# Valuation

## BEGINNER'S GUIDE

Process of determining the present value of a company or an asset
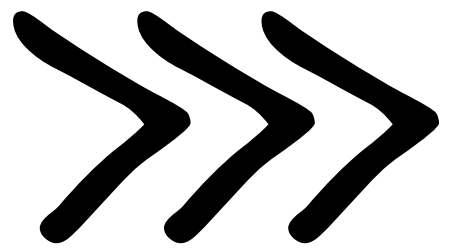
**Yash Mundada**
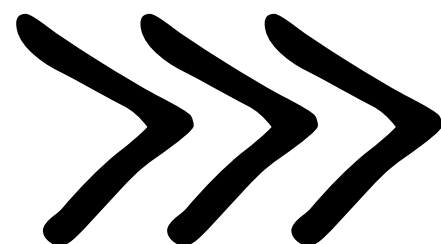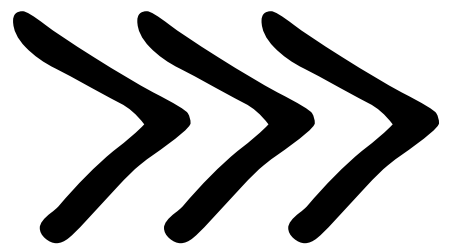
# What is Valuation?

Valuation refers to the process of determining **the present value of a company,** investment or an asset.

Analysts who want to place a value on an asset normally look at the prospective future earning potential of that company or asset.
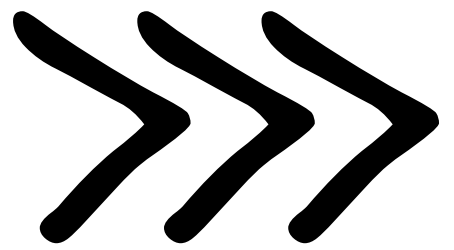
# Reasons for Performing a Valuation

Valuation is a crucial process as it can uncover undervalued or overvalued investments and guide a company's project decisions.

Key reasons for conducting a valuation:

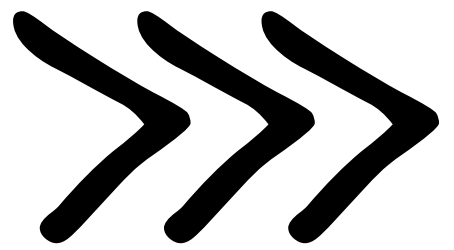# 1. Buying or selling a business

**BUY**

**SELL**

Buyers & sellers will normally have a difference in the value of a business. Both parties would benefit from a valuation when making their ultimate decision on whether to buy or sell and at what price.

# 2. Strategic planning

A company should only invest in projects that increase its net present value. Therefore, any investment decision is essentially a mini-valuation based on the likelihood of future profitability and value creation
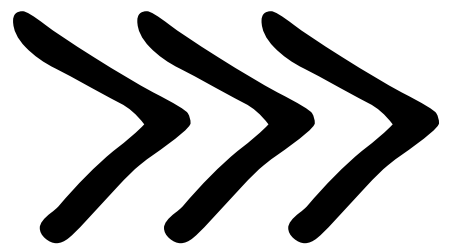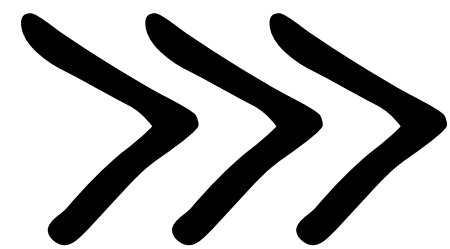
# 3. Capital financing

An objective valuation may be useful when negotiating with banks or any other potential investors for funding. Documentation of a company's worth, and its ability to generate cash flow, enhances credibility to lenders and equity investors.

