

THE ROLE OF EARNINGS AND BOOK VALUES IN PRICING STOCKS: EVIDENCE FROM TURKEY

Abstract

In this study, we examine factors associated with equity valuation in a newly emerging market, Turkey. In the United States and other developed countries, research indicates that both earnings and book value are important predictors of equity valuation. In Turkey, earnings appears to have information content but earnings, by itself, appears to be declining in importance over time. Book value adjusted for inflation has a stronger association with equity values. In the inflationary and risky environment of Turkey, where future value of earnings is quite uncertain, investors may be paying less attention to earnings and more attention to book values. With respect to the role of book value there are competing explanations. While some researchers conclude that it is only important because it is a control for scale differences, (Barth and Kallapur 1996) others conclude that it is relevant as a proxy for normal earnings (Ohlson 1995). Still others conclude that it is only relevant in the valuation of loss making and generally unsuccessful firms (Berger, Ofek and Swary 1997; Burgstahler and Dichev 1997). The additional contribution of this study is to show that book value is also important as a value proxy for firms operating in environments where there is rampant inflation. Our study also indicates that, overall, earnings and inflation-adjusted book values combined virtually explain almost 75 percent of the variation in equity prices in Turkey.

Keywords: Earnings, book values, equity values, Turkish firms, Istanbul Stock Exchange