



**SPICE ROUTE**  
FINANCE

2020



THE ULTIMATE GUIDE TO  
**BUSINESS**  
**VALUATION 2020**

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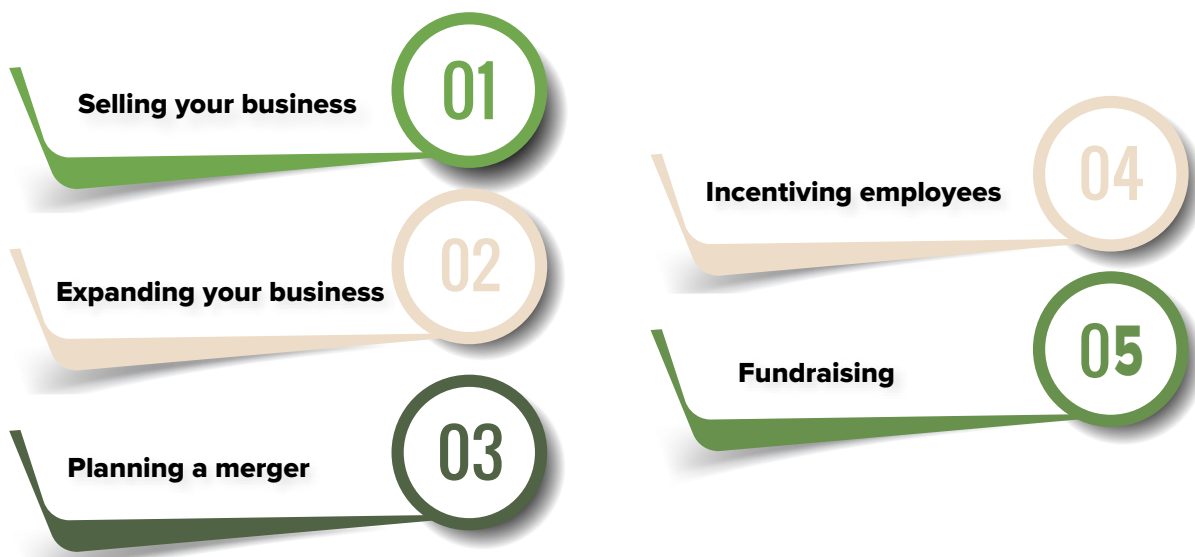
# INTRODUCTION

Any entrepreneur looking to grow their business will at some point have to answer the question: “What is my business worth?” And while conventional wisdom states that a business is only worth what someone is willing to pay for it, business valuation is more complex, particularly when you are an early-stage start-up without an extensive financial history.

Our Ultimate Guide to Business Valuation will help you identify key factors you must consider and provide actionable techniques to help you reach an accurate valuation of your business.

## 1. Why is Business Valuation Important?

Business valuation helps you understand the financial health and the future potential of your business. It is also one of the major factors that influence potential investors and venture capitalists (VCs) looking to invest in a business. Business valuation is particularly useful if you are:



While calculating the value of a business might seem fairly straightforward anticipated future profits adjusted against perceived risk, it is not a perfect science. To determine the fair value of a business, you must account for all the factors that affect valuation

