

Performing Business Valuations

Presenter: **Nestene Botha (CA)SA**

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Presenter

Nestene Botha (CA)SA

- Explore ProTech Entrepreneurial Haven (Co-Founder)
- Top 35 under 35 Chartered Accountant (SAICA)
- Top 50 women in accounting
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COURSE OUTLINE

Learning Outcomes

By the end of this webinar you should:

- Understand business valuation and its drivers.
- Know how to assess the required ROI.
- Understand how to construct an argument.
- Understand the different business valuation methods.
- Be aware of online tools that may be used in the business valuation process.

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Module 8:	Online Tools

Quote

Almost every business in South Africa is faced with an uncertain future. To maximise the chances of survival, every company and board will need to conduct an honest assessment of the business and market environment, understand the available support, engage with its stakeholders and implement the changes that are required to maximise the chances of its survival. This process will need to be redone many times over the coming years and many companies will no doubt need to downsize or change their business model to survive. Those that act quickly and decisively are going to be best placed to not only survive, but thrive in the aftermath of the COVID-19 pandemic.

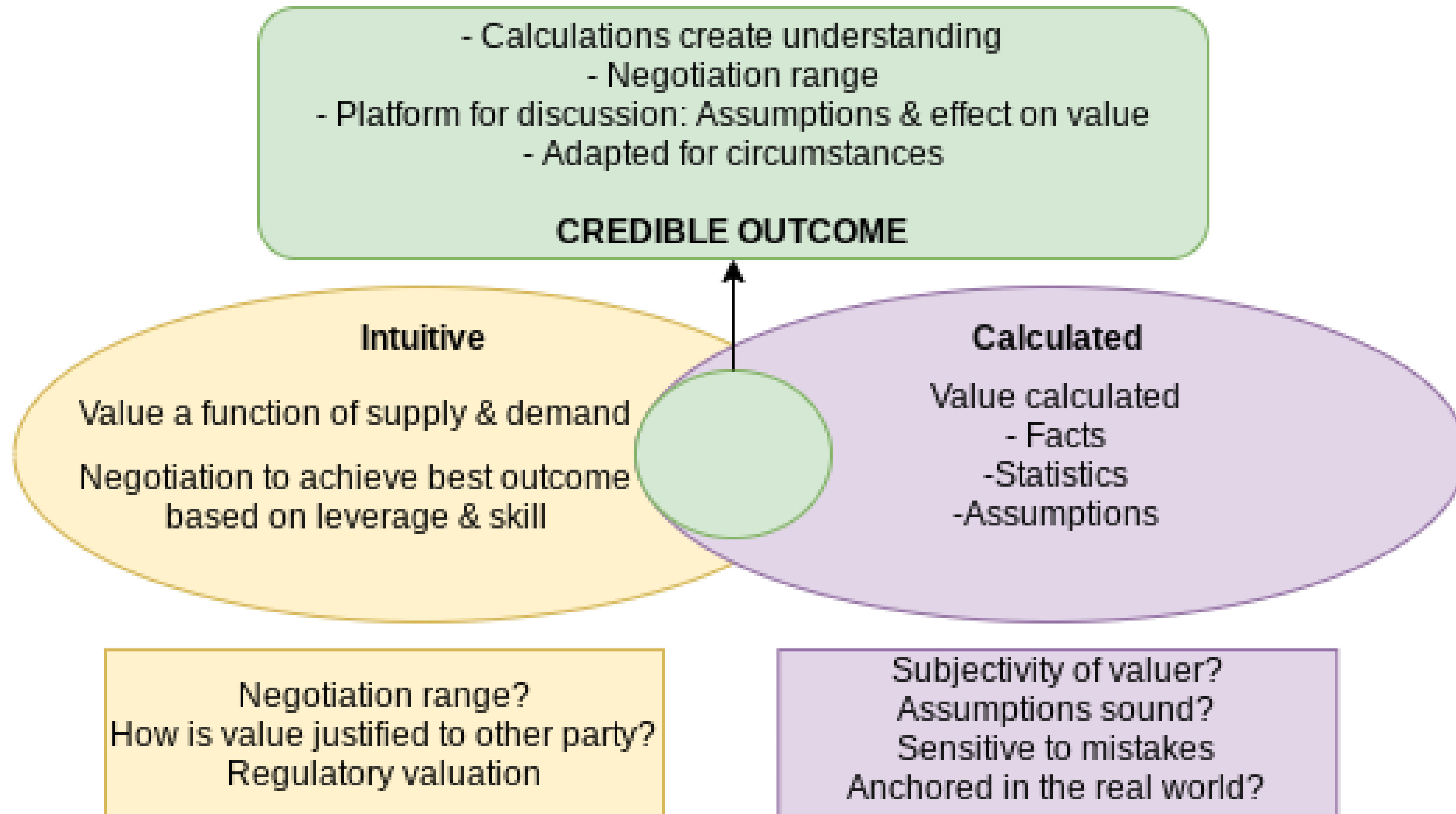
- John Evans CA(SA) via Accountancy SA

MODULE 1

WHAT IS VALUE?

WHAT IS VALUE?

ART (INTUITIVE) VS SCIENCE (CALCULATION)



WHAT IS VALUE?

ENTERPRISE VALUE VS EQUITY VALUE

ENTERPRISE

- +Working Capital
- + Fixed Assets
- +Intangibles

ENTERPRISE VALUE

- +Non operating assets
- Debt

EQUITY VALUE ON A NON-MARKETABLE BASIS

- + Control premium* / - Minority discount**
- Marketability discount***

EQUITY VALUE ON A MARKETABLE BASIS

*Control premium

- Majority stake
- Expected synergies
- Larger stake = Larger premium

**Minority discount

- Minority stake
- Lack of influence = increased risk
- Smaller stake = Larger discount

**Marketability discount

- Lack of trading liquidity
- Listed v non-listed
- Contractual restrictions

MODULE 2

VALUATION APPROACHES

4 Most commonly used Valuation Models

Cost Approach
(Net Asset Value)

① MV

NBV

Market Approach
(Relative Value)

EV = EBITDA x multiple ②
+ Non-operating assets - Debt
+ Control premium / - Minority discount
- Marketability discount

Income Approach
(Intrinsic Value)

EV = NPV of free cash flows ③
+ Non-operating assets - Debt
+ Control premium / - Minority discount
- Marketability discount

NPV of dividends ④

CHOOSING VALUATION METHODS

FACTORS TO CONSIDER

TYPE?

Holdco?
Property?
Investments?
Trading company?

Recent
Market
Transactions?

