

EUROPEAN BUSINESS VALUATION STANDARDS

1ST EDITION – 2020

CONTENTS

Preface.....	9
Introduction.....	13
Members of the European Business Valuation Standards Board, Contributors, Acknowledgements.....	19
I. European Business Valuation Standards	23
EBVS 1 Market Value and Bases of Value Other than Market Value.....	25
1. Introduction	26
2. Definition of Market Value and commentary	27
3. Bases of value other than Market Value	35
4. The specific definitions of Basis of Value under Commission Delegated Regulation (EU) 2018/345 of 14 November 2017	40
EBVS 2 The Valuation Process.....	43
1. Introduction	44
2. Scope	44
3. Terms of Engagement	45
4. Liaison with client's advisers, auditors and others	46
5. Commentary	46
6. Supporting the valuation	52

EBVS 3	The Valuation Approaches and Methods.....	55
1.	Introduction	56
2.	Purposes of valuation	56
3.	Scope	57
4.	Overview of the business valuation approaches and methods	57
5.	General observations	58
6.	Applications	61
7.	Conclusion on opinion of value	70
EBVS 4	Reporting the Valuation.....	73
1.	Introduction	74
2.	Scope	74
3.	The Valuation Report	74
4.	Valuation review	80

II. European Business Valuation Guidance Notes 83

EBVGN 1	Control Premium, Discount for Lack of Control and Discount for Lack of Marketability.....	85
1.	Introduction	86
2.	Definitions of premiums and discounts	86
3.	Scope	87
4.	Application of premiums and discounts	88
EBVGN 2	Discount Rates in the Discounted Cash Flow Method.....	93
1.	Introduction	94
2.	Scope	94
3.	Commentary on discount rates	95
4.	Capital Asset Pricing Model (CAPM)	96
5.	Build-up method	103

EBVGN 3 Valuation of Intangible Assets.....	105
1. Introduction	106
2. Scope	106
3. Commentary on intangible asset categories	107
4. Data, documentation and information sources	111
5. Usual bases of value	112
6. Income Approach	113
7. Market (Comparison) Approach	117
8. Asset-based Approach	118
9. Reconciliation processes	120
10. Legal aspects in valuation of intellectual property	120

III. Business Valuation and Sustainability 123

1. Introduction	125
2. Sustainability	128
3. Sustainability and Business	133
4. Valuation and Sustainability	140

IV. European Business Valuers' Code of Conduct 149

V. European Union Legislation and Business Valuation 153

1. General Introduction	156
2. Valuation for EU Company Law	159
3. Valuation of Credit Institutions	165
4. Valuation of Insurance and Reinsurance Institutions	167
5. Valuation for Investment Funds	169
6. Valuation for Taxation Legislation	171
7. Valuation for Transfer Pricing	175
8. Valuation for State Aid Rules	179
9. Valuation for Enforcement of Intellectual Property Rights	184
10. Valuation for Insolvency Proceedings or Restructuring Plans	185
11. Schedule of EU Legislation	187

Membership of TEGOVA.....	193
Glossary of terms.....	201

PREFACE



In the public mind, TEGOVA is real estate. Its 72 associations from 38 countries – 70 000 valuers in Europe, are all majority real estate valuers. For the EU authorities, the real estate aspect is also determinant in the Mortgage Credit Directive's recommendation of European Valuation Standards to the member states of the Union, as in the European Central Bank's accordence of precedence to EVS over all other standards in its Asset Quality Review manual for the valuation of banks' real estate collateral.

Yet business valuation is also prevalent among a number of members with valuation firms or individual valuers often combining real estate and business practice. This is a welcome tendency for the profession and for European society at large because land and buildings are such an important and integral part of most businesses that the combination of real estate and business knowledge provides a solid grounding for business valuation excellence.

Conversely, business valuation is an attractive field of activity for real estate valuers in a mutating economic and professional environment where no source of activity is permanently guaranteed and new opportunities arise.

Responding to increasing member demand, European Business Valuation Standards now provide fundamentals of best practice in business valuation, with a quality that can be relied upon by valuers, public authorities, investors and the financial industry throughout the Union and beyond.

Like EVS, European Business Valuation Standards are anchored in the EU legal order, putting all valuation definitions and concepts in step with EU law and providing a separate section on EU Legislation and Business Valuation. The EU has always been part of TEGOVA's DNA, underpinning our mission to provide Europeans with a common set of standards fit for their single market and emerging polity. Our standards are founded on the understanding that Europe has reached a tipping point: the EU is now the dominant sculptor of our regulatory environment and valuers can no longer limit their horizons to the national policy and regulatory framework. This is at least as important for business valuation as for real estate given the number of key business areas regulated by EU law.

