DOWNLOAD PDF VALUE AND VALUATION

Chapter 1 : Valuation: How to Value Cyclical and Commodity Companies

VALUE AND VALUATION. The terms value and valuation and their cognates and compounds are used in a confused and confusing but widespread way in our contemporary culture, not only in economics and philosophy but also and especially in other social sciences and humanities.

Knowing what an asset is worth and what determines that value is a pre-requisite for intelligent decision making -- in choosing investments for a portfolio, in deciding on the appropriate price to pay or receive in a takeover and in making investment, financing and dividend choices when running a business. The premise of valuation is that we can make reasonable estimates of value for most assets, and that the same fundamental principles determine the values of all types of assets, real as well as financial. Some assets are easier to value than others, the details of valuation vary from asset to asset, and the uncertainty associated with value estimates is different for different assets, but the core principles remain the same. This introduction lays out some general insights about the valuation process and outlines the role that valuation plays in portfolio management, acquisition analysis and in corporate finance. It also examines the three basic approaches that can be used to value an asset. A philosophical basis for valuation A postulate of sound investing is that an investor does not pay more for an asset than it is worth. This statement may seem logical and obvious, but it is forgotten and rediscovered at some time in every generation and in every market. There are those who are disingenuous enough to argue that value is in the eyes of the beholder, and that any price can be justified if there are other investors willing to pay that price. That is patently absurd. Perceptions may be all that matter when the asset is a painting or a sculpture, but we do not and should not buy most assets for aesthetic or emotional reasons; we buy financial assets for the cashflows we expect to receive from them. Consequently, perceptions of value have to be backed up by reality, which implies that the price we pay for any asset should reflect the cashflows it is expected to generate. Valuation models attempt to relate value to the level of, uncertainty about and expected growth in these cashflows. There are many aspects of valuation where we can agree to disagree, including estimates of true value and how long it will take for prices to adjust to that true value. But there is one point on which there can be no disagreement. Asset prices cannot be justified by merely using the argument that there will be other investors around who will pay a higher price in the future. That is the equivalent of playing a very expensive game of musical chairs, where every investor has to answer the question, "Where will I be when the music stops? The problem with investing with the expectation that there will be a bigger fool around to sell an asset to, when the time comes, is that you might end up being the biggest fool of all. Inside the Valuation Process There are two extreme views of the valuation process. At one end are those who believe that valuation, done right, is a hard science, where there is little room for analyst views or human error. At the other are those who feel that valuation is more of an art, where savvy analysts can manipulate the numbers to generate whatever result they want. The truth does lies somewhere in the middle and we will use this section to consider three components of the valuation process that do not get the attention they deserve â€” the bias that analysts bring to the process, the uncertainty that they have to grapple with and the complexity that modern technology and easy access to information have introduced into valuation. Value first, Valuation to follow: Bias in Valuation We almost never start valuing a company with a blank slate. All too often, our views on a company are formed before we start inputting the numbers into the models that we use and not surprisingly, our conclusions tend to reflect our biases. We will begin by considering the sources of bias in valuation and then move on to evaluate how bias manifests itself in most valuations. We will close with a discussion of how best to minimize or at least deal with bias in valuations. Sources of Bias The bias in valuation starts with the companies we choose to value. These choices are almost never random, and how we make them can start laying the foundation for bias. It may be that we have read something in the press good or bad about the company or heard from an expert that it was under or over valued. Thus, we already begin with a perception about the company that we are about to value. We add to the bias when we collect the information we need to value the firm. The annual report and other financial statements include not only the accounting numbers but also management discussions of performance, often putting the best possible spin on the numbers. With many larger companies, it is easy to access what other analysts following the stock think about these companies. Valuations that stray too far from this number make analysts uncomfortable, since they may reflect large valuation errors rather than market mistakes. In many valuations, there are institutional factors that add to this already substantial bias. For instance, it is an acknowledged fact that equity research analysts are more likely to issue buy rather than sell recommendations, i. The reward and punishment structure associated with finding companies to be under and over valued is also a contributor to bias. An analyst whose compensation is dependent upon whether she finds a firm is under or over valued will be biased in her conclusions. This should explain why acquisition valuations are so often biased upwards. One is to find that the deal is seriously over priced and recommend rejection, in which case the analyst receives the eternal gratitude of the stockholders of the acquiring firm but little else. The other is to find that the deal makes sense no matter what the price and to reap the ample financial windfall from getting the deal done. Manifestations of Bias There are three ways in which our views on a company and the biases we have can manifest themselves in value. The first is in the inputs that we use in the valuation. When we value companies, we constantly come to forks in the road where we have to make assumptions to move on. These assumptions can be optimistic or pessimistic. For a company with high operating margins now, we can either assume that competition will drive the margins down to industry averages very quickly pessimistic or that the company will be able to maintain its margins for an extended period optimistic. The path we choose will reflect our prior biases. It should come as no surprise then that the end value that we arrive at is reflective of the optimistic or pessimistic choices we made along the way. The second is in what we will call post-valuation tinkering, where analysts revisit assumptions after a valuation in an attempt to get a value closer to what they had expected to obtain starting off. The third is to leave the value as is but attribute the difference between the value we estimate and the value we think is the right one to a qualitative factor such as synergy or strategic considerations. This is a common device in acquisition valuation where analysts are often called upon to justify the unjustifiable. In fact, the use of premiums and discounts, where we augment or reduce estimated value, provides a window on the bias in the process. The use of premiums â€" control and synergy are good examples â€" is commonplace in acquisition valuations, where the bias is towards pushing value upwards to justify high acquisition prices. The use of discounts â€" illiquidity and minority discounts, for instance â€" are more typical in private company valuations for tax and divorce court, where the objective is often to report as low a value as possible for a company. What to do about bias Bias cannot be regulated or legislated out of existence. Analysts are human and bring their biases to the table. However, there are ways in which we can mitigate the effects of bias on valuation: As we noted earlier, a significant portion of bias can be attributed to institutional factors. Equity research analysts in the s, for instance, in addition to dealing with all of the standard sources of bias had to grapple with the demand from their employers that they bring in investment banking business. Institutions that want honest sell-side equity research should protect their equity research analysts who issue sell recommendations on companies, not only from irate companies but also from their own sales people and portfolio managers. Any valuation process where the reward or punishment is conditioned on the outcome of the valuation will result in biased valuations. In other words, if we want acquisition valuations to be unbiased, we have to separate the deal analysis from the deal making to reduce bias. Decision makers should avoid taking strong public positions on the value of a firm before the valuation is complete. In far too many cases, the decision on whether a firm is under or over valued precedes the actual valuation, leading to seriously biased analyses. The best antidote to bias is awareness. In Bayesian statistics, analysts are required to reveal their priors biases before they present their results from an analysis. Thus, an environmentalist will have to reveal that he or she strongly believes that there is a hole in the ozone layer before presenting empirical evidence to that effect. The person reviewing the study can then factor that bias in while looking at the conclusions. Valuations would be much more useful if analysts revealed their biases up front. While we cannot eliminate bias in valuations, we can try to minimize its impact by designing valuation processes that are more protected from overt outside influences and by report our biases with our estimated values. It is only an estimate: Imprecision and Uncertainty in Valuation Starting early in life, we are taught that if we do things right, we will get the right answers. In other words, the precision of the answer is used as a measure of the quality of the process that yielded the answer. While this may be appropriate in mathematics or physics, it is a poor measure of quality in valuation. Barring a very small subset of assets, there will always be uncertainty associated with valuations, and even the best valuations come with a substantial margin for error. In this section, we examine the sources of uncertainty and the consequences for valuation. Sources of Uncertainty Uncertainty is part and parcel of the valuation process, both at the point in time that we value a business and in how that value evolves over time as we get new information that impacts the valuation. That information can be specific to the firm being valued, more generally about the sector in which the firm operates or even be general market information about interest rates and the economy. When valuing an asset at any point in time, we make forecasts for the future. Since none of us possess crystal balls, we have to make our best estimates, given the information that we have at the time of the valuation. Our estimates of value can be wrong for a number of reasons, and we can categorize these reasons into three groups. Even if our information sources are impeccable, we have to convert raw information into inputs and use these inputs in models. Any mistakes or mis-assessments that we make at either stage of this process will cause estimation error. The path that we envision for a firm can prove to be hopelessly wrong. The firm may do much better or much worse than we expected it to perform, and the resulting earnings and cash flows will be very different from our estimates. Even if a firm evolves exactly the way we expected it to, the macro economic environment can change in unpredictable ways. Interest rates can go up or down and the economy can do much better or worse than expected. These macro economic changes will affect value. The contribution of each type of uncertainty to the overall uncertainty associated with a valuation can vary across companies. When valuing a mature cyclical or commodity company, it may be macroeconomic uncertainty that is the biggest factor causing actual numbers to deviate from expectations. Valuing a young technology company can expose analysts to far more estimation and firm-specific uncertainty. Note that the only source of uncertainty that can be clearly laid at the feet of the analyst is estimation uncertainty. Given the constant flow of information into financial markets, a valuation done on a firm ages quickly, and has to be updated to reflect current information. Thus, technology companies that were valued highly in late , on the assumption that the high growth from the nineties would continue into the future, would have been valued much less in early , as the prospects of future growth dimmed. With the benefit of hindsight, the valuations of these companies and the analyst recommendations made in can be criticized, but they may well have been reasonable, given the information available at that time. Responses of Uncertainty Analysts who value companies confront uncertainty at every turn in a valuation and they respond to it in both healthy and unhealthy ways. Among the healthy responses are the following: Building better valuation models that use more of the information that is available at the time of the valuation is one way of attacking the uncertainty problem. It should be noted, though, that even the best-constructed models may reduce estimation uncertainty but they cannot reduce or eliminate the very real uncertainties associated with the future Valuation Ranges:

