# BUSINESS VALUATION

MAZARS

# BUSINESS VALUATION METHODS

## DISCOUNTED CASH FLOW METHOD (DCF METHOD)

- Dynamic approach to business valuation based on **future cash flows – future cash flows that an asset will generate** determine the value of that asset
- Cash flows are discounted at **weighted average cost of capital (WACC)**
- Based on **going-concern concept**, i.e. assumption that a business will operate indefinitely

## MULTIPLES METHOD

- **Relative approach** to business valuation
- Two main approaches: **comparable companies approach** and **comparable transactions approach**
- Key step – selection of **comparable companies and comparable transactions**
- Based on "**law of one price**" – the price of an identical asset traded anywhere should have the same price

## ASSET BASED VALUATION METHOD

- Business valuation method based on **current financial position** of a business – not based on future business performance
- It is necessary to ascertain if book value of assets and liabilities reflects fair market value
- Key step – finding **hidden losses or hidden profits**
- Used when **DCF method and multiples method** are not applicable – often indicates that liquidation of the business maximizes value for business owners

# KEY STEPS IN THE DCF METHOD

1

- Forecasting financial statements for planned period based on business plans, historical analysis and financial statements normalizations as well as macroeconomic and industrial environment
- Calculating free cash flows to firm (FCFF) by using following formula:

**FCFF = EBIT(1-t) + Depreciation and amortization +/- Changes in working capital – CAPEX**

2

- Discounting FCFF to present value using **risk adjusted discount rate** that represents the **required rate of return** of investors (owners and creditors) – **WACC or weighted average cost of capital**
- WACC is the future oriented opportunity cost of investing in a business – represents the cost of capital that will finance operating assets of a business in future periods:

**WACC = ke x (E/(D+E)) + kd x (1-t) x (D/(D+E))**

3

- Going-concern concept – the business will continue to operate indefinitely and will grow at **stable growth rate („g")**
- Calculating **terminal value** („TV") using the Gordon's constant growth formula:

$$TV = FCFF_{TV} / (WACC_{TV} - g)$$

**or**

$$TV = FCFF_{n}(1+g) / (WACC_{TV} - g)$$

# ENTERPRISE AND EQUITY VALUE

**Enterprise value**

- FCFF is generated by operating business
- Financial statements are normally forecast in a five-year period after which terminal value is calculated (FCFF+TV)
- FCFF and TV are discounted to present value using risk-adjusted discount rate (WACC)

**FCFF provides returns to investors (creditors and owners) and provides repayment of debt to creditors**

| | |
|---|---|
| Enterprise value | Equity |
| Non-operating assets | Financial liabilities |
| Cash and financial assets | |

**Equity = Enterprise value + Non-operating assets + Cash and financial assets − Financial liabilities**

**Net debt** = Cash and financial assets − Financial liabilities

**Share value – business value is very sensitive regarding key assumptions (growth rates, WACC, EBITDA margin(%), stable growth rate)**

# MULTIPLES METHOD

**MULTIPLES METHOD**

**Comparable Companies**

- Choosing comparable companies from the same industry

**Comparable Transactions**

- Using information related to recently closed deals in which comparable companies were acquired

**Most commonly used multipliers**

- Enterprise value/EBITDA („EV/EBITDA”);
- Enterprise value/EBIT(„EV/EBIT”);
- Enterprise value/Sales(„EV/Sales”);

