Navigating the business valuation process

A guide for New Zealand mid-market businesses

Contents

This guide has been prepared to help you navigate the business valuation process.

Navigating the business valuation process

Understanding the value of your business and its value drivers can provide clear insights at defining moments throughout its lifecycle, including a business sale.

A business valuation reflects the unique circumstances of your business, your industry, the broader economic environment, and buyer expectations. It requires an estimate of future business earnings potential and the associated risks - both opportunities and challenges - in achieving those earnings.

Whether you are thinking about obtaining or already have a requirement for a business valuation, this guide has been prepared to help you further understand the business valuation process. It explains key valuation process considerations including:

- why valuations are typically required
- using a valuation to inform a business sale or purchase
- the differences between price and value
- different types of valuation engagements
- typical valuation information requirements
- common valuation methodologies used.

Steps in preparing a valuation

The valuation process generally involves the following steps, which we explore further throughout this guide.

1. **Establishing your valuation needs**
   There are many reasons why you might need a valuation, including buying or selling a business, raising capital or securing finance, resolving a dispute, or you might be considering strategic options.
2. **Scoping the valuation**
   Identifying what needs to be valued, the valuation purpose, the valuation date, and the type of valuation.
3. **Gathering the required information**
   Includes both financial and operating information about your business, and broader information about the industry and markets it operates in.
4. **Performing the valuation**
   This includes analysis of the business being valued and its key value drivers, and the valuation itself.
5. **Presenting the valuation findings**
   The business valuer will present you with their valuation report and can talk you through their rationale for the value they have assessed.

Establishing your valuation needs

Some common reasons for valuation include:

- preparing for a business or share sale (see opposite)
- issuing shares to employees, including share schemes
- resolving shareholder or other business/personal disputes
- relationship property disputes
- transferring ownership between related parties
- the discharge of directors' duties
- succession planning
- tax planning and compliance.

Create value

Transactions
- Bid support
- Transaction structuring
- Non-cash payments
- Fairness opinions
- Related party transfer

Strategy
- Growth strategies
- Performance improvement
- Capital allocations
- Strategic alliances
- Share base compensation

Intellectual property (IP)
- Brand value analysis
- Licensing agreements
- Royalt rate setting

Report value

Accounting and tax
- Purchase price allocations
- Impairment reviews
- Related party transfer

Fund management
- Net asset value reporting

Protect value

Disputes
- Relationship property
- Contractual
- Mergers and acquisitions
- Shareholder
- Taxation
- Intellectual property

Distressed businesses
- Value break calculations
- Restructuring options analysis
- Security review
- Related party transfers
- Stakeholder negotiations

Using a business valuation to guide a sale

A sound business valuation provides more than just a number – it helps to tell the story of your business.

Does it provide a stable, reliable source of earnings? Or is the story about a high-growth opportunity with greater risk? Understanding this narrative is key to positioning your business effectively and attracting the right buyer at the right price, and helping to ensure that the expectations of your shareholders are aligned.

Beyond the numbers, a valuation provides an external perspective about your business's strengths and weaknesses. This insight allows you to make operating and strategic adjustments to enhance value before going to market.

Once you understand your business through a valuation lens, you will also gain clarity about the likely potential buyer(s), whether that be a competitor, a financial buyer, or someone looking to both own and manage the business.

When the right buyer is identified, a valuation can be a powerful tool to support your negotiations. It provides a well-supported financial foundation to justify the price, helping you negotiate from a position of strength. It arms you with confidence, clarity, and an informed value range to guide your decision-making.

Preparing your business to maximise value

Whether you are planning for a future sale, succession, or simply want to build a more resilient and valuable business, taking proactive steps to enhance value can provide meaningful benefits. The checklist below outlines some practical actions that can improve performance, reduce risk, and position your business for stronger outcomes.

Financial readiness

- Review and document historical financial performance trends to support valuation assumptions and quality of earnings assessments.
- Remove non-operating assets such as excess cash or personal assets.
- Clean up working capital including uncollectible accounts receivable and slow-moving inventory.
- Eliminate material discretionary non-business expenses and quantify their impact on historical financial performance.
- Assess and document any contingent liabilities (e.g., legal claims or disputes, warranties, guarantees, unresolved tax matters).
- Utilise imputation credits that may be lost after the sale of the business.
- Prepare audited accounts.