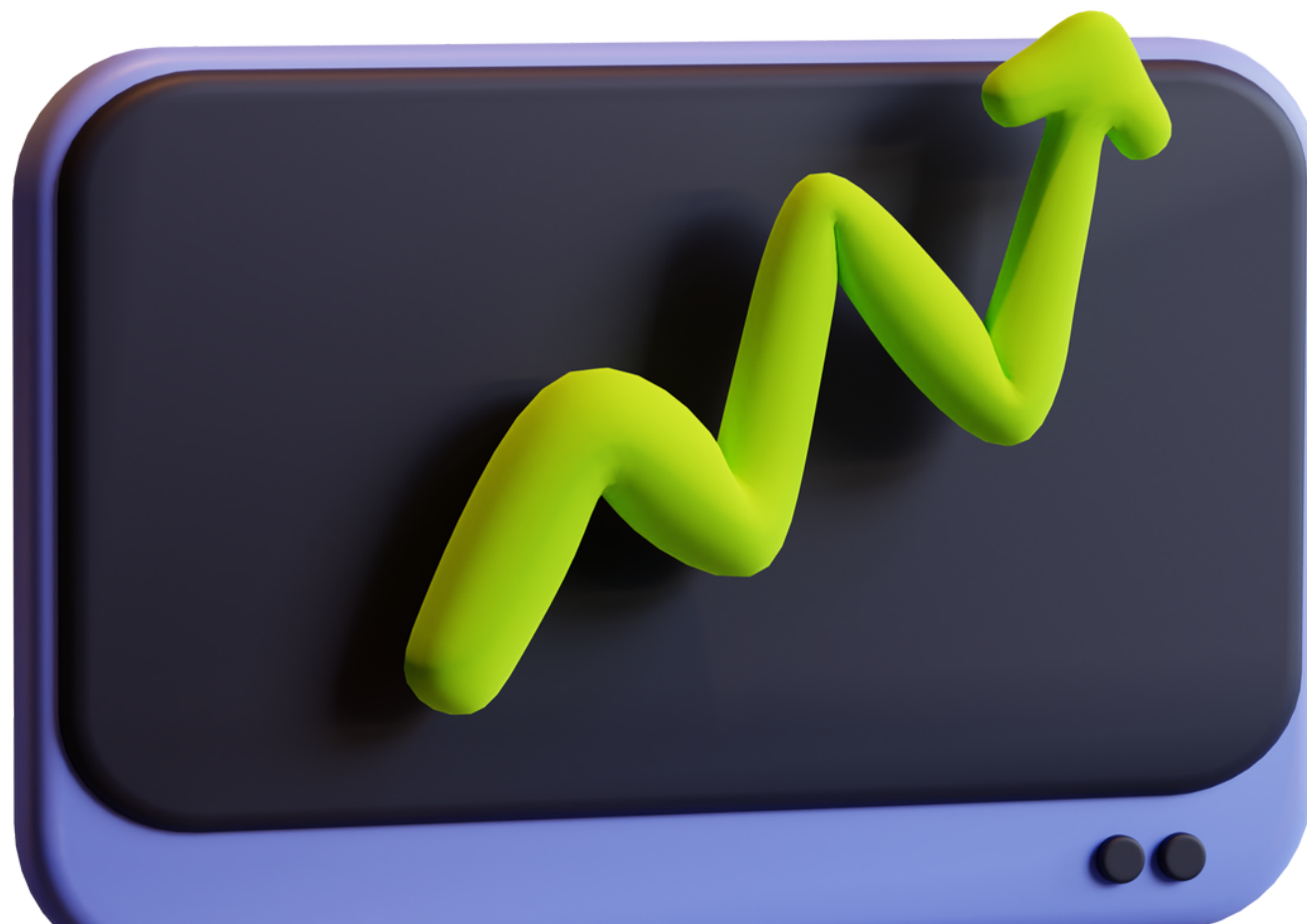# 4. Securities investing

Investing in stock or a bond is essentially a bet that the security's current market price does not reflect its intrinsic value. A valuation is necessary in determining that intrinsic value.
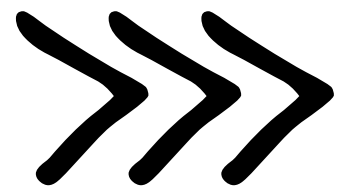
# Company Valuation Approaches

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## 1. DCF analysis
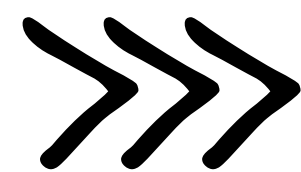
## 2. Comparable company analysis

## 3. Precedent transactions

# 1. DCF analysis

Discounted cash flow (DCF) analysis is an intrinsic value approach where an analyst forecasts a business's **unlevered** free cash flow into the future and **discounts** it back to today at the firm's weighted average cost of capital (**WACC**).

A DCF analysis is intricate, demanding extensive **detail** and **assumptions** in an Excel model.

Can be **less accurate** due to its many inputs but offers scenario forecasting and sensitivity analysis.

