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Relative valuation roles of equity book value and net income as a function of financial health

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Abstract

This study tests predictions that pricing multiples on and incremental explanatory power of equity book value (net income) increase (decrease) as financial health decreases. Tests using a sample of 396 bankrupt firms and tests using a larger, pooled sample both yield inferences consistent with predictions. Findings are robust to inclusion of controls for industry, size, return-on-equity, and volatility of equity returns. Equity book value and net income multiples and incremental explanatory power vary predictably across three illustrative industries, selected based on the likely extent of unrecognized intangible assets.



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JEL classification

M4; G33; C2

Keywords

Capital markets; Equity book value; Financial health; Net income; Valuation

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