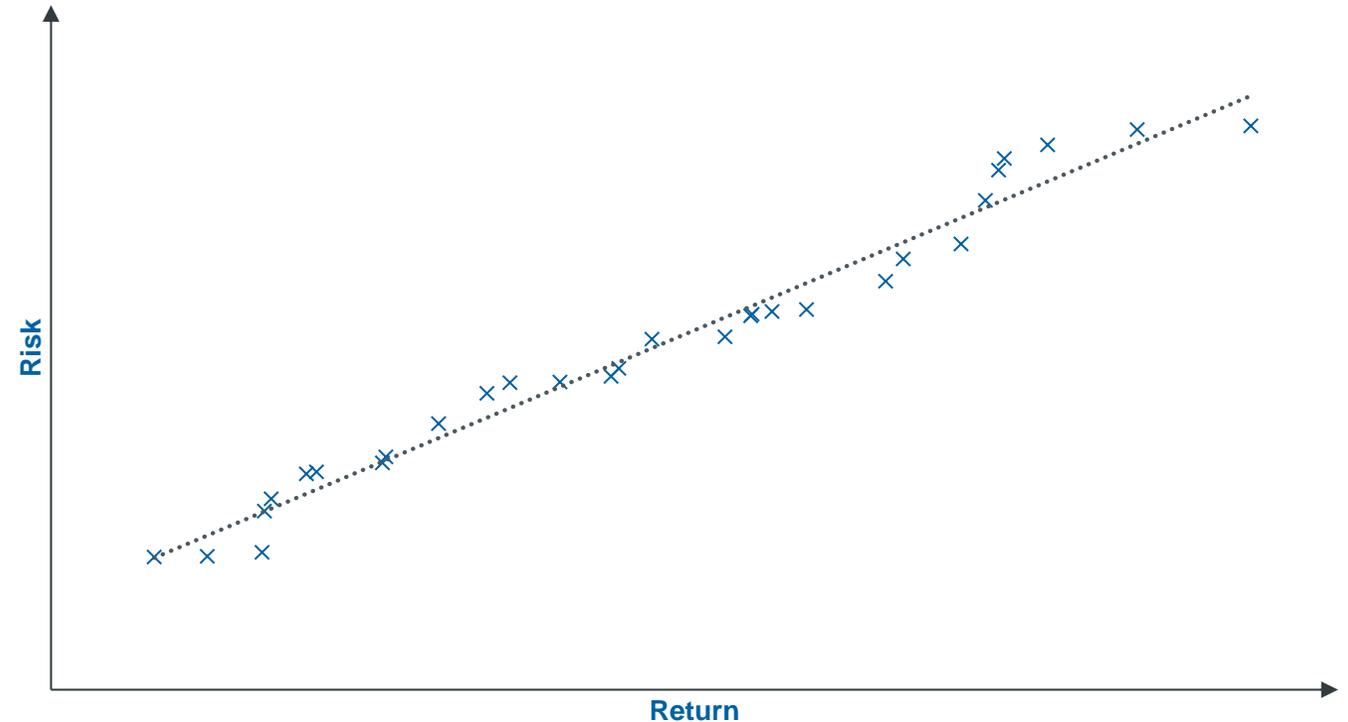




The Black Arts of Valuation White Paper – November 2019

The basics

- At the heart of a valuation is matching risk with reward and gauging the prices paid for similar assets with a similar risk profile;
- We do this using quoted company share prices, or debt pricing, and transactions in the market where a company is bought outright;
- “Copper bottomed” assets to the left;
- More uncertainty in the assets as you move to the right, and the greater the likelihood of material movement in the future.



The basics



- Typically, there are two approaches for established businesses: an earnings-based multiple and a discounted cash flow;
- Adjust EBITDA for any “non business” costs or exceptional items;
- For new ventures, NAV or new money multiples just as BVCA guidelines would suggest.
- Profoundly simple, but the devil is in the detail.

