BUSINESS APPRAISALS LTD

# BUSINESS VALUATION NOTES

## Goodwill and restraints of trade

A recent engagement to value a partnership highlighted the importance / value of a restraint of trade or non-compete undertaking.

Our fair market value definition is *"the amount at which the business would change hands between a willing buyer and a willing seller when neither is acting under compulsion and both have reasonable knowledge of the relevant facts"*. We believe this standard assumes a restraint of trade on the selling owner and reasonable training and transition provisions.

With our engagement one partner was "retiring" from the partnership and there was no partnership agreement in existence or employment contract to prevent him setting up in opposition to the business.

Based on the specifics of this particular subject business it was our belief that this risk was real and extinguished any goodwill content. Of course, this penalized the exiting partner's payout as well as harming the residual business.

## Valuing Real Estate Agencies

We have valued a number of large real estate agencies in the last four months. Ten offices in total… some with rent rolls, some without. These businesses pose particular challenges. They are top-line driven, sensitive to changes in the economy, very dependent upon the calibre of their salespeople, and location is important. Their volatility makes historic performance less persuasive and the future more difficult to forecast. EBITs can fluctuate dramatically and a significant portion of the value may be in the rent roll.

## Forecasts, projections, budgets etc.

One of the basic principles of business valuation is that it should be **forward-looking.** Value should reflect the realities of the market place and the focus of business buyers is on **future profits**, i.e. what is the **future** maintainable earnings and what are the risks involved. Historic performance may provide some guidance but the pace of change has so accelerated in recent years that credible valuations are likely to rely on a level of financial forecasting.

This will entail more assumptions and subjective judgements, but these need to be carefully and soundly based. The appraiser needs to look beyond the past financial statements, recognise trends, fully understand the business and its value drivers, research the industry and consider the state of the general economy.

Warren Buffett is, arguably, the best business valuer in the world and famously said *"Forecasts usually tell us more of the forecaster than of the forecast"*. This warns us to be cautious in accepting forecasts by management (who may have a vested interest) unless they can demonstrate a track record of realistic projections.

All valuations are opinions. The only true test of value is a sale on the open market after a full marketing program. A valuer must observe professional standards, be clear in definitions and terminology, follow the process systematically… and apply a **"sanity test"** at the conclusion of the exercise.



**For clear, accurate and affordable business valuation**

**We supply independent business valuations for partnership splits, property relationship matters, business planning, expert witness, and litigation support.**