**“** *High valuations entail high risks.* **”**  
- Benjamin Graham

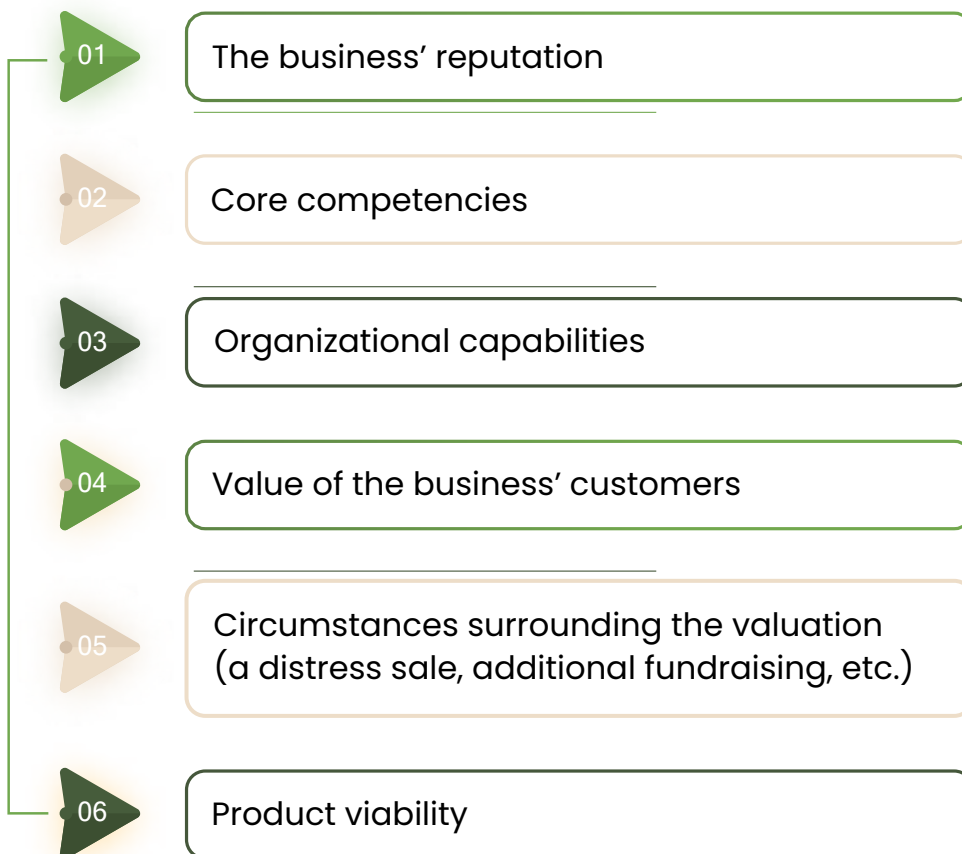


## 2. Key Factors Affecting Business Valuation

Value creation is at the heart of every business. It is the purpose of the institution: to create and deliver value that will generate profit after cost. Businesses create and capture economic value through work (operations), however, not all value is created equal.

Value creation is dependent on multiple factors that determine how a business performs in the long run. Broadly speaking, all business value can be broken down into two distinct categories – tangible value and intangible value. Tangible value refers to business value that can be measured in simple mathematical terms such as stock price, revenue, fixed assets and the like. Intangible value, on the other hand, is based on the perception of a business by both the market (customers, competitors) and its employees. Intangible value often reflects a business' commitment to delivering the promise of future growth. Over the past few decades, intangible value has grown as a percent of total market valuation. Economic volatility, slowdowns, and periods of rapid growth affect companies of similar size and earnings in different ways. That's in part because investors have more confidence in the future of some companies than others.

When valuing a business, you must also consider the following:



These factors make it difficult to arrive at an accurate valuation of a business. but there are several ways you can make it easier. In the next chapter we've listed some of the most common valuation methods, you can use to calculate your business' worth.

