vlassis & co

# Client Guide
## Business Valuation

# Introduction

**This guide is designed to provide clients a basic understanding of how we think about our valuation engagements and practices.**

We aim to clarify common queries and provide a foundational understanding on various technical aspects associated with valuation.

**Industry Qualifications**

The Tax Institute

TAX AGENT
43874005

STEP
ADVISING FAMILIES ACROSS GENERATIONS

CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

# Agenda

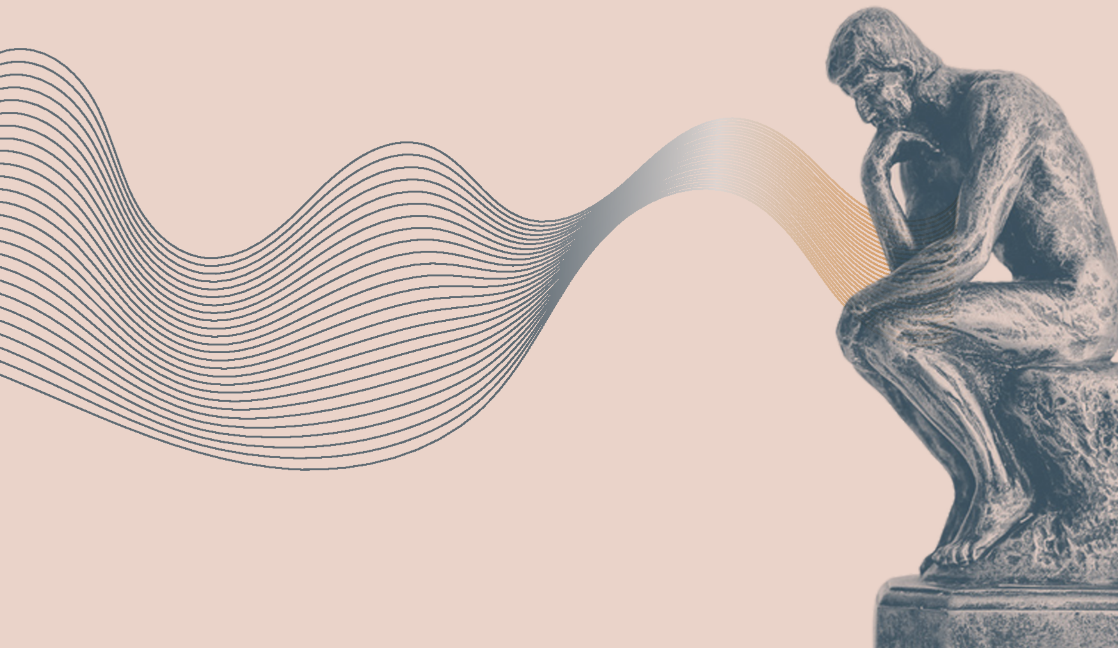
# When Do You Need a Business Valuation?

## Knowing the inherent value of your business or the business you wish to purchase is a fundamental step in planning

It helps guide your strategic direction and sets the marker for future growth. However, valuations can be subjective.

It's critical you have a partner that understands the nuances that drives value, while being on the pulse with industry standards and norms.

Each valuation case is unique and contains its own variables that inform the methodology used. We take into account operational structure, size and sector as well as the nature of the business, long-term plans and growth prospects.



# Typical Scenarios Where You Need a Business Valuation

### Mergers & Acquisitions

- Transaction Advisory and Analysis
- Negotiation Support

### Business Succession

Succession from one generation to the next or a sell down requires planning and understanding the underlying value of the business asset in question.

### Family Law & Litigation Support

Valuing businesses and/or estates linked to spouses or deceased estates.

### Taxation Requirements

There are various circumstances whereby a tax calculation or issue is dependent on a market value, assessed through a valuation engagement. These include:

a. Tax consolidation
b. Acquisitions and divestments
c. Capital gains.
d. Changes in ownership and/or capital structure.

### Shareholder Dispute

Differences in shareholder vision and direction often create circumstances where a restructure is necessary. This requires an independent business valuation to set the stage, providing a clear picture on fair market value.

