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Mergers & Acquisitions: When & How to Use a Valuation Expert

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Very often a business appraiser is hired to determine the "Fair Market Value" of a business. This involves what amounts to an academic pursuit to determine what a hypothetical buyer would pay and a hypothetical seller would accept for the business. One of the assumptions is that the buyer and seller are both equally motivated and equally informed of all the relevant facts.

Mergers and acquisitions present the need for business valuation expertise under entirely different circumstances. Obviously, the rules of engagement are quite a bit different. Either the buyer or seller are known (sometimes both are known), the buyer and seller are rarely if ever equally informed of the relevant facts, nor are both parties equally motivated. Therefore, a valuation expert should be used that has experience in transactional work as it presents unique challenges and requires specific expertise.

Price, Value, and Proceeds

Transactional valuation requires an appraiser who understands that there is a difference between price, value, and proceeds. There is an old saying in business negotiation: "You pick the price if I can name the terms." And, depending on the terms, the proceeds of the sale can be very different that the price or value.

Very often the terms price, value, and proceeds are used and interpreted interchangeably when discussing the sale of a business. Often, that is done to the detriment of the participants in a transaction since there can be significant differences between the value of the business, the stated price, and the eventual proceeds from the sale. It is often said that "you can name the price if I can set the terms." This is a truism in the negotiation of all kinds of transactions.

The most readily applicable illustration for most readers is the purchase of a car. There is a good reason why a car salesman wants the buyer to focus on the monthly payment (proceeds) rather than the ultimate price of the car. If the salesman can get the purchaser comfortable with the monthly payment they know that the ultimate price of the car becomes less important if not totally unmentioned in the closing negotiation. When the deal is done, many buyers privately realize they ended up paying a higher price for the car than it was really worth (value). Of course, few admit this publicly as everyone tells their friends what a great "deal" they negotiated on the car.

This same dynamic applies to the purchase and sale of a business. Many sales include complex terms that may include stock of the purchasing company in lieu of cash, a note in lieu of cash, compensation packages that are closely tied to the price and subsequent performance of the company, and look-back provisions that ultimately may adjust the purchase price after-the-fact. The process of understanding and negotiating terms can be frustrating and, potentially, utterly confusing.

Valuation Services

If a merger or acquisition is contemplated, the following are ways a valuation expert could be used:

- ***Appraisal –***the buyer and/or the seller hires an expert to place a value on the business and to obtain transactional data on the sale of other similar businesses.
- ***Due diligence –*** the buyer retains the services of an appraiser to evaluate the impact of the value of the firm based on information obtained during the due diligence process.
- ***Negotiation –*** the appraiser acts as a consultant to the primary negotiator to provide the constantly changing differences in the deal between price, value, and proceeds.

- ***Fairness opinion –*** depending on circumstances the selling management team or board of directors will want the opinion of an independent appraiser as to whether the negotiated price is reasonable and fair to all interested parties.
- ***Accounting –*** After the completion of the transaction there is a need to account for the transaction for financial accounting and tax reporting purposes. Price allocation sometimes requires the services of a valuation professional.

About the author:

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