

## Business Valuation "Multiples"

- Important to distinguish between valuation of business assets from non business assets (e.g. investment properties, cash deposits).
- Business Valuation will reflect
  - stock & debtors balances
  - quality of the customer base
  - unique qualities of the product line e.g. key agencies, brand names.
  - relationship with suppliers including access to credit facilities.
- As shares in Private Companies are not traded on the open market (e.g. Stock Exchange), we look to share prices of listed companies as guidance.
- The share price of listed companies tend to trade at a consistent multiple of their reported profits (after tax)
- This multiple is called the Price/Earnings or P/E multiple.
- Some examples (from The Guardian)

Marks & Spencer	11.0
Morrisons	12.9
Sainsbury	15.8
Vodafone	13.5
- On account of small private companies not being as efficient as PLCs, it would be normal to mark down the P/E multiple to a range of 5-8 times.

## Simple example

- Private Company enjoys annual profits of €300,000 after tax.
- No. of shares in issue is 1000.
- A similar company listed on Stock Exchange has a reported P/E Ratio of 10.
- There are no non business assets such as properties.
- What is the value of this company?

### SOLUTION:

- Annual Post tax earnings €300,000
- P/E Ratio is 10
- Value of Company is
$$300000 \times 10 = 3,000,000$$
- Value of each share is
$$3,000,000 \div 1000 = \text{€}3000.$$

## OTHER CONSIDERATIONS

- The total value of the company will be greater if there exists non business assets.
- If there exists any borrowings on non business assets, the value of the company will be reduced accordingly.

### VALUE OF A COMPANY is

- Value of Business (using P/E Ratio)
- + Value of non business assets
- borrowing on non business assets.

## QUESTION

BELOW IS THE MOST RECENT BALANCE SHEET OF SWAN DISTRIBUTORS LTD, A PRIVATE COMPANY, AT 30TH APRIL 2007:

PROPERTY & INVESTMENTS	2,800,000
STOCKS	300,000
DEBTORS	700,000
BANK & CASH BALANCES	60,000
	<u>3,860,000</u>
ORDINARY SHARES €1.00.	100,000
RETAINED PROFITS.	2,060,000
TERM LOANS	1,200,000
TRADE CREDITORS & ACCRUALS	500,000
	<u>3,860,000</u>

- IN THE YEAR ENDED 30-4-2007, YOU ARE ADVISED THAT PROFITS AROSE AS FOLLOWS:

PROFIT BEFORE INTEREST & TAX	290,000
INTEREST ON BORROWINGS	60,000
PROFIT BEFORE TAXATION	230,000
TAXATION	34,000
PROFIT AFTER TAXATION	<u>196,000</u>

- QUOTED COMPANIES LISTED ON THE STOCK EXCHANGE & WHICH OPERATED IN THIS SECTOR HAD "PRICE/EARNINGS" RATIOS OF 9.2 ON AVERAGE.

REQUIRED:

- COMPUTE
  - TIMES INTEREST COVERED RATIO
  - GEARING RATIO
  - EARNINGS PER SHARE.
- USING THE AVERAGE P/E RATIO OF 'LISTED' COMPANIES, COMPUTE THE VALUE OF THE SHARES IN SWAN DISTRIBUTORS SETTING OUT ~~THE~~ THE VALUE OF THE TRADE & THE VALUE OF OTHER ASSETS.
- WHAT DO YOU UNDERSTAND BY THE RISK-RETURN TRADE OFF IN HIGHLY GEARED COMPANIES.

# SOLUTION

$$a) \text{ Interest Cover} = \frac{\text{PBIT}}{\text{Interest}} = \frac{290000}{60000} = 4.83 \text{ times.}$$

$$\text{Gearing} = \frac{\text{Borrowing}}{\text{TOTAL LONG TERM SOURCES}} = \frac{1200000}{3360000} \times 100 = 35.7\%$$

$$\text{EPS} = \frac{\text{PROFIT after tax}}{\text{No. shares}} = \frac{196000}{100000} = 196 \text{ cent.}$$

$$b) \bullet \text{ Value of trade} = \text{EPS} \times \text{P/E} \times \text{No. shares}$$

$$1.96 \times 9.2 \times 100,000 = \boxed{1,803,200}$$

## • NON TRADES ASSETS:

- Property & investments	2,800,000
- Cash & bank	60,000
less term loans	-1,200,000
	<u>1,660,000</u>

TOTAL VALUE OF THE COMPANY 3,463,200

VALUE OF EACH SHARE

$$\frac{3463200}{100000} = \text{€ } 34.63$$

c) Risk Return trade off of high gearing

Return: funds borrowed at low interest used to earn a return in excess of ~~cost~~ interest cost

Risk: Return on invested money not sufficient to cover interest cost and/or interest rates Rise.

