

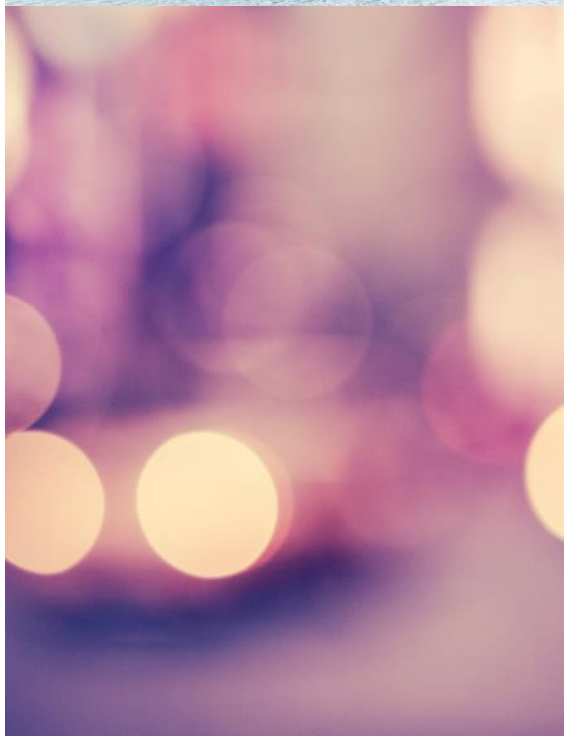
Real Situations That Demand a Valuation

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2. Real Situations That Demand a Valuation

🧭 Real Situations That Demand a Valuation

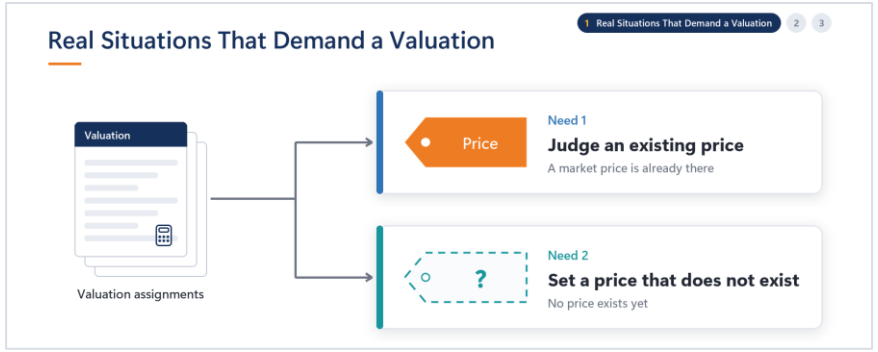
- Every professional valuation assignment traces back to one of two needs.
- Need 1: judge whether an existing market price is fair.
- Need 2: set a price where no market price exists yet.

🔍 Judging an Existing Price

- The first need is judging whether a price already in the market is fair.
- Example: a stock trades at $150; an equity research analyst values it at $180.
- The analyst issues a buy recommendation because the price sits below the estimated value.
- A pension fund manager applies the same logic to add to or trim a position.
- In each case a market price exists; valuation tells you whether it is reasonable.

🏷️ Setting a Price That Does Not Exist

- The second need is establishing a price where none exists yet.
- A private company preparing for an IPO has no market price; bankers value it to set the initial offering price.
- A startup has no trading history and no observable market price.
- The VC firm values the startup to decide how much equity its investment receives.
- In M&A the acquisition price exists only after negotiation; valuation is its foundation on both sides.



