



Valuation – Science or art?

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# Agenda

- Why is valuation required?
  - Illustrative case studies
- Purposes of valuation
- Valuation approach/methods
  - Value vs Price
  - Buyers vs sellers valuation
  - Different buyers
- Case study – Bid for Hotel
- Valuation – critical aspects
- Illustrative case studies – valuation methods



## Why valuation ???

- Govt of India put up ITDC hotels for sale; Potential bidders needed to know the value of hotels for making an winning bid. How to value?
- JV partners of an unlisted company wanted to part ways; At what value should one buy the other or both sell to a third party?
- An investor wants to buy a loss making, though operational, steel company; At what value should it buy?
- A company with limited track record wanted to get its brand valued to justify to its venture capital fund provider the value it has created. How to value?
- Two companies want to merge – one listed, the other unlisted. Unlisted company has significant expansion plans, the other one does not. How to factor in the difference?
- A media company wanted to restructure its businesses; Use its content library to raise funds. How to value?

# Different purposes of valuation

M & A	Restructuring	Reporting	Management analysis
Sale/buyouts	Business	Purchase price allocation post acquisition	Strategic decision making
Private/strategic equity placement	Corporate	Reporting to shareholders	
Family/JV splits	Financial	Review for impairment of assets	
Swap ratio for mergers			

# Valuation approach / methods

There are a number of methodologies to value businesses using historical and forecast financials. The principal valuation methods are:

Market Price  
(MP) method

Multiples method  
• Comparable companies  
Multiples method (CCM)  
• Comparable Transaction  
multiples (CTM)

Discounted  
Cash Flows  
(DCF) method

Net Assets  
Value (NAV)  
method

Applicability of a particular/or a combination of valuation methods is usually guided by the context of the valuation:

1. On whose behalf? – buyer vs seller; one buyer vs another buyer
2. For what purpose? – strategic acquisition, financial reporting, restructuring
3. When? – distress situation, industry downturn



## Value vs price

- A company's value
  - Is different from the price, which is quantity agreed between the seller and a buyer
  - Different for the buyer and seller
  - Different for different buyers

Price is 'what you pay'; Value is 'what you get'



## Case Study – buyer's valuation vs seller's valuation

An MNC wishes to buy a well known national company to gain entry into the local market

- It intends to use manufacturing facilities and distribution network of local company
  - Buyer will value only the above assets but not the brand or technology of local company as it would use its own brand & technology
  - Seller will assign value to its brand too and technology
- From buyers viewpoint, it would estimate the maximum value it would be prepared to buy
- From sellers viewpoint, valuation objective is to ascertain the minimum value which it should accept

Deal price is negotiated; Usually between the two extremes



## Case Study – different buyers valuation

ITDC offered Delhi hotels for disinvestment

- Several buyers including existing hoteliers, real estate developers, cash rich corporate intending to enter hospitality business
- Same hotel company was valued at different level due
  - Different strategic objective
  - Different economies of scale
  - Difference in perception about the industry and company

# Bid for hotel – different bidder valuation

Bidder profile	Strategic Intent	Key value drivers
Existing hotel chains	Expansion Keep competition out	Synergies
Global hotel majors	Entry to India Expansion of global network	Access to new market Expansion of global network
Real estate players	Access to prime piece of land Financial investment	Additional/ alternative use of land ROI
Cash rich corporate	Financial investment Diversification	ROI vs other investment opportunities

# Appropriate valuation method

## Market Price (MP) method

- MP not available
- Even if available, may not be appropriate as hotel buyer was free to alter the business model
  - Reposition the hotel post renovation/rebuild
  - Alter cost structures ~ VRS

## Comparable Companies' Multiples (CCM) method

- Hotel loss making in past
- PE or EV/EBIDTA multiple could not be used as negative EBITDA
- Price to sales was inappropriate as
  - Hotel's occupancy/ARR below industry average
  - Higher cost structure

## Discounted Cash Flows (DCF) method

- Most appropriate as different business models
- Useful in case of scenario building
- CCM used for benchmarking; Value estimated by DCF should be realistic multiples
- Listed companies used to derive discounting rates (beta; debt-equity), capex etc

## Net Assets Value (NAV) method

- Used for sanity check
- DCF value should not be lower than current value of land



## Valuation – critical aspects

- Valuation is an imperfect science
- Stock market provides the only visible flow of data w.r.t corporate valuation on ongoing basis
- At a point in time, the stock market reflects the prevailing consensus pricing for particular securities (and for the market)
- The market may be “right” or “wrong” with respect to its pricing decisions at a moment in time. But market is always right when viewed over 3-6 months
- Stock market data cannot and should not be applied blindly



## Valuation – critical aspects

- Valuer needs to interpret the markets as they relate to the valuation (especially) of private companies
- All valuation should be backed by fundamental analysis to determine what drives the valuation
- Do a SWOT of the asset/business being valued
- Look at
  - Current and expected conditions in the business environment
  - The industry's relationship with the economy
  - The competitive environment prevailing in the industry
  - The relative competitive advantages of the business in terms of the management capabilities and its market reputation
  - The historical operational and financial performance of the business, etc.

# Case studies – valuation approach

Case study	Valuation method	Why appropriate?
Valuation of ITDC hotels for potential bidders	DCF; CCM for benchmark; NAV for sanity check	Bidders may have different business plan based on different strategic intent
Valuation of unlisted JV partners for JV partners	CCM/CTM	CCM based on current financial performance and market multiples; Future plans may be disputed; NAV may be unacceptable to one party or both;
Valuation of loss making, though operational, steel company	Combination of CCM and NAV	For buyer, it is a 'setup' vs 'acquire' decision; Current replacement value is the benchmark for setup cost; CCM based on maintainable performance and market multiples

# Case studies – valuation approach

Case study	Valuation method	Why appropriate?
Valuation of brand of start up company	CTM most appropriate DCF – Relief from Royalty method; Premium profit method	Unique asset Cost based method inappropriate
Merger valuation - one listed, the other unlisted.	Combination of MP/CCM, DCF and NAV	Accepted principles by Courts in India
Library valuation for fund raising	DCF; Replacement cost method as benchmark	Unique asset

Thank you

