Barreau du Québec

LA VALEUR AJOUTÉE EN MATIÈRE DE FUSIONS ET ACQUISITIONS

29 novembre 1996

"VALUING THE TARGET BUSINESS"

presentation by

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1. INTRODUCTION

The total economic value of a business enterprise is the aggregate value of its equity and debt; this is referred to as "corporate value". The equity component is referred to as "shareholder value". In public-company parlance, the aggregate market value of equity and debt is called "market capitalization". The debt component includes the market value of interest-bearing debt, capitalized long-term lease obligations, unfunded pension obligations and other claims such as preferred shares.

The foregoing may be expressed by the following equation:

CORPORATE VALUE = SHAREHOLDER VALUE + VALUE OF DEBT

Therefore,

SHAREHOLDER VALUE = CORPORATE VALUE - VALUE OF DEBT

As noted below, corporate value on a "stand-alone" basis (i.e., intrinsic value) of an ongoing commercial enterprise comprises two basic components:

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(a) The present value of anticipated future benefits (cash flow from operations) accruing during the selected forecast period

plus

(b) The present value of the value of the business attributable to the period *following* the forecast period, i.e., “residual” or “terminal” value.

In determining shareholder value, in addition to the stand-alone value of the business operation, there must also be included the current market value of any “redundant assets”, i.e., non-operating assets and other excess assets not required in the day-to-day operations of the business and which could be extracted from the corporation without impairing the ability of the business to continue to operate as is.

The foregoing components of shareholder value, (a) and (b), constitute intrinsic value, which can be referred to as notional fair market value on a stand-alone basis. This contemplates that the business operation will continue “as is”, either alone or as part of an integrated operation, without considering possible additions or, in future, combining with another business entity. As will be discussed below, fair market value on a stand-alone basis (intrinsic value) excludes consideration of “special purchaser” or “strategic purchaser” synergies/advantages which will generally add a premium over stand-alone value because of post-acquisition anticipated economic value added.

This paper will focus on the valuation of privately-held business and business ownership interests. The principles and concepts generally apply to the valuation of a business enterprise, irrespective of whether it may be carried on through a corporate entity, partnership, joint venture or sole proprietorship. These principles and concepts apply equally to the valuation of controlling interests in public companies, where the unaffected[1] quoted market price (being

(1) The unaffected price is that with respect to which the market has not reacted to a pre-acquisition public announcement or rumours thereof.

merely a minority price) is often a benchmark against which an initial bid price is determined by the purchaser.

From a total-enterprise marketability standpoint, public companies generally differ from private companies to the extent that the former (a) are generally more "visible" in the marketplace; (b) are regulated by securities commissions and stock exchanges; (c) are required to present audited financial statements and annual reports with respect to which there is a relatively high degree of public disclosure[2]; (d) do not charge operations with the various types of discretionary items (such as excess management remuneration, non-arm's length expenses, personal travel and entertainment, salaries to non-productive family members, inventory reserves and other items which are highly income-tax motivated) which are so typical for many closely-held business.[3]

2. PRICING

There are three possible components comprising any given transaction price:

(a) Intrinsic Value ("Stand-Alone" Value) of Acquiree

A price component which represents the "intrinsic" value of all of the outstanding shares (or net operating assets of the business) viewed on a stand-alone basis, i.e., the value of the business interest assuming that the business will continue to operate "as is".

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(2) For example, management discussion and analysis in the annual report containing the financial statements.

(3) Admittedly, and without mentioning firms, there are some public companies which have paid what their minority shareholders have considered to be "exorbitant" bonuses. (The financial press is quick to disclose these!)

(b) Net Economic Value Created by Acquisition

An incremental value (over the above stand-alone value) anticipated by a purchaser at the time of acquisition. This purchaser-perceived incremental value comprises:

- post-acquisition synergies, including economies of scale, and/or
- strategic advantages

which are expected to accrue to the purchaser following acquisition.

The maximum price the purchaser would pay for the acquiree would be the excess of the post-acquisition value of the combined firm over the pre-acquisition stand-alone value of the purchaser. If the purchaser actually pays the maximum price, then the vendor receives all of the net economic value created by the acquisition.[4]

(c) Value of Redundant Assets

To the extent that the acquiree has assets which are excess or redundant to the operations of the business, i.e., they are either operating assets which are excess and/or non-operating assets which are owned by the business but totally unrelated to the day-to-day operations, shareholder value would include this third component. Often, prior to a sale of the shares, the vendor will remove these from the corporation and sell the shares with only the underlying operating assets included.

You may also wish to keep in mind the following "axioms":

(4) There may be circumstances, however, in which the purchaser might be prepared to pay even more than the sum of the stand-alone value of the acquiree and the post-acquisition net economic value created.

(a) The stand-alone value of the acquiree is ordinarily the vendor's minimum acceptable price, as the vendor can continue to operate the business. Accordingly, the vendor would demand an amount in excess of this "floor price" and often a purchaser can be negotiated into paying a premium.

In the case of a publicly-traded company, the quoted market value is generally the benchmark for establishing stand-alone value.

The authors of *Diversification Through Acquisition* provide the following rationale for the quoted market value of a public company for establishing the intrinsic value thereof:

> "Stated in terms of the concept of present value, market value can be understood as an equilibrium point balancing buying and selling prices for future returns among investors with differing perceptions of present value. It is useful to emphasize the mundane point that investors typically have different perceptions of an asset's present value. Indeed, investors trade assets precisely because they have a differing judgment than the marketplace of the current worth of future values. Thus, the effect of a market transaction is to establish a comprise measure of investors' estimates of an asset's present value. Since buyers and sellers are presumably acting in their basic self-interest, the 'bloodless verdict of the market' is a practical expression of present value that should be preferred to more subjective, individual expressions of value."[5]

As noted earlier, market value is assumed to be unaffected by any announcements or rumours with respect to a possible acquisition.

(b) The maximum acceptable price for the purchaser to pay for the acquiree is equal to the acquiree's stand-alone value plus the net economic value created by the acquisition. However, the closer an acquisition price comes towards the upper end of the purchaser's pricing parameters, the greater the purchaser's post-acquisition risk.

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(5) Malcolm S. Salter and Wolf A. Weinhold, *Diversification Through Acquisition*, Free Press (New York: 1979), page 117.

(c) The greater the degree of anticipated post-acquisition net economic value added, the higher the possible final negotiated price.

(d) Generally, the more possible purchasers there are for any given privately-held business interest, the greater the market liquidity for the business and the higher the transaction price.

