



Valuations for the sale or purchase of a business

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A business owner is typically passionate about their business and for many reasons may not be able to assess its value objectively or the value that an unrelated dispassionate party may place on the business.

The business owner would naturally want to achieve the highest price possible in the sale of the business, while the buyer would want to pay the lowest price possible. How do these two parties come to an agreement?

Why is an independent valuation worthwhile?

When deciding to sell or buy a business, it is advisable, before any steps are taken, to seek specialist financial advice and get an independent valuation of the business. For a seller, a valuation of the business is useful for several reasons, including:

- establishing a line in the sand and helping set realistic expectations of the potential price range that could be bid. A seller commissioned valuation should not be shared with prospective buyers;
- understanding the value drivers for negotiations between parties down the track;
- uncovering any issues that may have been previously glossed over such as transactions on non-arm's length basis and the optimal capital structure for funding the business operations;
- helping the specialist financial adviser work out a price range to be sought or bid for the business. The expected price by a seller will depend on the appetite of the targeted buyers for the business, whether the buyer will be able to achieve

synergies if they have a similar or complementary business to be merged;

- assessing whether the small business concession is available to the seller; and
- tax planning, capital gains tax and accounting purposes

Obviously, it would be more difficult for a buyer to undertake a valuation of the target business because they would not have the same level of necessary information and knowledge of the business. If some of such information is available, a prospective buyer and their financial adviser should calculate the indicative value of the business to determine the indicative price range they would be willing to bid. This indicative valuation is because there will most likely be insufficient detailed financial information available; hence the buyer's valuer would need to make more assumptions compared to the seller's valuer. Therefore, there would be less confidence as to the 'true' value of the business.

Preparing a valuation of a business can be tricky. There are various valuation methodologies; each used in different circumstances. Terminology can be confusing, and concepts may not be applied consistently. There is a lot of science and craft in undertaking business valuations. Therefore, it is well worth appointing a suitably qualified independent business valuer rather than the company's accountant as they may not be impartial in applying their judgement nor as experienced in preparing valuations. It will save time and unnecessary frustrations in the process.

Price vs value

"Price" is not to be confused as being the same as "value" and vice versa. "Price" is what is negotiated and ultimately paid, it is an objective measure – hard cash - and is influenced by supply/demand and market sentiment. Whereas, "value" is what you get. "Value" is subjective and is dependent on the cash flows and risk exposure of the business. "Value" can mean many different things to different people and can be the subject of disagreement.

What about discounts and premiums?

In deciding to sell or buy a business, it is important to understand the difference in the value of 100% of the business and a lesser %. There are control benefits in owning 100% of a business, such as:

- voting on resolutions;
- cash flows of the business;
- the strategy of the business;
- the appointment and removal of management and directors; and
- payment of dividends.

Therefore, a 100% stake in a business is worth more (not just proportionately) than a lesser % stake, because buyers are prepared to pay a premium for a larger stake which translates into control. The premium is called a control premium. There are plenty of academic studies from past corporate transactions of listed companies analysing the level of premiums paid for various % interests in companies at various times and points in the economic cycle and within different industries.

Confusingly the premiums observed in the market also incorporate premiums paid for synergies because some buyers can achieve synergies from merging similar or vertically integrated businesses. It is extremely difficult to separate the control premium from the premium for synergies or any other synergies.

These are just some of the valuation issues to consider in buying or selling a business.

Our valuation services

FTI Consulting provides opinions on the value of businesses, shares, financial instruments and intangible assets. We deliver independent and reliable valuation advice that complies with the relevant ASIC regulations, tax authority guidance, financial reporting and valuation standards, and is attuned to the broader commercial context, covering:

- transactions & restructurings
- tax valuation
- transfer pricing
- infrastructure valuations
- financial reporting
- disputes & litigation

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