BUSINESS VALUATIONS - INTERNATIONAL NOTE

0. Introduction

1.1 The International Valuation Standards Committee (IVSC) adopted this Guidance Note (GN) to improve the consistency and quality of business valuations among the international community for the benefit of users of financial statements and users of business valuations.

1.2 Business valuations are commonly sought and performed on the *Market Value* basis of valuation applying the provisions of International Valuation Standard 1 (IVS 1).Where other bases of valuation are used, with proper explanation and disclosure, the provisions of IVS 2 are applied.

1.3 In general the concepts, processes, and methods applied in the valuation of businesses are the same as those for other types of valuations. Certain terms may have different meanings or uses. Those differences become important disclosures wherever they are used. This GN sets forth important definitions used in business valuations.

1.4 Care should be taken by Valuers and users of valuation services to distinguish between the value of a business entity or specialised trading property, the valuation of assets owned by such an entity, and various possible applications of business or going concern considerations encountered in the valuation of real property interests. An example of the latter is valuations of property with trading potential (see Property Types, para. 4.3.2).

2.0 Scope

2.1 This GN is provided to assist in the course of rendering or using business valuations.

2.2 In addition to the elements that are common to other GNs to the International Valuation Standards, this GN contains a more expansive discussion of the business valuation process. This is included to typify what is commonly involved in business valuations and to provide a basis of comparison with other types of valuations, but the discussion should not be considered as either mandatory or limiting except as provided in this GN or otherwise in the International Valuation Standards.

2.3 Because other basic valuation principles International Valuation Standards, and Guidance Notes are also applicable to business valuations, this GN should be understood to incorporate all other applicable portions of the IVS.

3.0 Definitions

3.1 *Adjusted Book Value.* The book value that results when one or more asset or liability amounts are added, deleted or changed from the reported book amounts.

3.2 *Asset-based Approach.* A means of estimating the value of a business and/or equity interest using methods based on the *Market Value* of individual business assets less liabilities.

3.3 *Book Value*

***3.3.1* With respect to assets, the capitalised cost of an asset less accumulated depreciation, depletion, or amortisation as it appears on**

the account books of the business.
***3.3.2* With respect to a business entity, the difference between total assets (net of depreciation, depletion, and amortisation) and total liabilities of a business as they appear on the balance sheet. In this case, *book value* is synonymous with *net book value*, *net worth*, and *shareholder's equity*.**
3.4 *Business Valuer.* A person who, by education, training, and experience is qualified to perform a valuation of a business, business ownership interest, security and/or intangible assets.
3.5 *Business Entity.* A commercial, industrial, service, or investment entity pursuing an economic activity.
3.6 *Business Valuation.* The act or process of arriving at an opinion or estimation of the value of a business or entity or an interest therein.
3.7 *Capitalisation*
***3.7.1* At a given date, the conversion into the equivalent capital value of net income or a series of net receipts, actual or estimated, over a period.**
***3.7.2* In business valuation, the term refers to the capital structure of a business entity.**
***3.7.3* In business valuation, this term also refers to the recognition of an expenditure as a capital asset rather than a periodic expense.**
3.8 *Capitalisation Factor.* Any multiple used to convert income into value.
3.9 *Capitalisation Rate.* Any divisor (usually expressed as a percentage) that is used to convert income into value.
3.10 *Capital Structure.* The composition of the invested capital.
3.11 *Cash Flow.*
***3.11.1 Gross Cash Flow*. Net income after taxes, plus noncash items such as depreciation and amortisation.**
***3.11.2 Net Cash Flow*. During an operating period, that amount of cash that remains after all cash needs of the business have been satisfied. *Net cash flow* is typically defined as being cash available to equity or invested capital.**
***3.11.3 Equity Net Cash Flow*. Net income after taxes, plus depreciation and other non-cash charges, less increases in working capital, less capital expenditures, less decreases in invested capital debt principal,**
plus increases in invested capital debt principal.
***3.11.4 Invested Capital Net Cash Flow*. *Equity net cash flow*, plus interest payments net of tax adjustment, less net increases in debt principal.**
3.12 *Control.* The power to direct the management and policies of a business.
3.13 *Control Premium.* The additional value inherent in the control interest that reflects its power of control, as contrasted to a minority interest.
3.14 *Discount for Lack of Control.* An amount or percentage deducted from a pro rata share of the value of 100 % of an equity interest in a business to reflect the absence of some or all of the powers of control.
3.15 *Discount Rate.* A rate of return used to convert a monetary sum, payable or receivable in the future, into present value.
3.16 *Economic Life.* The period over which property may be profitably used.
3.17 *Effective Date.* The date as of which the Valuer's opinion of value applies (Also referred to as *Valuation Date*, and/or *As Of Date*).