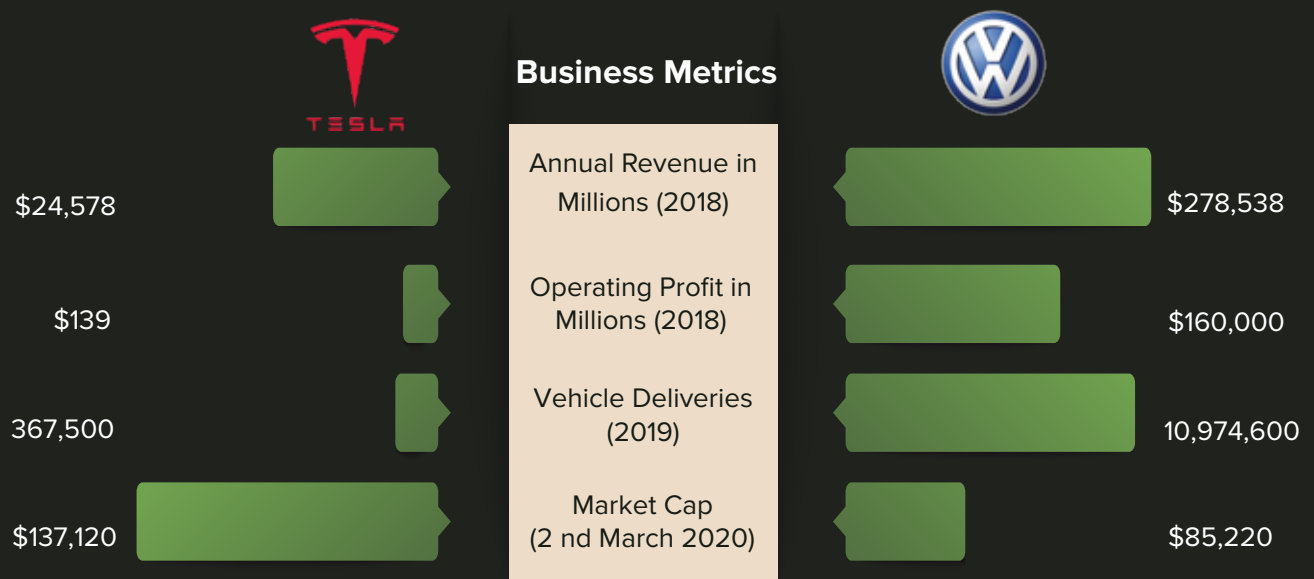


# Case Study: What the Rise of Tesla Tells Us About Business Valuation

Something exceptional happened in the early months of 2020 with Tesla overtaking Volkswagen as the second most valuable automotive company in the world. The electric car maker's market value surpassed the \$100 billion mark in January 2020, eclipsing Volkswagen's \$99 billion.

Tesla's stock has soared in recent months, more than doubling in value since late October 2019. In February 2020, the company's stock hit an all-time high of \$917. Tesla, a relatively new entrant in the industry, was founded by Elon Musk in 2003 while Volkswagen's history can be traced back to 1930's Germany. In addition to being one of the oldest automotive manufacturers, Volkswagen also owns an impressive portfolio of luxury auto brands such as Audi, Lamborghini, Porsche, and Bentley amongst others. So, after decades of churning out huge profits and setting the standard for premium cars, how did Volkswagen lose out to Tesla in business valuation?

## Tesla vs Volkswagen: Numbers at a Glance



The answer is innovation. Tesla's reputation as a disruptive automotive company helped it cement its position at #2 in market cap. Its R&D focus and electric-only approach to vehicle manufacturing makes it the industry leader in future automotive technologies. Tesla was able to solve one of the fundamentals challenges in electric mobility – battery range and performance. While Volkswagen developed its first electric car in the 1970s, it wasn't able to drive market demand or popularise the technology until much recently.

Tesla flipped the electric vehicle market on its head by developing cars that could outperform their petrol counterparts on speed, acceleration, and range. In addition to better batteries, Tesla has also revolutionised automotive software. In recent years, it has been described as a “software company that also makes cars.”

Tesla can fix everything from battery performance to suspension sensitivity remotely via software updates. It has also developed a vast network of charging stations across key markets.

Volkswagen on the other hand, is yet to find widespread adoption of its electric vehicle offerings. Barring a few premium models, Volkswagen has failed to emerge as the car manufacturer of choice for customers looking to switch to electric cars. In February 2020, Audi had to halt the production of its popular e-Tron SUV due to a battery shortage. Issues like these have chipped away at the credibility of the automaker as a premium electric vehicle manufacturer.

