

What's my business worth? A comparison of common valuation techniques.

"What is my business worth" is a common enquiry from business owners who are looking to grow or sell their business. While "~3 times profit" is probably the most common response from many business brokers – this is far from a rigorous assessment and not a true reflection of a business' value.

There are several legitimate valuation techniques that may be employed, and in some cases, it may be diligent to apply multiple methods to establish an estimated valuation range. The following provides an overview of some of the key business valuation methods and a description of how they may be applied in practice.

Note that we typically refer to a "valuation range" as the same business could be valued differently by different prospects (for example: consider a listed company trading at a substantial EV/EBITDA multiple where the business offers synergies versus a financial investor who is seeking consistent yield).

Common business valuation methods

Technique: *Capitalisation of future maintainable earnings*

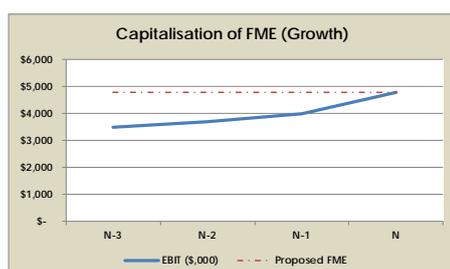
Description: A market relevant capitalisation rate is applied to an estimate of future maintainable earnings (FME). The estimate of future maintainable earnings is typically based on earnings before interest and tax (EBIT), normalised to remove items such as non-recurring revenues/expenses and adjusted to include market relevant expenses such as owners' remuneration and rent (if a commercial lease is not in place).

Furthermore, determining the FME of a business requires careful consideration of historic earnings, current trend and likely future profitability, and is therefore not necessarily an average of recent earnings. Similarly, the capitalisation rate will be determined based on a variety of factors relating to the specific industry, customer concentration, extent of contracted and recurring revenues, scalability, independence of owners and perceived level of risk associated with the future profitability.

Application: This is a common technique applied to established and profitable businesses.

Example:

Suppose that 3 businesses within the same industry each have 4-year average normalised EBIT of \$4.0 million, the future maintainable earnings and capitalisation rates could vary significantly:



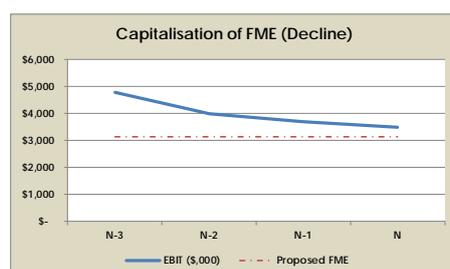
4-year average EBIT: \$4.0 million

Estimated FME: \$4.8 million

Key valuation drivers: diversified client base, high level of contracted and recurring revenue

Multiple range (example): 5.5 to 6.0 (cap rate 13% - 18%)

Value range: \$26 - \$28 million



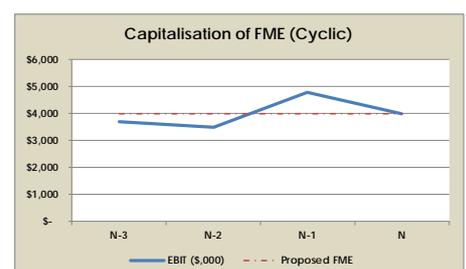
4-year average EBIT: \$4.0 million

Estimated FME: \$3.2 million

Key valuation drivers: high level of project work, high proportion of revenues from few clients

Multiple range (example): 2.5 to 3.5 (cap rate 29% - 40%)

Value range: \$8 - \$11 million



4-year average EBIT: \$4.0 million

Estimated FME: \$4.0 million

Key valuation drivers: unique intellectual property, mix of project and recurring income

Multiple range (example): 4.5 to 5.0 (cap rate 20% - 22%)

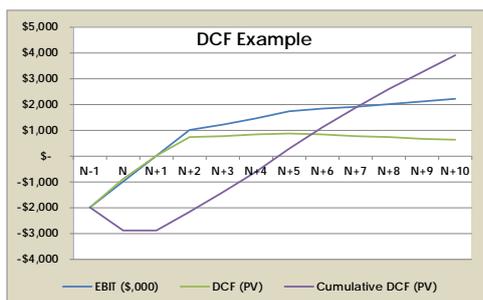
Value range: \$18 - \$20 million

Technique: *Discounted Cashflow (DCF)*

Description: The future cashflows (eg 5-10 years) of a business or asset are forecast and are discounted back at a rate applicable to the cost of capital and the risk associated with the forecast. As a result, this provides an estimate as to the net present value of the business or asset.

