



Value of Business Advantages in Evaluation of Company in Preparation for Equitization

by TRẦN BÍCH VÂN

The value of business advantages as part of the value of company to be equitized, according to Decree 187/2004/ND-CP, is expressed in the following formula:

$A = S(R - I)$ where:

A: business advantages

S: part of capital in the company held by the State as shown in accounting books at time of evaluation

R: average ratio of after-tax profit to state-owned capital in a 3-year period before evaluation

I: interest rate of government bond with maturity of 10 years or more at the nearest point to the time of evaluation

R is expressed in the formula:

$R = P/S$ where:

P: average after-tax profit in a 3-year period before evaluation

Application of these formulas, however, reveals many unreasonable points:

(1) The estimation of the average ratio of profit to state-owned capital in a 3-year period before evaluation against the interest rate of government bonds with maturity of at least 10 years at the nearest point to the time of evaluation is not appropriate because:

- Many companies have the business advantage that is much bigger than one gained by companies with

the same average ratio of after-tax profit to state-owned capital in a 3-year period before evaluation.

- Equitization could take place at different times in different stages in development circle of the companies with the result that the average ratio of after-tax profit to state-owned capital in a 3-year period before evaluation differs over companies.

(2) According to many foreign survey, the value of business advantage accounts for a large percentage in the total value of a company, it could be 71% in McDonald, 68% in Walt Disney, or 51% in Nokia and Coca-Cola for example. When calculating this value according to the said formulas, the result is not so high. Let's take a look at the value of business advantage of a tourist agency in Đà Lạt City, Lâm Đồng Province (according to the report on the evaluation of the company for equitization dated March 31, 2005).

a. Average after-tax profit in the 3-year period before the evaluation:

2002	VND 334,690,532
2003	VND 519,048,828
2004	VND 619,235,941
Average	VND 490,991,767

b. Average state-held capital in accounting books in the 3-year period before the evaluation:

2002	478,275,682
2003	478,278,682
2004	478,278,682
Average	478,278,682

c. Interest rate of 20-year government bonds at the nearest point of time: 8.42% prepaid.

d. Ratio of after-tax profit to state-held capital in the 3-year period before evaluation:

$$490,991,767 / 478,275,682 = 102.66\%$$

e. Value of the business advantage: $478,278,682 \times (102.66\% - 8.42\%) = 450,738,311$

f. Value of the company: 35,504,132,000

g. Business advantage ratio of the company: $450,738,311 / 35,504,132,000 = 0.0127$ or 1.27%.

Thus, the business advantage is worth only 1.27% of the total value of the company although it is a famous tourist agency in Đà Lạt.

According to the said quantitative formulas, only company whose average ratio of after-tax profit to state-owned capital in a 3-year period before evaluation is higher than the interest rate offered by 10-year government bonds is considered as advantageous in terms of business. The business advantage, however, is an intangible asset whose value changes over time. In some periods, the profitability ratio of the company could be lower than the interest rate of government bonds and its business performance could be poor and the company could even suffer losses. In these periods, the value of the business advantage could be very low but this advantage still exists. Let's have another look at a seafood trading company in HCMC at the end of 2004.

a. Average after-tax profit in the 3-year period before the evaluation:

2002	VND 2,395,357,447
2003	VND 692,638,584
2004	VND 1,049,324,281
Average	VND 1,379,106,771

b. Average state-held capital in accounting books in the 3-year period before the evaluation:

2002	34,210,792,597
2003	47,114,873,725
2004	63,848,183,374
Average	48,391,283,232

c. Interest rate of 10-year government bonds at the nearest point of time: 8.0037% prepaid (issued on Jan. 25, 2005).

d. Ratio of after-tax profit to state-held capital in the 3-year period before evaluation:

$$1,379,106,771 / 48,391,283,232 = 2.85\%$$

e. Value of the business advantage: 0 (because the ratio of after-tax profit to state-held capital in the 3-year period from 2002 to 2005 was lower than the interest rate of government bonds).