3. VALUATION METHODOLOGY

3.1 General

As noted earlier, a company's value is derived from its anticipated future benefits. This value is continually changing as those future benefits increase or decrease with the passage of time. As there are different risks and earnings characteristics applicable to each business, these benefits cannot be measured with certainty.

However, no single formula can be used to determine the value of every business in every situation. Accordingly, different concepts, approaches and methods have evolved for estimating future benefits and corporate values.

Irrespective of the valuation approach to be adopted, there are a host of fundamental factors to consider in valuing a business:

- Nature of the business and history of the firm since inception;
- The economic outlook in general and the condition and outlook of the industry in particular;
- The book value of the shares;

- The capital structure and financial condition of the company;
- The earnings capacity of the business;
- The dividend-paying capacity of the company;
- Whether or not the target has goodwill or other intangible value;
- Transactions in the target's shares;
- The market price of shares of corporations engaged in the same or a similar line of business having their shares actively-traded in a free and open market, either on an exchange or over-the-counter (i.e., guideline companies);
- The marketability, or lack thereof, of the shares;
- Whether there are other identifiable purchasers in the marketplace who might be prepared to pay a premium for the firm, or the shares, over what ordinary purchasers would pay.

3.2 Valuation Concepts

There are three "concepts" which are the basis for valuation *approaches* and valuation *methods*:

(a) Cost concept;

(b) Income concept; and

(c) Market concept.

In considering the foregoing valuation concepts, one or more of the undernoted valuation "approaches" may be adopted. Similarly, one or more of the valuation "methods" or "techniques" may be applied under a particular valuation "approach", depending on the benefit stream used to arrive at value.

3.3 Valuation Approaches

There are three basic, generally-accepted approaches for determining the stand-alone value of a business, business ownership interest or security:

(a) the Asset-Based Approach;

(b) the Income Approach; and

(c) the Market Approach.

In certain cases, a combination of the foregoing three approaches may be appropriate.

Once having determining the acquiree's stand-alone value, any "premium" for synergies and/or strategic advantage is a matter for negotiation between buyer and seller.

3.3.1 Asset-Based Approach — General

The Asset-Based Approach is adopted where either (a) liquidation is contemplated because the business is not viable as an ongoing operation, (b) the nature of the business is such that asset values constitute the prime determinant of corporate worth (e.g., vacant land, a portfolio of real estate or marketable securities, etc.), or (c) there are no indicated earnings/cash flows to be capitalized.

If consideration of all relevant facts establishes that the Asset-Based Approach is applicable, the methodology to be applied will be under either a going-concern scenario ("Adjusted Balance Sheet Method") or a liquidation scenario (on either a forced or orderly basis).

In applying the "Adjusted Balance Sheet Method", each asset and liability appearing on the acquiree's balance sheet is written up or down, as the case may be, to its respective current fair market value as of the valuation date, on a going-concern (as opposed to liquidation) basis. Corporate income taxes relating to the above adjustments are notionally deducted to arrive at adjusted shareholders' equity on a net basis.

3.3.2 Income Approach — General

The Income Approach is a general way of determining a value indication of a business (or its underlying assets), applying one or more methods wherein a value is determined by converting anticipated benefits. This approach contemplates the continuation of the business operations.

These anticipated benefits are expressed in monetary terms. Depending on the nature of the business or asset, anticipated benefits may be reasonably represented by such items as net cash flow, dividends, and various forms of earnings. The benefits are estimated considering such items as the nature, capital structure, and historical performance of the related business entity or asset, expected future outlook for the business entity and relevant industries, and associated economic factors.

Anticipated benefits are converted to value applying procedures which consider the expected growth, timing and the risk profile of the benefits stream along with the time value of money.

The conversion to value normally requires the determination of either a "capitalization rate"[6] or "discount rate".[7] In determining the appropriate rate, the valuator considers such factors as interest rates, rates of return expected by investors on relevant investments, the risk characteristics of the anticipated benefits, etc. (see below).

Typically, the capitalization rate or discount rate used is consistent with the types of anticipated benefits used.[8]

The earning power of a viable going-concern is usually greater than the aggregate values of its individual tangible assets because of the value-in-use of the intangibles[9] and the tangibles are viewed together.

The more common methodologies applied under the Income Approach are:

(a) Capitalizing operating earnings or cash flow, applying either the Earnings Method or the Cash Flow Method;

(b) Discounting the anticipated future stream of benefits, applying either the Discounted Cash Flow ("DCF") Method or the Discounted Future Earnings ("DFE") Method; and

(c) Multiplying, or capitalizing, gross revenues[10].

(6) Any divisor (usually expressed as a percentage) that is used to convert income into value.

(7) A rate of return used to convert a monetary sum, payable or receivable in the future, into a present value.

(8) For example, pre-tax rates of return are used with pre-tax benefits; common equity rates of return are used with common equity benefits; and net cash flow rates of return are used with net cash flow benefits.

(9) Intangibles include goodwill as well as intellectual property such as patents, licences, copyrights, trade marks, etc.

(10) In certain businesses the purchaser focuses on the target's book of business (however, the price is corroborated by one of the other methodologies).

3.3.2.1 Earnings Method — General

The Earnings Method is a technique applied under the Income Approach. It is a two-variable process, requiring (a) an estimate of the acquiree's earning power and (b) the selection of an appropriate capitalization rate to apply thereto. To value a business applying the Earnings Method, the reported (i.e., accounting) profits, usually for the last three to five years, are analyzed and, where necessary, adjusted or "normalized" for valuation purposes to arrive at a representative level of likely, future maintainable earnings ("indicated earnings"), representing the earning power of the business.

This involves determining a representative level of future, normalized indicated earnings, adjusted for the following factors:

- extraordinary and non-recurring items that would otherwise distort the estimate of future profits;
- non-arm's length expenses which are of an uneconomic nature;
- consistency with the operating conditions that are expected to prevail; and
- additions to, or reductions in, capital employed.

Once a representative level of earnings is calculated, a multiple (i.e., the price/earnings multiple or the inverse thereof, the capitalization rate) is applied thereto to arrive at the capitalized earnings value of the practice. If there are also "redundant" assets included, the value thereof is aggregated with the capitalized earnings value to arrive at the global value of what is being transacted.

Where there is a definite trend in the subject's sales patterns and adjusted earnings, the normalized (maintainable) earnings are generally weighted (in order to place more emphasis on the most recent or indicative years) to arrive at a likely trend of annual, future (indicated) earnings.

