

Dear Frank ,

Market Update

Back in March this year we advised several reasons why Tabak felt it may be slightly more challenging year, including election uncertainty, tighter bank lending ratios and a peaking Christchurch economy with regard to rebuild activity. Whilst these all remain factors in a slightly subdued market, it is clear that there is still strong demand for fairly priced appealing businesses. We have sold 7 businesses this financial year, with another two about to go under offer.

For example we released a flyer to our database a week ago, had over 70 responses in two days, and have had several buyer-seller meetings in the ensuing week with a conditional full-priced SPA likely within the next few days. Is this an “easy win”? Not at all, as we have been in regular contact with the vendor for the past two years prior to the listing and were able to advise how best to structure the Information Memorandum and promotional material to best leverage interest from the Tabak database.

The business has not been advertised outside our database of registered buyers, also assisting confidentiality through the whole process.

What Price Goodwill?

How long is a piece of string? The Tabak records over twelve years show that goodwill/intangibles is around 65-70% of the overall sale price, across 450+ sales during that time. However each region, industry and business has its own unique set of variables that will impact on the risks around future maintainable earnings, and hence the goodwill component. Commonly goodwill multiples vary from 1.0 earnings to perhaps 2.0/2.5 times earnings – and perhaps up to 3 x or more if there is little to no tangible assets and the business has secure and established cash flows.

However if the business has a high value of tangible assets e.g. stock or plant then the capacity for then including a high goodwill multiple is limited. Why? It's all about ROI and as importantly bank funding. Tabak have seen several more recent examples of where a business with excellent tangible assets, but also a high-ish desired goodwill multiple has resulted in ROI's below 20% (i.e. over 5 x EBIT) and when bank funding is considered against the assets, the EBIT from the business simply cannot sustain interest & principle repayment over the first 3-4 years, as well as generate an appropriate profit for the new owner.

“Quasi-Goodwill”

This is Tabak's term for the difference between an estimated “market value” of assets and their Book Value. We do explain to vendors wanting to bulk up the asset values within the business that they may be up for tax on depreciation recovered and that whilst their business should still be valued at an appropriate overall ROI – the “true” goodwill component is both the intangibles together with any “quasi-goodwill” existing within the asset values.

In summary cashflow, working capital and ROI remain critically important when considering fair values for businesses – and MUST be considered when assessing value. Finally I would like to welcome Sam Cherry CA to the Tabak Christchurch team and the five of us in the South Island look forward to continuing to assist your clients as they consider succession and the sale of their businesses.

As always, if you no longer wish to receive these occasional newsletters, please reply with “unsubscribe”.

Thanks & Regards

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