

value

"It is people who have no idea on how to value their business [that] I find difficult to deal with"

James Caan, Dragons Den on tour

**So how much is a business worth?
...A business is worth what someone is willing to pay for it!**

In the situation where we have a willing buyer and seller then it is reasonable to assume the price agreed will be a 'fair value' but even then it should be recognised that the price will have been influenced by various factors such as comparative negotiating positions.

Value in the absence of negotiated price

There are a number of circumstances where a business valuation is required or desired outside of an arms length business transaction, these include:

- Matrimonial Disputes
- Enterprise Management Incentive (EMI) and other share schemes
- Probate
- Future planning; including succession planning
- Incorporation

In these circumstances a 'theoretical' valuation method is required to arrive at a value or range of values. Similarly, a 'theoretical' valuation is often used in the context of a (possible) business transaction as a base/ starting point for assessing an offer made or to make an offer.

Our valuation methodology

Generally we would look to value a business on a number of bases and combine these to arrive at a single valuation. The various methods we often use are outlined on the reverse of this factsheet.

The methodology for selecting the appropriate bases and combining the resultant values is based on a rationalisation of what drives value for a particular interest in a business at a particular stage of the businesses development e.g., the 'value' to a minority shareholder of their shareholding in an established business with no immediate prospect of a sale will be the dividend stream value.

The specific weightings we use for established businesses are influenced by published guidance but as with all aspects care and thought are required in arriving at the value and assessing its credibility.

So how much is my business worth?

What we hope this fact sheet has given you is a flavour as to how we approach a valuation – if you wish us to value a specific business please do not hesitate to contact:

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Valuation techniques – overviewed on reverse

- Maintainable Earnings
- Net Assets
- Dividend Yield
- Net Present Value/Discounted Cash Flow
- Discounted Exit Value
- Prior Transactions

free cash flow

"With Discounted Cash Flow valuations, the value is derived by using forecast 'free cash flow' and discounting them to the present using a 'risk adjusted cost of capital'."

Maintainable Earnings

This method uses an estimate of 'maintainable' earnings for the business to which a multiple is applied to produce an approximate value of the business.

Maintainable earnings are calculated by reference to the historic results of the business. Given that the valuation is based on multiple years a weighted average is calculated to ensure that maintainable earnings are not skewed by aberrant results in one year. This weighting applied is often affected by the age profile of profits, consistency with the overall trend in profits and any exceptional factors identified.

The multiple used is generally based on comparable values for listed companies as at the date of valuation and/or from recent transactions involving FTSE or AIM companies. A discount is applied to relevant Price Earnings Ratios (PER) to account for the relative lack of marketability for example in the case of any small Owner/ Manager business.

Net Assets

The starting point here is the latest balance sheet for the business, which is then adjusted for any differences between the carrying value of assets and their market values. In addition, tax adjustments may be required for increases in property value, for example.

Dividend Yield

Models such as the dividend growth model are often used but this is more applicable in valuing the dividend stream for plc's/ listed companies. For the purposes of putting a value on dividends in a Small to Medium sized entity (SME) valuation we often use an approximation of dividend yield where:

$$\text{Share value} = \frac{\text{Average dividend paid}}{\text{Required yield}}$$

For required yield we have often used a rate of "x" times yield on say 3% Treasury Stock: the multiplication factor of x to reflect the increased risk in investing in the company as opposed to (risk free) treasury stock and the lack of marketability of a small private company share.

Net Present Value/ Discounted Cash Flow

With Discounted Cash Flow valuations, the value is derived by using forecast 'free cash flow' and discounting them to the present value using a 'risk adjusted cost of capital'. For the purposes of our valuations we often use a degree of approximation/ simplification. For example the following is a guide to which discount rates are applicable for a business based on its stage of development:

- Early start ups seeking money: 50% – 100%
- Early start ups: 40% – 60%
- Late start ups: 30 – 50%
- Mature Companies: 10 – 25%

Discounted Exit Value

The 'discounted exit value' is a calculation of the estimated value of capitalised earnings in say 5 years time, based on year 5 profit being representative of maintainable earnings at that time. Discount rates used are based on our evaluation of the stage of investment/ stage of development as in Net Present Value calculations.

Prior Transactions

If there have been any prior issues and/or transactions in the share capital of the company these should be taken into account in a valuation.