Business optimisation

- Improve margins through operating efficiencies.
- Demonstrate growth by creating and achieving budgets.
- Improve forecasting and budgeting accuracy.
- Settle any litigation, and address any compliance issues or risks.
- Lock in a strong management team.
- Develop a strategic plan outlining opportunities and how they will be pursued.
- Clarify IP ownership (e.g., trademarks, patents, software).

Value enhancement

- Convert personal goodwill into commercial goodwill.
- Enter, formalise, or extend existing contracts with key customers and suppliers.
- Reduce economic reliance on key customers and suppliers.
- Optimise tax planning measures ahead of a transaction.

Scoping the valuation

Scoping means agreeing with your valuer the **what**, **why**, **when**, and **how** of your valuation.

This ensures your valuer clearly understands what needs to be valued, the valuation purpose and date, and the type of valuation engagement needed. The valuer will work with you at the outset to establish these elements.

What is being valued?

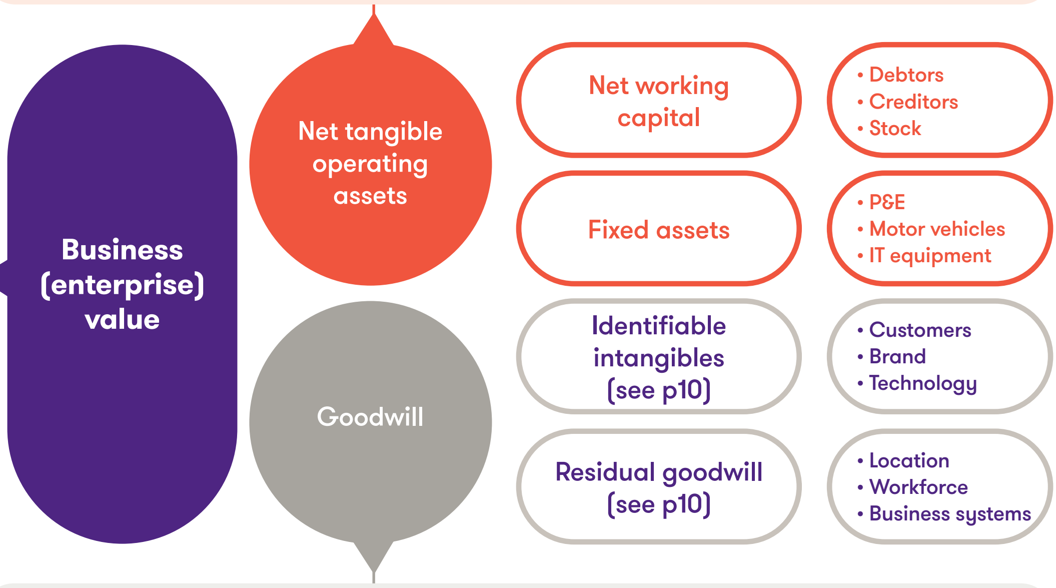
Scoping a valuation requires identifying exactly what is being valued. For business owners, this usually means identifying whether the valuation is of the operating business (also called the **enterprise value**), an ownership interest in the company (the **equity value**), or both.

Net tangible operating assets

These are the tangible resources required to maintain operations and generate revenue. They include **net working capital** and **fixed assets** such as property, plant, and equipment. Net tangible operating assets are generally not valued separately, with their value instead assumed to be reflected in the business value assessed.

Business (enterprise) value

This is the value of the core business operations, regardless of how it's financed. It reflects two key components – net tangible operating assets and business goodwill.



Goodwill

Business goodwill is not usually directly valued but represents any intangible portion of business value over and above the net tangible operating assets. The goodwill value consists of identifiable intangible assets and residual goodwill.

Identifiable intangible assets

These are specific, identifiable business assets. Examples include:

- brands and trademarks
- patents and proprietary technology
- customer relationships and contracts
- software, databases, and licences.

These assets contribute directly to earnings and provide competitive advantage. In a typical business or share sale valuation, they are not separately valued but are implicitly captured within the business value. However, in certain situations – such as accounting for acquisitions, disputes, or tax structuring – they can be carved out and valued individually using specialist intangible asset valuation techniques.