Application: This is an appropriate technique for early stage or high growth companies where the future cashflows can be forecast with a level of reliability.

Example:



A company has recently commercialised proprietary technology and has some IP protection in place. In the recent months the company has commenced generating sales and has a credible revenue plan going forward.

Even though the company has not generated profits, the DCF methodology can be used to estimate the present value (PV) of the stream of future cashflows.

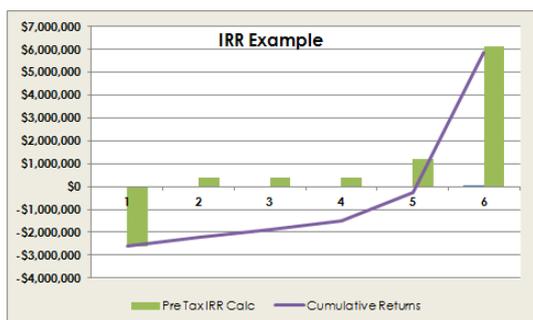
Based on a 12% weighted average cost of capital (WACC), the present value of a 10-year stream of cashflows is ~\$4 million (this assumes no terminal value of the income stream).

Technique: *Internal Rate of Return (IRR)*

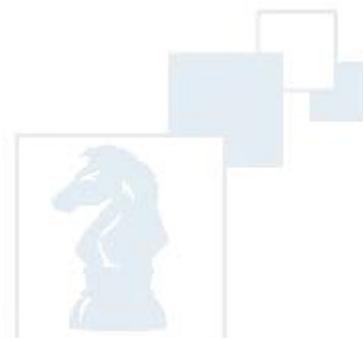
Description: Closely associated with DCF, IRR is the discount rate at which the Net Present Value of all cash flows from a particular asset equal zero.

Application: This is a useful technique to describe the return to investors based on an initial investment and a stream of future dividends prior to a potential return of capital. IRR is often used by fund managers or to express the return to investors within a syndicate.

Example:



A business that generates \$2.0 million in EBIT is purchased by investors in a syndicate at a multiple of 4.5 using 35% debt. Assuming annual EBIT growth of 5%, an annual dividend payout ratio of 100% and a sale after 5 years at the same multiple as purchase, the forecast IRR to investors is 24% (based on grossed-up dividends).



Technique: *Net Asset Value*

Description: Estimates the value of a business based on the net assets on the balance sheet

Application: This is an appropriate technique to estimate the value of a company that is generating losses or more generally, where the value of tangible assets significantly exceeds the goodwill in a company.

Example:

Balance Sheet		Settlement Balance Sheet	
Assets		Assets	
Plant and Equipment	\$ 1,275,000	Plant and Equipment	\$ 1,275,000
Stock	\$ 350,000	Stock	\$ 350,000
Debtors	\$ 200,000	Debtors	\$ -
Goodwill	\$ -	Goodwill	\$ -
Total Assets	\$ 1,825,000	Total Assets	\$ 1,625,000
Liabilities		Liabilities	
Loans	\$ 500,000	Loans	\$ -
Creditors	\$ 150,000	Creditors	\$ -
Total Liabilities	\$ 650,000	Total Liabilities	\$ -
Net Equity	\$ 1,175,000	Net Equity	\$ 1,625,000

An established company is "break-even" with EBIT typically within the -\$50,000 to +\$50,000 range.

The market value of the company's plant and equipment are accurately recorded on the balance sheet and the stock is 100% usable.

While an acquirer's return on equity (ROE) will be negligible, the business could be valued based on the balance sheet as at the time of sale.

In this example, the business is sold as an "asset sale" and the seller will payout their loans and creditors and collect their debtors.

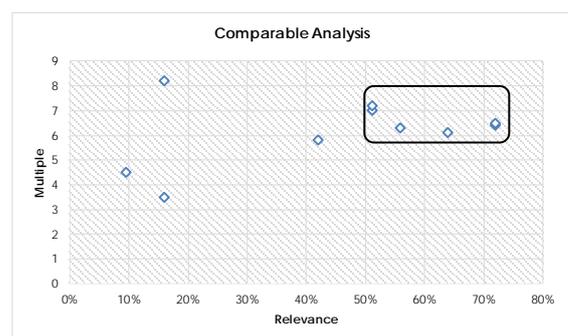
Technique: *Comparable Analysis*

Description: Estimates the value of a business or asset by comparing it to a relevant set of recent transactions.