### Financial Reporting Requirements

# What Type of Business Valuation Engagement Do You Need?

## TIER 1

### Calculation Engagement

(Pre-valuation estimate | Option 1)

This represents the most basic tier of appraisal; typically, a calculation engagement omits several valuation procedures that are essential for a formal valuation engagement or a limited business valuation engagement. In instances of a calculation engagement, it's customary to include a disclaimer indicating that the valuation might have differed if a full-scale valuation engagement had been conducted.

**A Calculation Engagement is typically performed when:**

- **Timing limitations exist**
- **Access to data is limited and, in some cases, unavailable**
- **There is a set agreement between various parties on how the business is to be valued**
- **Early-stage negotiations where the client is seeking an independent opinion**

## TIER 2

### Business Valuation Engagement

This type of engagement is a formal business valuation where the valuer may employ or consider various valuation methodologies that a reasonable and informed third party would perform after considering all the specific facts and circumstances.

This is the highest level and most common form of valuation that is undertaken. Reports are written and presented to a court standard.

Depending on scope, these types of engagements may include research and analysis of industry value drivers and systematic / unsystematic risk factors in which the business and/or industry is affected by.

# TIER 3

## Business Advisory

When contemplating the acquisition or sale of a business, clients lean on their advisors in determining the most effective course of action in assessing the integrity of the transaction and its viability.

We examine the purchase price and outline the risk profile of both the business and the industry it functions in. Offering a wider perspective than a standard business valuation, our advisory services furnish the buyer (and seller) with a comprehensive overview of the business. This is often supplemented with qualitative KPI mapping that identifies how the business is tracking on key value drivers.

### We can address the following areas:

- **Summary of total acquisition costs and the initial working capital requirements**
- **There is a set agreement between various parties on how the business is to be valued**
- **Review the businesses' financial performance, including:**

  Business benchmarking | Major expenses | Budget projections | Payback period | Return on investment | Break even point
- **Assessment of qualitative aspects of the business that increase value and how they can be improved**
- **Review of financing options and recommendations relating to the acquisition.**

# How Will the Business Valuation be Calculated?

In selecting the valuation methods to apply, we have considered the valuation guidelines issued by the Australian Securities and Investments Commission ("ASIC").

This is not an exhaustive list. Each of the valuation methods highlighted below have application in different circumstances. These circumstances include the nature, profitability and financial position of the business being valued and the quality of information available.

**Determining a fair market value is normally achieved using one or more accepted valuation techniques.**

**These include but are not limited to:**

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## The Net Present Value of the Projected Cash Flows

(Discounted Cash Flow Method)

The discounted cash flow method ("DCF") is normally considered a superior technical approach because it allows for fluctuations in future performance to be recognised. It also values the business on the basis of the future free cash flows generated. However, to utilise this methodology requires reliable long term cash flow forecasts.

This technique prioritises cash generation rather than earnings. The business's valuation is derived by calculating its generated free cash flows over a certain duration, in addition to its terminal value. The terminal value, accruing after the forecast period of a decade, typically forms a significant portion of the overall valuation. By discounting the cash flows produced by the business, this method evaluates the investment considering both its timing and associated risks.

### This method can be used for valuing:

- **Start-ups and high growth companies**
- **Businesses with predictable cash flows**
- **Businesses in mature markets**

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## The Capitalisation of Future Maintainable Earnings

The capitalisation of future maintainable earnings ("FME") is a reliable methodology to employ for mature profitable businesses. This method capitalises pre-tax earnings and establishes a value for the enterprise.

This method requires the determination of the future maintainable earnings of the business, assessment of an appropriate capitalisation rate and valuation of any assets surplus to the core business.

This method is commonly used in the valuation of businesses and is appropriate where there has been sufficient trading history to establish business continuity and where it is reasonable to expect that the value of the business is likely to exceed the underlying value of the net assets.

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## Net Asset Backing Based on an Orderly Realisation of the Assets

The net asset backing method ("NAB"), whilst valuable as a comparison tool, is generally considered to be inappropriate for valuing businesses under a going concern concept.