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In finance, valuation is the process of determining the present value (PV) of an theinnatdunvilla.comions can be done on assets (for example, investments in marketable securities such as stocks, options, business enterprises, or intangible assets such as patents and trademarks) or on liabilities (e.g., bonds issued by a company).

Jeffrey Kadlic March 7, Takeaway: Value creation is the strategy business owners put in place to get to the valuation result that satisfies their wants and needs. We had the good fortune of speaking with Dr. Sheeler addressed the difference between a business valuation and value creation. While these are two very distinct processes, as a small business private equity firm, Evolution Capital Partners believe that these are crucial concepts for business owners to understand, and not only in definition, but in relation to the effect they have on one another. Valuation, as defined by Divestopedia. Valuations are highly subjective calculations that aim to determine the fair market value of a company. Many business operators now focus on value creation both in the context of creating better value for customers purchasing its products and services, as well as for shareholders in the business who want to see their stake appreciate in value. Email Newsletter Join thousands of subscribers who receive actionable insights from Divestopedia. With these definitions as reference points, Dr. However, there is some gray area. Who is assessing the risk? What period of time are they looking at? Are you satisfied with this valuation of your business? Does it meet your goals? If it falls short, you have the opportunity to put a strategy in place to get you to the valuation that satisfies your wants and needs. This is value creation! Company Assets Identified During our discussion, Dr. He describes governance, relationships and knowledge as assets of the company, which all impact the risk or the value of the business. Important takeaways for business owners include: Both tangible and intangible assets affect value creation. You have the opportunity to create value in your business by establishing AND executing a strategy or vision for your business with very specific, measurable goals. The 5 Pillars of Business Freedom At Evolution Capital Partners, we support small growing businesses in the value creation process by building a foundation for sustained growth through the implementation of The 5 Pillars of Business Freedom SM , which consist of:

Chapter 3 : An Introduction to Valuation

A valuation can be useful when trying to determine the fair value of a security, which is determined by what a buyer is willing to pay a seller, assuming both parties enter the transaction.