(3) This formula is not applicable to subsidiaries where business performance is included in financial statement of their holding companies. Data from a branch of the Saigon Water Company on Dec. 24, 2004 will show this shortcoming. (see Table 1)

(4) According to this quantitative formula, the value

Table 1: Results of evaluation (Dec. 24, 2004) of a branch of Saigon Water Company

Indicator	Book value	Revaluated value	Difference
1	2	3	4
A. ASSETS IN USE (I+II+III+IV)	83,436,471,957	95,758,129,074	12,321,657,117
I. Fixed assets and long-term investment	82,293,659,347	94,304,367,207	12,010,707,806
1. Fixed assets	81,173,234,762	93,183,942,622	12,010,707,806
a. Tangible assets	81,173,234,762	93,183,942,622	12,010,707,806
b. Intangible assets	-	-	-
2. Long-term financial investment	-	-	-
3. Unfinished capital investment	1,120,424,585	1,120,424,585	-
II. Current assets and short-term investment	1,142,812,610	1,453,761,867	310,949,257
1. Cash	661,148,316	661,148,316	(93)
+ Fund in cash	30,675,093	30,675,093	(93)
+ Deposit with banks	630,473,223	630,473,223	-
2. Short-term financial investment	-	-	-
3. Receivable	130,000,000	130,000,000	-
4. Inventory	117,580,524	428,529,874	310,949,350
5. Other current assets	234,083,770	234,083,770	-
6. Overheads			
III. Value of business advantage			
IV. Value of land use right			
B. UNUSED ASSETS			
I. Fixed assets and long-term investment			
II. Current assets and short-term investment			
C. FROZEN ASSETS			
D. ASSETS FROM FUND FOR BENEFITS			
TOTAL VALUE (A+B+C+D)	83,436,471,957	97,758,129,074	12,321,657,117
Of which			
Real value (=A)	83,436,471,957	97,758,129,074	12,321,657,117
E1. Payable	2,145,656,671	2,145,656,671	
E2: Balance of fund for benefits			
E3: Fund for overheads			
REAL VALUE OF STATE-HELD CAPITAL (A - [E1+E2+E3])	81,290,815,286	93,612,472,403	12,321,657,117

of business advantage is determined by the value of state-held capital in the company. When the company employs various sources of finance, the formula can't produce exact result. We can see this shortcoming in the following data about an HCMC-based seafood trading company gathered on Dec.12, 2004.(see Table 2)

Table 2: Data about an HCMC-based seafood trading company

Sources of capital	Notes	At beginning of fiscal year	At the year's end
A. PAYABLE		230,480,631,535	318,764,654,383
<i>I. Short-term loan</i>	3.9	213,630,705,088	308,068,843,126
1. Short-term borrowing		173,846,498,751	255,115,252,246
2. Long-term borrowing due for repayment		-	3,500,000,000
3. Payable to suppliers		13,319,224,386	18,436,722,285
4. Advance from buyers		2,711,346,874	8,453,652,616
5. Taxes and other payments to the State		2,038,774,426	9,458,477,072
6. Payments to employees		2,992,288,346	2,753,400,778
7. Payments to subsidiaries		-	-
8. Other payables		18,722,574,305	10,351,338,174
<i>II. Long-term loan</i>		16,092,134,998	10,217,134,998
1. Long-term borrowing		16,092,134,998	10,217,134,998
2. Others		-	-
<i>III. Other loans</i>		757,791,449	478,676,259
1. Expenses		464,718,177	224,222,006
2. Frozen assets		210,173,272	254,454,253
3. Long-term advances		82,900,000	-
B. OWNER'S CAPITAL		48,440,322,200	65,521,406,706
<i>I. Funds</i>		47,114,873,725	63,848,183,374
1. Working capital		25,045,408,885	25,045,408,885
2. Difference when evaluating assets		-	-
3. Exchange rate differences		-157,626,566	-
4. Fund for development		1,765,867,434	1,766,568,381
5. Fund for financial contingency		677,448,210	681,529,346
6. Retained profit	3.12	-	-
7. Fund for capital investment		19,783,775,762	36,354,676,762
<i>II. Other sources</i>		1,325,448,475	1,673,223,332
1. Fund for benefits and bonuses		1,325,448,475	1,673,223,332
2. Fund for redundancy payment		-	-
3. Overheads - from the previous year - from the previous year		-	-
4. Fund realized in fixed assets		-	-
TOTAL CAPITAL		278,920,953,735	384,286,061,089

These data show that the state-held equities account for only a small part of the total capital (63,848,183,374/ 384,286,061,089 = 16.615%). This means that calculation of the business advantage based on the value of state-held equities is not exact.

(5) In certain cases, it's necessary to prolong the time of observation to more than three years in order to adjust changes in the past advantages and future ones.

The determination of the business advantage before the equitization is a matter of great importance now. The evaluation of this advantage based on financial values and tangible assets is not enough to exact and fails to express the total value of a company. This leads to not only inexact evaluation of state-owned companies but also failure to enhance their values by managing effectively their intangible assets.

To deal with this problem, the government had better work out a more perfect method of estimating the value of the company based on econometrics and analyses by experts in evaluation of assets ■