Business valuers must master a fast-Europeanising business-regulatory environment and I trust that these, the first ever truly European Business Valuation Standards, prepared by highly skilled professionals in business valuation, will provide the grounding for that.



Krzysztof Grzesik REV FRICS
Chairman of the Board of TEGOVA

INTRODUCTION



This is the first edition of European Business Valuation Standards (EBVS), developed by TEGOVA to meet the demand of its 72 Member Associations, other valuation organisations, individual valuers, regulators and other stakeholders on the European market.

TEGOVA is committed to setting standards that are compatible with the Europeanisation of business activities. The rationale for providing a set of business valuation standards for Europe comes from a demand for valuations which are consistent with EU company law requirements and of a quality that can be relied upon as a common benchmark by investors, the financial industry and valuers throughout the Union and beyond.

Scope

The scope of EBVS 2020 is to cover business valuation issues, assuming business to be:

"An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities."

(The new definition of a Business in Amendments to IFRS 3, adopted by Commission Regulation (EC) No 1126/2008)

Purpose

EBVS 2020 provides harmonised European standards, guidance and technical information that serve:

- ▶ To assist business valuers in preparing coherent Reports for presentation to their clients;
- ▶ To promote consistency by the use of standard definitions of value and approaches to business valuation;

- ▶ To enable users of valuations to know and understand more fully what is meant by particular terms and definitions so that they are better able to utilise the business valuations which have been prepared as a result of their instructions;
- ▶ To provide a quality standard in terms of a validation of recognised qualifications and best practice as a benchmark for users of valuations;
- ▶ To provide an accurate basis for economic analysis of business undertakings;
- ▶ To increase awareness of the role of the business valuer;
- ▶ To institute procedures which are likely to lead to clearly set out, accurate, unambiguous Valuation Reports that are consistent with EU law and valuation and accounting standards;
- ▶ To promote coherence in EU and national regulations and recommendations of best practice.

Structure

The Standards and Guidance Notes follow a regular layout, as far as practical. There is also a list of what each Standard and Guidance Note contains, followed by detailed commentary and in some cases by country-specific interpretation.

Introduction

I. European Business Valuation Standards

EBVS 2020 sets out four core standards:

- ▶ **EBVS 1** – Market Value and Bases of Value Other than Market Value, provides definition of various bases of value, applicable in business valuation, Highest and Best Use analysis in connection with Liquidation (disposal) and Going Concern business scenario, assumptions and special assumptions in arriving at an opinion of value;
- ▶ **EBVS 2** – The Valuation Process, incorporates detailed Terms of Engagement with appropriate commentary;
- ▶ **EBVS 3** – The Valuation Approaches and Methods, presenting the recognised business valuation practice;
- ▶ **EBVS 4** – Reporting the Valuation, presenting general reporting requirements, the content of the Valuation Report and valuation review.

II. **European Business Valuation Guidance Notes**

The Guidance Notes follow on from the Standards and provide more detail and explanation of key issues and techniques in the following topics:

- ▶ **EBVGN 1** – Control Premiums and Discounts for Lack of Control, Discounts for Lack of Marketability;
- ▶ **EBVGN 2** – Discount Rates in Discounted Cash Flow Method;
- ▶ **EBVGN 3** – Valuation of Intangible Assets.

III. **Business Valuation and Sustainability**

IV. **The European Business Valuers' Code of Conduct**

V. **European Legislation and Business Valuation**

EBVS 2020 considers business valuation issues in a European context and, in particular, addresses the valuation requirements and definitions of EU company law legislation.

This fifth part of EBVS is devoted to the body of EU law impacting enterprises and business valuation.

In Conclusion

EU law impacts the principles and practice of valuation in many different areas such as banking, the environment, social policy, financial accounts, new issues and prospectuses, taxation and competition. Much of this regulation falls under EU company law.

The purpose of EU rules in this area is to enable businesses to be set up anywhere in the EU enjoying the freedom of movement of persons, goods, services and capital, to provide protection for shareholders and other parties with a particular interest in companies, to make businesses more competitive, and to encourage businesses to cooperate or merge over the old borders.

Although there is no codified European company law as such, EU harmonisation of national rules on company law has created minimum standards in areas such as the protection of interests of shareholders and their rights, rules on takeover bids for public limited companies, branch disclosure, mergers and divisions, minimum rules for single-member private limited liability companies, financial reporting and accounting, easier and faster access to information on companies, and certain disclosure requirements for companies.

The performance of business valuation services under the above EU rules requires a high degree of skill, and imposes upon the valuation professional a duty to communicate the valuation process and conclusion, as appropriate to the scope of the engagement, in a manner that is clear and not misleading.

Effective Date: 24 March 2020

A handwritten signature in blue ink that reads "Ilić Danijela". The signature is written in a cursive style.

