

Ralf Hafner

# Corporate Valuation





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## Preface

I wrote this book for my students at HTW Berlin, where I teach valuation in our master's degree program in international business (MIB)<sup>1</sup>. There are excellent books available on valuation. Most of them are quite comprehensive and come with a lot of pages (400, even 800 plus). My personal experience is that students tend to be somewhat reluctant to make use of these textbooks on top of some hundred pages of lecture notes. I wanted to write something more “handy” to address this. Consequently, this book is far away from being a compendium on valuation<sup>2</sup>. It is what I cover in my class<sup>3</sup> and it should go along with my lecture notes<sup>4</sup> and the work assignments for the students.

Since the background of an author usually influences her or his view on and the way she or he teaches valuation, here is mine so that you know where I come from. I had my first encounters with valuation in my last semesters as a student. In 1985, I became a research assistant of Prof. Dr. Günter Sieben at the University of Cologne in Germany. He certainly belongs to the pioneers and innovators of this discipline in Germany and made significant contributions to the so-called functional valuation theory.<sup>5</sup> So my first interest in valuation was academic and consequently I wrote my PhD thesis on a topic in the field of corporate valuation.<sup>6</sup>

Luckily, I also had the opportunity to assist my former teacher in his valuation practice. The first valuation “in real life” I worked on (still as a young research assistant) was for one of the two parties in a divorce, where the value of the company formed the basis for the equal distribution of the surplus earned during the marriage. I learned that valuation practice has its own set of rules<sup>7</sup> and that valu-

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<sup>1</sup> To be precise, the name of the class as per our curriculum is “Contemporary Financial and Accounting Issues“, but what I teach is corporate valuation.

<sup>2</sup> This book is based on my German publication “Unternehmensbewertung” in Schmeisser/Eckstein/Hafner/Hannemann/Stengel, Wertorientiertes Finanzmanagement, 2015, 81–158. I gratefully acknowledge the permission of my publisher, UVK Verlagsgesellschaft, to reuse the contents in English language. Apologies to my readers in advance for any lexis, grammar and other inaccuracies – I’m not a native English speaker.

<sup>3</sup> Prerequisite for the class is good knowledge of the basic principles of corporate finance.

<sup>4</sup> In case you would like to receive the lecture notes, please send me an E-mail ([ralf.hafner@htw-berlin.de](mailto:ralf.hafner@htw-berlin.de)) or download them from my publisher’s website here: **uvk-lucius.de/corporate-valuation**. I’m happy to share, but have not found the time yet to set up an own website where they can be downloaded.

<sup>5</sup> The main message of the functional valuation theory is that the value of a company is determined by the purpose of the valuation. We will look at this in more detail in chapter 8.

<sup>6</sup> It was an attempt to apply the toolset developed by Keeney and Raiffa for decisions with multiple objectives to corporate valuation theory.

<sup>7</sup> I still remember the hockey stick projection the adviser of the counterparty made for this mature old-fashioned business without any input from the company’s management.

ations outside the academic world usually serve as a tool to realize the interests of the parties involved in a transaction.<sup>8</sup>

After my time as a research assistant and the finalization of my PhD thesis I worked for over 20 years as a M&A (Mergers & Acquisitions) adviser before I returned to the University in 2012. These years certainly had the biggest impact on my view of what valuations are about and what they are not about. M&A advisers usually don't focus on true values or fair values.<sup>9</sup> If life is not fair, why should valuations be? The focus is on a realistic estimate of a price that will be achievable in a transaction, given the status and the projections of the company for sale, the likely interest in the company as well as the expected distribution of the negotiation power. Valuations are used to get the negotiations or bidding processes started. Therefore, a valuation to me is a medium of communication between the buyer and the seller, like a language. And that is what this book (and my valuation class at HTW) is about, to make you acquainted with this language.

I would like to thank my faculty and the management of HTW Berlin for granting me a research semester in the winter term 2016/17. This made it much easier for me to finalize this book. And many thanks to Ambar, Farel, Frida and Felix, my wonderful family, who had to bear the social costs of this project.

Berlin, April 2017

Ralf Hafner

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<sup>8</sup> To be fair, this applied to both valuations in the case described, i.e. ours as well.

<sup>9</sup> Although these terms are often used by investment bankers and corporate finance advisers, what they do (should do) is to determine a potential range for the purchase price.



## How to Use this Book

People don't learn how to play football (soccer) by sitting in front of a TV watching FIFA World Cup games of their favorite team with their friends. They need to go out with them, take a ball along and play!

The same applies to valuation. Please don't just read books, listen to lectures or watch others performing valuations. Pick a company and value it!

## What I ask my students to do

- Team up in groups of 3 to 6 students.
- Choose an industry (e.g. apparel, social media, beer, pharma, etc.). Avoid banks and insurances if you do this for the first time in your life.
- Each group member picks a company within this industry. The company should be quoted on a stock exchange. This ensures the availability of sufficient data for the valuation. Make sure you like your company – you will spend an entire semester to analyze and value it.
- Develop the balance sheets shown in chapter 2.1 for your company.
- Perform a company analysis using the structure introduced in chapter 2.2.1. Be brief, work with bullet points, tables and charts. Use a Bloomberg terminal to collect the necessary data. If possible, do field research (if your industry is e.g. apparel, luxury or sporting goods, go downtown and visit the shops, touch the products, compare them – you will learn at least as much as from desk research).
- Perform a DCF valuation for your company as described in chapters 2.2.2 till 2.2.5. Determine a range for the enterprise value.
- Perform a Comparable Companies Analysis as described in chapter 3, and a Precedent Transactions Analysis as described in chapter 4. Focus on EBITDA and sales multiples.
- Determine a range for the equity value of your company using the information given in chapter 6.
- I strongly recommend meeting regularly with your team – you will benefit from the ideas of your group members. And it will be much more fun, too.

