
MATRIMONIAL

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BUSINESS VALUATION IN THE CURRENT ECONOMY

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In the business world, location is everything. In valuation, the same can be said for timing. The worth of your client's business today is most certainly different than it was a year ago. So how do we handle the valuation of a business that is not as profitable in today's economy?

First of all, expect to see higher discount (and related capitalization) rates. The more unstable the market is, the more unknown factors there are in the economy, the higher the rate of return an investor is going to demand. The rate of return and the discount rate have an inverse relationship with business value. In other words, as the discount rate increases, value decreases and visa versa.

Secondly, expect to see more emphasis placed on the exact date of valuation. The value of your client's business is driven by what was known or knowable on the date of valuation. Whether the valuation date is determined through legal proceedings, an agreed-upon date, or an alternative valuation date decided by the court, timing is everything. The difference between an analysis of a business in October 2008 could yield a significantly different valuation than the same analysis done for April 2009.

Economic Factors

The majority of businesses were sent reeling during the fourth quarter of 2008 after the financial crisis and the resulting credit freeze. Business owners struggled to replace operating lines of credit that vanished overnight. Crucial vendors and suppliers went out of business. Consumers stopped spending and Wall Street held its breath as the world waited to see how the financial crisis would change the face of the global economy.

While there are still many uncertainties about today's economy, most of the big questions have been answered. Investors may still be hesitant to take on riskier opportunities, however their confidence in the market is returning. Because of this, businesses analyzed after the first quarter of 2009 are expected to have higher values than if the same analysis had been conducted for the fourth quarter of 2008.



Valuation Methods

How can my client's business be worth THAT when it did not make any money last year? Many business owners are reporting net losses for the first time while others are on their second year of losses. The value of a business is in its ability to generate future profits to the owners, not how much the company earned last year.

As a result of declining profits that might be temporary, expect to see more valuations utilizing the Discounted Future Returns method instead of the Capitalized Returns method for businesses with fourth quarter 2008 valuation dates. The Capitalized Returns method relies on historical financial information to indicate future performance. The Discounted Future Returns method utilizes projections and forecasts to estimate the future revenues of the company. Management input, historical revenue trends, and industry and economic forecasts will play an important role in projections of the company's future earnings. The Discounted Future Returns method might be preferred to more accurately reflect the company's future prospects.

Brisbane Comment

While the Discounted Future Returns method has not been widely used in matrimonial cases, it is a commonly accepted method of valuation. It is used extensively in valuations for non-marital litigation and by the finance industry as a method of valuing future economic benefits and converting (discounting) those benefits to present value.

Given these unusual economic conditions, additional analysis and alternative valuation methods may be appropriate in order to reasonably value your client's business.

