

CASE STUDY

VALUATION OF WB TECHNOLOGY SUPPLIES SA (FICTITIOUS COMPANY)

WB Technology Supplies SA (Pty) Ltd (“WBTech”) is a provider of Information Technology and Communications infrastructure which is supported by customised network design and support services. The founders have taken a decision to sell a stake in the company and to prepare to approach several private equity firms to make such an investment. Several of these private equity investors have expressed an interest but need to assess the value at which such an investment can take place.

The shareholders wish to sell 30% of their shares and have appointed you, as a consultant, to determine a suitable value for such a stake.

1. Background

WBTech’s head office and warehouse are both in Wynberg, Sandton. It sources its network components and technology from suppliers in South Korea. The business was established in 2003 by Johann de Lange to address the growing need of corporate clients for sophisticated communication networks that create a platform for employees to collaborate remotely with one another. Today the business has a wide range of communication platforms that are applied according to the specific needs of clients. It has also built up a workforce of highly skilled engineers and technicians to support the implementation and maintenance of these platforms. Their clients are mostly medium to large sized companies in South Africa, operating in most sectors. They have some clients in Europe and Asia.

Management considers WBTech to trade in the Information, Communications and Technology industry. It is a large sector in the South African economy and has grown steadily over a long period as the dependence on information technology does not abate. This increase in demand largely offsets the softer trading conditions in South Africa. South African ICT companies are competitive internationally as their cost base is in Rands whilst revenue is a hard currency earner. The outlook for the ICT industry is steady to positive.

South Africa has a Gross Domestic Product of US\$350bn per annum. It has an annual inflation rate of 3.1%, last measured in December 2020. The inflation rate varied between 7% and 2% in the last five years, but mostly in the 4.5% to 3% range in the last year. The repo rate varied between 7% and 3.5% in the last five years but aggressive cuts in 2020 saw rates decline from 6.25% to 3.5%. The Rand/Dollar exchange rate is highly volatile, having lost ground from R14.23 to R19.03 but then recovering to R14.69 to the dollar in 2020 alone. GDP growth has been modest in the last year and South Africa is currently in a steep recession. The impact of COVI-19, low business confidence, uncertainty about electricity supply and the slow pace of economic reforms contribute to a particularly challenging trading environment in South Africa.

2. Extracts from financial statements

WBTech’s year-end is on the last day of December. Management supplied the following financial statements:

- Pro-forma financial statements as at 31 December 2020.
- Audited financial statements as at 31 December 2018; and
- Audited financial statements as at 31 December 2016.

The following are selected extracts from those financial statements:

2.1. Income Statement

INCOME STATEMENT	2020	2019	2018	2017	2016	2015
Revenue	53 232	48 001	43 220	41 330	39 156	38 253
Cost of Sales	24 566	21 009	18 881	18 182	17 699	16 162
Gross Profit	28 666	26 992	24 339	23 148	21 457	22 091
Other income	160	128	108	95	80	70
Gross Income	28 826	27 120	24 447	23 243	21 537	22 161
Overheads*	8 931	8 562	8 103	7 800	7 200	6 902
Net operating income before interest and taxation	19 895	18 558	16 344	15 443	14 337	15 259
* Depreciation included in overheads	1 395	1 383	1 344	1 316	1 303	1 423

2.2. Balance Sheet

	2020	2019
ASSETS		
Non-current assets	12 735	13 443
Property, plant & equipment	6 606	7 541
Goodwill	1 899	1 899
Investments	4 230	4 003
Current assets	25 039	10 257
Inventory	337	315
Trade and other receivables	6 390	6 228
Cash and cash equivalents	18 312	3 714
Total assets	37 774	23 700
Equity and liabilities		
Capital and reserves	29 281	16 135
Share capital	1 000	1 000
Retained earnings	28 281	15 135
Non-current liabilities	3 912	3 892
Shareholder loans	2 625	2 405
Interest bearing borrowings	1 287	1 487
Current liabilities	4 581	3 673
Trade and other payables	3 832	3 348
Interest bearing borrowings - current portion	316	325
Taxation	433	312
Total equity and liabilities	37 774	23 700

2.3. Property, plant & equipment notes

PROPERTY, PLANT & EQUIPMENT note	2020	2019	2018	2017	2016	2015
Property	-	420	-	-	-	-
Motor vehicles	260	-	232	-	-	-
Fixure and fittings	-	62	-	93	28	11
Office equipment	114	23	43	87	10	26
Computer equipment	86	17	75	70	62	43
Total additions	460	522	350	250	100	80

	FY2020			FY2019		
	Cost	Acc depr	Carrying Value	Cost	Acc depr	Carrying Value
Property	4 500	-	4 500	4 500	-	4 500
Motor vehicles	3 862	2 126	1 736	3 602	1 766	1 836
Fixure and fittings	1 236	1 162	74	1 236	1 038	198
Office equipment	1 482	1 301	181	1 368	1 164	204
Computer equipment	5 247	5 132	115	5 161	4 358	803
	<u>16 327</u>	<u>9 721</u>	<u>6 606</u>	<u>15 867</u>	<u>8 326</u>	<u>7 541</u>