THE MOST RECENT SUMMARISED RESULTS OF ORANGE LTD & GREEN LTD ARE AS FOLLOWS:

<u>PROFIT &amp; LOSS ACCOUNT</u>	ORANGE	GREEN
PROFIT BEFORE INTEREST & TAX	190,000	210,000
INTEREST ON BORROWINGS	<u>26,000</u>	<u>92,000</u>
PROFIT BEFORE TAXATION	164,000	118,000
TAXATION	<u>30,000</u>	<u>22,000</u>
PROFIT AFTER TAXATION	<u>134,000</u>	<u>96,000</u>

<u>BALANCE SHEET</u>	ORANGE	GREEN
PROPERTY & NON TRADE ASSETS	400,000	1,800,000
STOCKS & DEBTORS	150,000	160,000
BANK & CASH BALANCES	<u>350,000</u>	<u>25,000</u>
	<u>900,000</u>	<u>1,985,000</u>
ORDINARY SHARES €1.00 ea.	200,000	100,000
RETAINED PROFITS	210,000	145,000
TERM LOANS	370,000	1,800,000
CREDITORS & ACCRUALS	<u>120,000</u>	<u>140,000</u>
	<u>900,000</u>	<u>1,985,000</u>

\* 100%  
\* 150%\*

a) COMPUTE FOR EACH COMPANY

- Interest cover
- Gearing Ratio
- Earnings per share.

b) ORANGE LTD & GREEN LTD ARE PRIVATE COMPANIES. PURPLE GROUP PLC ARE INTERESTED IN ACQUIRING THE BUSINESSES CARRIED ON BY BOTH COMPANIES AND ~~ARE~~ IS WILLING TO PURCHASE THE NON TRADE ASSETS ALSO. TO THIS END, YOU ARE ADVISED THAT THE 'PRICE EARNINGS' RATIO OF LISTED COMPANIES OPERATING IN THIS SECTOR IS 8.2 ON AVERAGE. WHAT OFFER SHOULD PURPLE GROUP PLC MAKE TO THE SHAREHOLDERS OF ORANGE LTD & GREEN LTD.

SOLUTION

ORANGE

GREEN

(a)	(a) Interest Cover	7.3 times	2.2 times
	(b) Gearing	* $\frac{370K}{780K} \times 100 = 47\%$	** $\frac{1600K}{1845K} \times 100 = 87\%$
	(c) EPS	$\frac{134000}{200000} = .67$ or 67 cent	$\frac{96000}{100000} = .96$ or 96 cent

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(b) ORANGE

• Value of trade	=	EPS × P/E × No. shares	
	=	.67 × 8.2 × 200,000	= <span style="border: 1px solid black; padding: 2px;">1,098,800</span>
• Non Trade Assets		400,000	
Bank & Cash Balances		<u>350,000</u>	
Less term loans		<u>- 750,000</u>	
			<span style="border: 1px solid black; padding: 2px;">380,000</span>
		TOTAL VALUE OF Co.	1,478,800
		VALUE OF EACH SHARE	$\frac{1,478,800}{200,000} = \text{€ } 7.39$

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GREEN

• Value of trade	=	EPS × P/E × No. shares	
	=	.96 × 8.2 × 100,000	= <span style="border: 1px solid black; padding: 2px;">787,200</span>
• Non Trade Assets		1,800,000	
Bank & Cash Balances		<u>25,000</u>	
Less term loans		<u>1,825,000</u>	
		<u>1,600,000</u>	<span style="border: 1px solid black; padding: 2px;">225,000</span>
		TOTAL VALUE OF COMPANY	1,012,200
		Value of Each Share	$\frac{1,012,200}{100,000} = \text{€ } 10.12$