

Valuing your business

General Business Factsheet | www.rousepartners.co.uk/factsheets

An overview of the latest changes and developments.


rouse
Chartered Accountants

Valuing Your Business

There are many reasons why you may need to calculate the value of your business. Here we consider the range of methods available as well as some of the factors to consider during the process.

It is important to remember throughout that valuing a business is something of an art, albeit an art backed by science!

If you would like discuss how we can assist you, please contact us on 01494 675321 or by email at info@rousepartners.co.uk

Why value your business?

One of the most common reasons for valuing a business is for sale purposes. Initially a valuation may be performed simply for information purposes, perhaps when planning an exit route from the business. When the time for sale arrives, owners need a starting point for negotiations with a prospective buyer and a valuation will be needed.

Valuations are also commonly required for specific share valuation reasons. For example, share valuations for tax purposes may be required:

- ▶ on gifts or sales of shares
- ▶ on the death of a shareholder
- ▶ on events in respect of trusts which give rise to a tax charge
- ▶ for capital gains tax purposes
- ▶ when certain transactions in companies take place, for example, purchase of own shares by the company.

Share valuations may also be required:

- ▶ under provisions in a company's Articles of Association
- ▶ under shareholders' or other agreements
- ▶ in disputes between shareholders
- ▶ for financial settlements in divorce
- ▶ in insolvency and/or bankruptcy matters
- ▶ measuring investments for the annual financial statements.

When a business needs to raise equity capital a valuation will help establish a price for a new share issue.

Valuing a business can also help motivate staff. Regular valuations provide measurement criteria for management in order to help them evaluate how the business is performing. This may also extend to share valuations for entry into an employee share option scheme for example, again used to motivate and incentivise staff.

Valuation methods

While there is a ready made market and market price for the owners of listed public limited company shares, those needing a valuation for a private company need to be more creative.

Various valuation methods have developed over the years. These can be used as a starting point and basis for negotiation when it comes to selling a business.

Earnings multiples

Earnings multiples are commonly used to value businesses with an established, profitable history.

Often, a price earnings ratio (P/E ratio) is used, which represents the value of a business divided by its profits after tax. To obtain a valuation, this ratio is then multiplied by current profits. Here the calculation of the profit figure itself does depend on circumstances and will be adjusted for relevant factors.

A difficulty with this method for private companies is in establishing an appropriate P/E ratio to use - these vary widely. P/E ratios for quoted companies can be found in the financial press and one for a business in the same sector can be used as a general starting point. However, this needs to be discounted heavily as shares in quoted companies are much easier to buy and sell, making them more attractive to investors.

As a rule of thumb, typically the P/E ratio of a small unquoted company is 50% lower than a comparable quoted company. Generally, small unquoted businesses are valued at somewhere between five and ten times their annual post tax profit. Of course, particular market conditions can affect this, with boom industries seeing their P/E ratios increase.

A similar method uses EBITDA (earnings before interest, tax, depreciation and amortisation), a term which essentially defines the cash profits of a business. Again an appropriate multiple is applied.

Discounted cashflow

Generally appropriate for cash-generating, mature, stable businesses and those with good long-term prospects, this more technical method depends heavily on the assumptions made about long-term business conditions.

Essentially, the valuation is based on a cash flow forecast for a number of years forward plus a residual business value.

The current value is then calculated using a discount rate, so that the value of the business can be established in today's terms.

Entry cost

This method of valuation reflects the costs involved in setting up a business from scratch. Here the costs of purchasing assets, recruiting and training staff, developing products, building up a customer base, etc are the starting point for the valuation. A prospective buyer may look to reduce this for any cost savings they believe they could make.

Asset based

This type of valuation method is most suited to businesses with a significant amount of tangible assets, for example, a stable, asset rich property or manufacturing business. The method does not however take account of future earnings and is based on the sum of assets less liabilities. The starting point for the valuation is the assets per the accounts, which will then be adjusted to reflect current market rates.

Industry rules of thumb

Where buying and selling a business is common, certain industry-wide rules of thumb may develop. For example, the number of outlets for an estate agency business or recurring fees for an accountancy practice.

What else should be considered during the valuation process?

There are a number of other factors to be considered during the valuation process. These may help to greatly enhance, or unfortunately reduce, the value of a business depending upon their significance.

Growth potential

Good growth potential is a key attribute of a valuable business and as such this is very attractive to potential buyers. Market conditions and how a business is adapting to these are important - buyers will see their initial investment realised more quickly in a growing business.

External factors

External factors such as the state of the economy in general, as well as the particular market in which the business operates can affect valuations. Of course, the number of potential, interested buyers is also an influencing factor. Conversely, external factors such as a forced sale, perhaps due to ill health or death may mean that a quick sale is needed and as such lower offers may have to be considered.

Intangible assets

Business valuations may need to consider the effect of intangible assets as they can be a significant factor. These in many cases will not appear on a balance sheet but are nevertheless fundamental to the value of the business.

Consider the strength of a brand or goodwill that may have developed, a licence held, the key people involved or the strength of customer relationships for example, and how these affect the value of the company.

Circumstances

The circumstances surrounding the valuation are important factors and may affect the choice of valuation method to use. For example, a business being wound up will be valued on a break up basis. Here value must be expressed in terms of what the sum of realisable assets is, less liabilities. However, an on-going business has a range of valuation methods available.

How we can help

With any of the valuation methods discussed above, it is important to remember that valuing a business is not a precise science. In the end, any price established by the methods described above will be a matter for negotiation and more than one of the methods above will be used in the process. Ultimately, when the time for sale comes, a business is worth what someone is prepared to pay for it at that point in time.

Please contact us to discuss how we can help value your business as well as help you develop an exit strategy to maximise the value of your business.

Trusted advice, *imaginative solutions.*

It's the old adage that all accountants are the same, but ask yourself this; what kind of service would most add value to your personal or business position? In our opinion, the quality of advice and service is what separates a good accountant from a great one. This is where Rouse Partners can make a difference for you.

Our award-winning team make it their business to get to know you and your specific needs. Whether your goal is to grow your business, increase your personal wealth or improve your work-life balance, by understanding your challenges, we will address them together.

We also know how important it is for you to have a team that you can rely on for timely advice and reassurance. At Rouse, our people are our most important asset and we will select team members who offer an optimum mix of experience, specialism and knowhow. From your Partner, to your Tax Advisor, each team member will be accessible to you or your team and be proactive in seeking solutions.

At the heart of our way of working is a determination to think differently, to challenge the 'status quo' and to ask 'what if?'. Whether you are facing a complex tax, accounting or management situation, we are ready to find a solution.

Contact us today to discuss how we can support your personal or business tax needs:

t: 01494 675321

e: info@rousepartners.co.uk

Accountancy

Audit

Tax

Business advice

Corporate finance

Company secretarial

Outsourcing

Payroll

Wealth management

International services



Rouse Partners LLP
55 Station Road
Beaconsfield
Buckinghamshire
HP9 1QL

t: 01494 675321
e: info@rousepartners.co.uk
www.rousepartners.co.uk

© Rouse Partners 2020. This guide has been produced by Rouse Partners LLP for general interest. No responsibility for loss occasioned to any person acting or refraining from action as a result of the information contained in this edition is accepted by Rouse Partners LLP. In all cases appropriate advice should be sought from us before making a decision. All information correct at time of publication (10 March 2020) and subject to change.