

IFF

HOW TO VALUE AN AGRIBUSINESS

By Julian Roche



How to Value an Agribusiness

Whatever valuation methods theoretically suggest should be its value, an agribusiness, like anything else, is only worth what is paid for it. This is the *critical rule* that applies to every business valuation. It follows that if a business valuation methodology, or a sales broker, cannot accurately predict the value at which an agribusiness will change hands, change methodology, broker, or both, then something is wrong with the methodology.

What then are the available methods? In theory, the value of a business ought to match the expected cashflows from it: discounted cash flow (DCF) should produce an accurate estimate of sale price. Unfortunately for the theoreticians, agribusiness provides an excellent demonstration of the fallacy of this assumption. One example from Australia, where agribusiness valuations are more clearly available than many other jurisdictions due to the absence of government support for farming, at least on the scale of the EU's CAP: land-based agribusiness persistently returns a higher EBIT multiple than comparable asset classes with higher profitability. Estimates for land valuation based on income generation regularly result in figures an astonishing 50%-60% lower than the reality of transactions. Why? Because *cashflow generation does not drive land valuation anywhere*, and especially in developed locations that are cash rich and potentially subject to development alternatives. Real options represent a more accurate way to estimate land, and hence agribusiness, valuations in most such jurisdictions. If it is not real development propping up land valuations, it is the government with grants and regulations.

So, with cashflows largely out of the way as a decisive factor in agribusiness valuation – except for those businesses with no land, such as agricultural machinery producers, fertilizer manufacturers or service industries, where conventional methodologies such as DCF on EBITDA or net profit can reasonably apply – the next, inevitable turn must be to comparables. Where transactions are frequent, even relatively unsophisticated calculations can produce reasonably accurate results; the less frequent the transactions, the greater the need for proper hedonic regression calculations that can take into account not only qualitative variations between properties but also the passage of time. Clearly cashflow does not disappear from the valuation altogether: by comparison with an average of comparable agribusinesses, higher earnings, cash flow and revenue growth will produce a higher valuation, and vice versa. Similarly, higher financial risk as measured by leverage, coverage and liquidity ratios will result in a lower valuation. In cases where the agribusiness includes both a cashflow positive element, such as an abattoir, a consultancy or a farm shop, it will probably be necessary to separate these elements from the land-based production component. Good agribusiness valuers know how to balance the different components to produce an answer that matches what buyers will pay.