Crowe

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Valuations: How to start valuing your business

I often have people referred to me say,

"I want to get my business valued. What will it cost?"

That's a fair question. To which I usually respond with three more.

Why do you need a valuation?

The client responses could range from:

- "I want to transfer shares to a trust for my kids."
- "One of my partners wants to retire and we want to buy him out at a fair price."
- "I don't get along with my uncle anymore. He is hurting the business and I want to buy him out. My lawyer tells me this will likely go to Court."
- "We are buying a business and there will be outside funding. The lender has told us we will need a Comprehensive Valuation Report."

These four situations are very different. In the first case, there may not be any transfer of wealth from the family group, but there will be for tax purposes. In the second case, it may be a friendly transaction, with no minority discount for a non-controlling interest. In the third scenario, it may or may not be friendly or go to trial. In the last case, the financier knows the difference between a Calculation Valuation Report (the lowest level of assurance), an Estimate Valuation Report, and a Comprehensive Valuation Report (the highest level of assurance). The purpose of the Valuation Report is a large determinant of the amount of work required and, therefore, the cost of the valuation.

What line of business are you in?

Again there could be a variety of responses:

- "Our company owns two commercial buildings."
- "We have a profitable local hardware store, but a big-box retailer is coming to town. Will that make a difference to your valuation?"
- "Our parent company is doing well, but one of our U.S. subsidiaries is losing a fair amount of money. We are thinking of closing it, but we have significant lease obligations."

The amount of work required to value a group of operating companies would likely be more than the amount of work required to value a company which owns two commercial buildings.

Is there a shareholders' agreement?

Often a well written shareholders' agreement stipulates how shareholders deal with each other upon the death of a shareholder, disability of a shareholder, when a shareholder wants to leave or wants you to leave. Many shareholders' agreements, however, state that the value to be used among shareholders is to be a certain multiple of the average of the last three fiscal years' earnings. While this approach may be relatively simple, it may result in unintended consequences if, for example:

- There are losses in any of the years
- A huge contract has been signed for next year
- A big box retailer is coming to town
- Key people depart
- There are significant non-operating assets
- There is a significant change in the local economy
- The Valuation Date doesn't align with the company's year end

To advise on the type of Valuation Report (such as a Comprehensive Valuation Report), the appropriate Valuation Date, the types of appraisals required from other professionals (e.g. real estate appraisal or Phase 1 Environmental Assessment) or to address if minority interests are even an issue, we would likely ask to see:

- The most recent year-end financial statements for the business
- The most recent interim financial statements
- Projections or budgets
- The most recent income tax return
- Any shareholders' agreements

After reviewing all of the above we would be in a position to:

- Address issues of confidentiality
- Identify what else we need to get started
- Plan when appraisals or other reports will be available to us
- Identify a date for us to deliver a draft report for your review
- Identify a date for us to deliver a final report
- Give an estimate or a quote with respect to our fees

All of the above, plus additional information, would be covered in an engagement letter that we would ask you to sign.

Then we get started…

Connect with us today

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