Enterprise Valuation Methods

Any valuation of the enterprise (organization) is an individual and a very complex process that is running by the team of experts from various professions (builder, engineer, economist, marketing specialist, auditor, etc. - according to the nature of the valuation). The aim of the enterprise valuation is to determine its market value (not its market price) in regards to many different factors effecting the present but also future economic situation of the enterprise. However, the market value of the evaluation can’t be precisely determined. The result prescribed by a specified method makes economic image of the enterprise and it is necessary to work with it further (evaluate, compare with other cases of valuation).

The method, extent and valuation method chosen depends on the purpose (reason) of this valuation. Reasons for enterprise valuation can be:

- Deposit of the enterprise to newly established company
- Sale and purchase of the enterprise
- Putting the company in financial market (e.g. stock exchange)
- Conversion, fusion, merger of the companies
- Decision on the remediation or liquidation
- Inheritance or another reason for the property settlement of the shareholders
- Entry of the foreign capital
- Lien
- Another reason

The valuation methods are in accordance with TEGoVA (The European Group of Valuers’ Associations) and international valuation standard EVS (European Valuation Standards).

- **Substantive Value Determination Method** - is based on the principle of compensation. Substantive value of the enterprise expresses how much would need to be invested to the same assets to be acquired. It is the basis for decision making process of the investor, whether it is better to buy an existing enterprise or build a new one. This valuation method involves the gradual current market valuations of individual items of assets, in adding their values and deducting all liabilities items. **Application**: detection of equity

- **Yield Methods** - are based on the concept of “time value of money and the relative risk of the investment.” An investor (buyer) actually buys a future income, or future cash flow. The basis for the future income flow can be either current use of business assets or consideration of its possible best and most profitable use.
  - **Capitalization of Profit Method** - the market value of assets (V) is equal to its stabilized and consistently achievable annual net income (Z), divided by the appropriate capitalization rate (r) in percent.
    \[ V = \frac{Z}{r} \times 100 \]

- **Discounted Cash Flow Method** (DCF) or Discounted Free Cash Flow (DFCF) - an alternative of yield methods where the profit is replaced by financial flows

- **Comparison of Market Value Method** (exercise price) - expanded in well-functioning market economies. Comparable companies are those that operate in the same sector, industry or field of the same or similar size. The method can be applied at three levels:
  - Comparison with similar companies whose value is known
  - Comparison with similar companies that were the subject of transactions and their exercise price
  - Comparison with similar companies, according to the data of companies referred on the exchange

- **Combined Method** - a method that takes into account both the property substance (amount of produced stabilized profit), and market behavior of the company in all activities affecting the resultant effect of business - profit.

The history of international organizations dealing with standards for enterprise valuation:
History of assets valuation dates back to thirties of last century. Gradually during the 60s and 70s years were developed valuation standards in individual states. At the end of the 70s but due to high rate of globalization of investment markets was necessary to harmonize these standards. Therefore, on the basis of cooperation of appraisers from UK and USA, was established in 1981 the International Valuation Standards Council (IVSC) uniting professional valuation associations around the world. Another member involved in creating standards is a European association TEGoVA.