BIZ STATS LIMITED

Terms & Conditions

March 2010

When a business is offered for sale, or is being valued on the basis of Fair Market Value, the terms and conditions relating to the potential sale can have a significant impact upon the value of the business. Some valuers apply one single earnings multiple to an industry without considering the difference that these terms of sale (and other value modifiers) can have on the value of a business.

<u>Case Study</u>:

Two Chartered Accountants with similar public practices are offering their practices for sale - but with markedly different sale terms:

Accountant 'A'	**Accountant 'B'**
Terms:	Terms:
• Full Payment on settlement date.	• Payment to be spread in equal amounts over 3 years (interest rate on outstanding amount 4.5%).
• Vendor assistance – minimum of 20 hours per week @ $90 per hour.	• Vendor assistance on an 'as-needed' basis @ $45 per hour.
• Vendor assistance – maximum period of 6 months.	• Subsequent assistance on an 'as-needed' basis @ $45 per hour for up to 3 years.
• Restraint of trade period 1 year.	• Restraint of trade period 3 years.
• No adjustment for lost clients.	• 50% of annual fees for any 'lost' clients to deducted from the final payment.

It is not difficult to see that the terms offered by Accountant 'B' are far more beneficial to a potential buyer than the terms offered by Accountant 'A'. The spread of the capital payment at a low interest rate, the adjustment for any clients lost in the transfer, the lower hourly rate and greater flexibility of vendor support; all these terms of sale offer much more value to a potential purchaser.

Even though the two practices have similar turnover and profit, the practice offered by Accountant 'B' has a higher value - **because of the terms and conditions offered**.

<u>Vendor Finance:</u>

Banks have recently adopted more vigorous lending criteria, and many secondary finance sources have disappeared. In the present economic climate, the role of vendor finance is becoming increasingly considered as one of the terms of sale to help vendors sell their businesses. If it makes the business more attractive, then it may increase the value.

In preparing a valuation, the valuer needs to clarify whether vendor finance will form part of the sale price valuation.

<u>Lease:</u>

Lease conditions can have a major impact on value - is the lease assignable, is there a demolition clause, how much of the lease remains, when is the next rent review due?

Vendor's Restraint of Trade:

The Fourth Edition 2008 ADLS form for the Sale and Purchase of a Business, allows the contracting parties to define the Vendors Restraint of Trade - in terms of either a period of time and/or distance from the current business.

Restraint of trade gives a purchaser some reassurance that the intangible value (goodwill) that he/she has purchased as part of the business price, will not evaporate as a result of the vendor immediately setting up in competition again and enticing back the customers. The details are negotiated by the parties to the agreement.

But what happens when there is no sale? – e.g. a valuation of a business for a matrimonial property settlement. Fortunately there is case law on this point.

In the Court of Appeal Judgment 16 August 1989 (Z vs Z), those representing the wife claimed that the professional practice of the husband should be valued as if a normal restraint of trade applied. The parties for the husband argued that a restraint of trade could not be given as he would need to continue working in that profession. The issue of a restraint of trade had a significant effect on the value of goodwill.

The Court of Appeal ruled that a true market value must be assessed on a hypothetical sale to the best advantage of both partners in the matrimonial partnership.

> *"This necessarily contemplates such a sale being accompanied by a covenant in restraint of competition by the husband so as to achieve the real market value of the practice as a going concern."*

However be aware that in an open market sale, the restraint of trade is a factor which is negotiated between the contracting parties. Depending on the terms agreed, it can affect the value of the business.

Vendor Assistance:

The period and nature of vendor assistance is decided during sale negotiations. However in some cases (e.g. a business being sold by a deceased estate) vendor assistance is not available. This might deter some buyers and could have a significant effect on the value of the business.

Other Terms and Conditions.

The ADLS standard contract form contains a further 16 warranties & conditions given by the vendor and covering a number of factors relating to the sale of the business. While these are standard clauses for most business sales contracts, they are underlying assumptions that support the fair market value of a business.

If you are valuing a business on the basis of Fair Market Value, it would pay to be familiar with these clauses as different terms and conditions may apply in some situations. Any variations have the potential to affect value.

Guy Crozier MBA B.Com