Application: This may be applicable to industries and assets (such as commercial property) where there is a meaningful database of directly comparable transactions. It can also be a useful technique to confirm other more rigorous valuation techniques.

Example:

Day Hospital	Scale Relevance	Location Relevance	Scope Relevance	Relevance Weighting	Multiple
Example 1	5.0	3.5	4.0	56%	6.3
Example 2	4.0	4.0	4.0	51%	7.0
Example 3	3.0	2.0	2.0	10%	4.5
Example 4	2.0	5.0	2.0	16%	8.2
Example 5	4.0	5.0	4.0	64%	6.1
Example 6	3.5	5.0	3.0	42%	5.8
Example 7	1.0	5.0	4.0	16%	3.5
Example 8	5.0	4.0	4.5	72%	6.4
Example 9	4.5	5.0	4.0	72%	6.5
Example 10	4.0	4.0	4.0	51%	7.2
Median (all)					6.35
Average (all)					6.15
Median (>50%)					6.45
Average (>50%)					6.58



An acquirer is preparing a bid for a day hospital under competitive conditions. To guide their offer, 10 recent acquisitions of private day hospitals are identified, and the associated multiples are estimated (these may be disclosed where the business was acquired by a listed company). Based on an assessment of relevant comparable transactions, an offer multiple of 6.4 is used by the bid team.



Market Value Assessment (MVA)

To assist owners to understand the value of their business, Scancorp has developed a Market Value Assessment (MVA) service. The MVA process analyses a business and provides the owners with the following deliverables:

1. An assessment of value range of the business in its current state *based on the perspective of potential buyers*,
2. The key value drivers influencing the assessed value range; and
3. Profiles of potential buyers for the business.

The MVA process leverages Scancorp's "5-Pillars" to provide rigour around the selection of capitalisation rate.

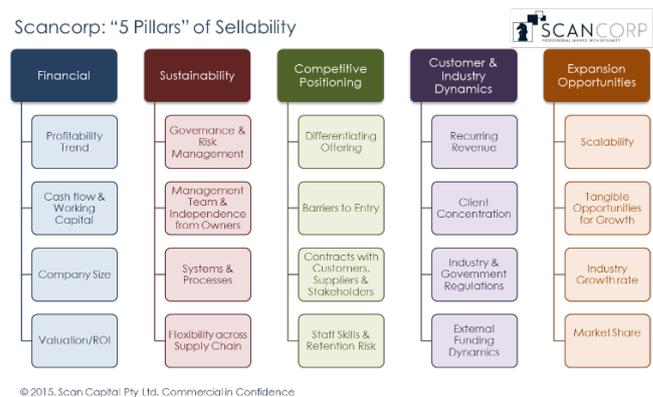
When applicable, multiple valuation techniques described above may be applied.

Importantly, the "universe of potential buyers" is considered as the type of buyer can significantly impact the price paid for a business.

For more information contact **Scancorp**:

E: scancorp@scancorp.com.au

T: +61 7 3902 2400



Divestment	Acquisition	Advisory	Valuation
-------------------	--------------------	-----------------	------------------

www.scancorp.com.au

About Scancorp

Scancorp comprises Scan Capital (Australian Financial Services License 400964), Scancorp Logistics Advisors, Scancorp Medical and Scan Business Brokers.

Scancorp has a 30-year history specialising in:

- Company sales (including complete acquisitions, partial divestment, asset sales & management buy-outs)
- Corporate acquisitions
- Preparation for business exit
- Advisory and Consulting (specialising in business improvement), and
- Transactional support (including licensing, joint ventures, tender management and complex negotiations).

Scancorp specialises in servicing high performing and high growth private companies – typically with Enterprise Value between \$3M - \$30M.

Scancorp's team has combined experience across \$10B in transactions and applies its tier-1 M&A and advisory experience to assist its clients to achieve exceptional outcomes.

Scancorp has representatives across Australia.

2017: Awarded "Leading Advisor 2017 – Australia" by Acquisition International	2016: Awarded "Boutique M&A Advisory Firm – Australia" by ACQ	2015: Awarded "Best for Strategic Consulting – Australia" by Acquisition International
--	--	---