**Enterprise value multiples**

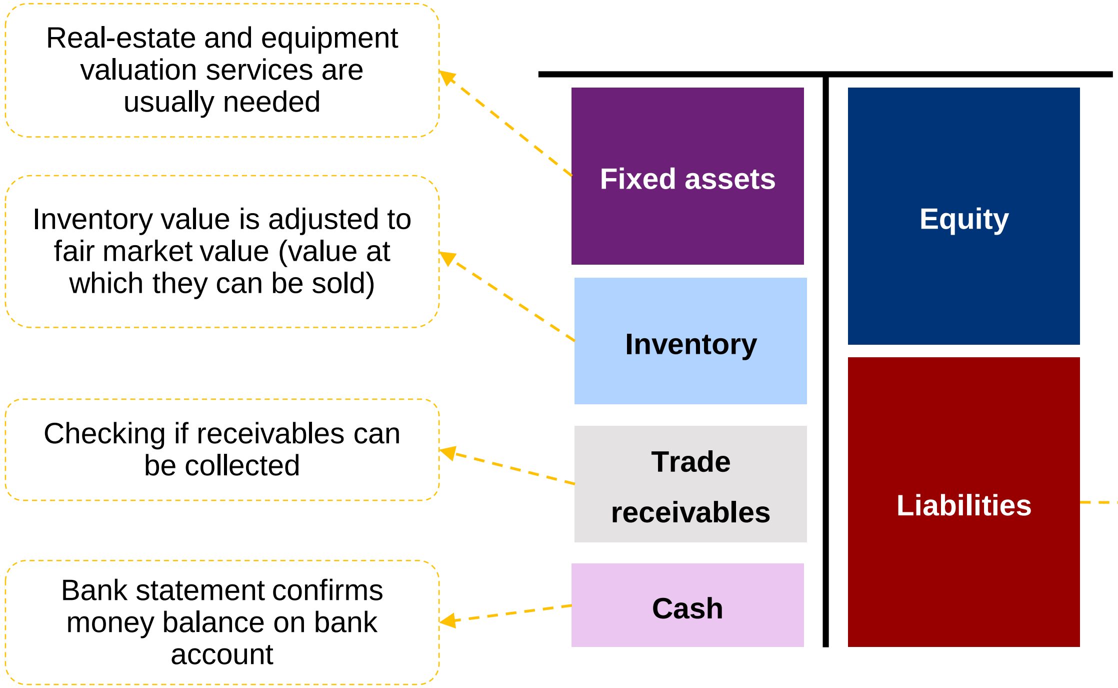
- Price/Earnings („P/E”);
- Price/Book („P/B”);

**Equity multiples**

Multipliers median is usually used in multiplies method valuation since median is not sensitive to „outliers” **– it is crucial to determine truly comparable companies and transactions, what presents a significant issue in practice**

# ASSET BASED VALUATION METHOD

- Used when DCF method or multiples method is not applicable
- Often indicates that liquidation of the business maximizes value for business owners as greater cash flow would be generated from liquidation than from future operating business
- **Key challenge – finding hidden profits or losses, i.e. determining whether the book value of assets and liabilities reflects their fair market values**




**Equity** = **Fair market value of assets** − **Fair market value of liabilities**

The fair market value of liabilities is mainly equal to their book value – **it is very important to ascertain if there are any undisclosed liabilities** that would, in case of existence, also be included in liabilities of the business being valued

# ABOUT MAZARS

**Mazars** is an international, integrated and independent organization, specialized in **audit**, **accountancy**, **tax**, **legal and advisory services.**

## Mazars Group

**EUR 1,6 bn**

**89 countries and territories**

**23,000 employees**

**310 offices**

## Mazars Croatia

**EUR 2,6m**

**70 employees**

## Mazars Croatia – Financial Advisory Services – Adria Regional Hub

Mazars Group → Mazars Croatia → Mazars regional HUB → Croatia, Slovenia, Serbia, Bosnia and Herzegovina, Montenegro


**Due diligence**

**M&A services**

**Valuation services**

**Debt restructuring**

**Project finance services**

Globally shared knowledge → Unique partnership → Expertise and regional specialization → Local presence and understanding of local needs


**Kristijan Cinotti**
Managing Partner
CPA, CTA, Croatian Certified Appraiser
kristijan.cinotti@mazars.hr
+385 1 4864 420



**Andrija Garofulić, ACCA**
Partner – Advisory Services
Croatian Certified Appraiser
andrija.garofulic@mazars.hr
+385 1 4864 423



**Lovre Botica, CFA**
Manager – Financial Advisory Services
Croatian Certified Appraiser
lovre.botica@mazars.hr
+385 1 647 0076