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Why are Valuations Important?


The most important objective of management is to increase the value of the company. Company Value is important to:

- ❖ Shareholders
- ❖ Employees
- ❖ Management
- ❖ Future Investors
- ❖ Creditors
- ❖ Community



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Defining Business Value

- ❖ Value is a reflection of your company's relevance and viability in the **EXISTING** and **FUTURE** supply chain
- ❖ Value can be determined using a number of methods, but the goal of every method is to establish the value of the firm **TODAY**

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Warren Buffet's Philosophy

- ❖ "Rule number 1—Never lose money. Rule number 2—Never forget Rule number 1."
- ❖ "It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price."
- ❖ "We want the business to be (1) something that we understand (2) a favorable long term prospect (3) operated by honest and competent people and (4) available at a very attractive price."

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Methods of Valuation

- ❖ **SWAG Method**—"Catch All" category that may or may not be based on logic
- ❖ **Balance Sheet Methods**—More conventional methods that focus on historic cash flows and accounting measurements
- ❖ **Income Statement Methods**—Some methods are based on historic cash flow multiples while others are future cash flow driven
- ❖ **Discounted Cash Flow Method**—This method is driven by long term value creation and future cash flows

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SWAG

- ❖ "We want it."
- ❖ "If we get it, we will be the biggest player in our market."
- ❖ "We won't pay a penny over Book Value."
- ❖ "This is a good deal."

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Balance Sheet Methods

- ❖ Net Book Value—Total equity on the balance sheet (total assets less total liabilities)
- ❖ Liquidation Value—Selling assets under various scenarios (i.e. orderly sale or forced sale)
- ❖ Replacement Value—What a willing buyer would have to pay to replace the assets at today's market prices



Income Statement

- ❖ Price Earnings Multiples or P/E Ratio—Commonly used as a benchmarking tool for public companies
- ❖ Enterprise Value/ EBITDA—A yardstick used in valuing private companies, particularly leveraged financial transactions



Discounted Cash Flow Approach

- ❖ This method recognizes that a dollar earned today is worth more than a dollar earned in the future and equity demands a higher return than debt
- ❖ Must understand your "value drivers"
 - ❖ CapEx, Working Capital, Competitive Advantage, Cost of Capital and Debt
 - ❖ Production trends, Market Share, Margin Structure, Transportation
 - ❖ Sum of Future Cash Flows discounted by Weighted Average Cost of Capital



Summary

- ❖ Value can be determined using a number of methods, but the goal of every method is to establish the value of the firm **TODAY**
 - ❖ Balance Sheet Methods
 - ❖ Income Statement Methods
 - ❖ Discounted Cash Flow Methods
- ❖ Many resources available to help determine an appropriate value and eliminate the SWAG method