Minority
or
Majority

**OTHER
FACTORS**

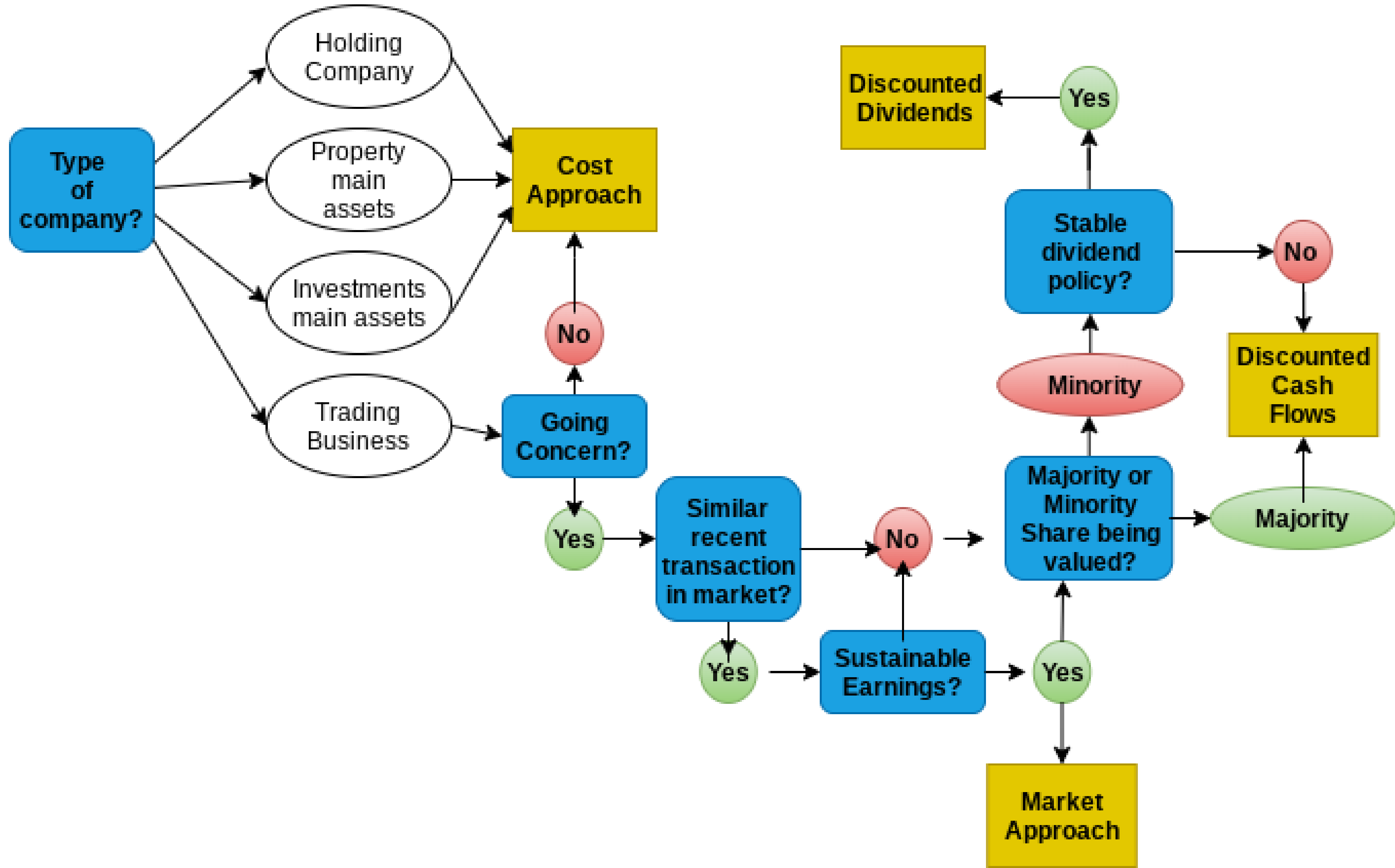
Past
Circumstances

Going
Concern?

Sustainable
Earnings?

Stable
Dividend
Policy?

CHOOSING VALUATION METHODS



LET'S LOOK AT THE DIFFERENT VALUATION METHODS

1. Cost Approach
2. Market Approach
3. Discounted Cashflows
4. Discounted Dividends

MODULE 3

THE MARKET APPROACH

THE MARKET APPROACH

Enterprise Value = Normalised EBITDA x adjusted EV/EVITDA Multiple

Step 1 - Normalise EBITDA

Step 2 - Determine Multiple

Step 3 - Calculate Enterprise Value

Step 4 - Calculate Equity Value

THE MARKET APPROACH

Enterprise Value = **Normalised EBITDA** x adjusted EV/EVITDA Multiple

Normalised EBITDA		R'000
EBITDA		9,004.00
- Margin on once-off project	-263	
- Insurance claim received	-65	
+Forex losses added back	1022	
+Non-operating expenses	308	
Adjustments	1002	1002
Normalised EBITDA		10,006.00

THE MARKET APPROACH

Enterprise Value = Normalised EBITDA x **adjusted EV/EVITDA Multiple**

EV/ EBITDA MULTIPLES	
Competitor A	5.50
Competitor B	10.20
Competitor C	9.30
Peer A	6.20
Average	7.80
+Different growth profile	0.50
-Systemic risk adjustment	-0.50
-Small stock risk adjustment	-1.50
-Specific risk adjustment	-0.50
Adjusted EV/ EBITDA Multiple	5.80

