



5 minutes



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February 2012

Business Valuations

If you are looking to buy into a small business or you are already in business then you need to understand business valuations, and when they are required. There are three main reasons why you would require a business valuation:

Internal Restructuring

Internal restructuring is where you have grown your business to a point where the structure needs to change to cope with external parties interested in the business. A typical example of this is where a business runs under a discretionary trust that grows significantly and then banks and/or external equity providers can take that business to the next level, in other words from a small to medium size business. This would involve the sale or rollover of that business to a company or unit trust which would require a business valuation to calculate the goodwill going into the new entity and any capital gains tax that may result.

Another example of internal restructuring is where Mum and Dad, who have say three children, pass the business on to Child Number 2. Mum and Dad's two other children who aren't in the business need to be dealt with fairly. To make sure the transaction is commercial for the whole family and for estate planning purposes a business valuation is required.

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Economy & Investment Seminar

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Chief Economist,
BT Financial Group

Mr David McMillan

Property Advisor,
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External Transaction Requirements

Many external transactions in business require a valuation. For example business owners who are considering selling their company require an objective opinion of value to make their plans. Business valuations also provide all involved parties with peace of mind during a transaction, as final values can either justify a buyer's investment or cause them to reconsider. Banks and equity financiers may require regular business valuations as part of their servicing requirements and return on investment calculations.

Another common external transaction that will require a valuation is a buy/sell agreement. This agreement allows a partner or shareholder in a closely held business to purchase the interest of another partner or shareholder who withdraws from the business. Agreements often include the need for an independent appraisal to determine a per-share price. Business valuers typically work in conjunction with lawyers when drafting the valuation portion of these agreements.

Litigation Purposes

The third category of requiring a business valuation is in legal disputes. As above with the buy/sell agreements, shareholders can have major disagreements which may trigger them being diluted as a shareholder or being voted out of the business. A resolution of this type of dispute will almost always require a business valuation whether this is written into a buy/sell agreement or not.

A dreaded divorce is also an obvious reason for a business valuation. Divorce proceedings are often complicated by ownership of a closely held business, which must be valued along with the rest of the marital estate.

Now that some of the situations requiring a business valuation have been outlined, how are businesses valued? There are a number of methods to value a business, and for the valuer it will require a large number of calculations and in more expansive cases a complete understanding of all areas of the business. However, these calculations will also require the skill of the valuer to choose the right valuation method and use business intuition to arrive at the fairest result. The most common valuation methods are:

Capitalisation of Future Maintainable Profit

The capitalisation of future maintainable profit focuses on the adjusted profits of the business. It values a business at a multiple of its maintainable profit, with the multiple being determined by the risk rating of the business. Most small to medium businesses have a multiple somewhere between one and five times. This approach is commonly used for mature businesses where there is a history of stable or growing profit.

Discounted Cash Flow

The discounted cash flow method looks at the cash flow of the business and calculates value based on the sum of the forward cash flow adjusted to its net present value. This method is commonly used for businesses where there is a defined time life to the business and where cash flow is reasonably predictable. Bigger businesses are often valued with this method.

Industry Standard

The industry standard method is the least scientific of all the approaches and is sometimes criticized for its lack of rigorous return on investment formula. Despite this, it is most appropriate for those businesses in particular sectors that are sold for less than \$1,000,000. It assesses value by a simple formula that will be calculated against some factor of the business such as revenue, gross profits or recurring income. It is only used for small businesses and it seeks to reflect market activity. To be able to utilize the industry standard method you need to have a large number of businesses in the sector, have ongoing turnover of these businesses and some level of market information needs to be available. The businesses all typically have a very similar business model. Examples of business sectors where an industry method does exist include newsagents, pharmacies, cafes, real estate agents and financial planning practices.

If you have a life event that requires a business valuation, being part of Paris Group enables us to offer you fair market valuations using the most appropriate method of the three above, for your business.



Superannuation: When to consider a Self Managed Super Fund

Despite concessional tax treatment on Superannuation, there is still reluctance with many clients to place a larger portion of their investment wealth within Superannuation.

When pressed about such matters, clients' responses focus on a range of explanations. Some, such as restricted access and potential for legislative changes can be valid. However, other explanations such as perceived limited investment choice, costs and control can be increasingly challenged when Self Managed Super Funds (SMSF) are discussed.

Traditional Industry Superannuation Funds are prevalent in Australia and provide a low-cost Superannuation option, run on a not-for-profit basis. Retail Superannuation Funds in contrast are commercially managed products that tend to have a wider range of investment funds and features. Whilst debate rages on comparative merits of such Superannuation products, a quiet revolution has been taking place involving a third Superannuation option, namely SMSF's.

