One of the stages of the enterprise acquisition and sale is valuation of the company constituting the object of the transaction. Due to the complexity of the valuation process, as well as its frequently occurring subjectivity, valuation of a company in a reliable manner is far from easy. This article aims to introduce to the reader the most popular methods of company valuation by providing example situations where there is a need for establishing an enterprise's value.

**Why are companies valuated?**

According to the theory of finance, the key aim of a company's operation is to maximise the its value to the owners. This idea expresses the sense of business operation in a simple and clear manner. A problem might arise if one wanted to measure the value of an enterprise, while situations, occurring for various reasons, where there is a need to answer the question "how much is this company actually worth?" can be numerous. Apart from the already mentioned company acquisition/sale, the following are among other circumstances of this kind:

- Establishing the value of debt collateral (e.g. mortgage),
- Establishing the net book value of stake owned or shares in other business entities,
- In the event of separating an organised part of an enterprise into another entity,
- In the event of a conflict between co-owners if either party is considering sale of their part of the business,
- For the purpose of establishing an enterprise's creditworthiness,
- For the purpose of establishing the value of an investment fund's net assets,
- Due to the need for composition or bankruptcy proceedings, or company liquidation,
- Due to an intention to increase an enterprise's share capital or remit its shares or stake.

**Company valuation methods**

The nature of the valuation process is complex and very often subjective. Thankfully, the theories of finance and market practice have developed a few key approaches to company valuation, divided into particular methods. Graph 1 shows the four most popular approaches applied in company valuation processes, along with a division into respective valuation methods.

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OnePress, Gliwice

2 Jajuga T., K., Investments, 2006, PWN, Warsaw
Graph 1. Approaches to company valuation with relevant methods

Property oriented approach

The valuation methods characteristic of this approach are based on the value of a company's assets and liabilities. The method of corrected net assets determines the value of an enterprise by taking into account the market value of its assets and then subtracting the market value of its liabilities. When performing the calculations, one must take into account off-balance sheet assets and liabilities. The liquidation method is applied in the event of liquidation of a company's operation, e.g. after a business entity's bankruptcy has been declared. The replacement value may be applied in the valuation of intangible and legal components which cannot be valued using the comparative or revenue-oriented approach due to a lack of an appropriate reference group.

Comparative approach

The approach entails two groups of valuation methods. In the method of comparative transactions, the valuation of a company is performed by comparing it with other, similar enterprises which over recent time have been objects of purchase / sale transactions. In the case of the other method, the valuation is performed by comparing a company to other business entities whose financial data has been made available. The reference group most often includes companies listed on the stock exchange subject to strict requirements with regard to provision of information.

Revenue oriented approach

The methods applied under this approach are based on the assumption that a company's value is a sum of future economic revenues to be generated by a given business entity, discounted by the rate of return expected for the present time. According to this approach, the most popular method, also one most frequently applied in the market practice, is the method of discounted cash flows (DCF). It may be based on cash flows due to company owners - i.e. free cash flows to equity (FCFE) or cash flows due to all financing parties, i.e. the owners and creditors of a given business entity - free cash flows to firm (FCFF). As far as the DCF method is concerned, the key factors are forecasting cash flows which a

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Panfil M., Szablewski A., Valuation of an Enterprise. From Theory to Practice, 2011, Poltext, Warsaw
company will be able to attain in the future, as well as selection an appropriate discount rate that would reflect the company's capital cost.

**Unconventional approach**

Nowadays, an increasing number of companies are being established that are characterised by a high level of business risk, i.e. so-called start-ups. In the case of valuating such business entities, both market methods and revenue-oriented methods may fail. Therefore, the real options model is becoming more and more popular, making it possible to appropriately allow for a company's high risk level in the valuation.

**Summary**

The literature on the subject describes several methods of company valuation, while the market practice most often applies only a few of them. In the case of merger and acquisition processes, a reliable valuation of a company's value is of key importance to the transaction's success. The valuation process itself is quite a complex one, often requiring relevant knowledge and experience on the part of the person performing the calculations. Therefore, it is not uncommon for companies to seek the assistance of entities specialising in consultancy in the area of M&A that have the right teams and experience ensuring reliability and professionalism of calculations.