Stewart III, G. Bennett – Best-Practice EVA

John Wiley & Sons, 2013, [Business] Grade ★★★★

In the second half of the 1980's shareholders were waking up to the enormous waste inflicted by managements who instead of acting as trustees for the owners milked the companies for perks, money and social benefits. This pawed the way for the corporate raiders of the day, but also - inspired by the trailblazer Alfred Rappaport – a more intellectual movement took root. In the center of this shareholder value movement was G. Bennett Stewart III and the consultancy Stern Stewart & Co with their concept Economic Value Added, or EVA for short.

I was an early devotee simply because the concept made sense as it relates to the notion of capital allocation as the method of economic progress and offered a theoretically sound framework for valuing stocks but also provided a link between finance and corporate strategy.

Then the shareholder value flames began to flicker and died out. Partly, this was due to the concept being hijacked by greedy managers who perversely used it to shower themselves in option riches and when the TMT-boom went into bust, shareholder value – guilty by association – was thrown out with the bathwater. However, it was also partly due to a lack of usability of many of the concepts such as EVA. The movement hibernated through concepts such as CROCI championed by Deutsche Bank and HOLT offered by Credit Suisse and now Stewart tries to relight the EVA flames with this impressive book.

At the center of the effort are a number of new financial EVA-based ratios. At its most basic, EVA is a measure of economic profit where not only operating costs and taxes have been deducted from sales but also the capital cost for using both debt and equity financing. In a world that uses ratios such as sales growth, ROI, profit margins or PE-ratios to compare business units or developments over time, to gauge the relative attractiveness of stocks etc. a monetary profit measure did not inspire much. Stewart now brings forward a number of ratios with the EVA-margin (EVA/Sales) and EVA-momentum (D EVA/Prior Sales) as the most prominent ones. Out of these the author constructs a full Du-Pont-type of schedule to analyze companies.

Stewart uses a lot of energy on convincing the reader of the superiority of the new EVA-based measures compared to more traditional accounting measures, financial ratios and valuation multiples. On a theoretical level he succeeds – I'm enthusiastic about testing the concepts for corporate analysis and investment decisions. I also love how the concept of EVA-margin facilitates comparisons of capital light and capital heavy companies.

But EVA still suffers from a complexity issue when the IFRS accounting is turned into economically rational EVA-figures. If EVA is to fly, an author must be overly explicit with regards to all the adjustments. Yet, when reading the book I find myself wishing for an excel file with all the calculations to be able to get a better overview of the full result. All the ratios and adjustments get a bit overwhelming as it is now. As Stern Stewart & Co has been split into Joel Stern's Stern Value Management and Stewart's EVA Dimensions and the author is actively marketing and selling his full service offer to corporate customers this level of transparency is not available. The last chapter of the book is also something of a sales pitch. Further I think the handling of financials could have warranted some comment. All this deducts a star in my rating of an otherwise important book.

Few concepts bring such clarity to so many areas in business and finance as EVA. It doesn't matter if your specialty is capital budgeting, corporate strategy, Mergers & Acquisitions, performance evaluation or incentive systems of security analysis; EVA and this book in particular will benefit you greatly.

Mats Larsson, October 16, 2014