These adjusted results are then capitalized by a price/earnings multiple in order to arrive at the going-concern value of the business and added thereto is the value of any "redundant assets"[11]. The aggregate so arrived at represents the fair market value of the entity as a whole, i.e., "corporate worth".

3.3.2.2 Cash Flow Method — General

A variation of the Earnings Method is the "Cash Flow Method". Using the latter technique, cash flows (derived from the elimination of non-cash expenses such as depreciation and amortization) are substituted for earnings. The Cash Flow Method also considers the increase in non-cash working capital required as well as the minimum level of recurring (annual) capital expenditures need simply to sustain operations at their existing levels[12]. As a notional purchaser in the marketplace is interested in the cash in-flows and out-flows of the business, capitalizing the net cash flow from operations can often be more reliable than capitalizing earnings in valuing a going concern, particularly when there have been substantial non-cash expenses booked in arriving at net earnings for accounting purposes.

For example, analysts and business valuators, in assessing an acquiree's cash flow return on invested capital, may compare the firm's after-tax earnings before interest, depreciation, amortization and rental expense to the value of the capital employed in the business, including any off-

(11) The value of redundant assets, if any, is aggregated, as it is assumed that a prudent vendor would either extract redundant assets from the company prior to a sale, or require compensation from the purchaser for the value thereof. Thus, "corporate worth" reflects the value of all underlying assets, tangible and intangible, that would inure to the hypothetical purchaser of the shares.

(12) Referred to as "ongoing capital maintenance" or "sustaining capital reinvestment".

balance-sheet items, including operating leases. The advantage of valuing a company by having focusing on *cash flow* (as defined above) rather than on *earnings* is that the latter can be misleading because of potential accounting-related distortions. For example, a highly capital-intensive business with huge depreciation charges and deferred tax credits may report earnings which are “misleading” for valuation purposes. Moreover, such earnings may not be comparable with reported earnings of the guideline companies[13] (see Section 3.3.3.1) used as a benchmark to assess the former’s operating performance. Secondly, to the extent that a business leases, rather than owns its capital assets, adjustments may have to be made when comparing the subject with other (guideline) companies. For example, if rental expense were to be added back in the foregoing definition of “cash flow”, the operating results in terms of such cash flow must be related to an invested-capital base which includes capitalized leases.

As another example of how reported accounting profits (earnings) can provide distorted results for valuation purposes, consider the case of a rapidly expanding chain of retail stores or restaurants which invests annually in new locations. The more locations it acquires, the higher the depreciation and amortization charges booked against operating profits. On a cash-flow basis, however, the depreciation and amortization would be added back, thus producing a higher operating result (measured in terms of cash flow). Hence, instead of the operating results decreasing each year (due to increasing depreciation charges), the cash flow from operations (which excludes capital expenditures for expansion) would likely be increasing each year.

3.3.2.3 Multiple (Capitalization Rate)

The price/earnings multiple — or price/cash flow multiple — is a risk/reward factor; it is the inverse of the required rate of return (capitalization rate) a purchaser seeks on an investment in the

(13) Guideline companies (also referred to as “comparable companies”) are companies which provide a reasonable basis for comparison to the relative investment characteristics of the company being valued and are ideally in the same industry.

business and indicates the rate at which investors are capitalizing earnings or cash flow per share at any given time. Hence, by applying a multiple to (i.e., by "capitalizing") the indicated net earnings (or cash flow) of a business, there is a conversion of the anticipated stream of income over a period of future years into a capital sum expressed at the beginning of such period, at the purchaser's required rate of return[14].

The quality of the income stream to be capitalized, i.e., the expected ability of the business to actually achieve the particular level of indicated earnings/cash flow, will have a direct bearing on the selection of the multiple. The greater the risk, the higher the rate of return required by the notional purchaser (and the lower the multiple).

In valuing the shares (or business) of a private or closely-held corporation, comparison is made (if and where possible) with actual, open market sales of shares of companies in the same or a substantially similar line of business as the subject. While comparative sales are important, they must be viewed in the context of the facts and circumstances surrounding the particular transaction, the relationship between specific parties thereto, the consideration, the market and liquidity of the shares, accounting policies, and so forth. The analysis must also consider whether the transactional data of the open-market transaction relate to an *asset* transaction or a *share* transaction.

Generally, in selecting a multiple (capitalization rate) to apply to the acquiree's indicated earnings or cash flow, a number of "internal" factors (relating to the company itself such as management, financial position, sales and profit trends, etc.) and "external" factors (relating to non-controllable factors such as the economy, interest rates, etc.) are considered. (These are enumerated in Section 3.3.3.3 below — see "Value Drivers".)

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(14) That is, the earning power is converted into an indication of value by dividing the measure of earning power by the selected capitalization rate (threshold rate of return).

3.3.2.4 Discounted Future Returns Method — General

In situations where (a) future capital investments are required, (b) the specific timing of the revenues/cash in-flows and expenses/cash out-flows is particularly significant (e.g., a new venture or start-up operation, expansion of capacity, significant change of management and/or financial structure, cessation or sale of a portion of a business) and/or (c) future expected results are either known or reasonably predictable, the DCF Method or a variation thereof such as the DFE Method (which are valuation techniques under the Income Approach) is often appropriate.

For example, the discounted cash flow method is recognized on the market as the main tool for valuing investment considerations in the high-tech industry and for service companies in the start-up phase. This method is particularly relevant in valuing new emerging technology or — serviced based networking companies which are in the start-up phase of operations as the prospects thereof are tied to a new product and significant fluctuations in cash flows are generated throughout the market penetration. The main difficulty with this approach is gathering the necessary information to accurately assess the future economic benefits to be generated by the business and related risks. Nonetheless this approach is widely used by the venture capital market, as it perceives it to be the most appropriate basis on which to determine the value of high technology service companies and/or operations in the start-up phase.

Applying such method, projected future cash flows or earnings are discounted by a rate of return (i.e., discount rate) which considers a number of internal and external factors relating to the business. When valuing a business applying a DCF Method, anticipated growth is already embedded in the cash flows projected and, consequently, is not a component of the discount rate. Rather, greater emphasis in the choice of a discount rate is placed on business risk associated with the projected earnings or cash flows.

The discount rate is a market-driven risk/reward factor, representing the expected rate of return required by an investor on the subject investment, given its inherent level of risk. The risk rate could also be expressed as the expected total yield rate used an investor to convert all of the expected future returns on an investment to an indicated present value.