Residual goodwill

This asset is represented by any remaining value after all identifiable tangible and intangible assets are accounted for. This type of goodwill often arises from factors such as:

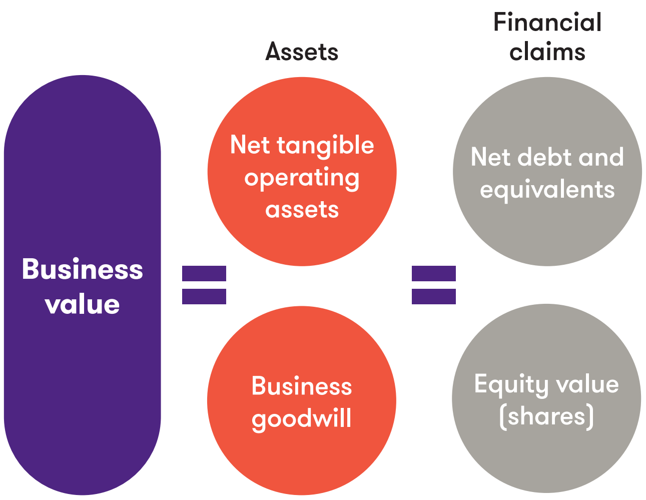
- the ability of the business to sustain or grow earnings
- an established and effective workforce
- operational know how and systems
- strategic location or market position
- synergies expected by a particular buyer.

Equity value (100%)

This reflects the value of the ownership interest in the legal entity. It typically comprises enterprise value, adjusted for net debt (subtracted) and surplus assets (added). Companies with significant net debt (including shareholder debt) will tend to have materially lower equity values compared to their enterprise values.

There may also be different classes of equity interests which need to be valued, including voting/non-voting shares, and minority share interests. Issues of control and liquidity relating to the valuation of these specific interests may need to be considered.

The components of business value



Why does the business need to be valued?

As part of commissioning a valuation, it's important to define the specific valuation purpose. The reason for the valuation may influence the scope of work, the valuation methodology applied, and the type of valuation engagement.

The many different reasons for needing a valuation are covered on p6. Identifying the purpose of the valuation ensures it is tailored to meet your specific needs and delivers relevant, actionable insights.

When does business value need to be assessed?

The valuation date is the specific point in time the business value is to be assessed. For business owners, common valuation dates are as follows:

- **Current date:** To get the most up to date view on value
- **Financial year-end:** Often used for planning or reporting purposes
- **Transaction date:** Relevant for buying, selling, or restructuring
- **Date of a key event:** Shareholder changes, disputes, or succession planning

Identifying the valuation date is important as the business may have a materially different value at different dates.

How is 'value' defined?

In New Zealand, while other value definitions are sometimes used, businesses and shares are most commonly valued at their fair market value which can be defined as, "... the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion." (International Valuation Standard 104 at 30.1).

Fair market value does not always equate to the final sale price, but it provides a yardstick against which the actual price can be evaluated. Fair market value assumes a level playing field between a hypothetical willing buyer and willing seller. However, real-world transactions rarely occur under such conditions.

Actual prices can be influenced by differences in knowledge, negotiating skill, financial strength, anticipated buyer synergies or emotional drivers. These may lead buyers and sellers to accept more or less than fair market value.

For example, special-interest purchasers may be willing to pay a premium because the business has unique strategic value to them. Legal or contractual restrictions, competing bids, forced-sale circumstances, or unequal bargaining positions can also impact price.

Example:

A large national manufacturer is looking to expand into the South Island and diversify its product line. Your business offers:

- **Established customer relationships** and market share where the buyer currently has no presence.
- **Specialised production capabilities** that complement the buyer's existing offerings.
- **A skilled workforce** and operational know-how that would take years to replicate.

Strategic value to the buyer

- **Revenue synergies:** The buyer can cross-sell its products to your customer base, potentially increasing revenue by $2 million annually.
- **Cost synergies:** By integrating operations, the buyer expects to save $500k annually in overhead and logistics costs.

