EVALUATION OF THE BUSINESS USING MULTIPLE ANALYSIS TECHNIQUE

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Multiples analysis is a financial modeling method of assigning a value to assets or to a business. Market multiples analysis is also referred to as direct comparison analysis or comparable companies analysis. Used as an alternative approach to a discounted cash flow valuation, a market multiples analysis uses comparable companies to devise valuations. The basic idea is that companies with similar characteristics should trade at similar multiples, all other things being equal.

A market multiples analysis can compare companies based on size, industry classification, financial ratios, customers, growth, leverage and technology. Increased reliability and a stronger financial analysis are obtained when comparison companies are highly similar. Usually a financial analyst determines what comparison factors are most important and finds companies that are similar based on these factors. For more critical analysis and a high level of accuracy, a market multiples analysis should be performed against a significant number of companies within the same industry.

Analysis takes each company to be compared and calculates the primary comparison ratios and valuation multiples. Standard financial ratios include liquidity ratios, asset turnover ratios, financial leverage ratios, profitability ratios and dividend policy ratios. An average of the comparison ratios is performed and it results in an assessment value. Based on the resulting value, an analyst makes a valuation judgment based on nonfinancial indicators and may make adjustments accordingly.

Generally, there exist two main types of valuation multiples:

Enterprise Value Multiples express the value of an entire enterprise – the value of all claims on a business – relative to a statistic that relates to the entire enterprise, such as sales or EBIT. (For example: EV/EBITDA, EV/EBIT, EV/Sales, EV/Unlevered Free cash Flow);

Equity Value Multiples, by contrast, express the value of shareholders' claims on the assets and cash flow of the business. An equity multiple therefore expresses the value of this claim relative to a statistic that applies to shareholders only, such as earnings (the residual left after payments to creditors, minority shareholders and other non-equity claimants). (For example: Price/EPS (P/E), Equity Value/Book Value, P/E/Growth (PEG Ratio)).

When using multiples to compare similar companies in a peer group as part of a comparable companies analysis, it is necessary to ensure that the comparison is "apples-to-apples". This means that the denominators of all multiples compared should span the same time period, whether historical or projected, and be adjusted for the same items, such as stock-based compensation.

Step-by-step procedure of valuation using multiple analysis is presented further.

Select a Peer Group: Pick a group of competitor/similar companies with comparable industries and fundamental characteristics.

Calculate Market Capitalization: It is equal to Share price × Number of Shares Outstanding.

Calculate Enterprise Value: Market Capitalization + Debt + Preferred Stock + Minority Interest (less common) – Cash.

Historical & Projected Financials: Use historical financials from filings and projections from management, sell-side equity analysts, etc.

Spread Multiples: Using Market Capitalization, Enterprise Value and historical/projected financials, spread (i.e., calculate) EV/EBITDA and P/E multiples.

Value Target Company: Pick the appropriate benchmark valuation multiple for the peer group, and value the target company based on that multiple. Typically, an average or median is used.

Business valuation using the multiple analysis allows to define target enterprise value and find a target price of share. Based on the results it is possible to give a recommendation for investors either “buy”, “hold” or “sell” shares of the valuated company.

Multiple analysis method has such benefits: Market multiples analyses are easy to understand, apply and use because there is no need for projecting cash flows. Information is also easy to obtain from published reports of publicly traded companies or annual reports. A market multiples analysis is a commonly used tool in the legal and investment banking fields.

But, it can be difficult to find good comparable companies to match up against the analysis company. Without a comparable company, results can be unreliable and can lead to a wide range of valuations. A market multiples analysis also excludes the time value of money and cost of capital from a company's valuation.

1. What Is Market Multiples Analysis? available at: http://www.ehow.com/about_5539297_market-multiples-analysis.html (Accessed 01 Apr 2014).
2. Valuation Multiples: A Primer, available at: http://www.grahamanddoddsville.net/wordpress/Files/SecurityAnalysis/Valuation/valuation-multiples-primer.pdf (Accessed 01 Apr 2014).

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