The discount rate is segregated into the following components:

(a) *Risk-free rate* — the rate available on investments widely considered to have virtually no possibility of default, such as long-term Government of Canada "benchmark" bonds.

(b) *Equity risk premium* — the risk pertaining to fluctuations in returns on the equity investment market in general. It indicates the additional rate of return required by investors over and above a risk-free return to induce them to invest in equities (or similar securities) to compensate them for the additional risk incurred in such an investment.

(c) *Company-specific risk* — the risk relating uniquely to the subject company or investment being valued. An important segment of company-specific risk is often the "size effect"; however, other differences between the subject being valued and companies publicly-listed on the stock market (from which the equity risk premium is calculated) such as profitability, diversification of products and markets, depth and experience of management, competition, customer base, the industry, financial leverage, liquidity and other miscellaneous factors are often comprised in the risk profile.

(d) *Minority and/or lack-of-marketability risk* — as the companies from which the equity risk premium is calculated have securities which are publicly-traded, the discount rate obtained therefrom relates to a rate of return on a minority position in the equity markets (i.e., as-if-freely-traded). Thus, adjustments to risk may have to be made if the subject being valued either involves a control position or represents an investment which is not publicly-listed on a securities exchange and, hence, is not readily marketable.

There are two principal variations of the DCF and DFE Methods: (a) the time-adjusted (or internal) rate of return, and (b) excess present value. These may be briefly outlined as follows:

(a) The time-adjusted rate of return is the discount rate that equates the present value of the project with the cost of the project. This method is useful in determining project viability when income is predictable, but is of limited application, since it is mainly used to equate the point at which the original investment equals the present value of future after-tax income.

(b) The excess present value method discounts all expected income to the present, using a desired rate of return or discount rate. Such rate would have regard to the various risks attached to, and the opportunity costs of, acquiring the assets. In addition, the residual, or "terminal", value of the assets is included in the calculation, since there is an assumption that assets purchased will ultimately be disposed of (converted to cash). To the extent that the sales proceeds of such assets would form all or part of the return of the initial purchase price, such proceeds would be considered in the same manner as other income/cash in-flows received during the period and would be discounted accordingly.

3.3.3 Market Approach — General

The Market Approach is a general way of determining a value indication of a target business or an equity interest, using one or more methods that compare the subject company to similar investments that have been sold. The use of guideline companies is a business valuation method within the Market Approach. Market transactions and businesses, business ownership interests or securities can provide objective, empirical data for developing value measures.[15] Such empirical data are found in transactions involving minority or controlling interests in either publicly-traded or closely-held companies.

The Market Approach is based on the principle of substitution which dictates that a potential hypothetical purchaser would not pay more for a business or its underlying assets (including research, intellectual property or access thereto) than for equally desirable opportunities of similar characteristics. To the extent that empirical data on similar investments (including technology and research projects) are available, this method can provide an excellent estimate of value as it is based on sellers' and purchasers' behaviour on the market. However, the principal weakness of this approach is that it is often difficult, if not impossible, to obtain information on actual transactions or sales offers which can reasonably compare to the business or operations being valued.

Adopting the Market Approach, an estimate is made, using public data, of the price that would be paid for the common shares of the subject company, assuming that it was traded in an active market or on an exchange. This is done by analyzing the share prices of reasonably and meaningfully comparable publicly-traded companies that operate in the same industry as the company being appraised (i.e., guideline companies), as their share prices most adequately reflect investors' expectations of return on an investment of similar risk *vis-à-vis* the subject company. To the extent that the riskiness of an investment in the subject company's common shares is different from that of the guideline companies, adjustments are made to the market ratios to reflect such differences for valuation purposes.

The Market Comparable, or Guideline Company, Method relies upon actual market transactions to provide objective, empirical data for use in business valuation. Similarly, financial and operating data of the comparable or guideline companies are also utilized, and are adjusted in

(15) These valuation measures are often referred to as "valuation ratios", wherein a value or price serves as the numerator and financial, operating or physical data serve as the denominator (discussed in Section 3.3.3.2).

order to reflect, among other things, dissimilarities with respect to accounting conventions, minority or controlling interests and marketability.

In applying the Guideline Company Method of valuation, the target's earnings and cash flows are determined on a similar basis to those of the guideline companies, for consistency in the bases used for comparison. Accordingly, an analysis of the operating statements of each of the guideline companies is performed to ensure that items such as extraordinary, non-representative, non-recurring and/or unusual income and expense were eliminated in the calculation of earnings (before income taxes and incentive compensation) and EBITDA[16]. Income or expense items unrelated to operations are eliminated. Gains or losses on the disposal of assets and on discontinued operations are also considered for purposes of rendering the results of the guideline companies comparative to those of the acquiree for valuation analysis purposes.

3.3.3.1 Guideline Companies

Ideally, guideline companies operate in the same industry as the subject business; however, if there is insufficient transactional evidence available in the same industry, it is sometimes necessary to consider companies with an underlying similarity of relevant investment characteristics such as size, markets, products, growth, cyclical variability and other salient factors.

In using the guideline companies, the comparison between the subject company and the guideline candidates is therefore made through the use of the valuation ratios. The computation and application of the valuation ratios are intended to provide significant insight concerning the pricing of the subject, considering all relevant factors.

In certain cases it is difficult to make direct comparisons between an appropriate rate of return for the subject company and that for similar public companies (as the respective financial

(16) Earnings before interest, taxes, depreciation and amortization.

conditions and operations are not identical). There can be material variations in relation to one or more of the following factors, thereby rendering comparisons as not being meaningful for valuation purposes:

- Levels of integration;
- Size of the business;
- Maturity of the business;
- Markets;
- Capital structure and leverage ability;
- Quality of earnings;
- Dividend-paying capacity;
- Distortion created by abnormally-low earnings;
- Accounting policies;
- Financial strength and condition;
- Reputation;
- Nature of competition;
- Order backlog;
- Key-person aspect;
- Days’ receivables; and
- Growth potential (of revenues, cash flow, earnings).

The factors to consider in judging a reasonable basis for comparing the acquiree to similar businesses, business ownership interests, or securities which have been sold in the open market, include:

- Sufficient similarity of qualitative and quantitative investment characteristics;
- Amount and verifiability of data known about the similar investment;
- Whether the transaction(s) in the open market related to shares or to assets;
- Whether or not the price of the similar investment was obtained in an arm's-length transaction, as a result of a forced or distressed sale, or other fact situation that may not provide evidence of fair market value; and
- The relevance of market conditions existing at the transaction date with those at or proximate to the valuation date of the subject's business or shares.