THE MARKET APPROACH

Valuation on an open market principle		R'000
Normalised EBITDA		10,006
x Risk Adjusted EV/ EBITDA multiple		5.80
Enterprise value		58,035
Property	6,000	
Investments	1,000	
Loans receivable	4,000	
Cash & equivalents	1,500	
Long term liabilities	-17,300	
Tax asset/ (liability)	-6,680	
Non-operating assets and liabilities	-11,480	-11,480
Value of enterprise on a non-marketable minority basis		56,567
Add: Control premium (10%)		5,657
Less: Discount for lack of marketability (6.8%)		-3,847
Value of enterprise on a marketable majority basis		58,377
Shareholding Valued		70%
70% of Value of enterprise on a marketable majority bas		40,864

- Certain balances are not included in the Enterprise Value of the business, as they are not necessary for the business to continue trading. These balances are stated at their fair values at the valuation date, after any adjustments.
- A majority shareholding implies a substantial influence on the operations of the business and material business decisions. Control premium of 10% on a 70% shareholding is considered by market participants as appropriate to recognise this influence.
- The business is not a listed entity. There is thus a substantial difference in the liquidity (tradeability) of its shares when compared to the shares of a listed entity, as a shareholder cannot readily sell his shares by placing a sales instruction with a stockbroker (which will be the case when listed shares are owned). A marketability discount factor of 6.8% on 70% shareholding is considered by market participants as appropriate to compensate for the illiquidity of its shares.