This method assumes that the value of the business rests in its underlying assets and that the value of those assets as recorded in the financial statements of the company is a reasonable reflection of current value. Where a business holds significant amounts of fixed assets the valuation of those assets under a going concern concept may be at variance with their realisation value.

Further the net asset backing method ignores goodwill considerations or the value of intellectual property, unless this has been recorded in the financial statements.

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## Industry Market Method

The industry market method ("IMM") may be used in industry sectors where there are a relatively large number of participants, sale of these businesses occur on a frequent basis and where the sale price is known to the broader public.

In these sectors, current market prices can be established for similar businesses and which allow for comparison with any features unique to the business under consideration.  This can provide a basis for forming a reasonable market opinion.

# General Framework On How We Approach An Engagement

| Business Type | Turnover ($m) | Valuation Method | Explanation |
|---|---|---|---|
| Micro | <1 | Rule of Thumb or Capitalisation of Future Maintainable | • Large number of industry participants<br>• The sale of these businesses occur frequently<br>• The sale price is known to the broader public |
| Small | 1-10 | CFME | Applies to mature, profitable business |
| Medium | 10-50 | Discount Cash Flow (DCF) or CFME | The business is more likely to prepare reliable forecasts |
| Large | 50+ | DCF | Forecasts are readily available Shares are liquid and can be publicly traded |

# Valuation Definitions

### Business Enterprise

A commercial, industrial, service or investment entity (or a combination thereof) pursuing an economic activity.

### Business Risk

The degree of uncertainty of realising expected future returns of the business resulting from factors other than financial leverage.

### Business Valuation

The act or process of determining the value of a business enterprise or ownership interest therein.

### Capital Structure

The composition of the invested capital of a business enterprise, and the mix of debt and equity financing.

### Capitalisation of Earnings Method

A valuation method that forms an opinion on the business value based on the sustainable profits generated by the business relative to the risk return expected. This method is a widely used and accepted methodology in business valuations.

### Capitalisation Rate

Any divisor used to convert anticipated economic benefits of a single period into value. This may also be referred to as the capitalisation multiple which is the inverse of the capitalisation rate.

### Cash Flow

Cash that is generated over a period of time by an asset, group of assets, or business enterprise.

### Control

The power to direct the management and policies of a business enterprise.

### Control Premium

An amount or percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control.

### Cost Approach

A general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

### Cost of Capital

The expected rate of return that the market requires in order to attract funds to a particular investment.

### Discounted Cash Flow method

a valuation method whereby the present value of the business is reflected in the future expected net cash flows calculated after applying a discount rate.

### Discount for Lack of Control

An amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

### Discount for Lack of Marketability

An amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

### Discount for Minority Interest

An amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of control.

### Dividend Yield

shows how much a company pays out in dividends each year relative to its share price. In the absence of any capital gains, the dividend yield is the return on investment for a stock. Dividend yield is calculated as follows:

= Annual Dividends Per Share / Price Per Share.

### Earnings Before Interest & Tax (EBIT)

An indicator of a company's profitability, calculated as revenue minus expenses, excluding tax and interest.

### Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)

An indicator of a company's financial performance which is calculated in the following EBITDA calculation:

EBITDA = Revenue – Expenses (excluding tax, interest, depreciation and amortisation).

### Economic Life

The period of time over which property may generate economic benefits.

### Fair Market Value

The price that would be negotiated in an open market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller dealing at arm's length within a reasonable time frame.

### Going Concern

An ongoing operating business enterprise.

### Going Concern Value

the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems and procedures in place.

### Goodwill

That intangible asset arising as a result of name, reputation, customer loyalty, location, products and similar factors not separately identified.

### Income (Income-Based) Approach

A general way of determining a value indication of a business, business ownership interest, security or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

### Intangible Assets

Non-physical assets that grant rights and privileges and have value for the owner. Examples of intangible assets include goodwill, trademarks, patents, copyrights and securities.

