

DETERMINATION OF COMPANY VALUE BY THE APPROACH BASED ON ASSETS

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Abstract:

This paper treats method based on assets of valuation of firm. So, after short theoretical considerations about this method we presented a practical study of valuation for a leasing firm. The method based on assets, also known as patrimonial method, the method based on costs and the method based on replacement costs, consists in correcting (adjusting) the book values of individual assets and company debts to convert them in market values. In this assessment, the company is mistaken with its assets, namely with the net asset, the valuator considering it as disjoined, respectively as an amount of assets.

Key words: company value; method based on assets; patrimonial value.

1. Introduction

The company has value because it owns assets of a certain value (real estates, lands, liquidities, etc.) and can be negotiated separately, outside any other considerations. The evaluation is done checking the possible sale price of different assets composing the company (**liquidation view**), or the possible purchase price for the same assets (**reconstruction view**). Therefore, we can speak about **patrimonial methods which support the seller's point of view** and, although, they refer to the company in its liquidation stage, creating the activity and **matrimonial method which support the buyer's point of view** referring to the situation of continuing the activity. But, there must be made an ascertainment that: in any case, the patrimonial methods ignore the company's capacity to create value, as it values only as much as the assets which compose it.

2. Content

Seen from the seller's view, there can be established the following **patrimonial assets** for the company:

- the total assets net value (the mathematic book value);
- discounted net asset or reevaluated;
- net asset corrected or amended (intrinsic mathematic value);
- liquidation asset.

The total assets net value (AN_c) is the simplest and fastest estimation method, being recommended, with precedence, for the evaluation of small companies. In case of relatively economic stability, AN_c literally represents a patrimonial value of the company, as it comprises the invested capitals and the unassigned benefits. It is recommended to use this method only in conditions of stability, as it uses historical costs which loose their significance in case of an inflationary economy. Despite all this, even if in our country we can not speak about stability, this method had been used in the management/employee buy-out process (MEBO method) and in the process of mass privatization. The main reason to select such type of method represents the possibility to calculate the net asset, without calling into requisition to the services of expert companies which not only require high costs, but also for a certain period of time.

Other names for the same method are the **evidenced net asset** or **net asset value**.

The evaluation based on the total assets net value is preferred by the owners whose company had been incorporated a long time ago, accumulated an important property, but which profitableness has the tendency to come to a standstill or event to regress. The determination of the total assets net value is done based on the data from the last balance sheet where the result of the financial year had

been assigned on destinations. Therefore, in the capital accounts we will not find the dividends to be assigned or the employees' participation to the results of the exercise. Therefore, **total assets net value corresponds to the value of capital accounts** and is obtained as a difference between the total assets net value and the total book value of debts:

$$AN_C = \text{Total assets value} - \text{total debts}$$

or breaking down the aggregate asset into its components (long term assets and circulating assets):

$$AN_C = \text{Long term assets} + \text{Circulating assets} - \text{Total debts}$$

Therefore, taking into considerations the accounting and fiscal usages, which alienate from the economic reality and, especially, the factors producing disturbances between the company balance sheet and economic balance, (the currency exchange ratio, price evolution, monetary erosion, redemption system, etc.) there occurs the stringent *necessity to correct the total assets net value*. So, taking into consideration the accounting and fiscal usages, which back away from the economic reality, and, especially, the factors causing disruptions between the company balance sheet and economic balance (the currency exchange ratio, price evolution, monetary erosion, redemption system, etc.) *the need to correct the total assets net value* appears as stringent. So, is done, first of all, when eliminating the non-values, when eliminating the provisions, when reevaluating the income units, the book debts and bond currencies etc., and also for correcting the asset elements depending the criteria of use. Therefore, first of all are eliminated the non-values, the provisions, are reevaluated the income units, the book debts and bond currencies etc., and also for the correction of assets elements depending on the utility criterion.

If the corrections made refer only to *price update and exchange ration* it is obtained the **reevaluated net asset** (AN_r).

But, if we take into account the *entire group of factors* which caused disturbances between the balance sheet and economic balance (which is founded based on the market exigencies) we obtain the **corrected** or **reformed net asset** (ANC).

The reevaluated net asset (AN_r) is the net property for the reevaluated values (updated) and represents the net property for the reevaluated values (updated).