Appraisers cannot decide matters of equity, but we can provide good and clear valuation evidence to courts in statutory fair value matters. This lack of understanding creates confusion and increases the difficulty of presenting valuation evidence in statutory fair value proceedings. The concepts in this chart are also the basis for much appraiser and judicial confusion. In the next post, we will introduce an updated levels of value chart that should begin to eliminate or reduce confusion over important valuation concepts. From there, we will proceed to the valuation concepts that provide the foundation for the levels of value chart. Valuation is a function of expected cash flows, risk and growth. When we understand not only the charts but the underlying cash flows that give rise to them, we will have a chance to reduce judicial and appraiser confusion over these concepts in the context of fair value determinations. While the valuation concepts of control, freely traded and nonmarketable minority have been around for several decades, they were not formally published in a chart until Since then, appraisers have worked on the concepts and have attempted to refine them. The three level chart shows the three conceptual levels of value noted above. It also shows conceptual discounts and a premium that enable appraisers and courts to move from one level to another. In the remainder of this post, we will discuss the three conceptual levels of value and the premium and discounts shown on the chart above. The Marketable Minority Level of Value as Benchmark The benchmark level is the marketable minority level of value, or the middle level in the chart above. Conceptually, it represents the pricing of the equity of a public company with an active and freely trading market for its shares. For a private company, it represents that same price as if there were a free and active market for its shares. For private company valuation, the marketable minority level of value is a construct. Appraisers examine the prices of public companies as similar as possible to a valuation subject called guideline public companies , and infer appropriate valuation metrics and multiples from the metrics and multiples of the similar public companies. Traditionally, appraisers would develop value indications at the marketable minority level of value first. If the assignment called for a nonmarketable minority conclusion, they would apply an appropriate marketability discount as seen in the chart above. If the assignment called for a controlling interest conclusion, they would consider an appropriate control premium as seen in the chart above. Note that the term, marketable minority, suggests that this valuation concept is a minority concept, i. Let me make a few foments here. The public markets capitalize expected earnings of public companies and reflect their collective valuations in the current market prices of public shares. The price of a public company multiplied by its number of shares outstanding is called the market capitalization of its equity. The market capitalization is a reflection of the value of the entire business enterprise, and not merely to a small minority interest of the enterprise. In the next post, we will introduce a modified levels of value chart to attempt to reconcile the seeming contradiction between minority and control at the marketable minority level of value. They are not penalized in value because they hold minority shares. In a sense, the marketable minority level of value was the starting point for developing either control value conclusions or nonmarketable minority level conclusions. The Control Level of Value The conceptual level of value above the benchmark marketable minority level of value is the control level of value. The control level of value represents pricing as if entire companies or controlling interests in them are sold. We move from the marketable minority level of value to the control level of value through the application of a conceptual control premium. When public companies are sold, control premiums are typically paid by their acquirers. The conceptual premium is shown on the chart above. Sometimes, the control level of value can be observed directly, as when public companies are acquired and pricing information before and after announcement become available. Market participants have been studying control premiums for years. Other organizations maintain control premium information on specific industries. Moving down from the control level to the marketable minority level, we see the minority interest discount in the chart. The minority interest discount eliminates the so-called value of control by deflating a control price by the amount of the actual or conceptual control premium. The minority interest discount in the example is Historically, control premium data like averages and medians or specific studies have been used by appraisers as a basis to estimate minority interest discounts. Since the mid s, there has been a growing consensus among appraisers that control premiums measure, in addition to any value that might be directly attributable to control, the added value of expected acquirer synergies or other strategic benefits. The evolution in thinking regarding valuation premiums and discounts and the levels of value has created growing confusion in the statutory fair value arena. This level represents the conceptual value of illiquid i. The concept of valuation discounts related to lack of marketability has been studied in the public securities markets since the s. Statutory fair value as defined in many states allowed for valuation discounts for a number of years. The trend has been toward eliminating valuation discounts like the minority interest discount and the marketability discount. Nevertheless, discounts are often the topic of discussion and debate in litigated statutory fair value cases. In the next post, we will introduce an updated levels of value chart that introduces two concepts of control, financial control and strategic or synergistic control. In the meantime, if you have comments, please feel free to post them here. I look forward to the continuing discussion. As always, be well!

Chapter 4 : Business Valuation

Comps is a relative valuation methodology that looks at ratios of similar public companies and uses them to derive the value of another business (also called "trading multiples" or "peer group analysis" or "equity comps" or "public market multiples") is a relative valuation method in which you compare the current value of a.

