COLLINS & MAY | LAW

NEWSLETTER

Volume 19, October 2014

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BUSINESS VALUATIONS—RELATIONSHIP PROPERTY

On most occasions where I have been acting for a relationship property client and the matter has ended up going to a full defended hearing in the Family Court the major reason for causing this is a dispute over a business valuation. Unlike a residential dwelling where the value can be ascertained from statistical data it is not uncommon for each party to have a valuation of a family business with quite a variance when it comes to quantum. Where that gap is on the high side it make it difficult for parties to reach a compromise and settle.

What is involved in obtaining a business valuation:

Expert -The first step is to obtain advice from an expert valuer. There are forensic accountants in New Zealand who specialise in providing expert valuation reports of private businesses for relationship property purposes.

Identification of Assets - First step of course is the valuer needs to identify the asset being valued. More often than not it is shares in a private company. Many clients get confused because the see the physical assets and start identifying the value of those physical assets. In fact the physical assets belong to the Company and it is the shares themself that must be valued.

Another item of relationship property which many clients are unaware of is the current account in the business. Normally the proprietor (i.e. Shareholder /or Director) have a current account credit. This is income earned allocated to the proprietor / or shareholder which has been retained in the business. This constitutes tax paid money and provided it was accumulated throughout the marriage or relationship constitutes a separate item of relationship property.

Methodology - The first step in the valuation process is for the expert to decide whether to use a liquidation methodology / or a future maintainable earnings (“FME”) methodology.

Where a business is not earning a very high income but has a number of valuable assets on its balance sheet then the appropriate method may be the liquidation approach. Simply that’s a matter of valuing the physical assets less the debt. The approach taken of course if making an assessment on the value of the assets as if the Company was in liquidation.

The other method of course where the Company is making a reasonable profit would be for the expert to make an assessment as to what the rate of return would be for a third party investor.

Shareholder Salary - When applying an FME methodology the valuer assess an appropriate market salary for the proprietor / owner. In a lot of private business situations the proprietor / owner has a salary roughly equivalent to the profit being made and the Company may operate on a break even basis. The expert might decide that the salary allocated to the proprietor / shareholder is far in excess of what the market would pay if the business employed a third party. The surplus salary above market of course would be allocated as to profit which would be available to an investor who would be interested in purchasing the shares.

Multiple Factor - Depending on the nature of the business the expert would normally apply a multiple factor to the profit of somewhere between 2 - 5 in order to determine the market value of the shares.

Minority Discount - Where a proprietor / shareholder does not own 100% of the shares the expert may consider discounting the assessed value as a result of the proprietor / shareholder not having total control over the business.

Conclusion - Unfortunately the valuation process is not an exact science and that is why the valuation of the business issue has a very high chance of forcing parties to litigation rather than compromise.