The only way to know the price a business can achieve is to expose it to the market. A valuation provides a reasoned and independent estimate of value, but is not a guarantee of any specific transaction price.

Types of valuation engagements

The level of detail and analysis needed for the valuation informs the type of valuation engagement. In New Zealand this will typically be either an AES-2 valuation or an indicative valuation.

AES-2 valuation

This is an independent valuation prepared in accordance with *Advisory Engagement Standard 2, Independent Business Valuation Engagements* (**AES-2**), a professional valuation standard issued by Chartered Accountants Australia and New Zealand. It comprises an independent conclusion of value based on a comprehensive review and analysis of the business, its industry, and other relevant factors.

Indicative valuation

Indicative valuation engagements encompass any valuation that does not meet the AES-2 standard. They can range from simple, high-level estimates ("back-of-the-envelope" calculations) to more detailed assessments that approach AES-2 quality.

Indicative valuations are generally based on more limited analysis and presented in a summarised report. If you are commissioning an indicative valuation, it's important to clearly define the scope of work with the valuer, particularly the extent of analysis and reporting, to ensure it meets your needs.

Which is needed for your valuation?

The choice between an AES-2 or indicative valuation can be guided by the purpose of the valuation. While AES-2 valuations require more time, resources, and cost, they offer the highest level of rigor and insight where accuracy and defensibility are critical. In other circumstances, an indicative valuation may be all that is required.

An experienced business valuer can help you determine which type of engagement best suits your needs, ensuring the valuation outputs align with your objectives.

Gathering the information needed for the valuation

Valuation processes typically begin with an analysis of the company's operating and financial results covering recent years and its expected future performance.

The core information needed to undertake that analysis is typically requested at the start of the engagement.

Core valuation information requirements

- Historical financial information (typically three to five years prior to valuation date), including annual accounts
- Any non-recurring, non-operating, or discretionary income or expense items in the historical period
- Information on assets not needed for core business operations (surplus assets)
- Information on the current capital structure of the ownership vehicle
- Financial budgets and/or forecasts, including material underlying assumptions
- Owner's/management's strategic plans
- A description of the main products/services sold
- Details about major customers, including any significant concentration
- A breakdown of significant suppliers
- An analysis of the company's main competitors
- Employee information including the number of employees, key individuals and their responsibilities, and details about historical turnover

A valuation engagement does not usually involve the same level of detailed analysis as due diligence on the business; the valuation information request reflects this higher-level analysis.

Value drivers and considerations

Following the initial information-gathering stage, the valuer will look to build a deeper understanding of the business, usually during meetings with management.

These discussions enable the valuer to interpret the context behind the reported figures, one-off items, unusual trends, clarify anomalies, and uncover qualitative value drivers such as growth potential, operational risks, and competitive positioning.

Outputs from these discussions inform key valuation inputs, particularly the assessment of likely future earnings and the appropriate discount rate or multiplier (see p17). By connecting the numbers to the underlying business realities, the valuer seeks to ensure the valuation properly reflects the key value drivers of your business.

Below are some areas the valuer may review during the valuation process.

Financial performance

- Are revenues and profits consistently growing?
- Are margins healthy compared to industry peers?
- Are the books clean with minimal adjustments needed?

Management team and owner reliance

- Can the business run without the owner?
- Is there strong, capable leadership in place?
- Are succession plans in place?

Customer base

- Is there a diversified customer base that doesn't rely on a few key clients?
- Do customers generate recurring revenue?
- Are there strong relationships or long-term contracts?

Market position

- What is the competitive advantage?
- Is market share stable or growing?
- Is the business a leader or innovator in its space?

Growth potential

- Are there untapped markets, products, or geographies?
- Is there a robust growth roadmap or strategic plan?

Systems and processes

- Are operations efficient, documented, and scalable?
- What level of automation exists in the business?
- Is technology used effectively?

Performing the valuation

Valuation approaches and methodologies

There are three main approaches to valuing a business:

- Market approach
- Income approach
- Cost approach

Each approach includes different underlying methods. It is the valuer's role to find the most suitable method(s) in the valuation circumstances, based on the:

- valuation purpose
- respective strengths and weaknesses of each approach
- specific valuation circumstances, including the type of business being valued and its current operations
- availability of reliable information needed to apply each method.

