Abstract: Since the beginning of the 1990s value based concept is discussed intensively as a new way for company management. According to its keynote capital augmentation and company’s value growth are priority aims of any organization. This article is devoted to discounted cash flow method, which is widely used for business valuation in Europe. The paper finds that DCF is a powerful tool to analyze Russian companies as well. A practical example of its implication is given.

Keywords: discounted cash flow, value based management, company valuation, Aeroflot

Continuous analysis of the company is one of the most important factors of its effectiveness and success on the market. To improve the quality of activity managers have to investigate a lot of aspects, such as organization departments, processes, products, areas of activity, because they need to examine the structure as a unity, taking into account internal and external relationship. But analysis of the structure components can be based on company’s valuation. It allows determining the value of the assets created by the company, managers’ performance and direction of further development. Moreover, knowledge of the business cost is required to access the outside investors and lenders in order to raise additional financing. The higher company’s value, the greater financial support it can count on. Thus, growth of the cost is the primary goal of any enterprise. That is why companies are looking for new approaches to manage more effectively than ever before.

Management concept, which focuses on value creation, is one of these approaches. It is based on understanding the fact that the only goal of shareholders is to maximize their wealth through the company they invest in. This aim becomes the main managers’ task by itself [1]. But to manage the cost it should be evaluated firstly.

Business as valuation object has its own features. Appraisers should remember that[2]:

- Any company is an investment good, what means that any investor will wait for payout in the nearest future;
- Business as a good is complicated system, which is influenced with internal and external changes;
- There are two interested parties in the process of valuation: managers and investors (stakeholders);
- Value of the company for investor depends on current cost of future profit, which could be got from its operation activity.

It’s important to understand that business valuation is necessary not only for selling, but also for strategic management. Value based management (VBM) is preferable to traditional accounting, because it disclose real company cost. The main idea of VBM is simple. The value of a company is determined by its discounted future cash flows. Value is created only when companies invest capital at returns that exceed the cost of that capital. VBM focuses on how companies use it to make both major strategic and everyday operating decisions. Properly executed, it is an approach to management that aligns a company’s overall aspirations, analytical techniques, and management processes to focus management decision making on the key drivers of value.[3]

Discounted cash flow method is more reasonable than others, because it takes into account current market condition, investors’ expectation, risks connected with this area of business and future market behavior in case of successful transaction. Its distinctive feature and main advantage is ability to consider unsystematic cash flow changes, which can’t be described by any mathematic model. This fact makes discounted cash flow method more attractive to use in Russian economy.

Valuation using discounted cash flow method includes next steps:
1. Cash flow model choice;
2. Determination of the forecast period duration;
3. Forecast of future net cash flows for each year of the forecast period;
4. Determination of the discount rate;
5. The calculation of the present value of the forecast and post-forecast period.

The methodology of this method is quite clear from economic and mathematical point of view, but cash flow forecasting makes it harder to use it in practice. This problem connected with the need to predict a large number of parameters, which is difficult to do precisely. However, using a variety of mathematical and statistical indicators, the necessary prediction can be made.

Discounted cash flow method was applied to “Aeroflot” JSC value calculation. Company market price is $19,923,450,000. The estimated value is not precise, since discounted cash flow method supposes the use of forecasts. However, the calculation based on maximum of available financial information for forecasting and this fact gives ground to believe that the cost is justified. In addition, the discounted cash flow method allows taking into account factors related to market changes, which is also argument for its application. Therefore, this method can be efficiently and successfully used by companies to evaluate their own cost, provided that accurate and realistic forecasts will be used.

References:
2. Business as valuation object (http://biznes-go.com/biznes-kak-obekt-ocenki/) in Russian

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