Information required to value a business

We are often asked to assess the value of a business, whether for a shareholder dispute, matrimonial dispute, breach of warranty or professional negligence claim.

It goes without saying that the reliability of any valuation will be dictated by the quality and integrity of the information that underpins it. Therefore, we summarise below the key information we would ordinarily request, together with a brief description of the relevance of each item:

1. *The Articles of Association and any shareholders' or investment agreements*

   Valuations are often performed under the framework of the Articles of Association; these might dictate the pre-emption rights of other shareholders and how shares should be valued – for example, the treatment of a minority interest. On occasions, these issues are covered in shareholders' agreements or investment agreements.

2. *The accounts:*

   The accounts should reflect the trading performance of the business, through its profit and loss account, and its financial position (assets and liabilities), through its balance sheet. However, there are different forms of accounts, and it is helpful to differentiate between them:

   a. *Annual financial accounts:*

      Each year, a company (we presume for these purposes that the business being valued operates through a corporate guise) must prepare a set of annual accounts to be presented to its members – usually at the annual general meeting. These are sometimes referred to as the "statutory" accounts, as they are required under the Companies Act.

      A copy of the statutory accounts must be filed at Companies House, and at that point they become publicly available. However, we raise two points of warning in this regard:

      Firstly, if the company qualifies as a "small company" under the criteria laid down in the Companies Act – the financial criteria here is quite generous, and most companies do qualify – then it is entitled to file only abbreviated accounts at Companies House. As the name suggests, abbreviated accounts include only very limited financial details (no profit and loss account is required, and most of the notes to the accounts can be excluded), and are next to useless when seeking to assess the value of the business. We require a copy of the *full* annual accounts presented to the members.

      Secondly, be mindful of timing issues. A private company has nine months from its accounting year-end reference date to file accounts at Companies House. There is often a delay in preparing and filing the annual financial accounts. By the time the annual accounts are finalised, they are often outdated. If an up-to-date valuation is required, more recent financial accounting information should be requested, such as:

b. *Management accounts:*

Many businesses produce management accounts on a monthly or quarterly basis, in order to monitor current financial performance. They might also assist directors in absolving their responsibilities under the Companies Act (particularly if there are doubts regarding the capacity of the business to continue trading as a going concern). By their nature, management accounts are generally less reliable than the annual accounts – as they are not prepared with the same level of rigor or scrutiny - but nevertheless they are prepared promptly and so represent a good guide as to current trading.

In order to assess the financial performance of a business, it is helpful to look at trends. This will help us to understand whether the trading profits generated in any one year are maintainable – or alternatively whether they are exceptional and will not recur. Ordinarily, we would ask for the last three years' annual accounts, together with the latest available management accounts.

3. *Details of any non-recurring income/expenditure, or transactions not conducted at market value:*

As explained above, we are interested in the maintainable trading performance of the business. To the extent that the accounts reflect one-off matters, or transactions not conducted at market value (most typically trading with related parties, such as a discounted rental charged by a property-holding company under common ownership), then the reported trading performance should be adjusted accordingly.

Often, the salaries charged by shareholder-directors might not reflect their respective contributions to the business – and instead simply reflect what the business can afford, or what they require to live. If so, we would request details of the nature and extent of work performed by each director, in order to better assess the market value of their input.

4. *Copies of any budgets and forecasts prepared:*

The capacity of a business to generate future profits forms an important aspect of the valuation equation. Most businesses prepare some form of budget or forecast, covering at least the year ahead. If financing is in place, some lenders will require these.

We appreciate that, sometimes, projections can be aspirational – a business might prepare a "stretch" budget that represents a target to motivate employees – rather than reflect realistic expectations. Nevertheless, budgets and forecasts will help us to better understand the anticipated prospects of the business.

5. *Details of financing:*

   To the extent that the business has loans or overdrafts, we would request details. In particular, what are the repayment terms, interest charges, and security given? Even a very profitable business might have limited value if it is burdened by onerous financing. Moreover, liquidity (and immediate access to cash) can be important, especially in shareholder and matrimonial matters.

6. *Details of recent transactions in shares or offers to acquire the business:*

   If there have been other transactions in the shares in recent years, then that will provide a useful benchmark. So long as the transaction was on arm's length commercial terms, then this will be the best evidence of the market value of the shares at that date. We can then assess how the trading performance and prospects of the business have changed in the intervening period.

   In a similar vein, if there has been a recent offer to acquire the business by a third party, that might be a valuable point of reference.

7. *Details of comparable businesses (quoted and unquoted):*

   In assessing the value of a business, we are guided by what a hypothetical purchaser might be prepared to pay. In order to appraise market sentiment, it is helpful to have details of comparator businesses – this will include competitors of the business being valued (particularly if any of those have been recently bought or sold), and quoted businesses operating in the same industry sector. By reference to those benchmark businesses, we can assess the appropriate valuation approach and multiples.

8. *Property valuation evidence:*

   Sometimes, the value of a business may be principally derived from the capital value of its assets. This may be the case for a venture capital business or a regulated business in the financial services sector. To the extent that the underlying assets are capable of being valued (for example, quoted shares or unit trusts), then we are able to make this assessment.

   When the assets comprise properties (for example, in a property rental business) or when the property is synonymous with the business (for example, a care home or public house), then it may be necessary to obtain valuation evidence from a surveyor. Freehold property valuation tends to be an area outside the sphere of expertise of an accountant; the value follows patterns dictated by particular market factors, such as geography (property value trends can be very localised), permitted use (for commercial properties), planning permission, and development potential. Whilst we are able to estimate property values based on published indices, we generally recommend obtaining a surveyor's valuation if a recent one is not already available.

You will appreciate that the above represents a general guide, and is not a definitive list. Ideally, any request for information should be tailored to the specific business being valued. It may be that the business is reliant on specific customers, suppliers, or contracts. If so, then the prospects of each of these might be highly relevant to any valuation conclusions. Also, a business operating in a sector at the forefront of technology could be very sensitive to competitor activity and new technology coming to market – product life cycles might be critical here - whilst a business in a regulated sector may face challenges brought on by a changing regulatory framework.