Their meaning was once relatively clear and their use limited. Value meant the worth of a thing, and valuation meant an estimate of its worth. The worth in question was mainly economic or quasi economic, but even when it was not, it was still worth of some sortâ€"not beauty, truth, rightness, or even goodness. The extension of the meaning and use of the terms began in economics, or political economy, as it was then called. Value and valuation became technical terms central to that branch of economics which was labeled the theory of value. Then German philosophers, especially Rudolf Hermann Lotze , Albrecht Ritschl, and Friedrich Nietzsche, began to take the notion of value and values in a much broader sense and to give it primary importance in their thinking. Philosophers from the time of Plato had discussed a variety of questions under such headings as the good, the end, the right, obligation, virtue, moral judgment, aesthetic judgment, the beautiful, truth, and validity. In the nineteenth century the conception was bornâ€"or reborn, because it is essentially to be found in Platoâ€"that all these questions belong to the same family, since they are all concerned with value or what ought to be, not with fact or what is, was, or will be. All these questions, it was believed, may not only be grouped under the general headings of value and valuation but are better dealt with and find a more systematic solution if they are thought of as parts of a general theory of value and valuation that includes economics, ethics, aesthetics, jurisprudence, education, and perhaps even logic and epistemology. This conception matured in the s in the writings of Alexius Meinong and Christian von Ehrenfels, two Austrian followers of Franz Brentano. Through them and through others like Max Scheler and Nicolai Hartmann , two twentieth-century German followers of Edmund Husserl himself influenced by Brentano , the idea of a general theory of value became popular on the Continent and in Latin America. Mackenzie, John Laird, and J. Findlay, but rather less than elsewhere, for, on the whole, British philosophers have held to more traditional terms such as good and right. Hall, and others, and later refurbished by S. Pepper and Paul W. This wide-ranging discussion in terms of value, values, and valuation subsequently spread to psychology, the social sciences, the humanities, and even to ordinary discourse. Philosophical Usages The uses of value and valuation are various and conflicting even among philosophers, but they may perhaps be sorted out as follows. The term can be limited to what might be said to be on the plus side of the zero line; then what is on the minus side bad, wrong, and so forth is called disvalue. Value is also used like temperature to cover the whole range of a scaleâ€"plus, minus, or indifferent; what is on the plus side is then called positive value and what is on the minus side, negative value. In its widest use value is the generic noun for all kinds of critical or pro and con predicates, as opposed to descriptive ones, and is contrasted with existence or fact. The theory of value, or axiology, is the general theory of all such predicates, including all the disciplines mentioned above. The classic example in English of this approach is the work of R. In its narrower use, value covers only certain kinds of critical predicates and is contrasted with descriptive predicates and even with other critical ones like rightness and obligation. In this case the theory of value, or axiology, is a part of ethics, rather than the other way around. The work of C. Lewis is the best example of the narrower approach. Those who take the wider approach sometimes distinguish "realms of value"; Perry and Taylor, for example, list eight of these: Even when value is used in the narrower sense, several meanings of the term, or kinds of value, are sometimes distinguished. The narrower distinctions may also be recognized by those who use value in the wider sense. These meanings correspond to the senses or uses of good, which G. Lewis distinguishes a utility or usefulness for some purpose; b extrinsic or instrumental value, or being good as a means to something desirable or good; c inherent value or goodness, such as the aesthetic value of a work of art in producing good experiences by being contemplated or heard; d intrinsic value, or being good or desirable either as an end or in itself, which is presupposed by both b and c ; e contributory value, or the value that an experience or part of an experience contributes to a whole of which it is a part not a means or an object. A stick of wood may be useful in making a violin, a violin may be extrinsically good by being a means to good music, the music may be inherently good if hearing it is enjoyable, the experience of hearing it may be intrinsically good or valuable if it is enjoyable for its own sake, and it may also be contributively good if it is part of a good evening or weekend. Dewey, however, attacks the distinction between means and ends while stressing the notion of total value or goodness on the wholeâ€”goodness when all things are considered. Ross for instance, would add moral value, the kind of value or goodness that belongs to a virtuous man, to good motives, or to morally approved traits of character. Von Wright distinguishes instrumental goodness a good knife , technical goodness a good driver , utilitarian goodness good advice , hedonic goodness or pleasantness a good dinner , and welfare the good of man. He also mentions moral goodness but argues that it is a subform of utilitarian goodness; Ross would deny this. The expressions "his values," "her value system," and "American values" refer to what a man, a woman, and Americans value or think to be good. Such phrases are also used to refer to what people think is right or obligatory and even to whatever they believe to be true. Behind this widespread usage lies the covert assumption that nothing really has objective value, that value means being valued and good means being thought good. But the term value is also used to mean b what has value or is valuable, or good, as opposed to what is regarded as good or valuable. Then values means "things that have value," "things that are good," or "goods" and, for some users, also things that are right, obligatory, beautiful, or even true. In both usage a and usage b it is possible to distinguish different kinds of values, corresponding to the different kinds of value or forms of goodness mentioned above. It is also common to distinguish more or less clearly between material and spiritual values or among economic, moral, aesthetic, cognitive, and religious values. Some philosophers, especially those influenced by Scheler and Hartmann, think of value as a general predicate like "color," which subsumes more specific value predicates analogous to "red" or "yellow. Just as "a color" does not mean "a thing that has color" but a particular color like red, so "a value" does not mean "a thing that has value" but a particular kind of value, like pleasure value or courage value. These philosophers call a thing that is good "a good" or "a value carrier," not "a value. But sometimes valuation and evaluation are used to designate only a certain kind of valuing, namely, one that includes reflection and comparison. In either case valuation may be, and is, used in wider or narrower senses corresponding to the wider and narrower uses of value. For Dewey and Richard M. Hare it covers judgments about what is right, wrong, obligatory, or just, as well as judgments about what is good, bad, desirable, or worthwhile. For Lewis valuation covers only the latter use. The expression "value judgment" is also used in both of these ways. Among the writers who distinguish two main kinds of normative discourse, evaluating and prescribing, some, like Taylor, classify judgments of right and wrong as well as judgments of good and bad under evaluations and judgments, using ought under prescriptions; others put judgments of right and wrong under prescriptions. Dewey always distinguishes two senses of "to value. In the second sense reflection and comparison are involved; in the first sense they are not. In the first sense, he seems to regard mere desiring or liking as a form of valuing. Others often follow him in this, but some writers limit valuing to acts in which something is not merely desired or liked but judged to be good or to have value. Thus, words such as value and valuation may be, and are, used in a variety of ways, even when they are used with some careâ€”which is, unfortunately, not often the case both in and out of philosophy. In using the terms, one should choose a clear and systematic scheme and use it consistently. Because of the ambiguity and looseness that the terms often engender, it would seem advisable to use them in their narrower senses or not at all, keeping to more traditional terms such as good and right, which are better English, whenever possible. Philosophical Theories Philosophical theories of value and valuation, whether conceived in the wider or in the narrower manner and whether formulated in the traditional or in the newer "value" vocabulary, have been of two sorts. Normative theories make value judgments or valuations; they tell us what is good or what has value, what is bad, and so on. Metanormative theories analyze value, valuation, and good; they neither make value judgments in this way nor tell us what is good or has value. Instead, they define what goodness and value are and what it means to say that something is good or has value. Sometimes philosophers also offer descriptive generalizations about what is valued or regarded as good in some culture or group of cultures, and explanatory theories about why this is so valued or regarded David Hume , Moritz Schlick , F. However, this is usually ancillary to their discussions of normative or metanormative questions. In themselves such descriptive and explanatory theories belong to anthropology, psychology, and sociology, not to philosophy. Recently, many analytical philosophers have been maintaining that even normative theories, however important they may be, have no place in philosophy proper, where theories of value and valuation should be limited to metanormative questions. In the narrower conception, normative theories of value have usually addressed themselves primarily to the question of what is good in itself or as an end or what has intrinsic value, an approach that Dewey has persistently attacked. They ask not what goodness and intrinsic value are but what the good is, what has value for its own sake, what is to be taken as the end of our pursuit or as the criterion of intrinsic worth. Some theories have answered that the end or the good is pleasure or enjoyment or, alternatively, that the criterion of intrinsic value is pleasantness or enjoyableness. More accurately, they say that only experiences are intrinsically good, that all experiences that are intrinsically good are pleasant and vice versa, and that they are intrinsically good because and only because they are pleasant. These are the hedonistic theories of value, held by such thinkers as Epicurus, Hume, Jeremy Bentham , J. Examples are to be found in the writings of Dewey, Lewis, Parker, P. Rice, and perhaps Brand Blanshard. Antihedonistic theories are of two kinds. Some agree that there is, in the final analysis, only one thing that is good or good-making but deny that it is pleasure or any other kind of feeling. Aristotle says it is eudaemonia excellent activity ; Augustine and Thomas Aquinas, communion with God; Benedict de Spinoza, knowledge; F. Bradley, self-realization; Nietzsche, power. Others, such as Plato, G. Ross, Laird, Scheler, Hartmann, and Perry, are more "pluralistic," holding that there are a number of things that are good or good-making in themselves. They differ in their lists but all include two or more of the following: Of course, hedonists and other "monistic" thinkers may also regard such things as intrinsically good, but only if and because they are pleasant, self-realizing, or excellent. Their questions and answers have been variously stated in the formal or material mode, or the linguistic or nonlinguistic, but they will not be classified here. One question or group of questions posed by metanormative theories concerns the nature of value and valuation: A subquestion here is what moral value and evaluation are, and how they are distinct from nonmoral value and valuation, if at all. Another question or set of questions has to do with the justification or validity of value judgments and normative theories: Here a subquestion is what is the logic of moral justification or reasoning, if there is one, and is it in any way distinctive. Beyond this there is an even more "meta" level of questioning: This last problem, as well as the subquestions just mentioned, has frequently been discussed in the twentieth century and earlier but will not be considered here. In reply to the first question or group of questions, some philosophers have held that terms like value and good stand for properties; that in value judgments we are ascribing these properties to objects or kinds of objects including activities and experiences , although we may also be taking pro or con attitudes toward them; and that, therefore, value judgments are descriptive or factual in the sense of truly or falsely ascribing properties to things. They are therefore cognitivists or descriptivists in value theory. Of these the naturalists add that the property involved is a natural or empirical one, which can be defined. Aristotle, von Ehrenfels, and Perry claim that value is the relational property of being an object of desire or interest an interest theory of value ; Parker, that it is the satisfaction of desire another interest theory of value ; Lewis and Rice as well as the early Meinong , that it is the quality of being, enjoyed or enjoyable in some way the affective theory of value. George Santayana seems sometimes to hold one of these views, sometimes another, and sometimes to regard value as an indefinable natural quality ascribed to what we desire or enjoy. Other cognitivists add that value or goodness is a metaphysical property that can neither be observed by or in ordinary experience nor made an object of empirical science. Examples of metaphysical definitions are being truly real Neoplatonists , being ontologically perfect Hegelian idealists , or being willed by God theologians. Still others assert that intrinsic goodness or value is an indefinable nonnatural or nonempirical quality or property different from all other descriptive or factual ones they even describe it as being nondescriptive or nonfactual. Meinong, Scheler, Hartmann, and Hall contend that value is intuited through the emotions even though it is objective; Sidgwick, Ross, Laird, and others, that it is an object of intellectual intuition.