### Internal Rate of Return

a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

### Inventory Turnover

A ratio showing how many times a company's inventory is sold and replaced over a period. Generally calculated as: Sales/Inventory.

### Key Person Discount

An amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

### Liquidation Value

The net amount that would be realised if the business is terminated and the assets are sold piecemeal.

### Majority Interest

An ownership interest greater than 50% of the voting interest in a business enterprise.

### Market (Market-Based) Approach

a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

### Marketability

The ability to quickly convert property to cash at minimal cost.

### Minority Interest

An ownership interest less than 50% of the voting interest in a business enterprise.

### Net Book Value

with respect to a business enterprise, the difference between total assets (net of depreciation and amortisation) and total liabilities as they appear on the balance sheet. With respect to a specific asset, the capitalised cost less accumulated depreciation or amortisation as it appears on the books of account of the business enterprise.

### Net Present Value

The value, at a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

### Normalised Earnings

Economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

### Price/Earnings Multiple

The price of a share of stock divided by its earnings per share.

**Return on Investment**

The reasonable return level that an investor would expect from a business.

**Recurring Revenue**

The portion of a company's revenue that is highly likely to continue in the future. This is revenue that is predictable, stable and can be counted on in the future with a high degree of certainty.

**Required Rate of Return**

The minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

**Risk Free Rate**

The rate of return available in the market on an investment free of default risk.

**Risk Premium**

A rate of return added to a risk-free rate to reflect risk.

**Rule of Thumb**

A mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

**Standard of Value**

the identification of the type of value being used in a specific engagement; e.g. fair market value, fair value, investment value.

**Surplus Assets**

Assets that a business holds, but which are not necessary for the operation of the business, i.e. they are not contributing to the core income-generating activities of the business.

**Valuation Date**

The specific point in time as of which the valuer's opinion of value applies

# Why Work With vco?

**VCO is a boutique accounting and advisory firm. With a history in working at "larger" firms, our dynamic team implement and deploy those standards, knowledge and systems in our current practice.**

### Commercial Minded

Our combined staff have collectively dealt with hundreds of client matters and the unique dynamics that come with it. Our senior heavy staff have seen it all.

### Broad Network

We have an extensive professional network and business buyer/seller pool which enhances opportunities for our clients and partners.

### Experts in Valuation & Drivers of Value

Valuation forms a core part of our service. We have been conducting business valuations for M&A, forensic and expert witness purposes for over 15 years. Over that time we have developed a deep understanding on what drives value and how to enhance it.

### Technical

M&A transactions, restructures, and valuation assignments often result in technical legal, tax and commercial issues that require specific expertise. Our experts can directly assist in complicated valuation and tax issues that arise and have the aptitude to identify issues that require other specialist assistance.

### Owners' Perspective

We understand the sweat it takes to develop, scale and manage a business to steady state. We view our engagements from the owners' perspective and ensure their interests are protected.

### Diligent

Our clients' success is predicated on our diligence. We are process driven and follow a proven methodology in extracting untapped value for our clients.

# Recent Engagements

### Large Private Hospital Group

Produce a comprehensive valuation report analysing the fair market value of shares, due to a re-structure with capital gains tax implications.

### Large Construction Company

Produce a comprehensive valuation report analysing the fair market value of shares, due to a company re-structure.

### Large Vineyard - Succession Planning & Family Dispute

Comprehensive valuation report valuing business assets and shares in the company.

### Farming – Estate Planning & Family Dispute

Comprehensive valuation report analysing the value of partnership to solve dispute.

### Nursery Franchise

Produce a comprehensive valuation report analysing the fair market value of the business with CGT implications

### Australia Wide Photography Business

Produce a valuation report in preparation for the sale of business.

### Growing Construction Company

Our clients' success is predicated on our diligence. We are process driven and follow a proven methodology in extracting untapped value for our clients.

### Largest Distributor Of A Manufactured Product In Australia

Produce a comprehensive valuation report analysing the fair market value of shares, due to a company re-structure.

### Large Restoration Company - Estate Planning & Family Dispute

Comprehensive valuation report analysing the value of partnership to solve dispute.

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