What is the real purpose of a valuation in the context of a sale transaction?

The valuation performed on a transaction can serve both as a key advise for fixing the price as well as for the compliance with accounting purposes in terms of purchase price allocation.

The valuation performed on a business is only an indication of ranges where negotiation can take place. The seller and the purchaser will need to settle on a price agreeable to both of them. Once the price is fixed the allocation in the purchasers' accounts if fundamental for the estimative of goodwill and other assets bought.

Valuations can be affected by many factors

The longer the specific business has been existence the more reliance can be placed on certain assumptions that are used in valuations, eg market risk. It can also assist the potential seller to back up their forecasts for growth, capex and overhead estimates. The smaller the business the more potential risks there would be. Smaller companies are more vulnerable to adverse market conditions as they do not necessarily have the back up capital to carry themselves through difficult periods. The price at which a business is eventually sold is also affected by timing, eg if it is a force sale and timing is of essence then the business could be sold for a lower value.

For financial institutions our experts can prepare business plans and financial estimates to factor prudential requirements and implications for the business.

Valuation methods

- **Net Asset values:** Asset based companies are often valued based on the assets that they own. A property company, for example, owns a property portfolio and generates its income from the rental of these properties. Therefore it would be valued based on the worth of its property portfolio.
- **Price Earnings Ratio, Value/EBIT & Value/EBITDA, Price and Value to Sales Ratios:** These are the most common method and the valuation is determined by multiplying after-tax profit/EBIT/EBITDA/Sales by the number of years a buyer is prepared to pay for these profits and sales.
- There are **other methods of valuation** such as discounted cash flow or entry cost (for new businesses).
- For **financial services** (commercial and investment banking and insurance companies) common methods are: dividend discount model and Price to Book Value.

Other considerations

- Experience of the management to grow the business going forward.
- How good is the relationships with other stakeholders of the company?
- Is there effective corporate governance in place?
- What is the business competitive advantages, what sets it apart from its competitors?

All these factors would have an effect on valuation multiples to be applied. For example, if a potential buyer likes the governance structures within the business he would be comfortable to increase the purchase price. Similarly if he feels that the board does not have the right experience a lower offer could be received for the business.

It is important to note that sellers should plan the selling of their business a couple of years in advance as it is normally required that the current management will need to stay on between two and five years depending on the complexity of the business.

PKF valuation team

At PKF Portugal we have an experienced team to cover both financial services sector and industrial and services activities for valuation needs.

In the financial sector we cover valuation of banks, asset management companies and insurance companies.

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