3.3.3.2 Valuation Ratios

In applying valuation ratios, care is exercised to ensure that the time periods considered for each firm are congruent with those considered by the other guideline companies and the target. Similarly, any adjustment of reported financial information or definition of a numerator or denominator component (e.g., cash flow) is applied in a standard fashion for all such guideline company data.

Generally, while several valuation ratios may typically be selected for application to the target business being valued, and several value indications may be thus obtained, the relative importance accorded to each of the value indications used is considered in arriving at the valuation/pricing conclusion.

Appropriate adjustments for dissimilarities with respect to minority and control, or marketability, are also considered.

As various market analyses are performed to assess the respective public-market valuations of the guideline companies for purposes of valuing the target, the calculation of the market multiples for the guideline companies are often based on a number of the following valuation ratios, such as (but not limited to):

- Market capitalization/earnings (before or after taxes).
- Market capitalization/dividends.
- Market capitalization/gross revenues.
- Market capitalization/EBITDA.
- Market capitalization/EBIT[17].
- Market capitalization/book value.
- Price/earnings (before or after taxes).
- Price/revenues.
- Price/dividends.
- Price/EBITDA.
- Price/EBIT.
- Price/book value.

(17) Earnings before interest and taxes.

The numerators in the foregoing valuation ratios, *viz.*, "market capitalization" and "price", are adjusted in respect of non-operating, or excess, assets (i.e., redundant assets), and related liabilities. Moreover, in any comparative analysis, where there are convertible bonds, debentures, preferred stock or "in-the-money" options, adjustments are made to take into account the dilutive effect of such security rights.

A frequently-used approach for reconciling the respective value indications obtained from the application of valuation ratios is to apply mathematical weightings to each of the ratios, using informed judgment as to the relevance and, hence, percentage weight to be given to each valuation ratio. Where the various valuation ratios yield similar indicated values, the weight accorded to each method may not be material. In other cases, however, the use of different valuation ratios may lead to notably different indications of value. In such situations, the relevance of each ratio applied is carefully considered, particularly those which produced the outlying value indications.

The weighting of valuation ratios is, of course, not an exact science. The factors which influence the appropriate degree of emphasis for different methods may change over time; hence, the methods used and weightings to be applied to each may be different in valuing the same company at a different time and/or under different circumstances.

As there is no prescribed formula for determining the appropriate weight to apply to the various indications of value derived from different valuation ratios or methods, the facts and circumstances of each situation will dictate the appropriate weighting. In addition, once an appropriate weighting has been established as of a particular valuation date, that weighting may not be appropriate for the same company at a different date.

3.3.3.3 Value Drivers

Value-driver adjustments must be made when guideline companies — from which a composite value multiple (i.e., valuation ratio) is derived — are not substantially similar in all material respects to the subject company being valued. Therefore, an adjustment to the indicated value multiple obtained from the guideline companies is required to take into account these inherent differences, particularly as such differences relate to the risk profile of the target company in comparison to the guideline company composite.

Under the Market Approach (and where the Guideline Company Method is applied), both quantitative and qualitative differences between the target and the guideline companies selected are assessed. Quantitatively, the respective performance ratios of the subject company and guideline companies are compared. The better (or worse) the target company's performance in comparison to the guideline company group, the higher (or lower) the valuation ratio(s) chosen to be applied to the subject. In contrast, qualitative factors are specific attributes of the subject which are normally not incorporated into quantitative analysis, due to their unique nature, as well as the fact they typically are not easily quantified empirically. These qualitative factors are also given thorough consideration in the determination of value for the target. Qualitative factors can either be analyzed in the process of selecting valuation ratios for the subject acquiree or can be applied by virtue of a net discount or premium to the value otherwise determined using quantitative analysis.

The existence of the qualitative differences which give rise to value drivers make the target's risk profile different from that of the guideline companies selected and this is reflected in the choice of the valuation ratio(s) to be applied to the former. However, due to the lack of empirical data to assist in difference quantification, the valuation process applies subjective judgment thereto.[18]

Therefore, the selection of the multiplier (valuation ratio) in applying the Guideline Company Method should be made based on comparing the subject to the guideline companies in areas where material differences exist. Such areas may include, among others:

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(18) For example, to the extent that any of the guideline companies exhibit some of these qualitative factors, certain financial ratios may be examined to provide guidance as to the extent of the implied quantitative difference(s). Often, however, the guideline companies selected may share many of the same value driver attributes as the subject; hence, there would not be any qualitative factors which would need to be adjusted in arriving at a value multiplier.

(a) historical trends and variability of results;

(b) rate of growth (revenues, cash flows, earnings, etc.);

(c) size of company;

(d) operating characteristics;

(e) financial risk;

(f) capital structure and leverage;

(g) liquidity;

(h) geographic diversification;

(i) types and diversification of products and/or services offered;

(j) degree of influence of economic and industry conditions on business;

(k) maturity of the business;

(l) size and stability of customer base (e.g., recurring clientele, order backlog);

(m) history and stability of supplier relationships;

(n) product pricing;

(o) market share;

(p) technological development and capability;

(q) dividend-paying capacity;

(r) employee productivity;

(s) days' receivables;

(t) key employee/owner dependence (management depth and continuity);

(u) key customer or supplier dependence;

(v) labour relations (e.g., existence and status of labour agreements);

(w) product innovation;

(x) access to credit, financial, and capital markets;

(y) profitability (e.g., return on revenues, assets, equity, etc.);

(z) degree of government regulation;

(aa) degree of vertical and horizontal integration;

(bb) other factors (i.e., unique aspects of a company's operations or industry, future outlook).

If the target company is weaker in certain of these value-driver areas than the guideline companies, the target's multiples should be correspondingly lower, and *vice-versa*. Essentially, these comparative value-driver assessments summarize the strengths and weaknesses of the subject company being valued relative to the guideline companies.

3.3.4 Combination of Approaches — General

In certain circumstances, a composite figure is determined (based upon a combination of valuation approaches as outlined hereinabove) where the values calculated under each approach are considered in arriving at the composite value of the enterprise. While there is no precise formula for determining the relative weights to be assigned to each approach, the results are usually weighted according to the reliability and significance of each, if and when this composite approach is considered appropriate.