3.18 *Enterprise.* See Business Entity.
3.19 *Going Concern*
***3.19.1* An operating business.**
3.2 A premise of valuation, under which Valuers and accountants consider a business as an established entity that will continue in operation indefinitely.
The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of *Market Value* for the business.
***3.19.3* The entity is normally viewed as a going concern, that is, as continuing in operation in the foreseeable future. It is assumed that the entity has neither the intention nor the necessity of liquidation or of curtailing materially the scope of its operations. (IAS 1, 23-24, Framework, 23)**
3.20 *Going Concern Value*
***3.20.1* The value of a business, or of an interest therein, as a going concern.**
***3.20.2* Intangible elements of value in an operating business resulting from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.**
3.21 *Goodwill.*
***3.21.1* Future economic benefits arising from assets that are not capable of being individually identified and separately recognised. (IFRS 3, Appendix A)**
***3.21.2 Personal Goodwill*.The value of profit over and above market expectations, which could be extinguished upon sale of the specialised trading property, together with those financial factors related**
specifically to the current operator of the business, such as taxation, depreciation policy, borrowing costs and the capital invested in the business.
***3.21.3* Transferable Goodwill. That intangible asset that arises as a result of property-specific name and reputation, customer patronage, location, products, and similar factors, which generate economic benefits. It is inherent to the specialised trading property, and will transfer to a new owner on sale.**
3.22 *Holding Company.* A business that receives returns on its assets.
3.23 *Income Capitalisation Approach.* A general way of estimating a value indication of a business, business ownership interest, or security using one or more methods wherein a value is estimated by converting anticipated benefits into capital value.
3.24 *Invested Capital.* The sum of the debt and equity in a business on a long-term basis.
3.25 *Majority Interest.* Ownership position greater than 50% of the voting interest in a business.
3.26 *Majority Control.* The degree of control provided by a majority position.
3.27 *Market Approach.* A general way of estimating a value indication of a business, business ownership interest, or security using one or more methods that compare the subject to similar businesses, business ownership interests, or securities that have been sold.
3.28 *Market Value.* See IVS 1, para. 3.1.
3.29 *Marketability Discount.* An amount or percentage deducted from an equity interest to reflect lack of marketability.
3.30 *Minority Interest.* Ownership position less than 50% of the voting

interest in a business.

3.31 *Minority Discount.* A Discount for lack of control applicable to a minority interest.

3.32 *Net Assets.* Total assets less total liabilities.

3.33 *Net Income.* Revenue less expenses, including taxes.

3.34 *Operating Company.* A business that performs an economic activity by making, selling, or trading a product or service.

3.35 *Rate of Return.* An amount of income (loss) and/or change in value realised or anticipated on an investment, expressed as a percentage of that investment.

3.36 *Replacement Cost New.* The current cost of a similar new item having the nearest equivalent utility as the item being appraised.

3.37 *Report Date.* The date of the Valuation Report. May be the same as or different from the Valuation date.

3.38 *Reproduction Cost New.* The current cost of an identical new item.

3.39 *Valuation Approach.* In general, a way of estimating value using one or more specific valuation methods. (see *Market Approach*, *Income Capitalisation Approach,* and *Asset Based Approach* definitions).

3.40 *Valuation Method.* Within approaches, a specific way to estimate value.