Danijela Ilić REV FRICS

Chair of the European Business Valuation Standards Board

Member of the Board of TEGOVA

MEMBERS OF THE EUROPEAN BUSINESS VALUATION STANDARDS BOARD, CONTRIBUTORS, ACKNOWLEDGEMENTS

Danijela Ilić
Chair

Vesna Stefanović
Technical Writer

Ella Dunphy

Ivars Strautins

Allan Traynor

Professionals who have engaged with the EBVSB:

Daiva Albertaviciene

Oleksii Amfiteatrov

Nino Beraia

Magdalena Habdas

Petr Horák

Oleksii Kalapusha

Muharem Karamujic

Kalina Kavaldzhieva

Jan Konowalczyk

Nadica Mladenovska-Krckoska

Heinz Muhr

Jaroslav Šantrůček

Bert van Scherpenzeel

Adrian Vascu

Alexander Weber

The authors of these Standards wish to express special thanks for the support of Anton Lezhja, Peter Ott and Andrew Strickland, all globally recognised professionals in business valuation. Though all are Directors of the Board of the IIBV (International Institute of Business Valuers) their contributions were made in a personal capacity.

Special thanks also:

To Jeremy Moody for his seminal contribution to Part III. Business Valuation and Sustainability;

To Jeroen Dewispelaere and his colleagues Astrid de Bandt, Sylvia de Graaf and Joren Vuylsteke of the leading EU law firm & DE BANDT for their high-precision work on Part V. European Union Legislation and Business Valuation;

To Professor George Matysiak for his decisive insights throughout; and

To the Blue Book's designers, Caroline Piette and her colleagues Félicie Bouckaert, Alexandre Marly and Isabelle Moulart of Hoet&Hoet whose work speaks for itself.

I.

European Business Valuation Standards

EBVS 1 Market Value and Bases of Value Other than Market Value

1. Introduction
2. Definition of Market Value and commentary
3. Bases of value other than Market Value
4. The specific definitions of Basis of Value under Commission Delegated Regulation (EU) 2018/345 of 14 November 2017

1. Introduction

- 1.1. A basis of value is a statement of the fundamental assumptions for determining a value of the subject of valuation for a defined purpose and should be distinguished from the methods or techniques used to implement a selected basis of value.
- 1.2. Market Value is a key concept in establishing an informed expectation as to the price of something, one that is neutral as concerns the buyer or the seller. The nature of the market in which that value is determined will differ according to the subject of the transaction while market conditions will vary with the changing balance of supply and demand, changing knowledge, technology, rules, trends, expectations, credit conditions and other circumstances.
- 1.3. "Value" does not mean the actual sum that may prove to be paid in a given transaction between specific parties. At an individual level, the value of a business, to a person will reflect its usefulness to her/him when judged against her/his resources and opportunities. In the context of a market with competing parties, it is rather an estimate of the amount that could reasonably be expected to be paid, the most probable price in market conditions at the date of valuation. While the business in question may have different values for different individuals who may be on the market, its Market Value is the estimate of the price in the present market on assumptions that are deliberately neutral to achieve a standard basis of valuation for both buyers and sellers. These assumptions are explored in EBVS 1 section 2.4. below.
- 1.4. The estimated Market Value will often differ from the price which might be achieved in the transaction, although the valuation analysis is based on the relevant market data which can be obtained and reasonable assumptions from the market perspective. There might be a number of reasons for such differences, because a buyer and seller might consider other or additional assumptions and agree on various specific contracting terms, including acquisitions-related synergies, which might influence the transaction price.
- 1.5. Although the majority of professional valuations will be on the basis of Market Value, there are circumstances in which alternative bases of value may be required or more appropriate. It is essential that both the valuer and the users of valuations clearly understand the distinction between Market Value and other bases of value, together with the effects that differences between these concepts may create in the valuer's approach to the valuation and in the resulting reported value.

- 1.6.** Sometimes clients may require valuations to be done as required by law or for any other purposes where strict application of the EBVS is not appropriate. In such case, a clear and transparent definition of the basis used must be expressly stated, and the valuer must explain the reason for deviating from the EBVS defined basis of value. If, in the opinion of the valuer, a departure from this standard is necessary and appropriate, such departure shall be disclosed and the reason for it clearly set forth in the Valuation Report. If the resultant valuation does not reflect a sum that would equate to a valuation prepared on the basis of Market Value, this should be stated in the Valuation Report.
- 1.7.** EBVS 1 considers Market Value and other Bases of Value in the context of business valuation including valuation of majority or minority interests and specific ownership rights.

2. Definition of Market Value and commentary

2.1. European Business Valuation Standard 1 – Definition of Market Value

'Market Value' means:

"The estimated amount for which the business should exchange on the date of valuation, in a transaction between a willing buyer and a willing seller, acting independently of each other after proper marketing, wherein the parties had each acted knowledgeably, prudently and without being under compulsion."

