Chapter 4 - Tailoring your valuation approach: Technology

Speakers

Russell Prior
Managing Director and Regional Head of Family Governance, Family Office Advisory & Philanthropy, for HSBC Private Banking in EMEA
Andra Ilie
Senior Adviser, Family Governance, Family Office Advisory & Philanthropy, for HSBC Private Banking in EMEA
Roland Emmans
Head of Technology Sector, HSBC UK

Transcript

Russell:
In chapter four, we focus on tailoring your valuation approach for technology businesses. I'm delighted to introduce Roland Emmans, Head of Technology at HSBC UK. The term technology encompasses a wide array of businesses. What are the main categories of technology businesses for valuation purposes?

Roland:
In my view, there's two broad categories. There's software, which includes software as a service, and then there's sort of 'everything else'. And in the 'everything else' category is hardware, data centres, cloud, consulting businesses, managed services. There is an overlap between both because definitely there is a valuation premium for businesses with recurring revenue and higher margins, but the two sorts of businesses are looked at differently because they have fundamentally different models.

Andra:
So let's explore how valuing tech businesses may differ depending on which of these groups it falls under.

Roland:
So if I look at the two groups, I think the strength of the business is probably more important in many ways than what they do. To give you some data points, UK current valuations on forward-looking multiples for software is around 12 times. And for the 'everything else' category, it's about nine times*. Recurring revenues, definitely people pay for those. And then you've got the rule of 40, which is a software adage that's been used for a long time, your profit margin plus your sales growth. If that number is above 40, it's often considered to be in the top quartile. I think in many ways it's how good you are versus your peers that will determine what somebody is willing to pay for a business versus what the business actually does and the sector it operates in.

Russell:
Valuing tech firms is clearly not straightforward, which is why we asked Roland if there are any specific challenges when it comes to valuing a technology business and how owners can address them.

*As of May 2024

Roland:
Valuing a tech business can be an absolute nightmare because before you get anywhere near valuing it, you've got to understand what it does. Technology is rife with jargon and cutting through that jargon is really hard. The most important thing is being able to explain what your business does in an easy way so that somebody can receive it. Entrepreneurs live and breathe their businesses and sometimes they really struggle to be able to simply explain what their business does. If you can't do that, everything else thereafter is potentially going to be wrong.

My challenge to entrepreneurs would be, can you explain your business in three sentences? Why do people buy your product or services? Why do they value it? Who is the buyer? If you can't concisely explain it, it's going to be hard for any potential buyer to value your business as they've got conflicting and competing priorities. There is a real risk if you can't in three sentences or less explain your business that they may just pass over your opportunity. You could be the best business, just not being explained properly.

Andra:
Different types of businesses grow at different rates, but in the fast-moving technological space, a company's valuation can vary significantly. It's a complex process and we hope Roland's expertise in this sector has given you some insights into how it works and how to navigate some of the challenges you may come up against.

To view the remaining chapters in this episode head over to our **'Beyond Business Ownership'** series page.