



Valuing Your Companies Shares

Most shareholders of private companies, or the companies themselves, need at some time a valuation of the company's shares, whether for commercial, legal or tax purposes.

This Help Sheet covers the valuation process, the information required by a valuer and the main methods of valuation.



Why are share valuations necessary?

There are many circumstances when shares in a private company need to be valued. These include:

- Management buy-outs, buy-ins or disposals;
- Determining a price for the purchase by a company of its own shares;
- Setting a price for employee share options and management incentive schemes;
- Inland Revenue "fiscal" valuations for capital gains tax, inheritance tax, capital duty and stamp duty;
- Determining a "fair value" in a legal or commercial dispute

What makes share valuations difficult?

There is often a perception that share valuations are "back of an envelope" calculations. This perception is almost entirely incorrect. A valuation is about understanding what makes a company tick, the industry in which it operates and the application of valuation techniques. Every company is different and the individual circumstances must be considered in depth in order to arrive at a value.

In any valuation there is likely to be some conflicting pressure between the parties. This reinforces the need for a valuation to be fully supported by reasoning and analysis.

The skills required of a valuer include:

- The technical skills to determine the appropriate valuation method for the business of the company and the purpose of the valuation;
- A high level of accounting and analytical skills to fully appraise a company's accounting information;
- For fiscal valuations, an in depth understanding of case law decisions, experience of the approach taken by the Shares Valuation Division ("SVD") of the Inland Revenue and the process of negotiating with SVD.

Information required by the valuer



The range of information required to value a shareholding is likely to vary according to the complexity of a company's business, the nature of the valuation and the size of the shareholding, both voting size and

monetary value. The information required is likely to include:

- The history and development of the business;
- Details of shareholder agreements and specific rights attached to the class of shares to be valued;
- The price or value agreed for any previous share transfers;
- Minutes of board meetings and information circulated to shareholders;
- Details of a company's market share, main competitors, customer profile, contracts with customers and dependence on specific customers;
- Audited and management accounts.
- Trading prospects, including budgets and forecasts;
- Details of claims or litigation against the business or contingent liabilities such as environmental matters.

Methods of valuation

The three main methods of valuation are by reference to maintainable earnings, maintainable dividends and net assets:

- Controlling holdings usually give the shareholder the right to appoint directors, determine company policy and draw out the earnings. A multiple of earnings is the normal method of valuation;
- Minority holdings are valued according to the circumstances, usually being based on the expectation of

dividends, known as the dividend yield, or on a discounted multiple of maintainable earnings;

- Holdings in property or investment companies are likely to be based on the value of the net assets.

In many instances, it may be appropriate to arrive at a value with reference to a hybrid of the different methods of valuation.

Commercial Valuations

Commercial valuations are usually determined so as to obtain the most favourable price in negotiations before a transfer of shares, or to comply with a valuation clause in an agreement.

The majority of commercial valuations which involve controlling shareholdings are earnings valuations, requiring a valuer to estimate a company's maintainable profits and then apply a multiple to this profit.

Estimating maintainable profits requires a critical review of the trend of past and current performance, with adjustment for items regarded as non recurring, of abnormal size or not wholly incurred for the benefit of a company's business. These could, for example, include:

- Remuneration and benefits for owner managers in excess of that necessary;
- Exceptionally large bad debts;
- Funding, rental or other arrangements on special terms with the shareholders;

- The benefits of any special buying or selling arrangements which are unlikely to continue.

The selection of a multiple to be applied to the maintainable earnings is one of the areas which requires the special skills, experience and judgement of a valuer.



Fiscal Valuations

Fiscal valuations are usually referred to the SVD who negotiate the share value. The SVD has a record of all previously agreed fiscal values for a company's shares and access to a wealth of information about other companies. It is essential to be well prepared when negotiating a fiscal value.

Remember that every valuation agreed with the SVD is important, however small the shareholding, as it can prejudice a later valuation. In some circumstances it may be possible to agree a value "without prejudice" to later valuations.

Planning Points



Planning points include:

- Save your valuer time by preparing a file of accounting and other information about the company whose shares are to be valued;
- Beware of a "quick valuation" which needs to be changed when challenged by the other side, particularly in a forensic or fiscal situation. This can be seen as a sign of weakness.

For further advice and assistance

Monahans can assist you in all aspects valuations, whether commercial, fiscal or forensic.

Our specialist Corporate Finance Department will be pleased to help.

Please contact **Peter Lugg** on **01225 472800** or e-mail on **peterl@monahans.co.uk**