2.2. Commentary

2.2.1. General

2.2.1.1. The definition of Market Value:

- ▶ Applies to all the components covered by the **business** definition if valued on the Market Value basis (*see business definition in the Introduction of EBVS*); and
- ▶ Is consistent with the Market Value definitions in EU law.

2.2.1.2. The key concept of the definition of Market Value involves the following:

- ▶ The valuation result (the valuation conclusion);
- ▶ The business valued;
- ▶ The transaction;
- ▶ The date of valuation;
- ▶ The nature of the hypothetical parties;
- ▶ The necessary marketing;
- ▶ The consideration by the parties;
- ▶ Other matters.

2.2.2. The result

2.2.2.1. "***The estimated amount ...***" – This refers to a price expressed in terms of money (in specific currency), payable for the business in the transaction between independent and unrelated parties. Market Value is measured as the most probable price reasonably obtainable in the market at the date of valuation on the assumptions of the Market Value definition. It is the best price reasonably obtainable by the seller and the most advantageous price reasonably obtainable by the buyer.

2.2.2.2. This estimate specifically excludes an estimated amount inflated or deflated by any special terms or circumstances such as special considerations or concessions granted by anyone associated with the sale, or any elements of Investment Value.

2.2.3. The transaction

2.2.3.1. "***... should exchange ...***" – It is an estimated amount in a hypothetical transaction, rather than a predetermined or actual sale price. It is the price at which the market expects a transaction to be completed on the date of valuation and that meets all the other elements of the Market Value definition.

2.2.3.2. The use of "*should*" conveys that sense of reasonable expectation in a hypothetical transaction between a hypothetical seller and buyer. The valuer must not make unrealistic assumptions about market conditions or assume a level of Market Value above or below that which is reasonably obtainable.

2.2.4. The date of valuation

- 2.2.4.1. **"... on the date of valuation ..."** – This requires that the estimated Market Value be specific to a given date; a value is a judgment at a particular point in time. This is normally the date on which the hypothetical sale is deemed to take place and is usually, therefore, different from the date the valuation is actually prepared. As markets and market conditions may change, the estimated value may be incorrect or inappropriate at another time. The valuation amount will reflect the actual market state and circumstances at the required date of valuation, not at a past or future date. The definition also assumes simultaneous binding agreement on terms and completion of the contract of sale without any variation in price that might otherwise be made in a Market Value transaction at the date of valuation.
- 2.2.4.2. Market Value is expressly not an assessment of value over the longer term but only at the time of the hypothetical transaction.
- 2.2.4.3. Information which was not available to the market participants at the valuation date or before, shall not be used as an input or assumptions in the valuation, unless a special assumption is adopted depending on the defined terms of engagement. If the objective of the valuation is to estimate a controlling interest, some information might be available for majority shareholders only. This would not require an introduction of special assumptions.
- 2.2.4.4. The phrases *"date of valuation"* and *"valuation date"* are used to refer to the date at which the valuation is conducted (and for which the evidence supporting it is to be relevant) rather than the, usually later, date when the valuation is prepared and considered, with the Valuation Report then being completed for the client. The completion of the Valuation Report will never be earlier than the date of valuation, as it would then be contemplating circumstances that have not happened and for which important evidence may not yet have been found. The Report should record both the date of valuation and the date on which the Report was completed.
- 2.2.4.5. The date of valuation will not be later than the date of the Valuation Report.

2.2.5. The parties

- 2.2.5.1. **"... between a willing buyer ..."** – This assumes a hypothetical buyer, not the actual purchaser. That person is motivated, but not compelled, to buy. The person is neither reluctant to buy nor determined to do so at any price.

- 2.2.5.2. "... and a willing seller ..."** – Again, this is a hypothetical seller, rather than the actual owner, who is assumed to be neither over-eager nor prepared to hold out for a price not considered reasonable in the current market.
- 2.2.5.3.** While the business is to be valued as it is in the real world, the assumed buyer and seller are hypothetical parties, albeit acting in current market conditions. The requirement that they both be willing to make the transaction creates the tension between them in which Market Value can be determined.
- 2.2.5.4.** Market Value is thus independent of and uninfluenced by the objectives of the client instructing the valuation.

2.2.6. The marketing

- 2.2.6.1. "... after proper marketing ..."** – The business would be exposed to the market in the most appropriate manner to release its disposal at the best price reasonably achievable in accordance with the Market Value definition. The length of exposure may vary with market conditions, but must be sufficient to allow the business to be brought to the attention of an adequate number of potential purchasers. The marketing period is assumed to have been before the date of valuation.