3.41 *Valuation Procedure.* The act, manner, and technique of performing the steps of a valuation method.

3.42 *Valuation Ratio.* A factor wherein a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

***3.43 Working Capital.* The amount by which current assets exceed current liabilities.**

4.0 Relationship to Accounting Standards

4.1 Business valuations are commonly used as a basis for making allocations of various assets to aid in the establishment or restatement of financial statements. In this context, business Valuers reflect the *Market Value* of all components of a business's balance sheet in order to meet Accounting Standards, having regard to the convention that reflects the effect of changing prices.

4.2 In some instances the business valuation provides a basis for estimating the extent of obsolescence of certain fixed assets. In this application the business valuation may or may not be the principal reason for the valuation, but the combination of services by the Business Valuer and, for example, a Real Property Valuer, is necessary to properly allocate and reflect the *Market Value* of assets to be reflected in a financial statement.

4.3 Other considerations relative to the relationship of business valuations and Accounting Standards are similar to the provisions discussed in International Valuation Application 1 (IVA 1).

5.0 Guidance

5.1 Business valuations may be required for a number of possible uses, including acquisitions and dispositions of individual businesses, mergers, valuation of shareholder ownings, and the like.

***5.1.1* Where the purpose of the valuation requires a *Market Value* estimate, the Valuer shall apply definitions, processes, and**

methodologies consistent with their provision in IVS 1.
5.1.2 **When an engagement calls for a value basis other than *Market Value,* the Valuer shall clearly identify the type of value involved, define such value, and take steps necessary to distinguish the value estimate from a *Market Value* estimate.**
5.2 If, in the opinion of the Valuer, certain aspects of an engagement indicate that a departure from any provision of IVS or of this Guidance, is necessary and appropriate, such departure shall be disclosed and the reason for invoking the departure clearly set forth in all Valuation
Reports (oral or written) issued by the Valuer. The requirements for Valuation Reports are addressed in the IVS Code of Conduct and IVS 3,Valuation Reporting.
5.3 The Valuer shall take steps to assure that all data sources relied upon are reliable and appropriate to the valuation undertaking. In many instances it will be beyond the scope of the Valuer's services to perform a complete verification of secondary or tertiary data sources. Accordingly, the Valuer shall verify the accuracy and reasonableness of data sources as is customary in the markets and locale of the valuation.
5.4 Business Valuers must often rely upon the services of Professional Property Valuers and/or other experts. A common example is reliance upon a Real Property Valuer to value the real estate components owned by a business. Where the services of other experts are relied upon, the Business Valuer shall;
5.4.1 **take such verification steps as are necessary to assure that such services are competently performed and that the conclusions relied upon are reasonable and credible, or**
5.4.2 **disclose the fact that no such steps were taken.**
5.5 Business Valuers must frequently rely upon information received from a client or from a client's representatives. The source of any such data relied upon shall be cited by the Valuer in oral or written Valuation Reports, and the data shall be reasonably verified wherever possible.
5.6 Although many of the principles, methods, and techniques of business valuation are similar to other fields of valuation, business valuations require special education, training, skills, and experience.
5.7 Going concern has several meanings in accounting and valuation. In some contexts, going concern serves as a premise under which Valuers and accountants consider a business as an established entity that will continue in operation indefinitely.
5.7.1 **The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of the *Market Value* of the business.**
5.7.1.1 **In liquidations, the value of most intangible assets (e.g., goodwill) tends toward zero, and the value of all tangible assets reflects the circumstance of liquidation. Expenses associated with liquidation (sales fee, commissions, taxes, other closing costs, administrative costs during close-out, and loss of value in inventory) are also calculated and deducted from the estimate of business value.**
5.8 Awareness of current market activity, and knowledge about relevant economic developments and trends are essential for competent business valuations. In order to estimate the *Market Value* of a business, Business Valuers identify and assess the impact of such considerations in their valuations and Valuation Reports.