The type of business can also impact the selection of the valuation approach. For example, early-stage businesses are often valued using a multiple of revenue, which recognises that while valuable IP may have already been created, that value has not yet been fully realised in the underlying earnings.

In some circumstances, business value is considered using multiple methods. For example, an early-stage business valued using a multiple of revenue may also be valued under a cost approach. This is because the development spend to create its IP may provide an indication of the amount a buyer would incur to replicate those assets. Using multiple methods together can offer a more balanced and reliable view of value.

While the choice of valuation methodology is important, it's essential to remember it serves a broader purpose: to help determine a reasonable and supportable value.

Income approach

Under the income approach, the business value is based on the income or cash flows it is expected to generate in the future, and the level of risk associated with achieving those cash flows.

There are two main methods under the income approach - discounted cash flow **(DCF)** and capitalisation of earnings method.

Discounted cash flow (DCF) method

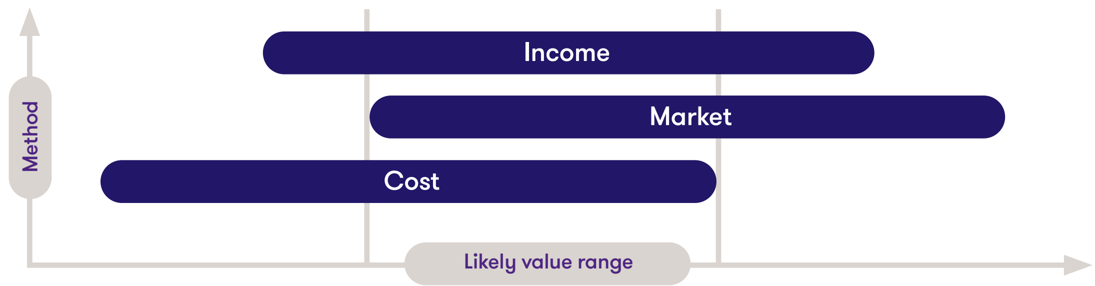
Future business cash flows are forecast and discounted at an appropriate discount rate to determine the value of the business. The DCF method is most useful when reliable forecasts are available.

Capitalisation of earnings method

The most commonly used method in New Zealand, this approach estimates business value by applying a valuation multiple to a single measure of expected future earnings. In practice, this is often earnings before interest, tax, depreciation and amortisation **(EBITDA)**, but other earnings, including EBIT and net operating profit after tax, are also used.

This method aligns closely with the basis on which many businesses are priced, which makes it a useful approach for valuations prepared for a potential transaction.

Three approaches to valuing a business



Approach	Income	Market	Cost
Value equal to	PV future benefits	Relative values	Hybrid (sum parts)
Usage	Most common	Sometimes	Sometimes
Methods	DCF approach Capitalisation of earnings	Sales transactions Market multiples	Adjusted net assets Notional liquidation

Earnings analysis

Earnings analysis for income based valuations typically requires a review of both historic earnings and forecast earnings, to establish the level of earnings assumed for the valuation.

The period selected to evaluate historic earnings will depend on its relevance as a predictor of future earnings but a period of three to five years is relatively common.

In addition to a review of historic earnings, the valuer may also consider any forecasts and budgets prepared by the company.

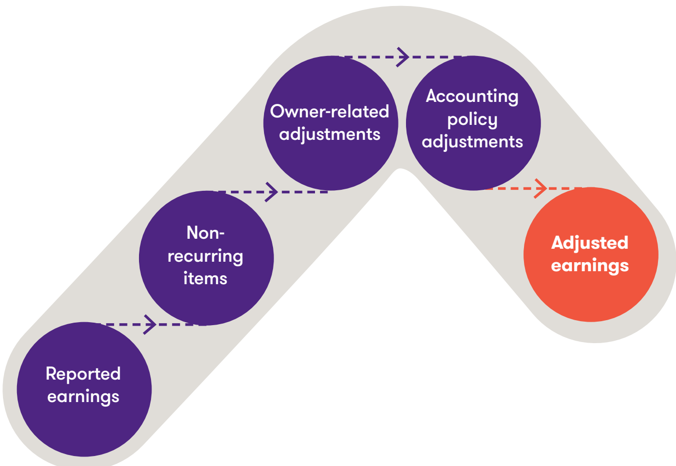
A valuer will often apply adjustments to present earnings on a basis consistent with expected ongoing operations. Common adjustments include:

- **Non-recurring items:** Revenues or expenses that are not expected to continue beyond the valuation date.