4. MINORITY INTERESTS

4.1 *Control* vs. *Minority Interests*

In quantifying the difference between minority and control values of an enterprise, a broad range of factors exist which influence the impact of control on value. These factors are relevant in a valuation context, as the ability of a controlling shareholder to institute policies which will enhance the value of his/her control position may affect the difference in value between control and minority ownership positions.

For example, certain "degree of control" factors may or may not exist in any specific ownership interest. Among such factors which typically influence the value of a control position in a company involve the shareholder's ability to:

- acquire or liquidate assets;
- appoint management and directors;
- block corporate actions;
- change the articles of incorporation or by-laws;
- declare and pay dividends;
- determine management compensation and perquisites;
- dissolve, liquidate, sell or recapitalize the company;
- make acquisitions;
- register the company's stock for a public offering;
- select people with whom to do business and award contracts;
- sell or acquire treasury shares; and
- set policy and change the course of business.

While business valuators may often encounter numerous obstacles in determining the worth of an entire business enterprise, they often face even greater challenges in valuing a shareholding of 50% or less, as such an exercise requires an even higher degree of subjectivity, judgment and due diligence on the part of the valuator.

The types of questions that valuators must generally address in appraising the enterprise as a whole (rather than a fractional interest therein) include, as appropriate:

- What is the proper valuation methodology in the circumstances: Asset-based, Income-based or Market-based?
- Having selected the valuation methodology, should a going-concern approach or liquidation approach be adopted?
- Considering that valuation is forward-looking, what is an appropriate, representative level of prospective earnings or cash flow to be considered for the entity being appraised?
- What is the appropriate capitalization rate (price/earnings multiple) to be applied to such earnings and what is the basis for the selection thereof?
- Does the enterprise own redundant (excess and/or non-operating) assets which could be removed from the company without adversely affecting its operating ability? If so, how should they be quantified in the valuation?
- Have off-balance-sheet assets, such as valuable intangibles, claims, dies and moulds, been considered and evaluated?
- On the other hand, are there potential off-balance-sheet claims, such as lawsuits, environmental-liability considerations, which require quantification?
- Does the capital structure permit the introduction of leverage such that a notional purchaser could cause the company to borrow against the company's assets and pay the purchaser a dividend?
- Are there "special purchasers" in the marketplace who might be prepared to pay a premium over and above the stand-alone value of the business because of perceived synergies?

- Have there been arm's length transactions of the company's assets or shares proximate to the effective valuation date? If so, are they representative of value in the open market?

- Have underlying income tax considerations been properly evaluated (e.g., with respect to assets versus shares)? Are there trapped-in capital gains? Has recaptured depreciation been factored into the valuation?

- If the business being valued is a professional practice, is there an appropriate analysis of the client list by segment (e.g., a law firm's gross billings would be analyzed, giving consideration to the different types of services, such as litigation, corporate and commercial, family law, real estate, taxation, insolvency, environmental, etc.)?

- In valuing an investment holding company which has a large and diverse portfolio of investments, or has various real estate holdings, should a "portfolio discount" and/or a "blockage discount" apply? If so, what size discount?

- If the business being valued is heavily dependent on the skills and efforts of one individual, should a key-person discount be applied to recognize the potential loss to the business if he or she were no longer to able to perform services by reason of death, incapacitation or withdrawal? The Tax Court of Canada recently approved a 35% key-person discount in arriving at the business' prospective income stream to which a multiple was to be applied in valuing the company. (*A&N Robitaille* v. *MNR*, 95 DTC 68.)

Many of the foregoing questions, which are far from exhaustive, are typical in valuing the business enterprise as a whole.

4.2 Valuing Minority Interests

However, there are myriad challenging, complex and sophisticated issues when valuing a *specific shareholding* or *business ownership interest* in that same enterprise, particularly if it represents less than *de jure* or *de facto* control. Because minority shareholders are often at a disadvantage compared to controlling shareholders, their shares suffer a discount when the degree of control and/or marketability of the interest being valued differ(s) from that inherent in the value otherwise indicated. Such a discount generally applies with respect to the *levels of value*, i.e., the gradations in value at the ownership level which result from differences in ownership attributes. Examples of "levels of value" include:

- Marketable minority-interest value.
- Absolute control value.
- Operational but less than absolute control value.

The value that would be otherwise arrived at is adjusted by an appropriate discount or premium, as described below.

While a control position commands a premium, there may be instances where a minority shareholding would fetch more than its pro-rata, let alone discounted, value. Consider a 2% minority position where each of the other (unrelated) shareholders owns 49%. If there is competitive bidding, the 2% shareholder is in the enviable position of being able to deliver *de jure* control to either of the other two shareholders (who, in this scenario, would be "special purchasers").

Similarly, if the minority shareholding has special "swing vote" characteristics because of the remaining shareholdings, there may be enhanced value offsetting any minority discount (see below). The holder of the minority shares can join hands with one or more other minority shareholders and thus gain control of the board of directors, pass a special resolution to force a liquidation or merger, or to block one.

There are three basic approaches in determining the fair market value of a minority shareholding:

- Value the entire enterprise (which assumes absolute control) and deduct from the pro-rata value of the minority shareholding any discount(s) for lack of control and/or lack of marketability (a so-called "top-down" approach);
- Value the shareholding by direct comparison with other minority shareholdings that may be truly "comparable"; and
- Value the shareholding using a "bottom-up" approach based upon the present value of the future returns that the minority shareholder may anticipate from his or her shareholding.

Canadian business valuators generally adopt a "top-down" approach.

The two principal discounts typically deducted from the pro-rata value of private-company minority shares are the *minority discount* (relating to lack of control) and the *marketability discount* (relating to lack of liquidity).

4.2.1 Minority Discount

In quantifying the minority discount, factors considered include the size of the minority interest, the shareholder's relationship to the other shareholders, the dispersion of the other shares, whether group control exists, the degree of harmony among the shareholders, whether there are identifiable special purchasers, dividend history and policy, the degree of influence on management policy, the terms of the buy-sell agreement (if any), etc. Over the years, Canadian tax courts have addressed the size of the discount, which often ranges from 10% to 20% and higher. Concerning family members' minority shares in a family-controlled corporation, Revenue Canada's position is that there is generally no discount. In the United States, however, IRS *Revenue Ruling 93-12* does permit a minority discount on family members' minority shares. This policy is the direct result of the IRS having lost several cases on this issue in the U.S. Tax Court.

In non-tax cases, such as matters dealing with shareholder appraisal rights, a minority discount is not applicable in determining the "fair value" of a dissentient's, or oppressed shareholder's, shares under the company law statutes.

