



BUSINESS VALUATION NOTES

Valuing “tech” companies

The times they are a-changing! Much of our business valuation theory evolved from a time when manufacturing, infrastructure, and consumer product companies dominated the market. Today, the proliferation of “tech” companies and huge increase in the importance of intangibles creates challenges to our traditional approaches and methods.

Aswath Damodaran makes this point clearly in a recent “musings on markets” blog. Technology companies tend to have compressed life cycles compared to traditional enterprises. It may be more difficult for them to maintain a competitive advantage, create barriers to entry, and have a solid base of tangible assets. Damodaran defines “tech” companies as those “that get the predominant portion of their value from technology” but concedes that technology is a continuum with almost every business today having a computerised component. Generally, he sees tech companies as those where scaling up is easy, competitive advantages are fleeting, and decline can be rapid.

The valuer has to assess where the business is in its life cycle, how sustainable is its growth, how protected is its mature phase, and what will be left if (or when) it declines.

Damodaran also warns of the dangers in focusing on PE ratios. In early stage and developing tech companies there may a huge investment in research and development which is not maintained in the mature phase of the company. This can skew the perceived value of the business leading us to under-value early on an over-value later.

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