



## August 2008

A year ago, Henry Kravis of the private equity group, Kohlberg Kravis Roberts, talked of the golden age of private equity. Larger and larger deals were being done, with huge valuations, and credit crunch was a chocolate bar. How different things are now! KKR's own listing will be worth less than 75% of last year's expectation. If you were a property company, you could even find that your value had halved, or worse.

Although valuations change with changing expectations, is there some intrinsic valuation basis which is relatively immune to these short term fluctuations? The short answer is no, but one can qualify that brusque response. It is important firstly to distinguish between valuation and price. A business may be valued at X, based on calculations such as the Net Present Value of future cash flows. But different buyers may be prepared to pay higher prices, depending on strategic calculations or even the exceptional expertise of an individual. It is this 'extra' element over the financial calculation which good merger brokers can maximise.

At Chesham, therefore, we work hard at understanding market conditions as well as the aspirations of both buyers and sellers. As brokers rather than corporate advisers, our task is clear – to find the right buyer prepared to pay an acceptable price within a reasonable time frame. But this means that we cannot, and should not, be involved in situations where the seller's price expectations are way ahead of either normal valuation bases or current market conditions.

We have sometimes lost mandates to competitors who encourage unrealistic valuations for the sake of an upfront fee. On one occasion, one of our brokers visited a small (less than £1m revenue) software business. After a long journey, our representative was greeted by the owner with an immediate demand for Chesham's view on the value of the business. The owner had been advised by one of our competitors that the business was worth a very large sum indeed. Given the small turnover (about £600k) and modest profitability, our broker estimated a figure of about £500k. Within minutes, he was shown the door. Three years later, however, the business remains unsold, is late in filing its accounts, and is still barely profitable.

How tempting it must have been for the owner to pay an up-front fee, with the dazzling prospect of a million pound valuation dangled before him! And how short-sighted!

Chesham is normally diffident about taking on very small businesses, but a year or so ago we were approached through our website by the owners of a small but interesting business. Our 'Best Practice Evaluation' revealed little to fault the company other than its size, which, however, was a deliberate decision by the owners who cared more for life-style than profit. The owner told us that all the other brokers he had interviewed were mainly interested in an up-front fee – delivery was another matter. With Chesham's "No Deal No Fee" basis, delivery is fundamental and the owner understood this. Research among our buyers produced 25 enquiries, eventually leading to a successful offer on good terms.

Our terms of business do incentivise us to seek the highest figure, but we cannot promise what cannot be delivered. Our long experience helps in getting our pricing right.