> **Example:** If the company incurred significant one-time expenses related to the closure of a product line or a legal settlement, these would be excluded from the normalised earnings base, as they do not represent ongoing operations.

- **Owner-related adjustments:** Revenues or expenses that do not reflect arm's-length, market-based terms, such as excessive or below market salaries or lease costs, and discretionary spending.

> **Example:** If the company leases a building from a shareholder at other than market rent, the rent expense would be adjusted upward to reflect a commercial market rate. Likewise, if management salaries do not reflect reasonable compensation, an adjustment may be applied.



Discount rates and multiples

The selection of an appropriate discount rate or valuation multiple is a critical assessment in determining the value of a business.

Valuation multiples

Valuation multiples are applied under both income and market approaches and can be derived from both transaction or listed company multiples, built up from first principles, or by considering all these factors. Common multiples include price-to-earnings (**P/E**), and enterprise value-to-EBITDA (**EV/EBITDA**).

Multiples capture expectations about growth, profitability, and risk in current market conditions. For example, a high EV/EBITDA multiple often suggests strong growth prospects or lower perceived risk compared to similar businesses.

Beware of industry rule of thumb multiples!

Industry "rule of thumb" valuation multiples should be treated with caution, as they are typically broad averages that mask the specific drivers of value in an individual business. They can often lead to misleading or overly simplistic conclusions and cannot substitute for a valuation grounded in the business's actual financial performance, future cash-flow potential, and risk characteristics.

Discount rates

The discount rate is used to answer the question of: "*What is the value of the expected future business cash flows today, given their risk?*", and is used for the DCF approach.

The discount rate reflects risk and the time value of money associated with future cash flows. It is usually derived from the company's weighted average cost of capital (**WACC**).

A lower discount rate indicates lower perceived risk, increasing the present value of cash flows. Factors influencing discount rates include economic and market conditions, industry volatility, and sometimes company-specific risk factors:

Company specific risk factors can have positive or negative impacts and may include:
Growth and profitability including revenue growth, margins, and cash flows
Market position and competitive advantages like market share, brand strength, and the existence of proprietary technology
Revenue stability, scalability, and customer diversification
Degree of operational efficiency
Management and governance strength
The relative size of the business

Market approach

Under this approach, value is estimated based on available transaction and market pricing data of businesses considered sufficiently comparable to the subject entity. This approach relies on real-world evidence of what buyers have paid for comparable businesses or how similar companies are priced in the market.

Careful judgment is required when assessing comparability. In New Zealand, the relatively small size of businesses, many niche industries, and limited transaction data can make suitable comparators harder to find or require significant adjustment to available comparators. However, where good comparable information exists, the market approach can provide a compelling estimate of value.

Replacement and reproduction cost methods are typically used to value individual assets, including IP, rather than entire businesses.

Cost-based approach

Under the cost approach, value is estimated assuming that a buyer would not pay more for an asset than what it would cost them to obtain another asset with the same utility. Broadly, there are three main cost approach methods:

1. **Replacement cost method:** indicates value by calculating what it would cost today to create an asset of equal utility to the subject asset.
2. **Reproduction cost method:** indicates value by calculating what it would cost to build an exact duplicate of the subject asset.
3. **Summation method:** calculates the value of an asset by adding together the separate values, or costs, of its component parts.

Replacement and reproduction cost methods are typically used to value individual assets, including IP, rather than entire businesses. The summation method is most common for business valuations and applied in one of two ways:

- **Notional liquidation method:** assumes the assets and liabilities of the business would be realised on an orderly liquidation basis and the company liquidated. This method is mostly used in distressed situations given it assumes the business is not a going concern.
- **Adjusted net assets method:** all of the company's assets and liabilities (including all intangible assets) are adjusted to reflect their fair market value. This approach is often applied to investment holding companies.

The valuation findings

A good valuation report does more than just present the numbers.

