SN Valuation

SN Capital SN Consulting SN English

Sung Nam

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Valuation Method

How much would you pay for a company that has $1 Billion in tangible assets, $200 Million in debt, and the company discontinues operation, with no more cash flow in the future? I would assume your value to be somewhere near the net tangible asset, which is $800 Million.

Disregarding cost of capital and etc, how much would you pay for the same company 5 years later, with no change in the capital structure? Somewhere near net tangible asset at $800 Million right? Maybe lower if you want to take into consideration opportunity cost.

Let's assume the same company generates EBITDA of $100 dollars/year. Most investment banks use comps and get an average multiple such as P/EBITDA, or EV/EBITDA and plug the average EBITDA and multiply it with the EBITDA. So if the comp universe's average EV/EBITDA multiple was 15x, then is the EV for the company only $1,500 or 15 x $100? The same company that has net asset of $800 Million?

Likewise, a typical valuation uses Terminal Value, which assumes the Co. grows their earnings perpetually. This TV figure constitutes more than 50% of the final intrinsic value. First of all, we don't know how long earnings will be positive. Second, most business industries die off in 20-30 years. Third, TV is based off distant future assumptions, when we don't even know what is going to happen next year. In other words, more than 50% of the value is derived by earnings which may never materialize.

My valuation methodology is primarily focused on the net tangible asset value because this is what I can retain as my property, after paying off the debtors, **now**. Not in the distant future, not assuming stuff I pull out of my butt. **Now. Certified present value.**

Even if I don't generate another dollar from my assets, if I can buy the Co. for less than the net book value, I would have made a profitable investment. However, I realize no company sells at less than tangible book and if it does, there probably is a going concern. So, I look for companies that have a strong net tangible book value (i.e. 50% net tangible book to price) and generates consistent, strong cash flow from operations. I assume a 5 year hold, which is the typical holding period for a PE firm.

I model the growth in the net tangible book value, which is essentially the growth in PP&E from capex investments minus depreciation plus the growth in cash balance. This is the justifiable disposition, or sale price, of my acquired company in Year 5. The new buyer will be able to look at the tangible book value in Year 5 and feel comfortable buying it too. I would like to collect a little premium, so I charge 3 years of Free Cash Flow on top of the Year 5 net tangible book value. Essentially, I am assuming the Co. will be able to generate positive, consistent cash flow for 8 years, based off historic cash flow averages.

So we have our $800 MM net tangible book today, let's assume $100 MM in FCF every year. Then, I may sell it for $1.6BB come Year 5. This is my valuation methodology. **There are tons of other ways of going about this, but I feel comfortable with my investments if it is backed by either assets or cash flow.**