5.9 A description of the business valuation assignment must include;
5.9.1 **Identification of the business, business ownership interest, or security to be valued;**
5.9.2 **the effective date of the valuation;**
5.9.3 **the definition of value;**
5.9.4 **the owner of the interest; and**
5.9.5 **the purpose and use of the valuation.**
5.10 **Factors to be considered by the Valuer in the valuation of a business include:**
5.10.1 **The rights, privileges, or conditions that attach to the ownership interest, whether held in corporate form, partnership form, or proprietorship.**
5.10.1.1 **Ownership rights are set forth in various legal documents. In various States these documents may be called articles of association and/or the capital clause in the memorandum of the business, articles of incorporation, bylaws, partnership agreements, and shareholder agreements, to name a few.**
5.10.1.2 **Whoever owns the interest is bound by the business's documents. There maybe rights and conditions contained in an owner's agreement or exchange of correspondence, and these rights may or may not be transferable to a new owner of the interest.**
5.10.1.3 **The documents may contain restrictions on the transfer of the interest and may contain provisions governing the basis of valuation that has to be adopted in the event of transfer of the interest. For example, the documents may stipulate that the interest to be transferred should be valued as a pro rata fraction of the value of the entire issued share capital even though the interest to be transferred represents a minority interest. In each case the rights of the interest being valued and the rights attaching to any other class of interest must be considered at the outset.**
5.10.2 **The nature of the business and history of the business. Since value resides in the benefit of future ownership, history is valuable in that it may give guidance as to the expectations of the business for the future.**
5.10.3 **The economic outlook that may affect the subject business, including political outlook and government policy. Matters such as exchange rates, inflation and interest rates may affect businesses that operate in different sectors of the economy quite differently.**
5.10.4 **The condition and outlook of the specific industry that may affect the subject business.**
5.10.5 **The assets, liabilities, and equity and financial condition of the business.**
5.10.6 **The earnings and dividend paying capacity of the business.**
5.10.7 **Whether or not the business has intangible value.**
5.10.7.1 **Intangible value may be embodied in identifiable intangible assets such as patents, trademarks, copyrights, brands, know-how, databases, etc.**
5.10.7.2 **Intangible value may also be contained in undifferentiated assets, often called "*goodwill.*" Note that goodwill value in this context is similar to goodwill in the accounting sense in that both are the residual value (historical cost in accounting terms) after all other assets have been taken into account.**
5.10.7.3 **If the business has intangible assets, the Valuer must ensure that the value of the intangibles is fully reflected, whether the identifiable intangible assets have been valued separately or not.**
5.10.8 Prior transactions in ownership interests of the subject

business.
5.10.9 The relative size of the ownership interest to be valued.
5.10.9.1 **There are different levels of control or lack of control resulting from differences in the size of ownership interests. In some instances effective control may be obtained with less than 50% of the voting rights. Even if one person owns more than 50% of the voting rights and has operational control, there may be certain actions, such as winding the business up (i.e., putting everything in order before the business may be dissolved), that may require more than 50% affirmative vote, and may require an affirmative vote of all owners.**
5.10.9.2 **It is essential that the Valuer be aware of the legal restrictions and conditions that arise through the laws of the State in which the business exists.**
5.10.10 **Other market data, e.g., rates of return on alternative investments, advantages of control, disadvantages of lack of liquidity, etc.**
5.10.11 **The market prices of publicly traded stocks or partnership interests, acquisition prices for business interests, or businesses engaged in the same or similar lines of business.**
5.10.11.1 **Often, particularly in the use of acquisition transactions, adequate information is difficult or impossible to obtain. While the actual transaction price may be known, the Valuer may not know what warranties and indemnities were given by the seller, what terms were given or received, whether cash or other assets were taken from the business prior to acquisition, or what impact taxation planning had on the transaction.**
5.10.11.2 **Comparable data should always be used with care, and inevitably numerous adjustments need to be made. When using market prices that reflect public trading, the Valuer must bear in mind that the market prices are from transactions for small minority holdings.**
The price for the acquisition of an entire business represents 100% of the business.
Adjustments must be made for differences arising due to different levels of control.
5.10.12 **Any other information the Valuer believes to be relevant.**
5.11 Use of financial statements.
5.11.1 **There are three goals of financial analysis and adjustment:**
5.11.1.1 **Understanding of the relationships existing in the profit and loss statement and the balance sheet, including trends over time, to assess the risk inherent in the business operations and the prospects for future performance.**
5.11.1.2 **Comparison with similar businesses to assess risk and value parameters.**
5.11.1.3 **Adjustment of historical financial statements to estimate the economic abilities of and prospects for the business.**
5.12 To aid in understanding the economics of and risk in a business interest, financial statements should be analysed in terms of 1) money, 2) percentages (percentage of sales for items in the income statement and percentage of total assets for items in the balance sheet), and 3) financial ratios.
5.12.1 **Analysis in terms of money as stated in the financial statements is used to establish trends and relationships between income and expense accounts in a business interest over time. These trends and relationships are used to assess the expected income flow in the future, along with the capital needed to allow the business to**