During the period when the inflation is measured with two or even three numbers its incidences are eliminated with the help of indexes calculated based on the price evolution or on the exchange ratio. These indexes shall apply to the initial values of the asset elements. They can be outlined separately for each element or generally as an average index. Usually, in practice, is often used the evaluation based on the *average index*.

If pursuant to the diagnostic analysis it is noted that occurred modifications also in regard of debts, they shall be corrected in addition or in reduction.

Corrected net asset (ANC) is the most used property value and it basically represents, the capital amount necessary to reconstruct the company existent net property, at the level of its availability real value. The inconvenience of the method of total asset net value, where the evaluation of its elements is performed at the historic cost impose the need to re-treat the balance sheet and to perform an economic balance to reflect, as precisely as possible, a company net property. Same as the method for reevaluated net asset, also now the main modifications shall take into account the patrimonial assets and very few of company debts.

The main *features* of the model are:

- operates with economic vales of property assets, but not with book values;
- at the base of determination of the company value is the economic balance, not the balance sheet;
- the company value is given by the value of the ... the company value is given by the value of the corrected net property.

The corrected net asset is based on the *value of use (usage)* of property elements needed for use. *The value of use* represents the price due to be paid in order to purchase, at the appropriate moment, an element capable of the same conditions of use, in the same working conditions, having the same period foreseen for residual use, same performances and same destination of use.

Elements outside the exploitation (needed for exploitation) are evaluated separately depending on the capitalization possibility. The later may be: lands, buildings, machines, deeds of property which can not be sold, stocks difficult to be sold etc. their evaluation is done at the *net venal value* which is the amount to be cashed at their sale. This operation to separate the assets necessary for the exploitation from the ones outside the exploitation has as effect the rise of beneficiary capacity in comparison with previous profits when by diagnosis it is noted the degree of use of assets patrimonial elements, weather by changing the destination of personal and real assets without any use or with reduce usage for performing the object of the exploitation of the respective company.

For the cases of companies found in difficulty for which is estimated the reduction or even the ceasing of their activity, the reevaluated net asset or the corrected net asset is replaced with a **net liquidation asset** (ANL) which takes into account if the liquidation is done progressively or immediately.

View by the buyer's point of view, there can be established the following values for the company:

- substantial value (operational);
- permanent capitals necessary for the exploitation.

The substantial value is a notion with reference to the exploitation of the asset taking into consideration only the specific assets which contribute to the basic activity. Therefore, **the substantial value** is the total value of the existing assets available for the company, no matter of their financing method, which they effectively use in order to ensure the performance of the object of activity, which provide the continuity of the activity. This supposes that at the total of the asset is added the value of assets used by the company, but which are not mentioned in its accounting, therefore it is not freeholder. The non-corporate elements shall be separate and evaluated according to specific criteria. Also, at the base of company value established using this method stands the economic balance, the value being given, as we mentioned before, by the net property afferent to the main activity.

The permanent capitals necessary for the exploitation (CPNE) contain the assets necessary for the exploitation plus the need of working capital for the exploitation. The assets are estimated at their net value, and the need for the working capital starting form the level of activity predicted. Therefore, we have the following calculation formulae:

$$\text{CPNE} = \text{Net assets for exploitation} + \text{NFRE}$$

CPNE does not show the real value of the company, but only the value of the capital necessary to set up a company with the same characteristics as the evaluated company. CPNE is quite appropriate as value to the total economic asset of the company, as it reflects the entire resources necessary to set up the exploitation assets and the need of working capital for exploitation.

For showing in practice the content of the evaluation method based on assets we determined the total assets value and the corrected net asset for the company S.C. RO LEASING S.A. Craiova in order to establish the value of shares to raise the authorized capital. At the evaluation date, the subscribed authorized capital was in amount of 12.808 millions lei divided into 80.050 shares with a nominal value of 160.000 lei.