Over the last 5 years, SMSF's have grown from holding 10% of the retirement savings of Australians to over a third. As SMSF's do not receive any more tax advantages than any other Superannuation account, we must look elsewhere for the reason for their blossoming popularity.

SMSF's will incur accountancy costs to set-up, operate and audit the fund, but these fees are explicit and may be preferable to largely percentage based fees in industry/retail product.

Trustees of a SMSF tend to enjoy more control over the funds, as they are not investing through a third-party. A wider investment choice facilitates a more diverse portfolio across assets and investment companies and this becomes very important for large superannuation balances. The main permissible investments with a SMSF often not available with other Superannuation products are:

- Commercial Property
- Residential Property
- Listed Shares
- Unlisted Shares
- Gold
- Term Deposits

Direct property investment within SMSF's is a complex area, especially when borrowing to buy property. This smashes the old choice of investing capital into either Superannuation or Direct Property and replaces it with the mouth-watering proposition of investing capital into Superannuation and Direct Property.

Despite the advantages, a SMSF is not suitable for everyone. Ongoing Accountancy and Audit Costs as well as set-up costs usually make funds with asset balances less than \$150,000 prohibitive. Furthermore, even if balances are above this figure, some superannuation providers (particularly Retail providers) can provide access to a wide enough range of managed funds to satisfy many clients' investment needs.

The decision should not be rushed, care must be taken that rollovers from older Superannuation funds do not relinquish valuable future income guarantees. It is also vital that insurance contracts are not surrendered without replacement cover being organised.

Whilst advice is a must initially, the level of ongoing investment, insurance and retirement planning advice will depend to what extent you may wish to take care of your own arrangements, but having the options laid-out for you is always a sensible step.



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Xero: Cloud based Small Business Software

If you are in small business and are considering changing or implementing a new software system, you should consider a cloud-based alternative such as Xero. The benefits of using Xero are:

Real-time view

You'll always be on top of your cashflow. At a glance the Xero dashboard gives you a summary of all your bank account details and balances with the ability to drill down to see transactions.

Banking and billing with ease

Xero lets you enter your invoices quickly and efficiently, whether you are creating an invoice for one or many items. You

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can create a schedule to automatically generate invoices on a regular basis, saving you the time and hassle of entering the invoice manually every month. You can also email formatted invoices directly to customers from within Xero. Simple.

Automated bank feeds make bank reconciliations a thing of the past

Xero has made bank reconciliation easy and fun. You can automatically import your bank statements into Xero daily, so you don't waste time downloading and uploading bank files manually.

Secure and private

Xero stores all your accounting information on servers with corporate graded security which are automatically backed up. Because it is online, Xero lets you collaborate with your accountant, sharing the same data at the same time – eliminating the need to email or send vital data insecurely by disc or thumb drives.

Don't just take our word for it. Try Xero for free or come in for a free demonstration. Call your accountant today for further details or to arrange a suitable time to have the benefits explained in more detail.

Buying for the Second Time

History rarely repeats itself and this is certainly true of buying a home second time around. As an established - or next time buyer - you have experience on your side but there are many new challenges to encounter that you may not have dealt with as a first home buyer.

Here are the answers to the most commonly asked questions by next time buyers.

Can I move my mortgage from one property to another?

The ability to transfer your home loan to another property without incurring exit or entry fees is known as portability and it is a common feature of the vast majority of loans. Portability is useful if you have your home loan set up just the way you like it and you sell your home and move into a new one before the mortgage is fully paid.



Portability cannot be used in all situations because it requires that exchange and settlement for both properties happen on the

same day and at the same time. It is also better suited to situations where the loan amounts between the properties are the same - if you need extra funds you may have to make a new home loan application or pay additional fees on top of the increase in mortgage repayments.

Should I sell before I buy?

There are strong arguments both for and against either option. Selling first means that you don't have the financial pressure of supporting two loans until the second property is sold, but it also means you have to find interim accommodation for yourself and your belongings.

Buying before you sell allows for an easier move but you will need to obtain bridging finance to cover the gap between the sale of one property and the purchase of another. The interest rate on a bridging home loan is usually on par with a standard home loan interest rate, with a term of between 6 and 12 months.

Bridging loans can be complex and you need to be sure you understand the fine print and have the finances available to cover the cost. Your mortgage broker can help you choose the right kind of bridging loan for your needs.

Can I use the equity in my existing home as a deposit?

Yes, this is one of the advantages available to next time buyers. It is especially useful if you buy before you sell because it provides you with a low-cost solution to coming up with a deposit. Another option available is to use your redraw to access any extra repayments made on your existing home loan.

Important: This is not advice. Clients should not act solely on the basis of the material contained in this newsletter. Items herein are general comments only and do not constitute or convey advice per se. Also changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. This document is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and not be made available to any person without our prior approval. Liability limited by a scheme approved under Professional Standards Legislation