2.2.7. The parties' consideration of the matter

- 2.2.7.1. "... acting independently of each other ..."** – Acting independently means that parties are unrelated e.g. do not have a particular or special relationship (as might be the case, for example, with parent and subsidiary companies) which may make the price level uncharacteristic of the market or inflated by any element of special value.
- 2.2.7.2.** In the Market Value definitions presented in some professional standards and regulations the uncontrolled character of the transaction is described by the term "*arm's length*" with the same meaning of a transaction between unrelated and independent parties.
- 2.2.7.3. "... each had acted knowledgeably ..."** – This presumes that both the willing buyer and willing seller are reasonably well informed about the nature and characteristics of the business, its actual and potential uses, and the state of the market at the date of valuation.
- 2.2.7.4.** The parties will thus appraise what might reasonably be foreseen at that date. This involves knowledge not just of the subject business but also

of the market and therefore the evidence (including such comparables as may be available) on which to judge the value of the business.

- 2.2.7.5. **"... prudently ..."** – Each party is presumed to act in their own self-interest with that knowledge, and prudently to seek the best price for their respective positions in the transaction. Prudence is assessed by referring to the state of the market at the date of valuation, not with the benefit of hindsight at some later date. It is not necessarily imprudent for a seller to sell a business in a market with falling prices which are lower than previous market levels. In such cases, as for other transactions in markets with changing prices, the prudent person will act in accordance with the best market information available at the time.
- 2.2.7.6. **"... and without being under compulsion ..."** – This establishes that each party is motivated to undertake the transaction, but is neither forced nor coerced to complete it. Each freely enters into and completes the transaction.

2.3. Highest and Best Use

- 2.3.1. The concept of *"highest and best use"* is normally applied in property valuation when the Market Value basis is applicable, but could also be relevant to business valuation, to support selection of going concern or liquidation scenario, as an appropriate scenario in the specific valuation engagement (*see below*).
- 2.3.2. IFRS 13 for Fair Value Reporting as adopted by EU Directive 1255/2012 defines the concept of highest and best use as *"the use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used"* (IFRS 13, Appendix A).
- 2.3.2.1. The highest and best use of an asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows (IFRS 13.28):
- ▶ **Physically possible:** the physical characteristics of the asset that market participants would take into account when pricing the asset (e.g. the location or size of a property);
 - ▶ **Legally permissible:** taking into account any legal restrictions on the use of the asset that market participants would factor in when pricing the asset (e.g. the unlawful business or the specific licences and permits which are legally required for specific businesses);

- ▶ **Financially feasible:** concerns whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce the investment return that market participants would require from an investment in that asset put to that use.

2.3.3. If relevant, the result of the highest and best use analysis serves as a criterion if the business is going to be valued under a 'going concern' scenario or 'liquidation' scenario. Its application should not be mandatory.

2.3.3.1. Going concern scenario – The business valuation scenario under going concern premise assumes that the business will continue running normally in the future, using all of its assets to generate income. This typically concerns the sale of an established business which will continue operating under the new ownership.

2.3.3.2. Liquidation (disposal) scenario – In this scenario, the business assets will no longer be used to generate earnings under current business circumstances. Rather, the situation requires that the assets be sold individually. Assets can be sold assuming orderly sale, when the seller has enough time for marketing to attract the best possible offers, or forced sale, when the assets should be disposed of immediately and presuming lack of appropriate time for marketing and other constraints imposed on the seller.

2.4. Assumptions

2.4.1. The valuation instruction may require the valuer to make an assumption, for example, that the expansion on new markets will generate a certain level of revenues. The valuer may have to make certain assumptions in order to complete the valuation effectively, often in the absence of particular information. In either case those assumptions should be clearly stated in the Valuation Report.

2.4.2. Valuers make an assumption where they assume (or are instructed to assume) something on a matter of fact which they do not or cannot know or reasonably ascertain.

2.4.3. The valuer must undertake investigations and analysis to the extent necessary to produce a professional valuation for the purpose instructed. Where the information provided or available is limited or restricted, the valuer may need to make assumptions to enable an opinion of value to be reported in the absence of full data or knowledge. Assumptions may relate to facts, conditions or situations affecting the valuation and, as assumptions are made in the absence of full information, they should be those considered most likely to be correct. For matters

such as actual and potential litigation that the valuer may not be able to check independently or the most likely outcome of which the valuer cannot estimate, the assumption may be accompanied by a recommendation that the client have the facts established by those with the appropriate specialist skills.

