

## Valuing the Business

A price range for the business should be determined prior to negotiating with the seller. The price of a business may be derived from the issues mentioned above as well as the following:

(i) Appraisal of the land and buildings. The fair market value of the property is affected by a number of factors:

(a) Location. The business's location in relation to the buyer, its customers and suppliers, employees, and competition should be considered.

(b) Condition. Are improvements necessary to bring the premises up to legally acceptable standards?

(c) Finances. The costs of property maintenance, transfer of title, licences, leases, property taxes, etc.

(d) Leases. There may be problems over the transfer of a lease on premises. Some leases prohibit assignment.

(e) External factors. Current interest rates and the state of the property market influence a property's value.

(f) Future outlook. Will the property meet the needs of the business as it grows?

(ii) Valuation of Fixtures and Fittings. There may be equipment leases that need to be transferred (eg photocopier). Check for any contingent liabilities.

(iii) Stock. The method of stock valuation must be agreed upon by the buyer and seller. The transfer value of the stock should be cost or 'net realisable value' (NRV), whichever is lower. For redundant stock the NRV is zero. Recorded valuation and stock count should be done by a third party.

(iv) Goodwill. Valuing the goodwill of the business is especially important. Goodwill reflects the cumulative effect of the reputation of the business, its relationship with customers, suppliers and competition, the skills of the staff and its market position. The elements of the business's goodwill that can be carried on by the buyer will have to be determined.

(v) Staff. Are the existing staff suitable for the business? How will they react to a new owner/manager? How will those who are not keen to stay on be replaced? The effects of the Transfer of Undertakings (Protection of Employment) Regulations must be considered (see BIF 217) - if long serving staff are transferred it will be expensive to make them redundant. What type of benefits will be offered (eg career plans, employment policies etc)? What will be expected of staff? National Insurance (NI) requirements, pension schemes and personal liability insurance must also be considered.

(vi) Accounts. An accountant should be recruited to evaluate the business's books, bank statements and tax records to get an accurate picture of the business's current financial situation and its future profitability.

(vii) The outstanding loans to the business, its relationship with its creditors and its repayment history should be evaluated. What is the buyer's ability to obtain financing for the venture and to repay the loan? Pro-forma income statements, balance sheets and cash budgets should be produced. When estimating how much income the business is likely to generate it is important to be conservative, especially in the early stages.

(viii) Methods of Valuing the Business. It may be useful to employ a business transfer agent or financial adviser when valuing the business. The four methods often used are:

(a) Asset Value. The value of liabilities is subtracted from the value of assets to obtain the business's net asset value. The value for the entire business will be net asset value plus goodwill.

(b) Earnings Multiple. A multiple is applied to the earnings from the business. Earnings should take account of interest charges to be paid after purchasing the business and any loans needed to make improvements.

(c) Return on Capital. After determining the desired rate of return, the income of the business before interest and tax should be calculated and also as a percentage of the capital invested. If the figure is less than the desired rate of return, then purchase of the business should not go ahead.

(d) Free cash flow. Based on the ROC model but specifically identifying cash generation over a period of time and discounting this back to a net present value. This method is useful where there is little trading history though it is likely to more speculative.