provide that income flow.

5.12.2 **Analysis in terms of percentages compares accounts in the profit and loss statement to revenues, and accounts in the balance sheets to total assets. Percentage analysis is used to compare the trends in relationships, i.e., between revenue and expense items, or between balance sheet amounts, for the subject business over time and among similar businesses.**

5.12.3 **Analysis in terms of financial ratios is used to compare the relative risk of the subject business over time and among similar businesses.**

5.13 For estimates of the *Market Value* of a business, common adjustments to the financial record of the business are made to more closely approximate economic reality of both the income stream and the balance sheet.

5.13.1 **Financial statement adjustments should be made to reported financial information for items that are relevant and significant to the valuation process. Adjustments may be appropriate for the following reasons:**

5.13.1.1 To adjust revenues and expenses to levels that are reasonably representative of expected continuing operations.

5.13.1.2 To present financial data of the subject and guideline comparison businesses on a consistent basis.

5.13.1.3 To adjust from reported values to *Market Values.*

5.13.1.4 To adjust for non-operating assets and liabilities and the related revenue and expenses.

5.13.1.5 To adjust for non-economic revenue or expense.

5.13.2 **Whether an adjustment is appropriate, or not, may depend on the degree of control held by the ownership interest under valuation. For controlling interests, including an ownership interest of 100%, most adjustments may be appropriate if the owner could make the changes implied by the adjustment.**

For valuation of minority interests, whose owners do not have the ability to change most items, the Valuer should be careful to reflect reality when considering potential adjustments. Common adjustments include:

5.13.2.1 **Elimination of income statement impact of non-recurring events, and balance sheet impact if any. Since these events are not likely to recur, a buyer of the interest would not expect to incur them, and would not include them in the income stream. Adjustments may be required in taxes. These types of adjustments are typically appropriate for both majority and minority interest valuations. Examples of non-recurring items include:**

5.13.2.1.1 **Strikes, if unusual,**

5.13.2.1.2 **New plant startup,**

5.13.2.1.3 **Weather phenomena such as floods, cyclones, etc.**

5.13.2.2 **The Valuer should be wary of adjusting for non-recurring items whenever nonrecurring items arise in most years, but in each year they appear to be the result of different events. Many businesses have non-recurring items every year, and the Valuer should make contingency provisions for these expenses.**

5.13.2.3 **Elimination of the impact of nonoperating items from the balance sheet and the income statement in the context of valuation of a controlling shareholder's interest. In the context of valuation of a minority shareholder's interest, these adjustments may not be appropriate. If non-operating items are on the balance sheet, they should be removed and valued separately from the operating**

