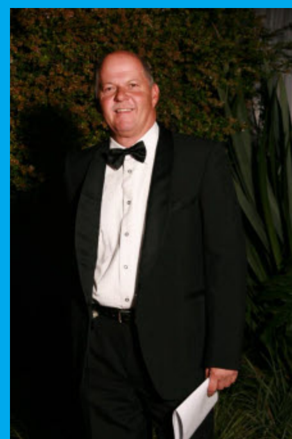
Different Valuations Methods Affect Price

Business Brokers ALDES Established 1979 Masters

ALL THINGS FINANCIAL

Paul Fyfe, an Independent Financial Advisor, Property and Business Broker explores and gives commentary on the above subject.



HOW DIFFERENT VALUATION METHODS AFFECT THE PRICE OF TWO BUSINESSES

Let's look at how valuation methods introduced last week affect the price of two businesses. One is take away Fish and Chips Shop and the other a Franchise Fast Food. Both have been established for two years and have profits of R50 000 monthly.

The Fish and Chips Shop has assets of approximately R350 000 comprising stock of R60 000 and fixtures and fittings of R290 000. It operates 7 days a week. Its clientele is derived from advertising locally. It is situated in a small centre.

The Franchise Fast Food shop has assets of R660 000, comprising stock at cost of approximately R60 000 and fixtures and fittings of R600 000. It has a good position in a busy centre and is open 7 days a week with its sales coming from passing trade. Advertising is national and a strong brand.

Payback period

As a guide, an older, more established business with a high asset base, would need 16 to 20 months to recoup the investment. A younger business with a low asset base and particularly businesses perceived to be higher risk because they are easier to start from scratch, would need 9 to 15 months. However a good Franchise, regardless of age, would be 24 to 30 months. The Franchise Fast Food would be calculated at 30 months, times the net profit of R50 000 (R1 500 000) and the Fish & Chips Shop at 18 months times net profit (R900 000). One issue that may affect the Fish and Chip shop is also the lack of adequate financial records.

Why the difference

As we have said earlier, the lower the risk in the business the higher the payback, Franchise are known to survive better than Non- Franchise businesses. With the Fish and Chip Shop it is not in as good an area and full financials are not available ie. The risk is greater.

Return on investment

Assess an acceptable percentage return tax and how much one would pay a manager to run the business. Some 35% to 45% before tax is the norm with small to medium sized businesses and a managers salary of say R12 000 a month would be acceptable particularly as both ventures do not require highly skilled people to run them. One could accept that the Franchise has a lower business risk and the expected return would then be 35% and 45% for the Fish and Chip Shop.

The sum would be as follows: Annual net profit, less salary, times by the return. In both cases R600 000 – R144 000 = R456 000. The difference would now be: Fish and Chip Shop R456 000, divided by 45% = R1 013 333. The Franchise R456 000 divided by 35% = R1 302 857.

Aldes Masters Business Brokers
Cell: 0833260683
Fax: 086 608 9389
E mail: paul@aldesmasters.co.za
Web: www.aldesmasters.co.za