2.4.4. The following is an indicative, non-exhaustive, list of cases that may be reported as matters where assumptions have been made in arriving at an opinion of value:

- ▶ A list of actual and potential litigation including a reliable estimation of the most likely outcome in terms of additional liabilities that may affect the value of the business may not be available. In such case, valuers would have to make an assumption regarding the litigation's impact on the liabilities, if any, also stating that they accept no responsibility or liability for the true interpretation and estimation of potential liabilities related to the litigation;
- ▶ When the financial statements of the business are not audited by an independent auditor, the valuer needs to assume that the financial statements give a true and fair view. Valuers should state that they have not audited them and do not accept responsibility;
- ▶ Assumptions may be needed with regard to the market analysis, based on the publicly available information, which the valuer takes as accurate and credible, without carrying out independent verification or confirmation of the sources of information used;
- ▶ It may be necessary to make assumptions about the risks of the presence of hazardous substances or of additional liabilities related to the necessary expenditure to comply with environmental regulation, which might require the engagement of specialist consultants;
- ▶ The valuer may need to assume that the business possesses all necessary licences, certificates and permits to conduct the business activities, such as importing, exporting or manufacturing of goods or providing services, as well as that all facilities and natural resources necessary as inputs for the business meet legal requirements and industry standards;
- ▶ The valuer may, on occasion, need to assume that business capacities, technology, equipment and workforce are sufficient to support the management plan related to the planned sales growth, extension of the product portfolio or expansion into new market.

2.5. Special assumptions

2.5.1. In contrast to the assumption described in 2.4., valuers may make a special assumption when they assume, usually on instruction, a fact or circumstance that is different from those that are reasonably achievable at the date of valuation. The result will be a Market Value (or other Basis of Value) on that special assumption.

2.5.2. The following is an indicative, non-exhaustive list of cases that may be reported as matters where special assumptions have been made in arriving at an opinion of value:

- ▶ The business (including all necessary resources) will obtain all certificates and permits necessary to conduct business activities in the specific industry and sell products and services on specific markets. At the valuation date, the company does not have or may be in the process of obtaining such documents but there is a high level of uncertainty as to whether they will actually be obtained, while the management plan, used by the valuer, may predict sales based on such assumptions;
- ▶ The business is in the process of financial restructuring or is heavily indebted at the valuation date; special assumptions may be that the going concern premise is applicable and that the company will remain in business and will successfully recover during the projected period of time assumed in the valuation;
- ▶ A non-operating asset owned by the company will be sold under market conditions during the expected time frame, and improve the cash flow that will then enable investments or debt payment to be made;
- ▶ The additional scenario requested by the client to assume liquidation of the business under forced sale basis, although such circumstance does not exist at the valuation date;
- ▶ The highest and best use analysis of the business may consider the assumption of changes to the current legal restrictions or the introduction of new restrictive regulation, or the obtention of a specific permit or license, if such changes are likely within a reasonable timeframe;
- ▶ The valuer may use information which was not available to market participants at the valuation date if that is defined by the terms of engagement and in line with the subject and purpose of the valuation.

2.5.3. Where special assumptions are made, they must be presented in the Valuation Report. If they are known before the valuation assignment, they are to be included in the terms of engagement as well.

2.6. Other matters

2.6.1. Documentation – A professional valuation performed under this standard should be properly recorded in writing in accordance with EBVS 4, in a way that is transparent and clear to the client and to the parties to whom a duty of care is owed and to those who review it.

- 2.6.2.** The definition of Market Value should be recorded in both the terms of engagement and the Valuation Report.
- 2.6.3. Transaction costs and taxes** – Market Value is to be the estimated total value of a business and excludes the additional costs that may be associated with sale or purchase of the business as well as any expected taxation imposed on the transaction.
- 2.6.4.** However, this position may vary according to law. In certain circumstances the valuer may choose to state the Market Value before and after the costs associated with disposal of the business. In this case, the valuer should clearly state the Market Value of the business and the amount of other costs taken into consideration by specifying the nature of these costs, their justification or purpose and why they are presented in the Valuation Report.

3. Bases of value other than Market Value

3.1. Fair Value for purposes other than financial reporting

3.1.1. Definition

Fair Value may generally be used as a basis of valuation for interests in a business as between specific, identified participants in an actual or potential transaction, rather than assuming the wider market place of possible bidders. As such, it may often result in a different value to the Market Value of a business. For this purpose, it is defined as:

"The amount that would be received to sell a business in an orderly transaction between identified market participants possessing full knowledge of the relevant facts, making their decision in accordance with their respective objectives."

3.1.2. Commentary

- 3.1.2.1.** The key concept of the definition of Fair Value for purposes other than Financial Reporting involves the following:
- ▶ The amount;
 - ▶ The business;
 - ▶ The transaction;
 - ▶ The nature of the identified market participants;
 - ▶ Other relevant matters.

