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Case Study

Industry Method applied in Business Valuations

Topics discussed in this paper include

Valuation Methodology | Buying a Business | Succession Planning

The price for the sale of a real estate franchise is under negotiation, with both buyer and seller failing to agree on the appropriate business valuation method to use. A third party professional was engaged to provide not only an independent fair market valuation, but to test and validate the most appropriate methodology to apply in the situation.

Background

Based on Auckland's North Shore, Aqua Real Estate was established over 10 years ago. The business is part of a nationwide real estate franchise.

After a long and successful career in real estate the firm's principal, John Teal, had made the difficult decision to retire. He had initiated preliminary discussions with one of his leading agents who was keen to purchase the firm from him upon his retirement.

The only problem was both buyer and seller had varying ideas on how the business should be valued.

Situation Analysis

Both parties were anxious to come to an agreement on price and finalise the transaction. Both parties agreed asking the firm's regular accountant to become involved would place him in an awkward position. An independent accountant, one with expertise in undertaking valuations, was engaged to undertake a fair market valuation of the business.

After reviewing the valuation proposals put forward by both parties the valuer began work on a separate assessment. An essential component of that process was to test the validity of competing methodologies.

The sale of Real Estate businesses is relatively common and most Real Estate businesses run under a consistent business model so the use of an industry method is quite common and justified. However, industry methods can sometimes provide a flawed valuation outcome with no relevance to the real value of a business.

The Valuer chose to test the business by applying two different valuation methods:

- The industry method of applying a multiple to recurring income generated from the business' rent roll.
- The capitalisation of earnings method by determining future maintainable earning and multiplying by an appropriate multiple.

Outcome

Both methods resulted in considerably different valuation amounts, however due to its close alignment with real market transactions and the availability of comparable sales, the industry method was adopted.

Valuers always treat Industry based methods with caution however there are a handful of industries where they can be applied to give an accurate valuation result and for this business that was certainly the case.

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web bizval.co.nz
email info@bizval.co.nz
phone (09) 971 9896

address PO Box 106910
Auckland, Auckland City 1143
NZBN 942 904 719 0474