CORPORATE VALUE PARTNERS
NEWS
CORPORATE FINANCE INSIGHTS

Summer 2019

Valuation Principles

In corporate finance we have principles that form the foundation of all our analyses for business valuations. The core of our principles took shape in the late 1950's / early 1960's with the work of Franco Modigliani and Merton Miller. Their theories are still being used today.

A common mistake in many business valuations is to get caught-up in details and lose sight of important principles. It's not by plan, it just happens. Analysts will dive deeper and deeper into trying to solve a problem, and forget about the basic principle that applies. When analysts can pull back and look at the problem with fresh eyes, they will often find the answer they were struggling over.

Here are a few of the more important principles that we rely on:

Cash flow not profits – Profits are only part of the story when it comes to value. We also have to look at the cash that gets tied-up in working capital, machinery & equipment and buildings. A company can be very profitable, but if it has to put a large amount of cash into accounts receivable, inventory, machinery, equipment and buildings each year then its value will be lower.

Future not history – Valuation is a prophecy of the future. I pay for the cash a business is going to generate in the future, not the cash it has generated in the past. This is why business valuation is so hard, and why different people can have different opinions of value for the same business.

Investment not the investor – When we value a business, we need to focus on characteristics that are specific to that particular business. Characteristics that are specific to anyone or anything else are irrelevant. As an example, when considering the cost of capital related to a business that is being marketed for sale, it is tempting to think about the cost of capital for the buyer when preparing a valuation. But when we value a company, the only appropriate cost of capital to consider is the cost of capital for the specific business being valued. That's because cost of capital is very specific to the operations, risks and opportunities of the business being valued.

Investment decision separate from financing decision – This is a tricky but important principle. I once devoted an entire newsletter to it (Spring 2015). The important idea to remember is that the value of a company is independent of how it is financed. It is not a good idea to mix financing concepts with value concepts. Look at value first, separately, then consider how to finance it.

"I am SO doing something — I'm making my coworkers look more productive!"

Corporate Value Partners, Inc.

Ronald D. DiMattia, President, 4545 Hinckley Industrial Parkway, Cleveland, OH 44109
(216) 741-1330 Office
ron@corporatevaluepartners.com • www.dealdesk.com

Corporate Value Partners, Inc.
4545 Hinckley Industrial Parkway
Cleveland, OH 44109-6009

NEWS

Corporate Finance Insights

Invested capital not just equity – Financial valuation is odd because it doesn't directly measure the value of the assets. It measures the value of the claims against the assets, which are the debt and equity of the business. We often refer to the debt and equity of a business as its invested capital. If we use a valuation technique that values the equity of a business directly, we can miss very important aspects of a company's value. This principle is so important, I devoted two newsletters to it (Fall 2013, Spring 2014).

It is tempting when thinking about principles to view them as theory only – interesting to discuss at a coffee shop but not practical for day-to-day use. The principles outlined in this newsletter are not only practical, they are critical to understanding the value of a business. They apply to my work as an analyst and to management teams' day-to-day decisions. Please keep them in mind, because they do help.

Summer 2019

Corporate Value Partners, Inc.

Please contact Ronald DiMattia at Corporate Value Partners at (216) 741-1330 or ron@corporatevaluepartners.com with any questions or if you need help with a valuation or corporate finance matter.

Corporate Value Partners is a corporate finance consulting firm. Services include:

- **Preparing business valuations**
- **Assisting with the acquisition or sale of a business, business unit or product line**
- **Assisting with corporate performance measurements**
- **Assisting with the placement of debt financing**
- **Assisting creditors in corporate bankruptcies**
- **Assisting attorneys with the financial aspects of lawsuits**