It's no wonder then, that Tesla enjoys a more favourable perception as an automaker of the future. And that effects its valuation.



“

*Asset values and earning power are the dominant factors affecting the valuation of a controlling interest in a business. Market price, which governs valuation of minority interest positions, is of little or no importance in valuing a controlling interest.*

- Warren Buffett

”



### 3. How Do You Value a Business

Now that you've understood the key drivers influencing the value of your business, it's time to look at some of the steps you can take to arrive at an accurate valuation.

Like most processes, there is no one-size-fits-all approach to valuing a business, it's about figuring out which method is the best option for your organization. Before we move on to the various methods available to you, let's look at some of the basic concepts of business appraisal.

**Valuation Multiple** : Multiples in business valuation or valuation multiples is a common multiplier method used to convert a single-point business benefit into the assumption that markets will price equivalent assets in a similar way and therefore the value of a company can be derived by calculating the market value of comparable firms. A comparable firm is a firm that operates in the same industry and has similar key financial parameters (i.e., growth and profitability) as the firm that is being valued. In case of the absence of comparables, near comparables are considered.

#### 1. Revenue Multiple Method

The enterprise value (EV) to revenue multiple method is commonly used for early-stage or high-growth businesses that are yet to show positive earnings. This method helps you understand how business valuation will be determined by future revenues.

$$\text{EV to Revenue Multiple Formula} = \text{EV/Revenue}$$

Where:


- ✓ EV (Enterprise Value) = Equity Value + All Debt + Preferred Shares – Cash Equivalents
- ✓ Revenue = Total Annual Revenue

#### Pros

- 1 Useful for companies with negative earnings
- 2 Useful for businesses with negative or near zero EBITDA
- 3 Easy to find revenue figures for most businesses
- 4 Easy to calculate the ratio

#### Cons

- 1 Does not take into account the company's cost structure
- 2 Ignores profitability and cash flow generation
- 3 Hard to compare across different industries and different stages of companies (early vs mature)
- 4 Results can be difficult to interpret



**“**  
*Nothing turns off an investor more than when an entrepreneur comes in with a ridiculous valuation.*  
**”**  
– Kevin Harrington

## 2. EBITDA Multiple Method

The EBITDA multiple method compares the EV of a business to its annual EBITDA. This method provides a normalised ratio for variations in the capital structure, taxation, fixed assets, and for comparing disparities of operation in various companies.

**EV to Revenue Multiple Formula**  $\text{EBITDA Multiple} = \text{EV} / \text{EBITDA}$

- ✓ Enterprise Value = (market capitalization + value of debt + minority interest + preferred shares) – (cash and cash equivalents)
- ✓ EBITDA = Earnings Before Tax + Interest + Depreciation + Amortization