business. Non-operating items should be valued at *Market Value.*
Tax adjustments may be required. Costs of sale should be taken into account.
Adjustments to the income statement should include removal of both income and expense arising from the nonoperating assets, including tax impacts.
Examples of non-operating items and the appropriate adjustments include:
***5.13.2.3.1* Non-essential personnel. Eliminate compensation expense and taxes related to compensation expense and adjust income taxes. The Valuer should be wary of adjusting for items such as non-essential personnel in arriving at a maintainable profits figure. Unless the Valuer knows that the acquirer, or whoever the Valuer is acting for, actually has the controlling power to make the change and intends of get rid of nonessential personnel, there is a danger of overvaluing the business if the expenses are added back to profit.**
***5.13.2.3.2* Non-essential assets (e.g., airplane). Eliminate the value of the non-essential asset(s) and any associated assets and liabilities from the balance sheet. (After the business has been valued, the value of the non-essential asset(s) is added to reconciled business value net of costs of disposal, including taxes if any.).**
Eliminate income statement impact of owning the non-essential asset(s), including support expenses (in the case of an airplane, the fuel, crew, hanger, taxes, maintenance, etc.) and revenue (charter or rental income).
***5.13.2.3.3* Redundant assets (surplus or not necessary to the requirements of the business) should be discussed in the Valuation Report similarly with nonoperating items. Such redundant assets may include principally: unemployed licences, franchises, copyrights and patents; investments in land, rental buildings and excess equipment; investments in other businesses; a marketable securities portfolio; and, excess cash or term deposits. The net realisable value of redundant assets (net of income tax and selling costs) must be added as inflow to operating net cash flow, especially in the first year of the specified forecast period.**
***5.13.2.4* Depreciation may need to be adjusted from the tax or accounting depreciation shown in the reported financial statements to an estimate that compares more accurately to depreciation used in similar businesses.Tax adjustments may need to be made.**
***5.13.2.5* Inventory accounting may need to be adjusted to more accurately compare to similar businesses, whose accounts may be kept on a different basis from the subject business, or to more accurately reflect economic reality. Inventory adjustments may be different when considering the income statement and when considering the balance sheet.**
For example, first-in-first-out (a method of costing inventory that assumes the first acquired stock will be the first sold) may most accurately represent the value of the inventory when constructing a *Market Value* balance sheet. But, when examining the income statement, last-infirst-out (a method of costing inventory that assumes the most recently acquired stock will be the first sold) may more accurately represent the income level in times of inflation or deflation. Tax adjustments may need to be made.
***5.13.2.6* Compensation of the owner(s) may need to be adjusted to reflect the market cost of replacing the labor of the owner(s). Severence pay for nonessential personnel may need to be considered.**

Tax adjustments may need to be made. Service contracts may need to be looked at carefully to adjust for the value (rather than the face amount of the cost) of terminating contracts with senior personnel.
5.13.2.7 **Cost of items leased, rented or otherwise contracted from related parties may need to be adjusted to reflect *Market Value* payments. Tax adjustments may need to be made.**
5.13.3 **Some adjustments that would be made in the context of valuation of the entire business might not be made in the context of valuation of a non-controlling interest in that entity since the non-controlling interest would not have the ability to make the adjustment.**
5.13.4 **Financial statement adjustments are made for the purpose of assisting the Valuer in reaching a valuation conclusion. If the Valuer is acting as a consultant to either the buyer or seller in a proposed transaction, the adjustments should be understood by the client. For example, the proposing purchaser should understand that the value derived after adjustments may represent the maximum that should be paid. If the purchaser does not believe the financial or operational improvements can be made, a lesser price may be appropriate.**
5.13.5 Adjustments made should be fully described and supported. The Valuer should be very careful in making adjustments to the historical record. Such adjustments should be discussed fully with the client. The Valuer should make adjustments only after sufficient access to the business to support their validity.
5.14 Business valuation approaches.
5.14.1 Market approach **to business valuation.**
5.14.1.1 **The *market approach* compares the subject to similar businesses, business ownership interests, and securities that have been sold in the market.**
5.14.1.2 **The three most common sources of data used in the *market approach* are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which entire businesses are bought and sold, and prior transactions in the ownership of the subject business.**
5.14.1.3 **There must be a reasonable basis for comparison with and reliance upon the similar businesses in the *market approach.* These similar businesses should be in the same industry as the subject or in an industry that responds to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading. Factors to be considered in whether a reasonable basis for comparison exists include:**
5.14.1.3.1 **Similarity to the subject business in terms of qualitative and quantitative business characteristics.**
5.14.1.3.2 **Amount and verifiability of data on the similar business.**
5.14.1.3.3 **Whether the price of the similar business represents an arm's-length transaction.**
5.14.1.3.3.1 **A thorough, unbiased search for similar businesses is necessary to establish the independence and reliability of the valuation. The search should include simple, objective criteria for selecting similar businesses.**
5.14.1.3.3.2 **A comparative analysis of qualitative and quantitative similarities and differences between similar businesses and the subject business must be made.**
5.14.1.4 **Through analysis of the publicly traded businesses or acquisitions, the Valuer often computes valuation ratios, which are usually price divided by some measure of income or net assets. Care**