	FY2018			FY2017		
	Cost	Acc depr	Carrying Value	Cost	Acc depr	Carrying Value
Property	4 080	-	4 080	4 080	-	4 080
Motor vehicles	3 602	1 406	2 196	3 370	1 069	2 301
Fixure and fittings	1 174	921	253	1 174	804	370
Office equipment	1 345	1 030	315	1 302	900	402
Computer equipment	5 144	3 586	1 558	5 069	2 826	2 243
	<u>15 345</u>	<u>6 943</u>	<u>8 402</u>	<u>14 995</u>	<u>5 599</u>	<u>9 396</u>

	FY2016			FY2015		
	Cost	Acc depr	Carrying Value	Cost	Acc depr	Carrying Value
Property	4 080	-	4 080	4 080	-	4 080
Motor vehicles	3 370	732	2 638	3 370	395	2 975
Fixure and fittings	1 081	696	385	1 053	591	462
Office equipment	1 215	779	436	1 205	659	546
Computer equipment	4 999	2 076	2 923	4 937	1 335	3 602
	14 745	4 283	10 462	14 645	2 980	11 665

2.4. Current assets and current liabilities

EXTRACTS FROM BALANCE SHEETS	2020	2019	2018	2017	2016	2015
Inventory	337	315	302	345	389	356
Trade and other receivables*	6 390	6 228	5 774	5 700	5 146	5 215
Trade and other payables**	3 832	3 348	3 026	2 923	2 800	2 633
*TRADE AND OTHER RECEIVABLES note						
Trade receivables	5 952	5 827	5 384	5 281	4 878	4 888
Prepayments	22	21	20	20	18	17
Sundry debtors	416	380	370	399	250	310
	6 390	6 228	5 774	5 700	5 146	5 215
*TRADE AND OTHER PAYABLES note						
Trade payables	3 139	2 684	2 413	2 323	2 262	2 065
Accruals & provisions	37	36	34	33	30	29
Other payables - VAT	332	312	280	266	247	256
Sundry creditors	324	316	299	301	261	283
	3 832	3 348	3 026	2 923	2 800	2 633

3. Other information

INCOME STATEMENT

- 3.1. Other income includes an insurance claim of R30,202. This is not deemed as normal income and is added back. Management forecasts other income as a % of revenue to be slightly than in the past.
- 3.2. An adjustment to overheads is considered for F2020, eliminating a once-off cost for a new ERP system incurred in FY2019 and FY2020, as well as staff attrition. These adjustments approximate R362,000
- 3.3. Management expects a sustainable GP%, based on the average historical margins, for the forecast period.
- 3.4. The growth in overhead expenses are forecast to be loosely correlated to forecast revenue growth but considering minimum inflationary increases.
- 3.5. Inflation is expected to continue in the lower end of the SARB targeted range of 4-6%.
- 3.6. Revenue volume is expected to grow marginally, in combination with inflationary price increases for the next three years. No revenue volume increases are expected after F2023 but price increases in line with inflation are expected from F2024. The net result of these expectations is a revenue growth forecast of 8% in F2021, 7% in F2022, 6% in F2023 and 5% thereafter

FIXED ASSETS

- 3.7. Capital expenditure is expected to increase as fixed assets are starting to age. useful lifetime A mixed depreciation rate of 15% p.a. is assumed.

WORKING CAPITAL

- 3.8. The net balance of other debtors and creditors is forecast to increase substantially in F2020 as a staff loan scheme is being implemented for wage earners. The combined level of other debtors and creditors are forecast based on **-0.5%** of revenue.
- 3.9. Inventory days on hand are forecast to remain at a level **similar to the last year**.
- 3.10. Trade debtors' days on hand is forecast to remain at a **level similar to the last year**.
- 3.11. Management expects trade creditors' days on hand to be **slightly less** than the last financial year, for the forecast period.

VALUATION

- 3.12. Management regards the **R2030 government bond** to mirror their expectation of a minimum remaining life expectancy of the business.
- 3.13. Research indicated that the share prices of competitors and peers are slightly more stable than the movements in the overall market. a **Beta of 0.9** is therefore assumed.
- 3.14. A market risk premium at the **lower end of the range** accepted by the market is assumed, due to the low returns of equities in the last few years.
- 3.15. A small stock risk premium, in line with the **average** premium applied in the market, for similar sized businesses, is assumed.
- 3.16. An additional risk premium is provided for, but at the **lower end of the range** for such a premium applied by the market because large long-term contracts are in place, eliminating the risk of future performance to a certain degree.
- 3.17. A **gearing ratio (EV/EBITDA) of 35%** is assumed, as this means WBTech can raise a financing facility at an EV/EBITDA ratio of 2.1, which is close to the limit at which banks could theoretically finance the company.
- 3.18. A **marketability discount factor of 13.6%** on a **30%** shareholding is considered by market participants as appropriate to compensate for the lack of liquidity in the trading of shares of private companies.
- 3.19. A **minority discount of 5%** is assumed as Management expects a private equity investor to negotiate substantial minority protection as part of the shareholder agreement, thus mitigating their risk.

4. Application

Register a trial account on [Worth.Business](#). Do a valuation, using this online valuation software application, by applying the information above. The notes provide the necessary guidance. This valuation will be demonstrated in a live webinar session.