Chapter 5 : Valuation (finance) - Wikipedia

Valuation definition is - the act or process of valuing; specifically: appraisal of property. How to use valuation in a sentence. the act or process of valuing; specifically: appraisal of property; the estimated or determined market value of a thing.

I see book value as generally a very secondary approach to valuation. For buying a very tiny business, you can probably just ignore it unless there are significant assets involved. Book value is a good way to test valuations of companies that have significant assets, such as inventory, receivables, equipment, or property. The book value approach to business valuation is not adequate for most small businesses. It is a good way to value companies which have significant assets. Book value might also be a good approach if a company has particularly low profits. So, in this case, the selling price of the company might be more based on the book value than the profitability. For example, maybe the selling price would be a 20 percent discount to book value, because the profits are so low. Fast and Simple Business Valuation Book Value Is Total Assets Minus Total Liabilities Book value, a multiple of book value, or a premium to book value is also a method used to value manufacturing or distribution companies. Book value is total assets minus total liabilities and is commonly known as net worth. In a book I published written by Russell Robb, Buying Your Own Business , he identified several situations where the use of book value as the primary method of valuation is prevalent: When the company is losing money on an operating basis. In such cases, there are no earnings on which to apply the multiples previously discussed. Therefore, the reconstructed or fair market value of total assets less total liabilities is used for the valuation. However, there are other ways to value unprofitable businesses, which I will discuss in a separate presentation. These relationships are tenuous because they are usually noncontractual and nontransferable. Such companies usually sell at their book value plus a modest premium. If the primary method of valuation is using a multiple of earnings, it is helpful to take the industry average of the book value multiples of other companies recently sold. Book value serves as a reference point. Some buyers will raise or lower their EBITDA multiple for valuation purposes based on the relationship to the proposed selling price; some buyers will use only multiples of 4. If book value is higher than half the selling price, some buyers will use a five to six multiple. By pegging the purchase price to a multiple of book value, the buyer is protected against a decline in the value of the business between the signing of the purchase and sale agreement and the completion date of due diligence. The Book Value Approach May Require Some Adjustments When the book value technique is used, there is an important variation that a seller will probably want the buyer to consider: Also, the inventory might be adjusted to reflect current values and to pick up items that have been written off in order to minimize taxes. The buyer must also determine whether all the assets are actually earning money for the business. If they are not, he or she should request an adjustment in the purchase price to reflect this condition. Takeaways You Can Use Book value should be seen as a secondary approach to valuation. Book value is more appropriate when there are expensive assets and low profits.

Chapter 6 : Valuation Methods - Three Main Approaches to Value a Business

Business valuation is the process of determining the economic value of a business or company. Business valuation can be used to determine the fair value of a business for a variety of reasons.

