THE CHALLENGES OF VALUING AN INTERNATIONAL BUSINESS IN 2021

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What is it worth?

Some things in life are easy to put a price on; others are not so straight-forward, leading to differences of opinion and, sometimes, disputes. International businesses can be tricky to value at the best of times, not least in the wake of a global pandemic that has wreaked havoc on certain industries.

The good news is that when valuing an international business (for the purposes of this article, defined as one operating largely or completely outside the UK), the same tried and trusted methods of business valuation apply as when looking at those closer to home. And our approach remains the same today as it was at the beginning of 2020; we always come back to the same core principles. The International Valuation Standards serve as a useful and widely respected reference. However, there are some areas that require careful consideration when valuing an international business.

Availability of information

Regardless of the location of the business we are valuing, or the approach we use, first and foremost we need to understand it. What does it sell? How has it been performing? What is its market position? How is it likely to grow? We need financial information to answer these questions.

One of the biggest challenges can be limited access to information. Quite simply, not all countries have a freely, publicly available registry like Companies House. It can be challenging to obtain the financial information needed to understand a business, assess its performance, and ascribe a value if not readily available from the business in question.

In some cases, the financial information developed by the business may also be less extensive, reliable or informative as a result of differing reporting and audit requirements in different jurisdictions and differing levels of investment in technology. Lack of information can of course be true of businesses in all jurisdictions, including the UK, although we benefit from minimum requirements for external reporting and audit. There can also be huge variances in the quality of available information at an industry and country level in developing regions, which can further confound estimates of, for example, market share, economic growth rates and inflation levels.

Country risk

Many practitioners use 'country risk premia' to reflect the different perceived levels of investment risk in different countries. This is used within the income approach and adds a premium to increase the discount rate applied to calculate the present value of future cash flows, thereby reducing the value. This is often intended to capture political, economic and financial risks, including factors such as:

- Government stability
- Socioeconomic conditions
- Law and order
- Internal and external conflict
- Real GDP growth
- Budget balance as a % of GDP
- Foreign debt as a % of GBP[1]

There are several ways of measuring this premium, which can have a significant impact on concluded value and can vary hugely between experts. Where the business operates in many different countries, premia can be calculated for each country and applied appropriately to the cash flows.

1 Example factors taken from the PRS Group "International Country Risk Guide"

Comparable businesses

In the market approach, we identify comparable companies that are either publicly listed or have recently been privately transacted and for which there is available pricing information. We take the price of the transaction or share price and the business' financial information and derive a market multiple as a comparable measure of value (most commonly, enterprise value – 'EV'/ EBITDA).

To find companies that are most comparable, we would naturally look for those operating and selling in the same country. It may be necessary to broaden the geographic search when seeking to identify comparable companies. In addition, there are a wide variety of stock exchanges globally and the valuer will need to be comfortable that the identified listed share prices reasonably reflect market values.

The impact of COVID-19

The impact of COVID-19 has varied hugely by sector and country, depending on the level and length of 'lockdowns' implemented and on the pandemic's impact on business models and supply chains. Clearly, in general terms it has been an extremely difficult time to run or sell a hospitality or events business, and a great time for businesses selling remote working software tools. In general, global equity markets have recovered strongly (particularly in the US where the S&P 500 and the heavily technology-focused NASDAQ are up 40% and over 60% respectively from their 1 January 2020 position), while the UK FTSE100 and All Share indices remain slightly below their January 2020 marks [2]. Each country and business must be considered carefully for the impact of COVID-19. Particular care should be taken when using market data affected by volatility in the period (predominantly Q1 2020) in which market prices were extremely turbulent due to the uncertainty at the beginning of the pandemic.

Currency

Finally, we must accurately translate financial information from local currencies to the valuation currency. This can be complicated by several factors.

- The performance of the business can be masked by changing forex rates. For example, a business may be deteriorating over time, but the forex rate improving, such that if you look solely at the translated financials, the business appears relatively stable. For this reason, the trends in the business may be best seen in the local current results.
- Economic growth and inflation rates can vary hugely by country and must be considered when assessing the forecast cash flows of the business. The (nominal) business forecasts may look exceptional where these are high, but in real terms, once strong economic growth or inflation is stripped out, the project growth may look a lot more modest or even become negative. Care must be taken to assess the likely trajectory of the business in real terms.
- Local government policy and availability of foreign currency: in some countries there are two (or more) exchange rates, an "official" rate and a parallel market rate. This can lead to confusion concerning underlying business performance and the potential for over-valuation of businesses.

So as ever in business valuation, there are many tricky issues to consider, but rest assured the same fundamental valuation principles apply.

2 Financial Times market data accessed at 19 October 2021