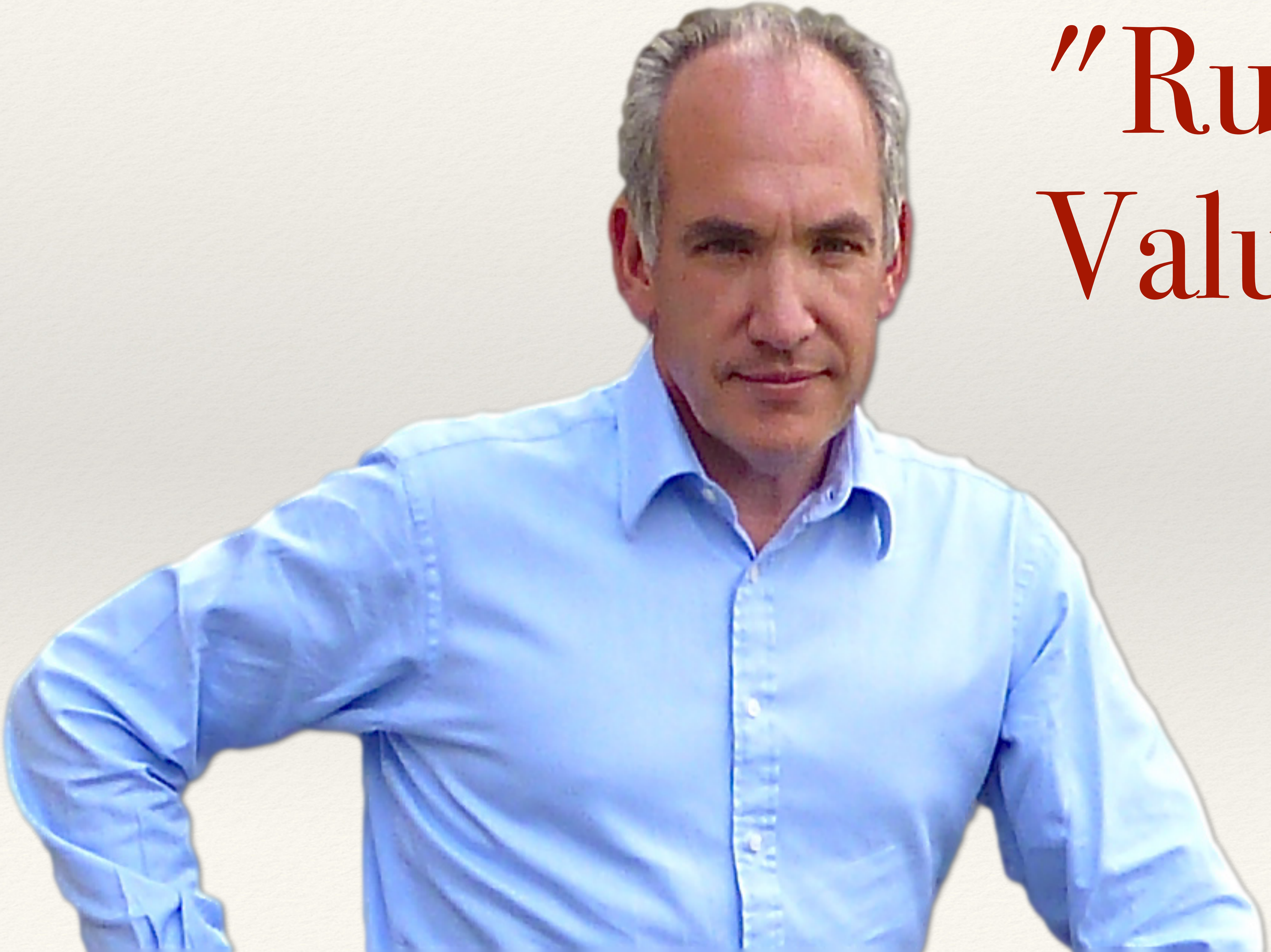
Beware "Rule of Thumb" Valuations



Beware "Rule of Thumb" Valuations

- Experience sector specialist derive "rule of thumb" approaches to valuation which are quick and easy but also risky and inaccurate

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- When looking at their sector and transactions within it, they will have a view that companies "trade" at 1x revenues
- M&A transactions occur between 4x and 6x EBITDA

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- Perhaps the worst exponents of this are Private Equity firms who sometimes seem to be obsessed with EBITDA multiples
- There is however method in their madness
- They always seek transaction arbitrage and want to buy at low multiples and sell at higher ones - its the easiest way for them to make money, providing EBITDA stays the same or increases

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- There are also different multipliers for different sectors
- Construction companies are said to trade a 1x sales
- Growth companies can trade a many multiples of revenues, but often have no profits
- This was particularly the case in the dot.com boom!

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- If you are tempted to use these "Rule of Thumb" metrics, make sure you use the right ones
- Better still, don't use them and rely on calculations based on the methodologies we are covering in this course!

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