## Textbooks on valuation

The following list of four books is my personal selection. All four are excellent and very comprehensive.

- Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset*, 3<sup>rd</sup> edition, 2012
- Holthausen/Zmijewski, *Corporate Valuation: Theory, Evidence & Practice*, 1<sup>st</sup> edition, 2014
- Koller/Goedhart/Wessels, *Valuation: Measuring and Managing the Value of Companies*, 6<sup>th</sup> edition, 2015
- Rosenbaum/Pearl, *Investment Banking, Valuation, Leveraged Buyouts, and Mergers & Acquisitions*, 2<sup>nd</sup> edition, 2013. The valuation templates that come with the book will give you a good flavor as to what is standard in valuation practice.

## Web

- [www.damodaran.com](http://www.damodaran.com). Everything you need to know on corporate finance and valuation. Contains lots of data, spreadsheets, webcasts. Best website of a professor I know.
  - <http://macabacus.com/learn>. A good place to visit if you're looking for Excel templates on valuation.
  - <https://www.bloomberg.com/markets/stocks>  
<http://www.morningstar.com>  
<https://www.google.com/finance>  
<https://finance.yahoo.com>  
<https://www.moodys.com>  
[https://www.standardandpoors.com/en\\_US/web/guest/home](https://www.standardandpoors.com/en_US/web/guest/home)  
<https://fred.stlouisfed.org>  
<https://www.destatis.de/Europa/EN/Homepage.html>
- A selection of websites I visit when I'm away from our Bloomberg lab at HTW.

# Contents

Preface .....	5
How to Use this Book .....	7
<b>1 Introduction .....</b>	<b>11</b>
<b>2 Discounted Cash Flow Valuation (DCF Valuation) .....</b>	<b>15</b>
2.1 DCF Valuation Models .....	17
2.2 Enterprise DCF Valuation .....	21
2.2.1 Company Analysis .....	23
2.2.2 Projection of Future Free Cash Flows .....	27
2.2.3 Estimation of Weighted Average Cost of Capital (WACC) .....	32
2.2.4 Calculation of Terminal Value .....	40
2.2.5 Computation of Present Values, Derivation of a Range of Enterprise Values, Sensitivity, Scenario and/or Simulation Analysis .....	44
<b>3 Comparable Companies Analysis .....</b>	<b>47</b>
3.1 Standard Multiples .....	49
3.2 Finding Comparable Companies .....	55
3.3 Preparation of Figures .....	56
3.4 Derivation of a Value Range .....	57
<b>4 Precedent Transactions Analysis .....</b>	<b>59</b>
<b>5 Further Valuation Methods .....</b>	<b>65</b>
5.1 LBO Valuation .....	65
5.2 Option-Based Valuation .....	69
5.3 Asset-Based Valuation .....	71
5.4 APV Valuation .....	72
5.5 Equity DCF Valuation .....	75
<b>6 From Enterprise Value to Equity Value .....</b>	<b>79</b>
6.1 Cash and Cash Equivalents .....	79
6.2 Holdings in Other Companies, Non-Controlling Interests and Other Assets Valued Separately .....	82

## 10 Contents

6.3	Pension Obligations, Accrued Liabilities and Provisions.....	85
6.4	Off-Balance-Sheet Financing.....	88
6.5	Stock Options, Option Bonds and Convertible Bonds.....	90
7	<b>The Area of Tension between Principals, Evaluators, Objectives and Leeway in Corporate Valuations .....</b>	<b>95</b>
7.1	Principals and their Objectives .....	96
7.2	Evaluators and their Objectives.....	98
7.3	Leeway in Valuations.....	100
7.3.1	Leeway in DCF Valuations.....	100
7.3.2	Leeway in Multiple-Based Valuations .....	104
8	<b>Value and Price – a Tangent on Valuation Theory.....</b>	<b>107</b>
8.1	Prices and Values of Companies .....	107
8.2	Intrinsic (Objective, Objectified, Fundamental) and Subjective Company Values .....	109
8.3	Functional Valuation Theory .....	110
	<b>Self-Test Questions – Proposal for Solutions.....</b>	<b>119</b>
	<b>Index .....</b>	<b>123</b>

# 1 Introduction

## Learning Objectives

- Get an overview on the different occasions for corporate valuations.
- Understand valuation as a complex, interdisciplinary, and comprehensive exercise that requires the application of the entire spectrum of management theory and practice.

Corporate Valuation is one of the most relevant subjects for management practice in business administration education. There are numerous occasions for the valuation of enterprises.

## Acquisition and Disposal of Companies (Mergers & Acquisitions; M&A)

In every M&A process, valuation plays a vital role. A potential seller should always investigate

- the price range that can realistically be expected from purchase price offers,
- how to back the own asking price with a valuation,
- and, most importantly, what the minimum proceeds from the sale must be so that the seller does not end up in a worse position compared to omitting the sale and keeping the company.

Conversely, potential buyers will value a target company before submitting a bid. They will analyze

- how to back their offer price with a valuation,
- how to justify an acquisition with a valuation towards shareholders and supervisory boards,
- how much other bidders would be willing to put on the table for the target company,
- and, most importantly, what the maximum price is that they could pay so that they do not end up in a worse position compared to not realizing the acquisition and following alternative projects instead.

The same applies to mergers, MBOs (management buyouts), MBIs (management buy-ins), transactions between shareholders, IPOs (initial public offerings) and other partial sales of enterprises.