from the same industry. The aim of this paper is to investigate the suitability of the sectorial division as a basis for forming peer group using multivariate statistical analysis. We take cross-sectional data of 180 European listed companies and we create different multiples that form the latent variables of profitability, efficiency and value. Our methodology uses cluster analysis, and factor analysis (PCA, PAF) to examine whether results differ from our hypothesized sectorial classification. Our hypothesis is confirmed that forming peer groups based on the Bloomberg sector categorisation is correct and stable. We come to the conclusion that in general it is a good proxy to align an enterprise's operations to the industry standards.

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