must be used in calculating and selecting these ratios.

5.14.1.4.1 **The ratio must provide meaningful information about the value of the business.**

5.14.1.4.2 **The data from the similar businesses used to compute the ratio must be accurate.**

5.14.1.4.3 **The calculation of ratios must be accurate.**

5.14.1.4.4 **If the data are averaged, the time period considered and averaging method must be appropriate.**

5.14.1.4.5 **All calculations must be done in the same way for both the similar businesses and the subject business.**

5.14.1.4.6 **The price data used in the ratio must be valid as of the valuation date.**

5.14.1.4.7 **Where appropriate, adjustments may need to be made to render the similar businesses and the subject business more comparable.**

5.14.1.4.8 **Adjustments may need to be made for unusual, non-recurring, and nonoperating items.**

5.14.1.4.9 **The selected ratios must be appropriate given the differences in risk and expectations of the similar businesses and the subject business.**

5.14.1.4.10 **Several value indications may be derived since several valuation multiples may be selected and applied to the subject business.**

5.14.1.4.11 **Appropriate adjustments for differences in the subject ownership interest and interests in the similar businesses with regard to control or lack of control, or marketability or lack of marketability, must be made, if applicable.**

5.14.1.5 When prior transactions in the subject business are used to provide valuation guidance, adjustments may need to be made for the passage of time and for changed circumstances in the economy, the industry, and the business.

5.14.1.6 Anecdotal valuation rules, or rules of thumb, may be useful in the valuation of a business, business ownership interest, or security. However, value indications derived from the use of such rules
should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them.

5.14.2 Income capitalisation approach **to business valuation**

5.14.2.1 **The** ***income capitalisation approach*** **estimates the value of a business, business ownership interest or security by calculating the present value of anticipated benefits. The two most common income approach methods are capitalisation of income and** ***discounted cash flow analysis*** **or** ***dividends method.***

5.14.2.1.1 **In (direct) capitalisation of income, a representative income level is divided by a capitalisation rate or multiplied by an income multiple to convert the income into value. In theory, income can be a variety of definitions of income and cash flow. In practice, the income measured is usually either pretax income or post-tax income. The capitalisation rate must be appropriate for the definition of income used.**

5.14.2.1.2 **In** ***discounted cash flow analysis*** **and/or** ***dividends method*****, cash receipts are estimated for each of several future periods. These receipts are converted to value by the application of a discount rate using present value techniques. Many definitions of cash flow could be used. In practice, net cash flow (cash flow that could be distributed to shareholders), or actual dividends (particularly in the case of**