- 3.1.2.2. **"The amount that would be received ... or paid ..."** refers to a fair price (expressed in terms of money), payable for the business (asset and liabilities) in a transaction between two identified parties taking account of their respective interests and the advantages and disadvantages to the buyer of acquiring the business.
- 3.1.2.3. **"... to sell a business"** means the business including certain assets and liabilities, which is the subject of transaction. In some cases the business may be transferred as a group of assets, without liabilities, as in a bankruptcy process or litigation.
- 3.1.2.4. **"... in an orderly transaction"** – This requires enough time for both parties to collect all relevant facts and information necessary to obtain appropriate knowledge and understanding of the subject business and specific circumstances, and be capable of making a decision considering their individual interests and motivation.
- 3.1.2.5. **"... between identified market participants"** – This assumes a specific, known buyer and seller, where both parties are not always motivated and willing, as in litigation where one party is usually compelled to undertake the transaction. Both parties will make their decision having in mind their personal interests, knowledge, objectives, understanding and consideration of specific circumstances. The position and interest of the specific buyer and specific seller may be different from that of market participants under general market conditions, and therefore, the Fair Value may be different from Market Value.
- 3.1.2.6. Fair Value is particularly pertinent in situations where, for whatever reason, it could be envisaged that the real buyer might pay a different amount than the Market Value. Examples of this might include:
- ▶ The co-owners of the business who want to divorce, might have their specific interests in agreeing on a different value than Market Value, taking into consideration various subjective criteria;
 - ▶ Divorce litigation between parties with equal ownership interests who cannot agree on the price to be paid, or litigation between majority and minority shareholders.
- 3.1.2.7. Fair Value therefore allows recognition of the individual value a business may have to one particular bidder.

- 3.1.2.8.** As an example, according to Directive 2004/25/EC on takeover bids, EU member states have to ensure the 'fair' squeeze-out price by obliging the person who has already acquired control of a publicly traded company to make an offer to all the holders of that company's securities for all of their holdings at an equitable price in accordance with a common definition.
- 3.1.2.9.** The Directive defines the "equitable" price as the highest price paid for the company's shares by the controlling offer or over a six- to 12-month period prior to the bid. However, if the bidder offers a higher price to any shareholder during the offer, the "equitable price" must be raised to such higher price. If a mandatory offer preceded the squeeze-out, the equitable price set forth in that offer is always deemed fair for the minority shareholders of that company, thus extending any premium paid for a control in the company to the minority shareholders.

3.2. Fair Value for financial reporting

3.2.1. Definition

Fair Value is specifically adopted as a term under International Financial Reporting Standards for which, albeit with slightly less detailed assumptions than the full definition of Market Value, it may often give the same result as Market Value. It is defined as:

"The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

Definition by IFRS 13 Fair Value Measurement adopted by Commission Regulation (EU) No 1255/2012.

3.2.2. Commentary

- 3.2.2.1.** In respect of financial reporting, Fair Value is a required basis of valuation, defined as in 3.2.1. above. While the definition differs from that of Market Value, being less detailed in its assumptions about prior exposure to the market, the value reported will frequently be indistinguishable from Market Value.

3.3. Investment value as basis of value

3.3.1. Definition

Investment Value is based on the investor's specific assumptions and interests, which are usually different from the market participant view and current market expectations. It is defined as:

"The value of a business to a particular identified party for investment, and/or operational purposes."

3.3.2. Commentary

3.3.2.1. This concept relates a specific business to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. As valuations prepared on this basis assess what an individual buyer, as a specific investor, may be prepared to bid, their overall judgment and criteria might be different from those of market participants and therefore not consistent with the Market Value.

3.4. Liquidation value

3.4.1. Definition

Liquidation value is the estimated amount that the dissenting creditors or equity holders could reasonably expect to receive in the event of the liquidation of the debtor's business, whether by piecemeal liquidation or by sale as a going concern, depending on the particular circumstances of each debtor.

Liquidation value applies when either the valuation is undertaken in a liquidation scenario, or the result of the highest and best use analysis performed by the valuer clearly indicates that the liquidation value of the business is higher than the value ensuing from a valuation on a going concern basis.

3.4.2. Commentary

3.4.2.1. There are two scenarios of the liquidation value concept that can result in different valuation figures:

- ▶ **Liquidation value on an orderly sale basis.** The orderly sale basis scenario allows for appropriate marketing time and the value of assets owned by the business, on a piecemeal basis, should be equal to their Market Value;

- ▶ **Liquidation value on a forced sale basis.** The forced sale scenario always presumes **lack of appropriate time for marketing** of assets owned by the business and includes other constraints imposed on the seller, so the value of assets on a piecemeal basis should be less than their Market Value.

When determining the liquidation value of a business under the forced sale scenario, the valuer estimates the amount for which each asset owned by the business would be sold at an auction. The auction is based on a short time frame and attracts a small pool of buyers, which means that the business will end up accepting less compensation for the asset offered for sale than it would under an orderly sale basis.