For larger businesses, it often involves a **sum-of-the-parts** approach, modeling individual units and summing them up.

# 2. Comparable company analysis

### ("comps")

Comparable company analysis (**"trading comps"**) is a **relative** valuation method in which you compare the current value of a business to other **similar** businesses by looking at trading multiples like **P/E, EV/EBITDA, or other multiples.**
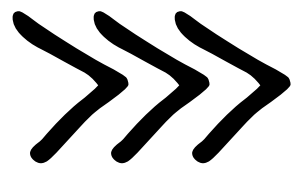
The "comps" valuation method provides an **observable value** for the business, based on what other comparable companies are currently worth.

It is most commonly employed approach because the multiples are easy to calculate and are always up to date.

If company A trades at a 10-times P/E ratio, & company B has earnings of ₹3 per share, company B's stock must be worth ₹30 per share (**assuming** the companies have similar risk & return characteristics).
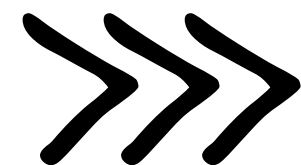
# 3. Precedent transactions

Precedent transactions analysis is another form of relative valuation where you compare the company in question to other businesses that have recently been sold or acquired in the same industry. These transaction values include the take-over premium included in the price for which they were acquired.
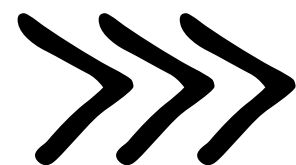
The values represent the entire value of a business and not just a small stake. They are useful for M&A transactions but can easily become dated and no longer reflective of current market conditions as time passes.

| | | Transaction | | Valuation | | |
|---|---|---|---|---|---|---|
| Date | Target | Value (₹M) | Buyer | EV/Sales | EV/EBITDA | EV/EBIT |
| 01/24/2019 | Pratham Limited | 2,350 | Averaaj Limited | 1.9x | 9.4x | 11.2x |
| 04/19/2020 | Nedhan Inc. | 6,500 | Mahasangh Udyog | 1.4x | 8.0x | 12.6x |
| 04/19/2021 | Purv Co. | 2,150 | Anya Samuh | 1.3x | 8.7x | 12.1x |
| 11/07/2021 | Itihasik LLP | 450 | Yuva Vyapar | 2.3x | 11.1x | 13.6x |
| 11/01/2022 | Purane Samuh | 325 | Sookshma Vyavasay | 5.1x | 18.8x | 21.5x |
| 10/07/2023 | Kalpanik Vyapar | 150 | Laghu Sathi | 2.1x | 9.3x | 13.2x |

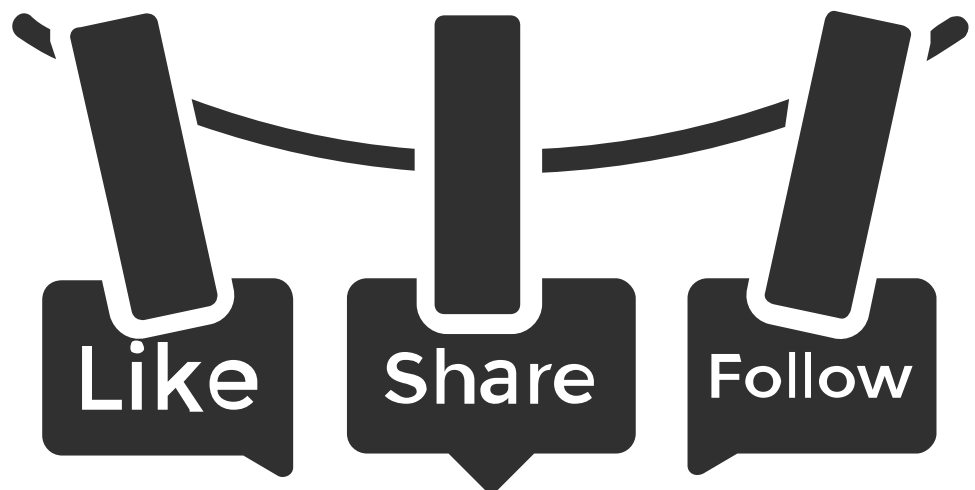| | | | | | | |
|---|---|---|---|---|---|---|
| Average | | | | 2.3x | 10.9x | 14.0x |
| Median | | | | 2.0x | 9.4x | 12.9x |

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*Valuation Principles*

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