Table 1. The evolution of the main financing economic-financial indexes

Crt. no	Indexes	1996	1997	1998	1999	2000	2001	2002	2003
1.	Authorized capital	3.970,0	6.500,0	7.875,0	8.005,0	8.005,0	8.005,0	8.005,0	12.808,0
2.	Capital accounts	4.099,8	7.538,6	9.997,7	11.777,2	13.091,0	16.150,3	17.137,3	18.716,2
3.	Average no of employees	1,7	9,5	11,5	13,2	13	13	13	13
4.	Total incomes	314,1	5.962,5	10.487,8	15.640,8	21.625,4	29.047,5	29.687,2	29.442,8
5.	Total expenses	104,3	1.723,9	4.211,7	6.647,5	13.367,6	18.670,9	23.532,3	24.247,9
6.	Gross profit	209,8	4.238,6	6.276,1	8.993,3	8.257,8	10.376,6	6.154,9	5.194,8
7.	Net profit	129,8	2.936,7	3.925,0	5.257,4	5.840,2	7.642,7	4.559,9	3.861,1
8.	Assigned dividends	-	1.864,8	3.506,2	3.748,0	4.300,0	4.400,0	3.418,0	2.160,0

Crt. no	Indexes	1996	1997	1998	1999	2000	2001	2002	2003
9.	Profitability (Gross profit/ total expenses)%	201,2	245,9	149,0	135,3	61,8	55,6	26,2	21,4
10.	Profitability of authorized capital (Net profit/ authorized capital) %	3,3	45,2	49,8	65,7	73,0	95,5	57,0	30,1
11.	Financial profitability (Net profit/ capital accounts) %	103,2	39,0	39,3	44,6	44,6	47,3	26,6	20,6
12.	Works productivity (incomes/ employee) mil. lei/ employee	184,8	625,6	912,0	1.184,9	1.663,6	2.234,4	2.283,6	2.264,8

The society registered during its period of existence a financial profit (due to shareholders) over the average profitability from the banking system and higher than the interest rate without risk, respectively the interest rate to CEC, the bank which guarantees entirely the population deposits.

In cases when society is not quoted on the stock market, the establishment of its value presents interest, first of all, for its shareholders, but also for its image in its relations with third parties (suppliers, clients, potential creditors).

a. The determination of the **book value per share** at 31.12.2003 takes into consideration the non-evaluated balance elements as follows:

1. Fully paid shares	12.808.000	thousands lei
2. Reserves	5.889.087	thousands lei
3. Capital accounts (total assets value)	18.697.087	thousands lei
4. Number of shares	80.050	
5. Book asset per share (3:4)	233.568	lei

b. The determination of the unitary value using the **method of corrected net asset**

1. Total assets value at 31.12.2003*	18.697.087	thousands lei
2. Doubtful clients and equipments which can not be recovered at 31.12.2003	1.259.111	thousands lei
3. Gross payments to be made, afferent to contracts in progress at 31.12.2003, during the period 2004-2007	25.069.828	thousands lei
4. Total expenses afferent to incomes (25.069.828 x 810,6 % ₀ registered in 2003)	20.321.602	thousands lei
5. Gross profit (3-4-2)	3.489.115	thousands lei
6. Net profit (rd.5-rd.5x25%-rd.2x25%)	2.302.058	thousands lei
7. Total corrected net asset (1+6)	20.999.145	thousands lei
8. Number of shares	80.050	
9. Corrected net asset per share – lei	262.325	lei

It is noted that by the approached based on assets, the values obtained are enclosed in an acceptable tolerance, respectively 12%, which justifies the proposal for a sale value of shares between these intervals.

3. Conclusions

Now, in our country, we consider that the approach based on assets will play a very important role because, although all companies have as main objective the rising of value, they do not have yet the role they should have on the exchange economy.

The patrimonial values do not cover the entire value of a company and, usually, they are avoided as exclusive values for transaction due to certain *limits*:

- *incorrect character*, because the non corporatist elements are not taken into consideration;
- *strictly static character*, as they do not take into consideration the company strategy;
- *complex character*, due to the fact that, sometimes, it is difficult to have an accurate idea over the value of some assets from the company property, especially the industrial specific ones and, implicitly the risks of occurrence of errors are significant.

The company is not only an amount of assets, book debts and debts, but it must be seen more of an “*alive organism*”, which beside the things mentioned before it disposes of a goodwill, intangible elements, market elements which make up the company goodwill, namely an additional value for the company, a fact which justifies the use of the method based on assets together with the methods based on income and comparison. Beside, the legislation mentioned precisely the use of several evaluation methods for the company in order to be sure that the company value is the most appropriate to the real one.

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