COLLIERS INTERNATIONAL MENA
VALUATION & ADVISORY SERVICES

KEY FACTORS IN BUSINESS VALUATIONS

INTRODUCTION

This paper aims to introduce some of the critical aspects associated with valuing a business and how seeking assistance from a professional valuation expert can help in determining a 'more realistic and reasonable' fair market value of your business.

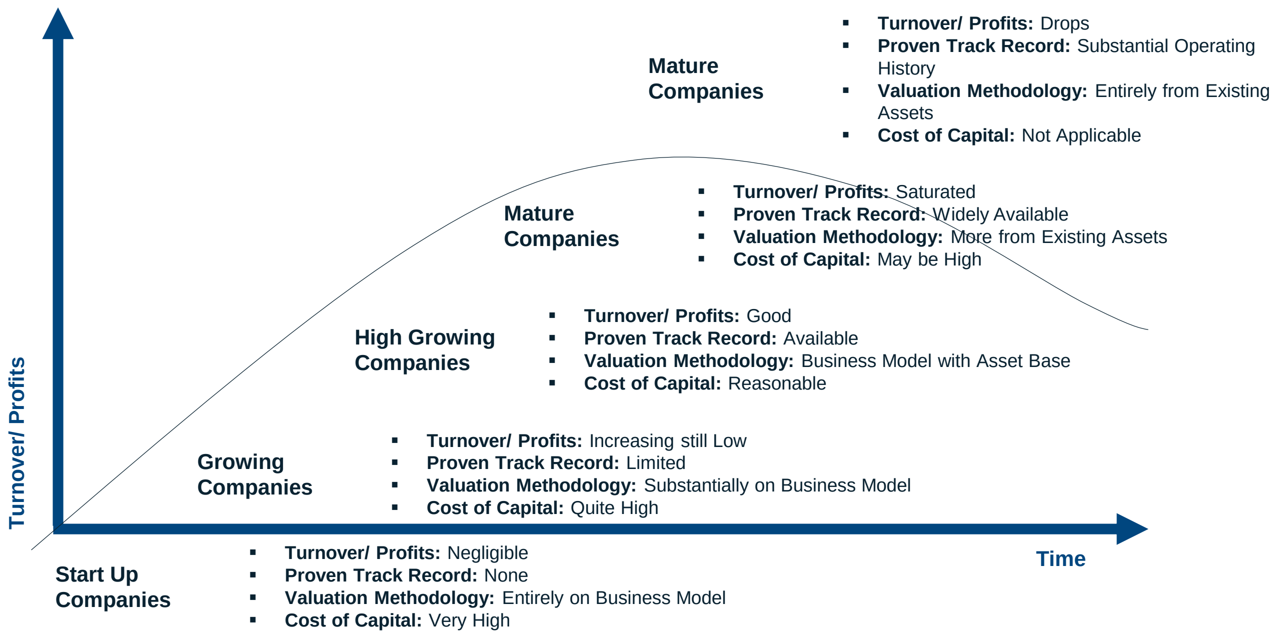
Is valuing business a 'Science'?

Valuing business is not a work of science. However, this does require deep understanding of the valuation concepts and how these concepts relate to any business being valued. Getting the help of a professional valuation expert can assist you in identifying the correct approach in determining the value of your business.

Generally, the majority of valuation professionals prefer discounted cash flows (DCF) based valuation method. Capital asset pricing model (CAPM) approach remains the most popular approach to estimate the appropriate discount rate for discounting the cash flows. However, in doing so, certain challenges need to be cautiously evaluated and considered. For example, one of the most critical aspects often overlooked is the stage of economic cycle (time horizon), i.e. whether the business is a start-up, growth or a mature stage. This can have a substantial impact on the eventual assessment of the value of business.

Exhibit 1 explains the typical business cycle and how professional valuation experts apply their judgement in determining the time horizon that needs to be employed as part of the projected cash flows when conducting a typical business valuation. Our analysis suggests that the cost of overlooking this aspect may result in a variation of up to +/- 20% from the realistic estimate.

Exhibit 1: Valuation across business cycle follow the law of economics



Source: Chander Sawhney, Partner – Valuation & Deals, Dec 2016

What is the right method of valuation?

When Valuing a business, choosing the right method of valuation is key. There are several methods available, see Exhibit 2 which mandate careful consideration understanding the following:
1. Each method is unique and has relative merits and demerits.
2. Different methods are preferred and used in different situations.
3. Each method provides a different perspective of value of the underlying business/ asset.
4. Enables to estimate a range of values rather than a point-based valuation.
5. Helps correlate the results of different valuation methods.

While conducting the valuation, as much as possible, all the methods of valuation must be considered and the right method must be selected which in the view of the professional valuer reflects the true value of the business. Applying distinct weights to several valuation methods can potentially be argued in some cases. **In summary, valuation is based on the professional judgement of the valuer and can vary from individual to individual.**

VALUATION APPROACHES		
FUNDAMENTAL METHOD		**RELATIVE METHOD**
Capitalization of Earnings Method (Historical)	Book Value Method	Comparable Companies Market Multiples Method (Listed Peers)
Discounted Cash Flow Method (Projected Time Value)	Liquidation Value Method	Comparable Transaction Multiples Method (Unlisted Peers)
	Replacement Value Method	Market Value Method (for Quoted Securities)

IS MY BUSINESS CORRECTLY VALUED?

A valid question frequently asked by Clients. Valuation is a result of assessment of several factors including discounts applied on the eventual value of the business, these may include; 'Discounts for Lack of Marketability' (DLOM) and 'Discounts for Lack of Control' (DLOC).

The term 'discount for lack of marketability' is used to describe discounts applied to reflect the fact that the equity interest being valued is not readily marketable and/or requires substantive time before the equity interest becomes readily marketable.

The discount applied specifically for the lack of marketability is distinct from discounts or premiums applied to reflect other factors such as minority status/lack of control, size of the business, lack of dividends, or strategic value carried by the shareholding.

Determination of an appropriate extent of DLOM is a complex subject and there are no definite methods to assess such discounts. The degree of discount to be applied in any valuation is largely dependent on the circumstances under each case. Accordingly, consideration should be given to various situation specific factors, such as:

1. Existence of any form of market in which the shares can be traded.
2. Size of the shareholding.
3. Prospects for the shares to become readily marketable/more marketable, or any restrictions on trading to be lifted. A larger discount could be considered if the listing of shares is unlikely.
4. Provisions, such as restrictions on transfer, under the company incorporation documents.
5. The way in which the value, to which the discount is being applied, has been derived. For example, if it is derived from a multiple based on the actual acquisition of a minority holding in a comparable unlisted company, it may not be appropriate to apply a discount for lack of marketability. However, if it is derived from multiples based on "freely tradeable" publicly traded comparable companies, a discount for lack of marketability will need to be applied.

We have identified some of the issues that affect valuation there are number of additional variables not highlighted here that need to be considered. Whilst it is important that your business is not overestimated and is unable to find a buyer, it is of greater importance that all aspects are considered and the business is not undervalued.

FOR MORE INFORMATION

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