Some of the most common are: Market value â€” The price at which an asset would trade in a competitive Walrasian auction setting. Market value is usually interchangeable with open market value or fair value. Value-in-use is the value to one particular user, and may be above or below the market value of a property. Investment value â€” is the value to one particular investor, and may or may not be higher than the market value of a property. Differences between the investment value of an asset and its market value provide the motivation for buyers or sellers to enter the marketplace. Investment value â€” the value of an asset to the owner or a prospective owner for individual investment or operational objectives. The mass appraisal process applies the data collected through various sources to real property to determine taxable value [7] Insurable value â€” is the value of real property covered by an insurance policy. Generally, it does not include the site value. Liquidation value â€” may be analyzed as either a forced liquidation or an orderly liquidation and is a commonly sought standard of value in bankruptcy proceedings. It assumes a seller who is compelled to sell after an exposure period which is less than the market-normal time-frame. Price vs value[edit] There can be differences between what the property is really worth market value and what it cost to buy it price. Sometimes, special considerations may have been present, such as a special relationship between the buyer and the seller where one party had control or significant influence over the other party. In other cases, the transaction may have been just one of several properties sold or traded between two parties. In such cases, the price paid for any particular piece is not its market "value" with the idea usually being, though, that all the pieces and prices add up to the market value of all the parts but rather its market "price". At other times, a buyer may willingly pay a premium price, above the generally accepted market value, if his subjective valuation of the property its investment value for him was higher than the market value. One specific example of this is an owner of a neighboring property who, by combining his own property with the subject property, could obtain economies-of-scale. Similar situations sometimes happen in corporate finance. For example, this can occur when a merger or acquisition happens at a price which is higher than the value represented by the price of the underlying stock. The usual explanation for these types of mergers and acquisitions is that "the sum is greater than its parts", since full ownership of a company provides full control of it. This is something that purchasers will sometimes pay a high price for. This situation can happen in real estate purchases too. This is unfortunate for one of the two parties. It is the obligation of a real property appraiser to estimate the true market value of a property and not its market price. Market value definitions in the United States[edit] In the United States, appraisals are for a certain type of value e. The most commonly used definition of value is Market Value. A type of value, stated as an opinion, that presumes the transfer of a property i. Thus, the definition of value used in an appraisal or Current Market Analysis CMA analysis and report is a set of assumptions about the market in which the subject property may transact. It affects the choice of comparable data for use in the analysis. It can also affect the method used to value the property. These are usually referred to as the "three approaches to value" which are generally independent of each other: The cost approach the buyer will not pay more for a property than it would cost to build an equivalent. The income approach similar to the methods used for financial valuation, securities analysis or bond pricing. However, the recent trend of the business tends to be toward the use of a scientific methodology of appraisal which relies on the foundation of quantitative-data, [10] risk, and geographical based approaches. One or two of these approaches will usually be most applicable, with the other approach or approaches usually being less useful. The appraiser has to think about the "scope of work", the type of value, the property itself, and the quality and quantity of data available for each approach. No overarching statement can be made that one approach or another is always better than one of the other approaches. The appraiser has to think about the way that most buyers usually buy a given type of property. What appraisal method do most buyers use for the type of property being valued? For instance, appraisals of properties that are typically purchased by investors e. Buyers interested in purchasing single family residential property would rather compare price, in this case, the Sales Comparison Approach market analysis approach would be more applicable. The third and final approach to value is the Cost Approach to value. The Cost Approach to value is most useful in determining insurable value, and cost to construct a new structure or building. For example, single apartment buildings of a given quality tend to sell at a particular price per apartment. In many of those cases, the sales comparison approach may be more applicable. On the other hand, a multiple-building apartment complex would usually be valued by the income approach, as that would follow how most buyers would value it. As another example, single-family houses are most commonly valued with the greatest weighting to the sales comparison approach. However, if a single-family dwelling is in a neighborhood where all or most of the dwellings are rental units, then some variant of the income approach may be more useful. So the choice of valuation method can change depending upon the circumstances, even if the property being valued does not change much. The sales comparison approach[edit] The sales comparison approach is based primarily on the principle of substitution. This approach assumes a prudent or rational individual will pay no more for a property than it would cost to purchase a comparable substitute property. The approach recognizes that a typical buyer will compare asking prices and seek to purchase the property that meets his or her wants and needs for the lowest cost. In developing the sales comparison approach, the appraiser attempts to interpret and measure the actions of parties involved in the marketplace, including buyers, sellers, and investors. Data collection methods and valuation process Data is collected on recent sales of properties similar to the subject being valued, called "comparables". Important details of each comparable sale are described in the appraisal report. Since comparable sales are not identical to the subject property, adjustments may be made for date of sale, location, style, amenities, square footage, site size, etc. The main idea is to simulate the price that would have been paid if each comparable sale were identical to the subject property. If the comparable is superior to the subject in a factor or aspect, then a downward adjustment is needed for that factor. From the analysis of the group of adjusted sales prices of the comparable sales, the appraiser selects an indicator of value that is representative of the subject property. It is possible for various appraisers to choose a different indicator of value which ultimately will provide different property value. Steps in the sales comparison approach Research the market to obtain information pertaining to sales, and pending sales that are similar to the subject property Investigate the market data to determine whether they are factually correct and accurate Determine relevant units of comparison e. The theory is that the value of a property can be estimated by summing the land value and the depreciated value of any improvements. Reproduction refers to reproducing an exact replica; replacement cost refers to the cost of building a house or other improvement which has the same utility , but using modern design, workmanship and materials. In practice, appraisers almost always use replacement cost and then deduct a factor for any functional dis-utility associated with the age of the subject property. An exception to the general rule of using the replacement cost is for some insurance value appraisals. In those cases, reproduction of the exact asset after a destructive event like a fire is the goal. For example, the replacement cost to construct a building can be determined by adding the labor, material, and other costs. On the other hand, land values and depreciation must be derived from an analysis of comparable sales data. The cost approach is considered most reliable when used on newer structures, but the method tends to become less reliable for older properties. The cost approach is often the only reliable approach when dealing with special use properties e. The income approach[edit] Main article: Income approach The income capitalization Approach often referred to simply as the "income approach" is used to value commercial and investment properties. Because it is intended to directly reflect or model the expectations and behaviors of typical market participants, this approach is generally considered the most applicable valuation technique for income-producing properties, where sufficient market data exists. In a commercial income-producing property this approach capitalizes an income stream into a value indication. Usually, an NOI has been stabilized so as not to place too much weight on a very recent event. An example of this is an unleased building which, technically, has no NOI. A stabilized NOI would assume that the building is leased at a normal rate, and to usual occupancy levels. Alternatively, multiple years of net operating income can be valued by a discounted cash flow analysis DCF model. The DCF model is widely used to value larger and more expensive income-producing properties, such as large office towers or major shopping centres. This technique applies market-supported yields or discount rates to projected future cash flows such as annual income figures and typically a lump reversion from the eventual sale of the property to arrive at a present value indication. When homes are purchased for personal use the buyer can validate the asking price by using the income approach in the opposite direction. An expected rate of return can be estimated by comparing net expected costs to the asking price. Used for most types of property where there is good evidence of previous sales. This is analogous to the sales comparison approach outlined above. Used for most commercial and residential property that is producing future cash flows through the letting of the property. If the current estimated rental value ERV and the passing income are known, as well as the market-determined equivalent yield, then the property value can be determined by means of a simple model. Note that this method is really a comparison method, since the main variables are determined in the market. Used for properties ripe for development or redevelopment or for bare land only. Used for trading properties where evidence of rates is slight, such as hotels, restaurants and old-age homes. A three-year average of operating income derived from the profit and loss or income statement is capitalized using an appropriate yield. Note that since the variables used are inherent to the property and are not market-derived, therefore unless appropriate adjustments are made, the resulting value will be value-in-use or investment value, not market value. Used for land and buildings of special character for which profit figures cannot be obtained or land and buildings for which there is no market because of their public service or heritage characteristics. Both the residual method and the cost method would be grouped in the United States under the cost approach see above. Market value see PS 3. In formulating the scope of work for a credible appraisal, the concept of a limited versus complete appraisal and the use of the Departure Rule caused confusion to clients, appraisers, and appraisal reviewers. In this, appraisers were to identify six key parts of the appraisal problem at the beginning of each assignment: Client and other intended users Intended use of the appraisal and appraisal report Definition of value e. Currently, minimum standards for scope of work are: By defining the scope of work, an appraiser can properly develop a value for a given property for the intended user, and for the intended use of the appraisal.

