
VALUATION

What is Valuation?

The process of figuring out the current worth of a business, investment, or asset is referred to as valuation.

There are several widely used valuation methods, which are listed below. Analysts who seek to assign a value to an asset typically consider the asset's or company's potential for future earnings.

The market value of a stock is determined by buyers and sellers through trading on an exchange. However, the term "intrinsic value" refers to the estimation of a security's worth based on expected future profits.

In order to determine if a firm or investment is undervalued or overpriced by the market, analysts must undertake a valuation.

Company Valuation Approaches

Three basic valuation methods are employed by business professionals when determining a firm's value as a continuing concern:

(1) DCF analysis
(2) comparable company analysis
(3) precedent transactions. .

The majority of financial sectors, including investment banking, equity research, private equity, corporate development, mergers and acquisitions (M&A), leveraged buyouts (LBO), and corporate development, utilise these valuation techniques

DCF analysis

In a discounted cash flow (DCF) study, an analyst projects the future unlevered free cash flow of a company and discounts it to the present day using the company's weighted average cost of capital (WACC).

It takes a lot of information and analysis to complete a DCF analysis, which is done by creating a financial model in Excel. Of the three ways, it is the most elaborate and calls for the most assumptions and presumptions.

As a result, the time spent creating a DCF model may frequently provide the least accurate value because of the overwhelming volume of variables. However, the analyst may anticipate value using several scenarios and even carry out a sensitivity analysis using a DCF model.

comparable company analysis

Based on what other comparable firms are now worth, the "comps" valuation approach assigns a measurable value to the company.

Since multiples are simple to compute and always updated, comps is the most commonly used strategy.

The reasoning is that if stock A has a 20 price-to-earnings ratio and business Y has earnings of around 50 cents per share, then company Y's shares must be worth 1,000 per share (assuming the companies have comparable risk and return characteristics).

precedent transactions

Another method of relative valuation is precedent transaction analysis, which compares the firm under consideration to other companies that have recently been bought or sold in the same sector.

These transaction prices take into account the takeover premium that was part of the purchase price.

The values indicate the full worth of a company, not simply a small portion of it.

They are helpful for M&A deals, but as time goes on, they may become out of date and no longer reflect the state of the market.

Purpose of performing a Valuation

In order to spot mispriced stocks or choose which initiatives a corporation should fund; valuation is a crucial process.

The following is a summary of some of the key justifications for doing a valuation.

Buying or selling a business

The worth of a firm will often change between buyers and sellers. When deciding whether to purchase or sell and at what price, both parties would profit from an evaluation.

Strategic planning

An organization should only engage in projects that boost its net present value. As a result, each investment choice is effectively a mini-valuation based on the potential of future profitability and wealth generation.

Capital Financing

When negotiating for finance with banks or other possible investors, a valuation could be helpful. Giving lenders and equity investors proof of a company's value and cash flow generation capacity builds credibility.

Securities investing

Purchasing a security, such as a stock or a bond, is simply a wager that the security's market price does not accurately reflect its intrinsic worth. To ascertain intrinsic value, a valuation is required.