4.2.2 Marketability Discount

Having discounted the minority shares for lack of control, the result is the "marketable minority-interest value" ("MMIV") or the "as-if-freely-traded" minority share value. A marketability discount, which recognizes that private-company shares cannot be readily sold (e.g., by simply phoning a stockbroker), is then deducted from the MMIV. While there are little empirical data relating to the size of such discount for Canadian private-company shares, there are a host of U.S. data which can be gleaned from studies performed during the past twenty-odd years; they support a deduction of 35% to 45% from the MMIV.

Quantifying the marketability discount includes consideration of factors such as current and future dividends; prospects for gaining liquidity, e.g., a sale, refinancing or going-public or having put rights, etc.; and holding-period risk, such as the volatility of earnings and cash flows.

The following "reconciliation" schedule highlights the discounting of a minority position in a closely-held company from rateable (pro-rata) value to its fair market value in the marketplace:

Pro-rata value based on total issued common shares (absolute control)	$100
Less: Minority discount (say 20%)	(20)
MMIV (as-if-freely-traded minority interest value)	80
Less: Marketability discount (say 40%)	(32)
Non-marketable minority interest value = Fair Market Value	$ 38

Hence, the minority shareholder in this example suffers a 62% effective discount.

In distinguishing between *minority* discounts and *marketability* discounts, while these concepts are often inter-related, they are, nevertheless, distinct in nature from one another. As a minority discount reflects a decrease in value attributable to the lack-of-control aspect of a minority interest, the value base from which a minority discount is subtracted is its proportionate share of the value of the total (common) equity, taken as a whole, including all rights of control. In comparison, a discount for lack of marketability, as it reflects a decrease in value due to lack of liquidity, relies upon a value base of an entity of an interest from which to subtract a discount that is otherwise comparable but enjoys higher liquidity. Thus, the value base used on which to establish a marketability discount may be either a control or minority interest.

5. VALUING PROFESSIONAL PRACTICES

5.1 Goodwill

Law firms distinguish themselves by their members (parties, associates, etc.), location, size, type of practice (general, specialized and/or full service) and, importantly, their clientele (e.g., corporate, institutional, civil, criminal, etc.):

> "Several studies of the organization of private practice have emphasized that the type of clientele is the determining force in the differentiation of law firms. In an intensive study of lawyers in Chicago, it was found that lawyers are specialized not so much according to substantial areas of law as by different clients: Their specialization is not so much a division of labour as a division of clientele. Lawyers tend to specialize in the representation of limited, identifiable types of clients and to perform as broad or narrow a range of tasks as their client demands."[19]

For valuation purposes, goodwill is "the excess of the *going-concern value* over the sum of the *net tangible assets* and other *identifiable intangible assets*". In the case of a law firm it generally refers to the transferable client list. In this connection, the following comments of various authors on the subject provide examples of what constitutes professional goodwill:

> "The acquisition of a professional practice usually allows the purchaser to access client files and results in the development of a network of relationships that will serve as a base for generating future earnings. An established presence and reputation plays an important part in creating goodwill."[20]

> "Goodwill ... reflects the probability that established clients will return to the practice in the future whenever they require legal services. For example, a thriving criminal litigation practice would likely have less commercial or transferrable [*sic.*] goodwill than a practice of similar size with a diversified base of commercial clients".[21]

> " ... a firm of competent lawyers engaged to a great extent in solicitors' work would undoubtedly build up a tremendous goodwill which is often separate and apart from any of the individuals in the firm; of great advantage to [person] acquiring successorship rights."[22]

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(19) David A.A. Stager with Harry W. Arthurs, "Private Law Offices", *Lawyers in Canada*, University of Toronto Press, 1990, page 170.

(20) Gary B. Leonard, "Business Valuation: Valuing a Professional Practice", *The Canadian Valuator*, Vol. 9, No. 11, page 3.

(21) Eleanor M. Joy, "Law Practices — How Much Are They Worth?", *Valuation Examiner*, Price Waterhouse, Fall 1994, page 1.

(22) "Valuation of a Legal Practice", *Canadian Chartered Accountant*, Canadian Institute of Chartered Accountants, December 1959.

> "The extent to which goodwill of a law firm is personal to the practitioners or commercial to the firm is of course heavily dependent upon the type of practice. A litigation practice relying on referrals from other lawyers will have virtually no transferable goodwill. Conveyancing practice or a general practice in which there are established relationships with mortgage companies, corporate and estate clients ... may have transferable goodwill."[23]

> "A conveyancing practice or a general practice in which there are established relationships with mortgage companies, corporate and estate clients, and general 'off the street' business, may have transferable goodwill. Such practices typically have staffs of non-professional and para-professional people who do much of the required non-consulting work and the change of a professional practitioner from one to the other is not fatal to the continuing relationship."[24]

Typically, the issues arising in connection with goodwill generally concern whether such goodwill is of a commercial nature (and therefore being transferable) or personal nature (and therefore not being transferable). Because commercial goodwill is transferable, it can have value. On the other hand, because personal goodwill cannot be transferred, it has little, if any, commercial value.

In the year that the American author, Professor James C. Bonbright of Columbia University, wrote his celebrated two-volume treatise, *Valuation of Property*[25], an English author, H.E. Seed, in the very same year published his book, *Goodwill as a Business Asset*[26], in which he quotes Sir Albert W. Wyon, a British chartered accountant:

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(23) Clayton A. Schultz, "But is My Practice Really Worth Anything?", *Advocate*, Vancouver Bar Association, 1983, Vol. 41, page 371.

(24) *Ibid*.

(25) McGraw-Hill Publishing Co. (New York: 1937); reprint by The Michie Company.

(26) Gee & Company (London: 1937).

> "Goodwill is ... the most valuable asset which a professional practice ... possesses, since it represents the probability of the retention by a professional man of the confidence of his clients and their continued employment of his services ... with all the implications that such likelihood of continuance of profitable association carries with it."

For a law practice, goodwill may be segregated among the following categories:

5.1.1 Personal Goodwill

Personal goodwill relates the unique advantage enjoyed by a given individual which arises from his or her particular abilities, skills, experience, contacts and reputation. It resides with the individual and is not transferable by contract or otherwise; to the extent it is not transferable, it may have little or no commercial value.