Chapter 7 : Real estate appraisal - Wikipedia

The book value approach to business valuation is not adequate for most small businesses. It is a good way to value companies which have significant assets. Book value might also be a good approach if a company has particularly low profits.

Two types of valuations are required, one for each of the sectors: Cyclical companies that rise and fall with overall economic conditions. Commodity companies that produce inputs to other, more complex products or have value as investments on their own gold and diamonds, for example. The valuations of both types of companies are affected by several common characteristics: Effects of the economic and commodity price cycles. Finite resources, meaning the availability of physical assets, and a condition that affects perpetual growth and terminal values. In addition, operating income will change at a greater rate than the economic variables commodity companies or the state of the economy cyclicals. Commodity companies, for example, have high fixed costs because they need to keep mines and agricultural fields open even during low points of the price cycle since it would be too expensive to shut down and then restart operations. For intrinsic valuations, this means greater volatility in earnings, which will then affect both equity and debt values, and leads to changes in the cost of capital. Damodaran argued the same dynamic holds for relative valuations as multiples of earnings will swing from one extreme to another. Growth rates are also subject to big changes over the course of a cycle. This points to the need for averaging and, according to Damodaran, there are three standard procedures for "normalizing" earnings and cash flows: Absolute averages over time: The most common technique, and should include enough years to cover a typical economic cycle five to 10 years. Relative averages over time: This involves using a scaled version of a variable over time; for example, average the profit margin over time, rather than actual profits. Dealing with a company with a limited or unreliable history? To illustrate, Damodaran did a valuation of Toyota TM in early ; at the time, it had the reputation of being the best-run automaker, but was still susceptible to global economic forces. In the last quarter of it reported a loss, and later would report a loss for its fiscal year April to March To get a normalized operating income, he applied the average pretax operating margin of 7. Getting to a valuation of the equity involved several steps: Assuming Toyota has a stable growth rate of 1. Add the value of cash: Using those assumptions and data, total equity would have been 16, billion yen. Dividing it by 3. Turning to commodities, such as oil or gold, Damodaran said there are two ways of establishing normalized prices: The average price of the commodity over time, adjusted for inflation. Determining a fair price for the commodity, given its demand and supply. With normalized prices, an analyst can estimate what revenues, earnings and cash flows would have been. As Damodaran noted, though, a normalized price does inject personal and corporate assumptions into the analysis. On the other hand, an analyst might use market-based prices, based on forward and futures markets; this approach also allows for hedging. To do this, an investor would buy shares of an oil company and also sell oil price futures for protection. The author wrote the two basic approaches used for the discounted flow intrinsic approach also work in relative valuations. Those two approaches were using normalized earnings or adapting the growth rate. For example, in comparing Petrobras PBR and Exxon Mobil XOM , he argued the two companies should trade at different multiples, even though they are similarly affected by the price of oil, because the earnings of Petrobras are riskier. At the same time, Petrobras would have higher growth potential. Further, the multiples of cyclical and commodity companies will change as they move through cycles. At the peak, multiples will bottom out. At the bottom of the cycle, the multiples will top out. Some investors become uncomfortable when valuation does not consider the interrelationship between a commodity price and the investment and financing actions of commodity companies. For example, some oil companies can produce more oil when prices are high, allowing them to return more cash to shareholders. Thus, these companies have "options" which can be exercised according to the price of oil. Summing up, in chapter 10 of "The Little Book of Valuation: How to Value a Company, Pick a Stock and Profit," Damodaran provided systematic and objective ways to assess companies affected by economic and commodity cycles. Story Continues The author: Damodaran is the author of three books on valuation and is a professor of finance and the David Margolis teaching fellow at the Stern School of Business at New York University. There he teaches corporate finance and equity valuation courses in the MBA program. His research interests lie in valuation, portfolio management and applied corporate finance. This article is one in a series of chapter-by-chapter reviews. To read more, and reviews of other important investing books, go to this page. I do not own shares in any company listed, and do not expect to buy any in the next 72 hours.

Chapter 8 : Valuation Definition | Investopedia

responsible for using reasonable care to enter, classify and determine the value of Customs Valuation Encyclopedia (5) to assist the trade community. We.

