Business Valuation of Companies with Incomplete Information

Companies may have incomplete information for valuation for various reasons, making the task more difficult for valuers but not impossible, said experts from corporate advisory and law firms who discussed how to handle such situations at a recent webinar organised by the Singapore Academy of Law and Institute of Valuers and Appraisers, Singapore (IVAS), themed “Business Valuation of Companies with Incomplete Information”.

Mr Chay Yiowmin, CVA, Founder and Chief Executive Officer of the Chay Corporate Advisory firm, and a Member of IVAS’ Standards and Technical Working Group, outlined reasons that companies may have incomplete information:

1. Instead of adopting customary double-entry bookkeeping principles, they may be using more informal accounting systems, such as single-entry systems, resulting in less recorded information about its financial health.

2. Even if they are using double-entry systems, they may have incomplete accounting records because they are covering up fraud, or because inadequate procedures and internal controls are leading to business transactions not being recorded. They may also have lost records when transitioning to new accounting systems.

Prioritising Valuation Approaches

To determine the best valuation approach in such situations, valuers need to consider what information is available, said Mr Chay. He added that valuers should prioritise:

1. The income approach

   The best and most commonly used approach is the income approach, but this requires substantial information about the firm’s financial status as well as data for projections, such as its amount and timing of future income. Valuers also need the firm’s cost of debt, cost of equity and other details to derive an appropriate discount rate.

   In using this approach, valuers must obtain or develop an asset-based balance sheet, determine which assets or liabilities need valuation adjustments, identify off-balance sheet intangible or contingent assets and liabilities that should be valued, estimate their value, construct a value-based balance sheet and quantity the value.

   If a company is undergoing liquidation, for example, the value of its outstanding trade receivables may need to be lowered to reflect the amount that can be realistically collected during the notice period.

2. The market approach

   If the income approach is not possible due to missing data, the market approach is the best alternative. It may also be more suitable in some situations, for example if there have been frequent and/or recent observable transactions involving substantially similar firms. For this approach, valuers will need information about appropriate comparable companies or transactions, and must make adjustments to account for differing business circumstances.

   When taking this approach, valuers usually consider several valuation ratios, including the price per share to earnings, cash flow, sales and book value per share, and various dividend-related figures, such as the dividend pay-out ratio.

EV/EBITDA, or the enterprise value to earnings before interest, taxes, depreciation and amortisation ratio, is a commonly applied multiple. It indicates the value of the overall firm, permits the use of statistics less affected by accounting policy variations, ignores firms' tax differences, can be modified to exclude non-core assets, and is less affected and easier to interpret when there are capital structure differences.

3. The asset-based approach

If the other two methods are not feasible, or if the value of the company is primarily derived from its assets, as in shipping and property holding firms, valuers can take the asset-based approach. This approach does not consider the potential revenue of the business, instead valuing it based on the costs of its assets.

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The Rules For Reporting

Ms Gwendolyn Gn, a Partner in law firm Shook Lin & Bok who specialises in corporate finance, added that specific information is needed for valuations in merger and acquisition deals. For acquisition or disposal of shares, the value of listed and unlisted shares should be represented by their market value and net asset value respectively.

For acquisition or disposal of assets other than shares, their value should be assessed with reference to their book value, or their market value if a valuation has already been conducted for the purpose of the acquisition or disposal.

"Many transactions in Singapore have real property assets as the underlying asset. In these cases, valuations should be carried out according to standards set by the Singapore Institute of Surveyors and Valuers if the properties are located in Singapore, or by international bodies or the relevant authority in the country if the properties are overseas," Ms Gn said.

She also summarised conditions for different types of transactions:

1. Voluntary announcements of non-disclosable transactions

"Some companies may decide to release such announcements to boost their profile. If they do so, the announcements must include various details, such as the aggregate value of the consideration, the factors taken into account in arriving at it, and if there is financial assistance, the value of the assistance and the interest payable on it," she said. For assets being acquired or disposed of, the firm must also disclose their book value, net tangible asset value and latest available open market value.

2. Disclosable transactions, major transactions, very substantial acquisitions and reverse takeovers

For announcements of these transactions, firms must state the particulars of the transaction, including the names of companies involved, the aggregate and individual value of the assets being bought or sold, details of material conditions attached to the transaction, such as put, call and other options, and other information.

They must also disclose the rationale for the transaction, if any director or controlling shareholder has direct or indirect interest in the transaction, and the details of service contracts of directors proposed to be appointed to the issuer in connection with the transaction.

Ms Gn added that for valuation reports commissioned for such transactions, directors should disclose existing or potential conflicts of interest in appointing a valuer. Those with such conflicts should recuse themselves from meetings and decisions related to the appointment.

Property valuation reports must include the name, professional qualifications and relevant license registration number of the valuer in charge, and the standards used for the valuation. “While the Singapore Exchange Listing Manual does not have specific requirements for other types of valuation reports, these details should also be included,” she said.

She added that commissioning a valuation report does not absolve companies’ boards of all responsibility. She stressed: “Boards have a fiduciary duty and responsibility to ensure that a qualified valuer is appointed, due diligence has been conducted in the appointment, it is in the best interest of the firm to appoint the proposed valuer, and any profit guarantee or forecast is carefully considered.”