MODULE 4

DISCOUNTED FREE CASH FLOWS METHOD

DISCOUNTED FREE CASH FLOWS

Enterprise Value = Forecasted Free Cashflows x Discount Rate

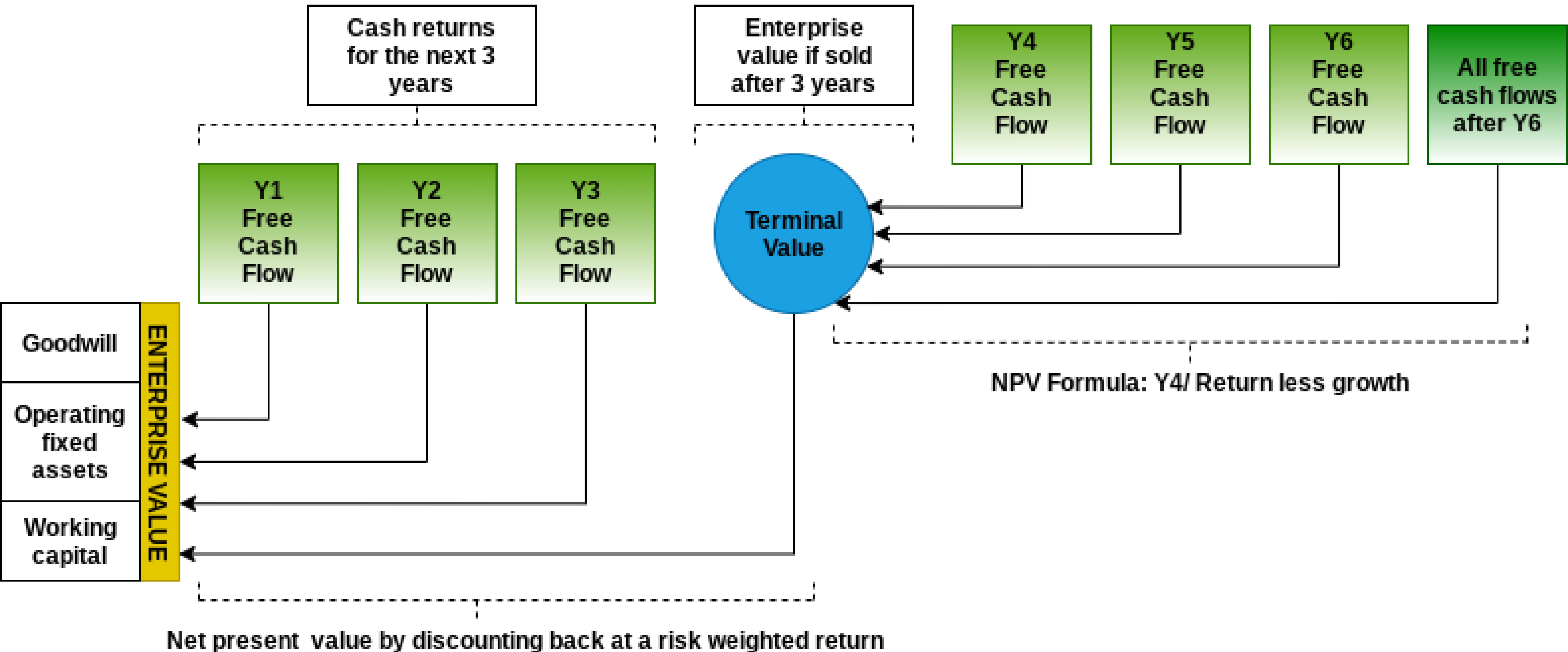
Step 1 - Forecast Free Cashflows

Step 2 - Determine Discount Rate

Step 3 - Calculate Enterprise Value

Step 4 - Calculate Equity Value

DISCOUNTED FREE CASH FLOWS



WHAT IS FREE CASH FLOW?

- Free cash flow (FCF) represents the cash a company generates after accounting for cash outflows to support operations and maintain its [capital assets](#).
 - Free cash flow is a measure of profitability that excludes the non-cash expenses of the [income statement](#) and
 - Cost of financing
 - includes spending on equipment and assets as well as changes in [working capital](#) from the [balance sheet](#).

Represents the cash available for the company to repay creditors or pay dividends and interest to investors

CALCULATING FREE CASH FLOWS

EBITDA		13,950
Less: <i>Wear and Tear</i>		-390
Taxable EBITDA		13,560
Taxation		-3,797
Normalised operating profit after tax		9,763
Add back: <i>Wear and Tear</i>		390
EBIDA		10,153
Change in working capital		-1,234
Capital expenditure		-543
Free Cash Flows		8,376

$$WACC = (Kd \times d\%) + (Re \times e\%)$$

$e\%$ = Ordinary share capital as a portion of the total invested capital (share capital + debt)

Kd = After tax cost of debt

$d\%$ = Debt as a portion of the total invested capital (share capital + debt)

Specific Risk Premium (SRP) represents unsystematic risk (excluding a Small Stock Premium - See below) that is inherent to the business. In a well-balanced portfolio of investments such unsystematic risk can be eliminated by diversification. Where such an investment is not part of a portfolio, unsystematic risk must be taken into account.