minority shareholders) are normally used.
The discount rate must be appropriate for the definition of cash flow used.
5.14.2.1.3 **Capitalisation rates and discount rates are derived from the market and are expressed as a price multiple (derived from data on publicly traded businesses or transactions) or an interest rate (derived from data on alternative investments).**
5.14.2.2 **Anticipated income or benefits are converted to value using calculations that consider the expected growth and timing of the benefits, the risk associated with the benefits stream, and the time value of money.**
5.14.2.2.1 **Anticipated income or benefits should be estimated considering the capital structure and historical performance of the business, expected outlook for the business, and industry and economic factors.**
5.14.2.2.2 **The *income approach* requires the estimation of a capitalisation rate, when capitalising income to arrive at value, or a discount rate, when discounting cash flow. In estimating the appropriate rate, the Valuer should consider such factors as the level of interest rates, rates of return expected by investors on similar investments, and the risk inherent in the anticipated benefit stream.**
5.14.2.2.3 **In capitalisation methods that employ discounting, expected growth is explicitly considered in the estimate of the future benefit stream.**
5.14.2.2.4 **In capitalisation methods that do not employ discounting, expected growth is included in the capitalisation rate. The relationship, stated as a formula, is discount rate minus long-term growth rate equals capitalisation rate (R=Y–Da where R is the capitalisation rate;Y is the discount, or yield, rate; and Da is the annualised change in value).**
5.14.2.2.5 **The capitalisation rate or discount rate should be consistent with the type of anticipated benefits used. For example, pre-tax rates should be used with pre-tax benefits; net after-incometax rates should be used with net afterincome-tax benefit streams; and net cash flow rates should be used with net cash flow benefits.**
5.14.2.2.6 When the forecast income is expressed in nominal terms (current prices), nominal rates must be used, and when the forecast income is expressed in real terms (level prices), real rates must be used. Similarly, the expected long-term growth rate of income should be documented and clearly expressed in nominal or real terms.*5.14.3 Asset-based business valuation* approach.
5.14.3.1 **In business valuation the *asset-based appr*oach may be similar to the cost approach used by Valuers of different types of assets.**
5.14.3.2 **The *asset-based approac*h is founded on the principle of substitution, i.e., an asset is worth no more than it would cost to replace all of its constituent parts.**
5.14.3.3 **In the execution of the *asset-based approach*, the cost basis balance sheet is replaced with a balance sheet that reports all assets, tangible and intangible, and all liabilities at *Market Value* or some other appropriate current value. Taxes may need to be considered. If market or liquidation values apply, costs of sale and other expenses may need to be considered.**
5.14.3.4 **The *asset-based approach* should be considered in valuations of controlling interests in business entities that involve one or more**

of the following:

***5.14.3.4.1* An investment or holding business, such as a property business or a farming business.**

***5.14.3.4.2* A business valued on a basis other than as a going concern.**

***5.14.3.5* The *asset-based approach* should not be the sole valuation approach used in assignments relating to operating businesses appraised as going concerns unless it is customarily used by sellers and buyers. In such cases, the Valuer must support the selection of this approach.**

***5.14.3.6* If the valuation of an operating business is not on a going concern basis, the assets should be valued on a *Market Value* basis or on a basis that assumes a shortened time period for exposure in the market, if that is appropriate. All costs related to the sale of the assets or the closing of the business need to be taken into account in this type of valuation.**

Intangible assets such as goodwill may not have value under these circumstances, although other intangible assets such patents, trademarks, or brands may retain their value.

5.14.3.7 If the holding business simply holds property and receives investment income from the property, *Market Values* should be obtained for each property.

5.14.3.8 If an investment holding business is to be valued, the securities (both quoted and unquoted), the liquidity of the interest, and the size of the interest may be relevant and may lead to a deviation from the quoted price.5.15 Reconciliation processes.

***5.15.1* The value conclusion shall be based upon;**

***5.15.1.1* the definition of value;**

***5.15.1.2* the purpose and intended use of the valuation; and**

***5.15.1.3* all relevant information as of the valuation date necessary in view of the scope of the assignment.**

***5.15.2* The value conclusion shall also be based on value estimates from the valuation methods performed.**

***5.15.2.1* The selection of and reliance on the appropriate approaches, methods and procedures depends on the judgment of the Valuer.**

5.15.2.2 The Valuer must use judgment when estimating the relative weight to be given to each of the value estimates reached during the Valuation Process. The Valuer should provide the rationale and justification for the valuation methods used and for the weighting of the methods relied on in reaching the reconciled value.

6.0 Effective Date

6.1 This International Valuation Guidance Note became effective 31 January 2005.