Valuation Methods

dfk australia new zealand
LEADING ACCOUNTANTS AND BUSINESS ADVISERS

Capitalisation of Future Maintainable Earnings	Discounted Cash Flow	Net Tangible Assets/Net Asset Backing	Rule of Thumb/Industry Norm	Cost to Create/Entry Cost Valuation
Generally Used For: • Mature Businesses • Businesses with stable revenue & profit streams	Generally Used for: • New or Growing Businesses • Businesses with Unstable Profits • Businesses with locked in forward revenue streams	Generally Used for: • Businesses dominated by their tangible assets • Businesses where the break up value is likely to exceed going concern position (i.e. Limited or no Goodwill businesses)	Generally Used for: • Where many business of the same type exist • E.g. Pharmacies, Newsagents, Financial Planners	Generally Used for: • Small startup businesses • Loss making businesses
How is it Calculated? • Future maintainable earnings multiplied by the cap rate • FME = 'normalised' expected future earnings • Capitalisation rate usually between 0 & 5 for SMEs – depending on stability of business and required rate of return etc. • E.g. $500,000 x 4 = $2,000,000	How is it Calculated? • Expected future net cash flows discounted to present day values	How is it Calculated? • Market value of tangible assets less market value of Liabilities	How is it Calculated? • By applying the generally accepted factor to the appropriate base. • E.g. Gross Revenue x 80%	How is it Calculated? • Based on what it would cost to create an equivalent business from scratch. • Usually recognises a minimal level of intangibles
Strengths: • Widely used and accepted • Relies on the past as a basis for the future • Useful comparison as widely used	Strengths: • Strong technical background • Focuses on the future cash flow stream that is being purchased	Strengths: • Inherently conservative • Typically low risk assessment • Excellent secondary method	Strengths: • Easy to calculate • Widely accepted in specific industries	Strengths: • Reasonably easy to calculate • Conservative • Avoids the difficulties of setting it up from scratch
Weaknesses: • Assumes future will continue as the past • Unreliable where volatility of earnings exist • Less reliable for immature businesses	Weaknesses: • Requires reliable historic and future cash flow forecasts • Requires assessment of a wide range of industry and finance factors to ascertain the discount percentage	Weaknesses: • Inherently conservative • Makes no allowance for Goodwill or intangible assets • Relies on assessment of market value which may be difficult to ascertain	Weaknesses: • Assumes all business of the same type will perform the same	Weaknesses: • Limited allowance for goodwill or intangible assets • Some subjective judgements required in the calculations