Risk free rate (Rf) represents the return on the lowest risk investment in the market that the company is being valued. This is typically a government bond in a well traded and regulated bond market.

$$Re = Rf + B(Rm - Rf) + SRP + SSP$$

Small Stock Premium (SSP) is commonly recognised by market participants as a risk premium related to the size of a business.

Beta (B) represents the risk of the business being valued relative to the risk of a market portfolio. A security with a beta of 1 would be expected to have a share price movement that is perfectly correlated with the overall movement in the market. A beta that is greater than 1 would be more sensitive and a beta of less than 1 would be less sensitive to systematic risk than the overall market.

Market Risk Premium ($Rm - Rf$) is the expected return on the market portfolio in excess of the risk-free rate. $Rm - Rf$ is also referred to as the market risk premium. This premium is required by the market as compensation for an investment in equities.

CALCULATING DISCOUNTED FREE CASH

FLOWS

Calculation of Enterprise Value (R'000)	F2020	F2021	F2022	F2023	F2024
EBITDA	13,950	14,970	13,881	15,210	16,410
Less: Wear & Tear	-399	-458	-538	-642	-775
EBIT	13,551	14,512	13,343	14,568	15,635
Taxation	-3,906	-4,192	-3,887	-4,259	-4,595
Normalised operating profit after tax	9,645	10,320	9,456	10,309	11,040
Add back: Wear & Tear	399	458	538	642	775
Change in working capital	-1,267	-411	-343	-479	-548
Capital expenditure	-561	-693	-857	-1,058	-1,308
Free cash flows	8,216	9,674	8,794	9,414	9,959
Discount period	0.50	1.50	2.50	3.50	4.50
Discount factor based on WACC	0.91	0.76	0.63	0.53	0.44
Discounted free cash flows (R'000)	7,477	7,359	5,575	4,973	4,384
Aggregate of discounted free cash flows over forecast period					29,768