### What are the Pros and Cons of the EV to EBITDA Multiple?

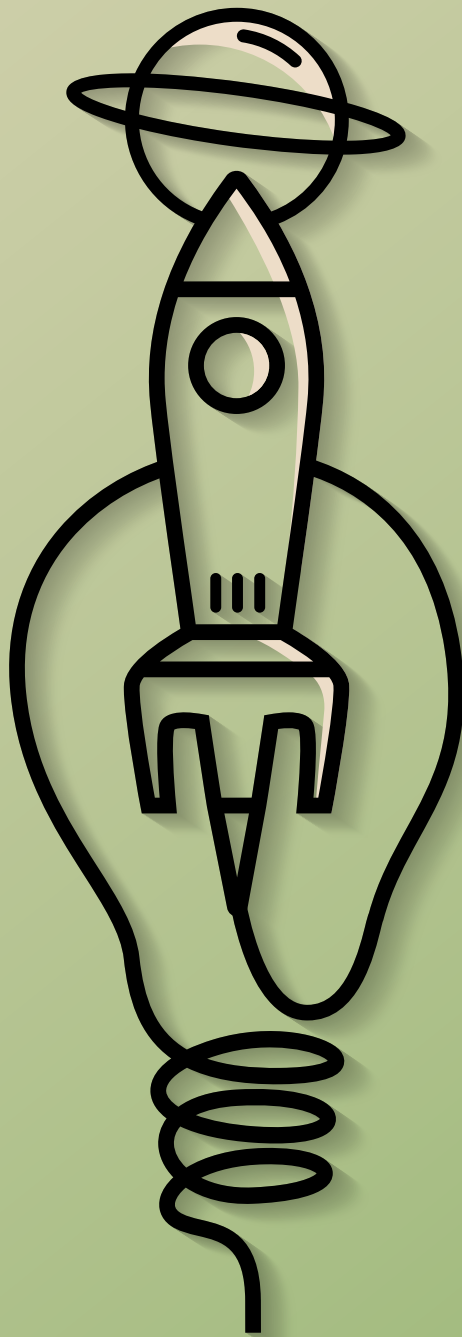
As with any valuation method, there are advantages and disadvantages, which are outlined below:

#### Pros

- 1 ✓ Can be easily calculated
- 2 ✓ Includes both debt and equity, providing an accurate representation of business performance
- 3 ✓ Used for identifying potential business for mergers and acquisitions
- 4 ✓ Widely used metric across major industries

#### Cons

- 1 ✓ Doesn't include capital expenditures which can inflate the earnings portion of the metric
- 2 ✓ Depreciation can underestimate CAPEX needs
- 3 ✓ Does not work for non-profitable companies



### 3. Discounted Cashflow Method

The discounted cashflow method is an income-based approach to business valuation that focuses on predicting what future cashflow potential is worth. The discounted cashflow method is used by businesses that have extensive historical finance data available which can be leveraged to project future cashflow scenarios. You can calculate the current value of future cashflow by using a discount rate, which accounts for the risk and time value of the money.

#### Discounted Cashflow Valuation Formula:

$$DCF = (CF/1+r)^1 + (CF/1+r)^2 + (CF/1+r)^3 + \dots + (CF/1+r)^n$$

Where:

CF = Cash Flow in the Period  
r = the interest rate or discount rate  
n = the period number

#### What are the Pros and Cons of the Discounted Cashflow method?

##### Pros

- 1 Includes all key assumptions about the business
- 2 Helps determine the intrinsic value of a business
- 3 Doesn't rely on comparable businesses
- 4 Lends itself well for sensitivity analysis and simulations

##### Cons

- 1 Doesn't include capital expenditures which can inflate the earnings portion of the metric
- 2 Depreciation can underestimate CAPEX needs
- 3 Does not work for non-profitable companies

## 4. Asset Valuation Method

Asset rich businesses are best suited for this valuation method. To begin with asset valuation you need to calculate the Net Book Value (NBV) of the business. The NBV refers to all assets recorded in the company's accounts after accounting for liabilities. This is a fairly straightforward method as asset value for tangible assets can be calculated easily. However, intangible assets can complicate this approach. Putting a value on business goodwill or the brand name can be tricky.

### What are the pros and cons of the asset valuation method?



## Case Study: Kingfisher Airlines and the Folly of Intangible Asset Valuation



When the now-infamous carrier – Kingfisher Airlines, decided to restructure its loans by pledging its brand name to banks, it roped in international advisory firm, Grant Thornton for a valuation of its brand.

Grant Thornton put the airline's brand value at \$500 million. After Kingfisher defaulted on its loans, the banks put up the nine pledged trademarks of the airlines for sale.

However, these trademarks remain unsold to date because the brand name is case, financial institutions and businesses will certainly be wary of intangible asset valuations, particularly brand names.

We know you've worked hard to establish your business. And our objective, data-driven assessment can help you maximise your business value and achieve your desired goals. Get in touch with us today to understand how we can help.

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