Involvement of the Chartered Business Valuator in the Collaborative Law setting.

Written by:

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There are a number of circumstances which lead to the requirement of a business valuation being prepared. Some of these are matrimonial disputes, potential sale of the business, obtaining financing and the transfer of a business to the next generation.

When there is a breakdown of the marriage, business valuations may be required in order to determine the value of the business as at the date of separation for inclusion in the statement of net family property. If the business was operational at the date of marriage, a second valuation would be needed to determine the value at this point in time as well. This is due to the fact that the increase in the value of the business is what will be included in the statement of net family property.

If the valuation report is to be used in litigation, an Estimate Valuation Report would be required. This is the second level of report, Calculation Valuation Report being the lowest and Comprehensive Valuation Report being the highest. The reason an Estimate Valuation Report is required is due to the scrutiny that will be applied in the court by opposing council as well as the judge.

In a Collaborative Law setting, the Chartered Business Valuator can be involved without providing official reports. This is understood by both spouses and any documentation prepared cannot subsequently be used in court if the collaborative process breaks down. The benefits of the collaborative process in using a financial professional is that feedback is obtained from both spouses and the costs can be significantly lower.

There are a number of different techniques used in valuing a business, as no two situations are identical. The three that we will touch on are asset based, income based and market based. In each situation it must be determined which methodology is to be used to arrive at fair market value.

The first method we will discuss is the asset based method. This can be done on either a going concern basis or a liquidation basis. The asset based approach will often be used when a business is not generating a significant return on the underlying assets of the business, which could be a situation with farm that is operating on land with a value that is much greater than the profit being generated. This method is also used in a situation where the business is depressed and losing money, resulting in the liquidation approach.

The basic premise of the asset based approach is that the value of the business is the fair market value of the assets less the fair market value of the liabilities. The liquidation calculation will also incorporate the costs of disposition and other professional fees required to wind up the company.

The income based approach incorporates a number of different methodologies. The one used will be determined based upon the situation of the entity being valued. In the case of a start-up company that is experiencing a variety of cash flows from year to year, a discounted cash flow approach will likely be used. This is because there are not stable cash flows to apply a multiple to going forward, so the future of cash flows of the company are present valued to determine the total worth of the company at the valuation date.

If the company has had stable earnings that are expected to continue into the future, a capitalization of earnings, cash flows or earnings before interest, taxes, depreciation and amortization (EBITDA) may be employed. The multiple applied will vary based on certain factors such as industry, geographic region or other company specific factors. Generally, if there is a greater potential for growth, there will be a higher multiple applied.

The market based approach has limitations when it comes to privately held businesses, generally because there are not a lot of comparable transactions available. It is much more commonly used in valuing public companies due to the availability of information. In general, this approach looks at the current business and compares to other businesses that are similar in nature and the amounts that they transacted for.

These methods are not used in isolation and the valuator will often use a combination of these, in conjunction with certain rules of thumb from the industry, to determine the value of the business.

If you have further questions regarding business valuations, please feel free to contact the writer or other financial services specialist at Durward Jones Barkwell & Company LLP