CALCULATING TERMINAL VALUE

$$TV = \frac{(FCF_n \times (1 + g))}{(WACC - g)}$$

CALCULATING TERMINAL VALUE

Calculating Discounted Terminal Value		R'000
Expected sustainable free cash flow for +1 year		10,750.00
+ Difference: WACC & assumed growth rate		15%
WACC		20%
Less: Accumulated growth rate		-5%
Terminal value		71,667
Discount factor at WACC for 5 years		0.4
Discounted terminal value		28,667

CALCULATING ENTERPRISE VALUE

Aggregate of discounted free cash flows over forecast period					29,768
Discounted terminal value					28,667
Enterprise value					58,435

DISCOUNT FACTOR FORMULA

$$\text{Discount factor} = \frac{1}{(1 + \text{Discount Rate})^{\text{period number}}}$$

CALCULATION OF EQUITY VALUE

Calculation of Equity Value				R'000
Enterprise Value				58,435
Property		6,000		
Investments		1,000	1	
Loans receivable		4,300		
Cash & equivalents		1,500		
Long-term liabilities		-17,100		
Tax asset/ (liability)		-6,680		
Non-operating assets and liabilities		-10,980		-10,980
Value of enterprise on a non-marketable minority basis				47,428
Add: Control premium (10%)				4,743
Less: Discount for lack of marketability (6.8%)				-3,225
Value of enterprise on marketable majority basis				48,946
x shareholding valued				70%
70% of Equity Value on a marketable majority basis				34,262

- 1 Certain balances are not included in the Enterprise Value of the business, as they are not necessary for the business to continue trading. These balances are stated at their fair values at the valuation date, after any adjustments.

MODULE 5

DISCOUNTED DIVIDEND APPROACH

DISCOUNTED DIVIDEND APPROACH

1. Calculate Forecasted Free Cash Flows
2. Apply Dividend Policy
3. Determine Discount Rate
4. Determine Equity Value

DISCOUNTED DIVIDEND APPROACH

Calculation of Equity Value - DDM	F2020	F2021	F2022	F2023	F2024
Forecast free cash flows	8216	9674	8794	9414	9939
x Dividends as % of free cash flows	65%	65%	65%	65%	65%
Forecast dividends	5340.4	6288.1	5716.1	6119.1	6460.35
Discount period	1	2	3	4	5
Discount factor based on Re	0.79	0.63	0.5	0.4	0.31
Discounted Dividends	4,219	3,962	2,858	2,448	2,003
Aggregate of discounted dividends over forecast period					15,489

DISCOUNTED DIVIDEND APPROACH

Terminal Value Calculation						
Expected dividends for +1 year		6,906				
+ Difference: Re & assessed growth		21%				
Re		26%				
Less: Assessed growth rate		-5%				
Terminal value		32,886				
Discount factor at Re for 5 years		0.31				
Terminal value		10,195				10,195
Equity value						25,683

MODULE 6

COST APPROACH

COST APPROACH

1. NAV from Balance Sheet
2. Eliminate Intangible Assets
3. Fair Value Adjustments
4. Calculate Equity Value

COST APPROACH

Net asset fair value			R'000
Net asset value per balance sheet			13,205
Fixed assets (excluding property)	1,000		
Property revaluation	1,500		
Investments market value adjustment	256		
Goodwill & Intangibles	-302		
Adjustments	2,454		2,454
Net tangible Asset Value (Fair Value)			15,659
x shareholding valued			70%
70% of enterprise on a net asset value basis			10,961

MODULE 7

CONSTRUCTING THE ARGUMENT

CONSTRUCTING THE ARGUMENT

- Comparisons of values per method
- Test reasonableness
- Investigate and explain variances
- Document assumptions
- Higher value wins approach
- Weigh values

MODULE 8

ONLINE TOOLS

COST OF CAPITAL

- [Discounted free cash flow example & template](#)
- [PwC's Valuation Methodology Survey Africa app](#)
- [BizEx Business Valuation Calculator](#)
- [The Small Business Valuations Handbook](#)

QUESTIONS

**Thank you
for your participation**