profitcents®

Projections Valuation Tool

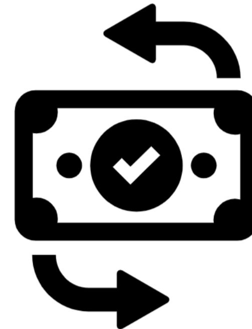
The Valuation in the ProfitCents Projections report is an excellent tool to use for a management level valuation for consulting purposes.

ProfitCents Projections uses a discounted cash flow method to value a company. The premise behind this method is that a company should not have a price higher than the amount of cash it will generate in the future. The time value of money is also factored in; $100 today is worth more than $100 in ten years, or even a year. This is an informal valuation for consulting purposes.

The reliability of this valuation depends heavily on the length and accuracy of the projection. It is strongly recommended to review your data in the Projections tab of the report before examining the valuation. Below outlines the calculations as well as the different variables that influence the value of the company.

KEY FEATURES:

- Exit Strategy
- Succession Planning
- Buying and selling decision-making



CASH FLOW

The discounted cash flow model uses future free cash flow projections and discounts them to arrive at the present value, or value of what the cash flow is worth at the end of the most current historical period entered into ProfitCents. To determine the discount rate, the model takes into account the Risk Free Rate plus the Risk Premium.
Present Value of Cash Flows = Net Free Cash Flow / (1 + Discount Rate) ^ X where X = Projected Year (1, 2, 3, etc)

Discount Rate
The discount rate is essentially a measure of how risky an investment in this particular company would be, or what the required return would be for investing. The higher the risk, the higher the discount rate and the higher the required return. Investments in operating companies are much riskier than investments in government securities. Consequently, a discount rate is used that is much higher than the risk free rate. This is captured by adding a risk premium to the risk free rate. A typical investment will carry a discount rate somewhere between 12% and 20%. You may change the discount rate by updating the risk premium.

Risk Free Rate
The base for the discount rate is the risk free rate, which is the rate of return on government bonds, considered to be among the safest investments. The risk free rate is set to equal to the rate on a 20-year US Treasury Note.

Risk Premium
The risk premium is meant to capture additional risk of the company, above the minimum risk, as set by the risk free rate. Investments in operating companies are much riskier than investments in government securities, so the default the risk premium is 10%. You may make changes to this as necessary. A lower risk premium indicates a safer investment, while a higher number signifies more risk.

*You must have Microsoft Excel on the computer you are using in order to run this program

About ProfitCents
ProfitCents is a financial information company that provides accounting, risk management, financial analysis and business valuation technology solutions to financial services firms and financial institutions. Our mission is to make complicated financial information easier to understand and analyze. Thousands of accounting firms, banks, credit unions, valuation firms and private companies use our applications and information to analyze private-company performance, determine the value of businesses, understand industry trends and assess the credit risk of borrowers. ProfitCents provides the largest real-time database of private-company financial statement information in the United States.

For more information, please email or call: profitcents.support@abrigo.com or 833-4-ABRIGO

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TERMINAL VALUE

The terminal value is a rough estimate of what the company will be worth at the end of the projection. This is important to include in the calculation of the value to account for years after the projected years in the report. To account for the cash flow of future years the last projected cash flow is treated as a perpetuity; an endless annual stream of cash flows that will grow at a specified rate. The further into the future, the harder to estimate the terminal value due to outside factors affecting the future cash flow of the business. Changes can be made to the terminal value directly or to the factors used to calculate this value.

*Terminal Value = (Free Cash Flow (Year 5) * (1+G)) / (DR - G) * (1 / (1+DR))^5*

Calculation Parameters

- *Discount Rate*
- *G (Estimated Growth Rate)*
- *Free Cash Flow (Year 5)*
- *Terminal Value*

PRELIMINARY COMPANY VALUE

In addition to the discounted cash flows and the terminal value, the valuation also accounts for cash on hand, long term investments, and long term debt. Taking on debt to purchase a company diminishes its value, whereas a company with cash on hand or long term investments will be more highly valued. For example, a company that will neither generate nor lose cash flow in the future (it will just break even indefinitely) would have a cash flow value of zero. However, if that company has $1 million in cash, the valuation should reflect this. By making these adjustments, a reasonable company value can be determined. If you would like to modify any of these values, please do so by directly changing the amount listed for that variable.

Preliminary Comany Value = Discounted Cash Flow + Terminal Value + Cash + Long-Term Investments - Long-Term Debt

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FINAL COMPANY VALUE

The Final Company Value is calculated after the Marketability Discount is applied to the Preliminary Company Value.

MARKETABILITY DISCOUNT

The Marketability discount is the final variable considered in our valuation of the business. Marketability is defined as the certain ability to convert the business interest into cash quickly with minimum costs. There is usually a cost and a time lag associated with locating interested and capable buyers in privately held companies. The marketability discount can also be used to discount for lack of control. It can apply a discount to cover the ownership of the interest of the company that is not compelled to be sold or liquidated. The Marketability Discount is very subjective, for example, the discount may be higher for a family-owned company if there is not a readily available buyer versus selling interests in a public company. You can modify the Marketability Discount by directly changing the amount. Once the Marketability Discount is determined, it is automatically applied to the Preliminary Company Value to become the Final Company Value.

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