Valuation overview[edit] Valuation of financial assets is done generally using one or more of the following approaches [2] ; but see also, generally, Outline of finance Valuation: These kinds of models take two general forms: These models rely on mathematics rather than price observation. See Discounted cash flow valuation. Option pricing models , in this context, are used to value specific balance-sheet items, or the asset itself, when these have option-like characteristics. Examples of the first type are warrants , employee stock options , and investments with embedded options such as callable bonds ; the second type are usually real options. The most common option pricing models employed here are the Blackâ€"Scholes - Merton models and lattice models. This approach is sometimes referred to as contingent claim valuation , in that the value will be contingent on some other asset; see Contingent claim valuation. Common terms for the value of an asset or liability are market value , fair value , and intrinsic value. The meanings of these terms differ. The International Valuation Standards include definitions for common bases of value and generally accepted practice procedures for valuing assets of all types. Usage[edit] In finance, valuation analysis is required for many reasons including tax assessment, wills and estates , divorce settlements , business analysis, and basic bookkeeping and accounting. Since the value of things fluctuates over time, valuations are as of a specific date like the end of the accounting quarter or year. They may alternatively be mark-to-market estimates of the current value of assets or liabilities as of this minute or this day for the purposes of managing portfolios and associated financial risk for example, within large financial firms including investment banks and stockbrokers. Some balance sheet items are much easier to value than others. Publicly traded stocks and bonds have prices that are quoted frequently and readily available. Other assets are harder to value. For instance, private firms that have no frequently quoted price. Additionally, financial instruments that have prices that are partly dependent on theoretical models of one kind or another are difficult to value. For example, options are generally valued using the Blackâ€"Scholes model while the liabilities of life assurance firms are valued using the theory of present value. Intangible business assets, like goodwill and intellectual property , are open to a wide range of value interpretations. It is possible and conventional for financial professionals to make their own estimates of the valuations of assets or liabilities that they are interested in. Their calculations are of various kinds including analyses of companies that focus on price-to-book, price-to-earnings, price-to-cash-flow and present value calculations, and analyses of bonds that focus on credit ratings, assessments of default risk , risk premia , and levels of real interest rates. All of these approaches may be thought of as creating estimates of value that compete for credibility with the prevailing share or bond prices, where applicable, and may or may not result in buying or selling by market participants. Where the valuation is for the purpose of a merger or acquisition the respective businesses make available further detailed financial information, usually on the completion of a non-disclosure agreement. It is important to note that valuation requires judgment and assumptions: There are different circumstances and purposes to value an asset e. Such differences can lead to different valuation methods or different interpretations of the method results All valuation models and methods have limitations e. Then they can weigh the degree of reliability of the result and make their decision. Business valuation[edit] Businesses or fractional interests in businesses may be valued for various purposes such as mergers and acquisitions , sale of securities , and taxable events. Alternatively, private firms do not have government oversightâ€"unless operating in a regulated industryâ€"and are usually not required to have their financial statements audited. Moreover, managers of private firms often prepare their financial statements to minimize profits and, therefore, taxes. Alternatively, managers of public firms tend to want higher profits to increase their stock price. Financial statements prepared in accordance with generally accepted accounting principles GAAP show many assets based on their historic costs rather than at their current market values. But under GAAP requirements, a firm must show the fair values which usually approximates market value of some types of assets such as financial instruments that are held for sale rather than at their original cost. When a firm is required to show some of its assets at fair value, some call this process " mark-to-market ". But reporting asset values on financial statements at fair values gives managers ample opportunity to slant asset values upward to artificially increase profits and their stock prices. Managers may be motivated to alter earnings upward so they can earn bonuses. There are commonly three pillars to valuing business entities: Discounted cash flow method[edit] Main article: Valuation using discounted cash flows This method estimates the value of an asset based on its expected future cash flows, which are discounted to the present i. This concept of discounting future money is commonly known as the time value of money. The size of the discount is based on an opportunity cost of capital and it is expressed as a percentage or discount rate. In finance theory, the amount of the opportunity cost is based on a relation between the risk and return of some sort of investment. Classic economic theory maintains that people are rational and averse to risk. They, therefore, need an incentive to accept risk. The incentive in finance comes in the form of higher expected returns after buying a risky asset. In other words, the more risky the investment, the more return investors want from that investment. If given a choice between the two bonds, virtually all investors would buy the government bond rather than the small-firm bond because the first is less risky while paying the same interest rate as the riskier second bond. In this case, an investor has no incentive to buy the riskier second bond. Otherwise, no investor is likely to buy that bond and, therefore, the firm will be unable to raise capital. For a valuation using the discounted cash flow method, one first estimates the future cash flows from the investment and then estimates a reasonable discount rate after considering the riskiness of those cash flows and interest rates in the capital markets. Next, one makes a calculation to compute the present value of the future cash flows. Guideline companies method[edit] Main article: Comparable company analysis This method determines the value of a firm by observing the prices of similar companies called "guideline companies" that sold in the market. Those sales could be shares of stock or sales of entire firms. The observed prices serve as valuation benchmarks. From the prices, one calculates price multiples such as the price-to-earnings or price-to-book ratiosâ€"one or more of which used to value the firm. Many price multiples can be calculated. Net asset value method[edit] The third-most common method of estimating the value of a company looks to the assets and liabilities of the business. At a minimum, a solvent company could shut down operations, sell off the assets, and pay the creditors. Any cash that would remain establishes a floor value for the company. This method is known as the net asset value or cost method. In general the discounted cash flows of a well-performing company exceed this floor value. Some companies, however, are worth more "dead than alive", like weakly performing companies that own many tangible assets. This method can also be used to value heterogeneous portfolios of investments, as well as nonprofits , for which discounted cash flow analysis is not relevant. The valuation premise normally used is that of an orderly liquidation of the assets, although some valuation scenarios e. An alternative approach to the net asset value method is the excess earnings method. This method was first described in ARM34,[further explanation needed] and later refined by the U. The excess earnings method has the appraiser identify the value of tangible assets, estimate an appropriate return on those tangible assets, and subtract that return from the total return for the business, leaving the "excess" return, which is presumed to come from the intangible assets. An appropriate capitalization rate is applied to the excess return, resulting in the value of those intangible assets. That value is added to the value of the tangible assets and any non-operating assets, and the total is the value estimate for the business as a whole. In the below cases, depending on context, Real options valuation techniques are also sometimes employed, if not preferred; for further discussion here see Business valuation Option pricing approaches , Corporate finance Valuing flexibility. Valuation of a suffering company[edit] Additional adjustments to a valuation approach, whether it is market-, income-, or asset-based, may be necessary in some instances like: Excess or restricted cash Other non-operating assets and liabilities Lack of marketability discount of shares Control premium or lack of control discount Above- or below-market leases Excess salaries in the case of private companies There are other adjustments to the financial statements that have to be made when valuing a distressed company. Andrew Miller identifies typical adjustments used to recast the financial statements that include:

Chapter 9 : Introduction to â€œLevels of Valueâ€• in Business Valuation | Chris Mercer

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Total Estimated Value: $, = ($, Estimated Business Value) - ($30, Liabilities) Subway's business-specific multiplier well exceeds the industry average multiplier of The industry is trending toward franchises, and since Subway is a franchise the transition to a new owner is less risky.