<i>Multiple-based</i>		<i>Discounted cashflows</i>	
EBITDA	£10m	Cashflows	...
Multiple	<u>8x</u>	Discount rate	<u>10%</u>
Enterprise Value	£80m	Enterprise Value	£80m

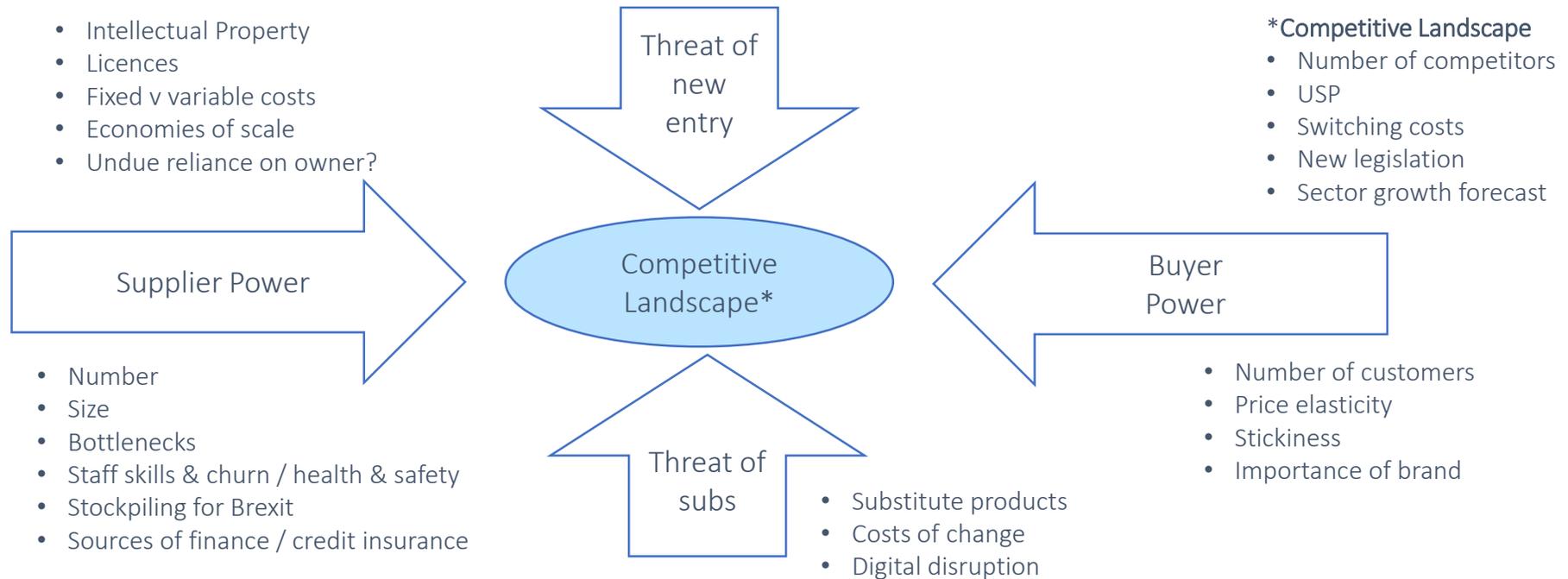
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Enterprise Value	£80m
Less: Debt	<u>£(30)m</u>
Equity Value	£50m

Here comes the detail !



The number of valuations where the valuer does not understand the business might surprise you !!!



The basics



Has your multiple considered all of the following?

- Have I really understood the five year historic track record, adjusting for non business items, FX impacts, acquisitions/disposals, exceptional items.....Has the business adequately invested in fixed assets, R&D or marketing over the last five years
- Do I understand how the forecasts have been produced – normal course of business or just for me? Historical accuracy?? Pipeline analysis;
- How does the P&L convert to cash;
- What are the real working capital requirements;
- Who will really buy this – how compelling will the Information Memorandum be;
- Have I found all the relevant quoted companies & transactions – are they using same GAAP and policies;
- Have I adjusted for differences in growth, margin & size.

Do you understand net debt?