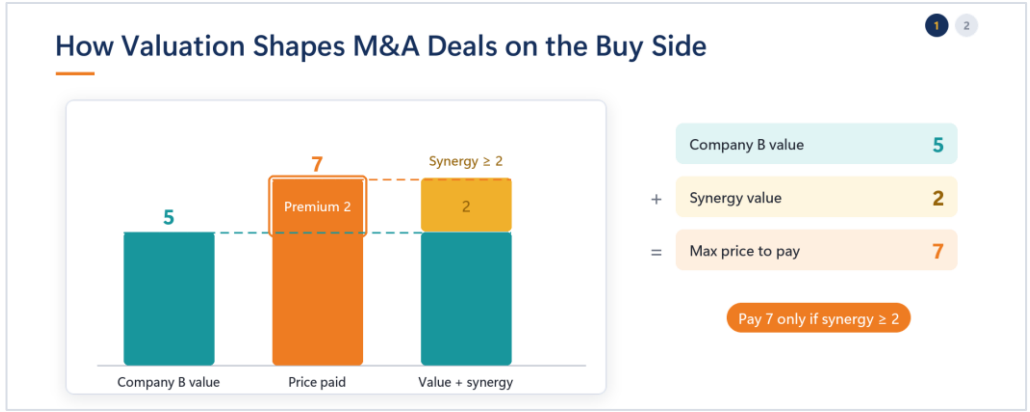




2. Real Situations That Demand a Valuation (Part 2)

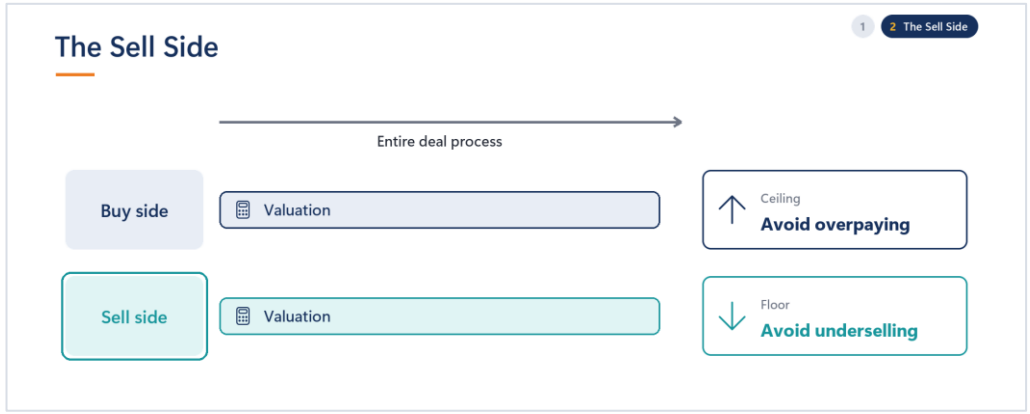
🛒 How Valuation Shapes M&A Deals on the Buy Side

- The buyer must determine the target's fair value before making an offer.
- In a competitive auction, pressure can push bidders above what the target is worth; a disciplined valuation sets a ceiling against overpaying.
- Synergies are the additional value created by combining two businesses into one.
- Company A worth 10 plus Company B worth 5 equals 15 without synergies; cost savings or new revenue should lift it above 15.
- Paying 7 for Company B only makes sense with at least 2 in synergy value, so identify its source before paying a premium.



🤝 The Sell Side

- The seller uses valuation to set an asking price and build negotiating leverage.
- In a public auction, valuation establishes the floor: the minimum acceptable offer.
- In a private negotiation, the seller's valuation anchors the discussion and prevents underpaying.
- Both sides use valuation throughout the deal: buyers to avoid overpaying, sellers to avoid underselling.
- The final negotiated price reflects where the buyer's and the seller's valuations overlap.



2. Real Situations That Demand a Valuation (Part 3)

🚀 Equity Capital Raising

- When a company raises equity capital, valuation determines the terms of the transaction.
- A startup's first venture capital round has no market price; the VC values it to decide its equity stake.
- Higher valuation: the founder gives away less ownership for the same amount of capital.
- Lower valuation: the investor captures a larger share of the company.
- In an IPO, bankers analyze comparable public companies and projected cash flows to reach an offering price range.



📊 Equity Research and Other Uses

- Sell-side analysts publish target prices, compare them with market prices and issue buy, hold or sell.
- Asset managers and pension funds value their portfolio holdings to calculate fund performance.
- Firms granting employee stock options value their shares to set the exercise price; U.S. private companies obtain an independent 409A valuation.
- Management teams track company value over time; shareholder disputes in private companies need a formal valuation.
- The methodology varies with the purpose, the company type and the available data.

