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Shareholder Disputes

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ISBN-10: 1-55093-731-6
ISBN-13: 978-1-55093-731-2

Valuation of Businesses: Issues Commercial Litigators Should Know in Contentious Shareholder Exits

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Legal Education Society of Alberta

For: *Shareholder Disputes*
Calgary, AB – October 25, 2019
Edmonton, AB – October 29, 2019

<u>**VALUATION OF BUSINESSES: ISSUES COMMERCIAL LITIGATORS SHOULD KNOW IN CONTENTIOUS SHAREHOLDER EXITS**</u>

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INTRODUCTION

The valuation of a business, or an interest therein, is fundamentally a subjective exercise that, in order to formulate a reasoned conclusion, requires detailed business analysis and application of valuation principles. Because each business valuation is unique, the business valuation exercise ought not to be approached using a 'one-size fits all' technique. In each instance, the principles, concepts and methodologies used to determine value will be tailored to the business in question, and moreover, the purpose for which the valuation exercise is being undertaken.

In this paper, I discuss aspects of the business valuation exercise that may underlie, or create consternation amongst shareholders, and their views on value; particularly in situations involving exits from a business. While this paper describes areas in business valuation that can lead to different beliefs on value, the topics reviewed are not, and should not be taken to be, an *exhaustive* list of all aspects of business valuation theory and practice that result in or create these differences.[1]

In the presentation, connected with this paper, I, among other things, review examples of legal cases that illustrate the issues raised in this paper.

VALUATION APPROACHES

Businesses can generally be separated into two categories: those that are 'going concerns' and those that are not. A business is a going concern if it is expected to continue to operate for the foreseeable future. A business is not a going concern if it is in financial distress and cannot, or soon will not be able to, meet its financial obligations.

Going Concern Valuation Approaches

There are three primary going concern valuation approaches: the asset approach, income approach, and market approach.

Asset Approach

The objective of the business valuator using this approach is to restate the historical cost balance sheet to fair market value, thereby disclosing the true economic value of all assets and liabilities of the business. The business valuator starts with the balance sheet of the business and adjusts all assets and liabilities to their fair market value. This approach is more useful in situations where the

[1] Much of the material discussed in this paper has been informed by two leading CBV valuation texts, "Business Valuation", by Howard E. Johnson, 2012; and, "Canadian Valuation Service, 2018 Student Edition", by H. Christopher Nobes, Howard E. Johnson, and Ian Campbell, August 2017.