- Is the year end position really net debt ?
- Allowance for tax liabilities
- IFRS 16 considerations

The complexity of both parties as shareholders

- Passive shareholders with no interest in the business – makes very little difference, beyond understanding if management providing you with information may have certain biases.
- Shareholders typically more informed about the business and hence may wish to make formal representations to the valuer. Makes for a more drawn out and costly exercise more akin to an expert valuation for disputes.
- Where it gets complex is both meaningfully employed by the business.– The inability to work together could easily be value destructive – (i) harder to do their own role properly (ii) “a poisoned atmosphere at work” leaks staff (iii) what is the end game – how do forecasts need to change.
- Forces a much harder review on the function, skills and appropriate salary for the parties – what value do they really contribute?
- Dynamics in the shareholder group – W owned 40%, H owned 20%, Others 40%. Prior to divorce the H&W team controlled the business, but if no longer acting together this no longer holds. Indeed other third party stakeholders start to have a more controlling position, especially around liquidity.

Date of Separation or Date of Divorce ?

- Typically I am instructed to provide a current valuation – which is two thirds (?) of the way between the two, but moving to date of divorce.
- I'm not a lawyer, but in the UK Rossi v Rossi [2006] with Mostyn says value at the trial date.
- Why will the asset have moved **substantially** in value??
 1. Active management v passive
 2. Fundamental change in circumstance – patent granted / FDA approval / loss of key customer
 3. Business sold to a special purchaser for significant premium
 4. Major stock market crash / global business event
- Interesting questions
 1. To what extent was the original valuation correct in its risk assessment?
 2. To what extent was the value creation or destruction in the hands of the shareholder?



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Background

- Steve is the founding partner of St James Valuation – a specialist independent valuation boutique focused on family law, commercial, private client and forensic engagements.
- Previously he was a senior valuation partner at EY London, where he was the Head of the UK team and the EMEIA region.
- Steve has 25 years of valuation experience including two years within the M&A department of Hill Samuel Bank on a broad range of transactions and corporate finance activity.
- He has a physics degree from Imperial College, is an FCA, is a Member of the Expert Witness Institute, previously sat on the Special Interests Group for Valuations at the Institute of Chartered Accountants of England and Wales and lectures on valuations at Kings College, London as part of the Business Management Degree.
- Steve was made an honouree Member of the Royal Institute of Chartered Surveyors.

Family, Litigation and Dispute

- Acting as SJE on the valuation of a UK specialist distribution business;
- Acting as SJE on the valuation of a UK manufacturing business;
- Gave evidence in the High Court of Justice on the valuation of a UK technology company as shadow expert for the purposes of divorce and ‘hot tubbed’;
- Provided ad hoc shadow expert in the travel sector for the purposes of divorce;
- Provided ad hoc shadow advice in the divorce of a celebrity chef including dealing with complex off shore tax structuring;
- Acted for a high profile sportsman/business man in valuing his business and agreeing a joint expert opinion for divorce;
- Acted as expert witness on the divorce of a hedge fund manager;
- Acted for a Akin Gump on balance sheet solvency and asset valuation under IA 1986 in litigation attaching to the Comet administration;
- Currently under appointment by the President of the ICAEW to settle a dispute between two parties on completion accounts adjustments;
- Gave evidence in the High Court of Justice on a valuation of a private bank (Rowland v Wright) for the purposes of commercial litigation;
- Appointed by the President of the ICAEW in a shareholder dispute in the creative media sector;
- Deposed in New York acting for a syndicate of UK banks advised by Allen & Overy on the valuation of a minority stake in a German bank;
- Acted for Blackstone as an independent expert valuer to support them in the Luxemburg Courts on the enforcement of certain debt securities equivalent to a pre pack over a property investment company;
- Acted for an individual advised by Mishcon de Reya in a wrongful dismissal case valuing her share options in an early stage start up;
- Acted for a corporate in the London Court of International Arbitration valuing a business both before and after an alleged breach of fiduciary duties of a director;
- Acted as the binding expert under a shareholder agreement between British Gas and EDF.
- Provided expert valuation evidence on the valuation of Birmingham City Football Club to the Hong Kong Courts to facilitate a quasi prepack and sale of the business to a new owner;
- Acted for a corporate advised by Avocats a la Cour providing written expert opinion for the Luxemburg Courts on the reasonableness of a third party’s.