While a professional firm, in and of itself, does not possess personal goodwill, one or more individual members of the firm may enjoy such goodwill. That is, a certain portion of a professional practice's client base may have been obtained as a result of the personal reputation of such practitioner(s), creating earnings for the practice itself. Moreover, should the practitioner(s) suddenly leave the practice, a significant amount of the income generated from their "personal" clients may likely depart as a result. However, even if personal goodwill could be transferred, such transfer would be more difficult to accomplish than the transfer[27] of practice goodwill (see below).

(27) There are various methods by which the selling practitioner can facilitate the transfer of his or her personal goodwill or at least a portion thereof, to another well-qualified practitioner.

5.1.2 Practice Goodwill

Practice goodwill pertains to the favourable attitude of clients toward a professional practice. As a specific asset of the practice entity, it is not substantially different from the goodwill enjoyed by any other small business. While a professional typically cannot transfer his or her reputation, skills or knowledge, he or she may nonetheless use these attributes to establish a successful practice and generate significant profits. In doing so, the practice will acquire certain elements, such as locational advantage, office facilities, trained and experienced staff, and an established client base, etc., all of which can generate value over and above the practice's net asset value, hence producing *practice goodwill*.

The value of practice goodwill often reflects the benefits it provides certain prospective purchasers by enabling them to enter into the profession quickly and economically by acquiring an existing practice's reputation and other (above-mentioned) advantages of an established practice. It is generally recognized that practice goodwill follows the practice, is transferable and therefore may have material value. Such value is typically a function of the degree to which practice goodwill is sustainable and its likely effect on the earning capacity of the firm.

5.2 Multiple of Gross Fees

As a transaction involving a legal practice in most cases relates to the transferable client list, what is really relevant is the top line, i.e., gross revenues. That is, the purchaser wishes to acquire the client list and certain professional personnel (partners, employees or associates) as well as possibly certain equipment. In fact, it may well be that the acquiree's lease will be cancelled or transferred to a sub-lessee, certain employees terminated and various assets simply liquidated. A client base is what is key and, hence, the focus on the gross-fee volume of the practice.

A generally-accepted methodology for valuing the goodwill of a legal practice is on a basis of a multiple of gross fees (as also evidenced by the number of partnership agreements on which buy-out formulas are based). In an open-market transaction, the multiple applied may vary depending upon the type of practice and particular characteristics of its clientele, such as its industry, types of services rendered, referral or repeat work, reputation of the firm, location, competition, etc.

By adopting the Multiple-of-Gross-Fees Method, greater emphasis is placed on the maintainable gross fees (or "billings") of the practice than on its current level of net (bottom line) earnings. The acquired client base adds to the purchaser's existing practice and creates certain synergies to existing overhead and other organizational set up. This approach makes implicit assumptions regarding a reasonably constant relationship between gross revenue, maintainable earnings level and value. It suggests that costs are relatively controllable and comparable across practices and/or charge-out rates are adjusted in a certain relationship to costs.

One commentary notes:

> "The rule-of-thumb approach is simple and direct. Multiplying one year's gross revenue by this multiplier ... . Some accounting firms, for example, are valued at 1.0 to 1.5 times annual gross receipts. A standard has not yet developed for the sale of law practices. However, based on the figures used in accounting and medicine, it would appear that a multiple for the rule-of-thumb method should be in the same range for law practices. Whether the multiplier is in the lower or higher level of this range depends primarily on how much repeat business is expected, the nature of the law practice, the number of clients and the transferability of client relationships. If there is a great deal of repeat business, and client loyalty can be transferred, the multiplier will be higher."[28]

Applying the Multiple-of-Gross-Fees Method, indicated or representative gross fee revenues are multiplied to arrive at the professional practice's goodwill.

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(28) "Negotiating the Value of Your Law Practice", *Law Office Economics and Management*.

The multiple to be applied to the gross fees using the multiple-of-gross-fees method will depend on a number of factors relating to the practice and the environment in which it is conducted. These include:

- ***Internal Factors:***
  - Make-up of the revenue, as noted earlier;
  - Type of professional practice;
  - Depth, experience and reputation of the practitioner(s);
  - Relationship among each practitioner and his/her clients;
  - Health and age of practitioner(s);
  - Work habits of the practitioner(s);
  - Size of the practice;
  - Location;
  - Referral sources;
  - Staff;
  - Transferability of the practice;
  - Demonstrated past earning power and expected future earnings;
  - Growth trends, etc.

- ***External Factors:***
  - Economy;
  - Present and future government legislation;
  - Money market and interest rates;
  - Political climate;
  - Social environment; and
  - Competition.

5.3 Capitalization of Pre-Tax Cash Flow

Another method of valuing a professional practice, but which usually applies to the smaller or even sole-practitioner type of operation, involves capitalizing pre-tax cash flow before remuneration to partners (or to the sole practitioner) by a particular multiple.

5.4 Discounted Cash Flow

A discounted cash flow method could be applied where the value of goodwill is calculated as the excess of the present value of the projected cash flow from the practice, before partners' or proprietor's remuneration, over the present value of the cash flow if the practice were just formed.

5.5 Capitalized Earnings

Quite apart from the calculation of goodwill, the valuation of a professional practice - as with other types of commercial enterprises - may be determined by using the capitalized earnings method.

A price/earnings multiple (the rate at which earnings of the practice are being capitalized at any given time) is applied to the annual maintainable earnings of the practice in order to determine the earnings value of the firm. Selecting an appropriate price/earnings multiple involves several factors, including:

- the practice's nature, history and size;
- the practice's net tangible asset value;

- the degree of risk attached to the level of maintainable earnings being capitalized;
- prospective earnings;
- the location and permanency of the business of the practice;
- the reputation and standing of the practice in the profession and with the public;
- the dependence of the practice on key practitioners;
- the practice's cash-generating capacity and, in particular, its ability to distribute the cash to its owners;
- the benefits to certain prospective purchasers of being able to practise in the profession quickly and economically by acquiring a going concern;
- rates of return and risk associated with alternative investments;
- the potential for growth in the markets being served and the degree of competition; and
- industry and economic conditions prevailing and future conditions reasonably anticipated at the valuation date, both in general and in the practice's particular area of endeavour.

6. CONCLUSION

The foregoing comments can only highlight the many issues and variables which come into play in valuing a business. The process is, admittedly, highly judgmental on the part of the valuator. As Viscount Simon stated: "Valuation is an art, not an exact science. Mathematical certainty is not demanded, nor indeed is it possible".[29] Thank you.

(29) *Gold Coast Selection Trust Ltd.* v. *Humphrey*, [1948] 2 All ER 379 (HL) at 384.