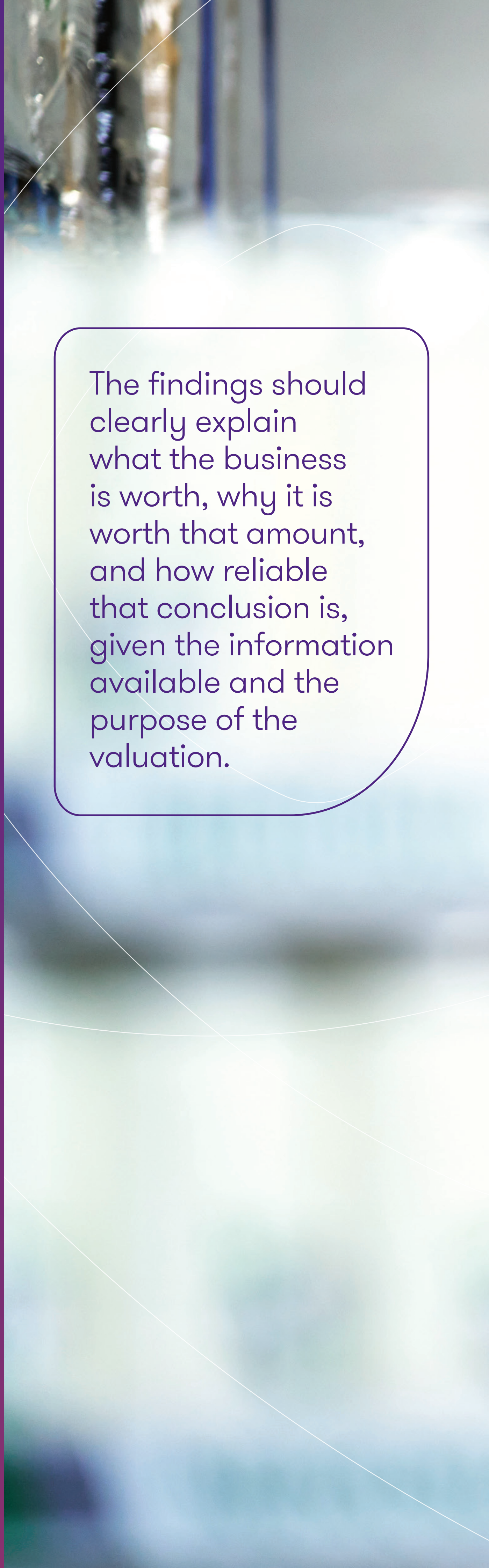
It should clearly explain what the business is worth, why it is worth that amount, and how reliable that conclusion is, given the information available and the purpose of the valuation.

The valuation report will typically set out a description of the business interest being valued (including summary financial information), a discussion of the valuation approach and rationale for its selection, a discussion of key valuation assumptions, and the valuation conclusion.

A draft report is often provided so all factual information can be reviewed before the valuation is finalised. This ensures report users have the opportunity to confirm all relevant factual information has been considered.

The time required to work through a business valuation process can vary according to the scope, but a period of three to four weeks from the date of receiving the main documentation needed for the valuation, to the issue of a draft report, is relatively common. Your valuer can work with you at the outset to establish any timing requirements.

The business valuer can also meet to talk you through their rationale for the value they have assessed and elaborate on any key points, including material value drivers.



The findings should clearly explain what the business is worth, why it is worth that amount, and how reliable that conclusion is, given the information available and the purpose of the valuation.

Next steps

Whether your goal is to create, protect or report value, understanding the value of your business and its value drivers can help achieve successful outcomes for you and your business.

The Grant Thornton valuation team has collectively performed hundreds of valuations of shares, businesses, and intangible assets for many different purposes. We value businesses of all sizes and at all lifecycle stages, from early-stage start-ups to established companies, including those in financial distress.

Our approach is commercial and pragmatic, underpinned by strong technical expertise. Our work is frequently reviewed and accepted by other valuation advisors, regulatory bodies, and the Courts.

Different valuation processes and reporting are required for specific situations. We take the time to understand your business or organisation to tailor our valuation services to your goals and desired outcomes. Our valuations range from desktop reviews to full expert reports for Court.

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