- 3.4.2.2. The need for a valuation on a forced sale **basis** usually **arises** when the seller is under compulsion to sell, is desperate to sell or a strict time limit is otherwise imposed. When assessing the liquidation value of assets owned by the business under the **forced sale basis**, the valuer may apply a reduction in the form of a forced sale discount to the observable market price of the assets **owned by the business**. To determine the liquidation value of assets which do not have a liquid market, the valuer shall consider observable prices on markets where similar assets are traded, with discounts for illiquidity reflected as appropriate.
- 3.4.2.3. In carrying out a valuation of a business or of an intangible asset where the value relates to an equity interest that has the option of putting the enterprise into liquidation, the valuer may perform the highest and best use analysis to investigate the possibility that the business may have a higher value on liquidation than it has on the basis of its continuing operation as a going concern, unless there are legal provisions to the contrary.
- 3.4.2.4. If liquidation value is an appropriate basis of value, any real estate or personal property to be included in the liquidation should be valued by a qualified valuer for each type of asset and under relevant valuation standards.
- 3.4.2.5. When assessing the liquidation value, the valuer should consider the insolvency rules and complex insolvency procedures provided for under national law. They refer not only to the sale or other disposal of assets, but also to the operational changes of the business, such as the termination or amendment of contracts which should comply with the general requirements that are provided for under national law for such measures, in particular civil law and labour law.

- 3.4.2.6. The estimation of liquidation value shall be net of liquidation costs, such as the fees charged by any third-party liquidation service hired to handle the sale.

4. The specific definitions of Basis of Value under Commission Delegated Regulation (EU) 2018/345 of 14 November 2017

- 4.1. The specific definitions of Basis of Value under this Delegated Regulation are generally to be applied in case of valuations performed within a framework for the recovery and resolution of credit institutions and investment firms (*see V – European Union Legislation and Business Valuation*).

EBVS 2 The Valuation Process

1. Introduction
2. Scope
3. Terms of Engagement
4. Liaison with client's advisers, auditors and others
5. Commentary
6. Supporting the valuation

1. Introduction

- 1.1. A Qualified Business Valuer is a person of good repute, whether self-employed or employed by a valuation company or other legal entity, who prepares and supervises business valuations and assumes responsibility for them. Such person shall act independently and shall demonstrate sufficient professional competence, experience and knowledge to perform the relevant valuation function effectively. The valuation must be performed impartially and with all due skill, care and diligence, in compliance with the European Business Valuers' Code of Conduct.

- 1.2. Sufficient professional competence, experience and knowledge is:
 - ▶ Sufficient valuation experience and knowledge of the specific industry, market, economy, etc., including obtaining suitable assistance from competent and knowledgeable persons where required and agreed with the client;
 - ▶ Where required by law, possession of any license to conduct the business valuation as a valuer or/and to be a member of a mandated professional association;
 - ▶ Compliance with all legal, regulatory, ethical and contractual requirements related to the valuation;
 - ▶ Maintenance of the highest standards of honesty and integrity and conduct of activities in a manner not detrimental to clients, the public, the profession, or the respective national or European professional valuation body. Valuation compliant with these Standards requires that the qualified valuer adhere to EBVS's European Business Valuers' Code of Conduct;
 - ▶ The maintenance and enhancement of professional knowledge through a relevant programme of continuing education.

- 1.3. Valuers have an absolute responsibility to ensure that they are, and can be seen to be, independent, competent, qualified and not debarred by reason of any actual, potential or perceived conflicts of interest or have otherwise declared, and taken steps to remedy, any real or apparent deficiency so that they may carry out the proposed assignment.

2. Scope

This Standard considers the procedural steps to define terms of engagement as a basis for the appraisal and preparation of the Valuation Report.

3. Terms of Engagement

- 3.1.** Terms of Engagement are the specific terms of the contract between the valuer and the client. These terms are submitted to the client or prospective client once verbal or written instructions are received to provide a valuation service. Specific terms are prepared for each instruction, clearly and accurately reflecting the nature and purpose of the valuation and the extent of investigation to be undertaken to justify the subsequent opinion of value reported.
- 3.2.** Detailed terms of engagement must be agreed in writing.
- 3.3.** The main agreed terms or instructions must be referred to in the Report.
- 3.4.** Terms of engagement as agreed may require subsequent amendment, and any amendments must be recorded in writing to avoid misunderstanding and consequential dispute.
- 3.5.** Failure to issue written terms will result in non-compliance with EBVS. This may also result in an inadequate defence in any legal action relating to fees, negligence or performance.
- 3.6.** The minimum terms to be submitted and agreed are:
 - ▶ The client's identity;
 - ▶ Any user of the Report other than client;
 - ▶ The purpose of the valuation;
 - ▶ The precise extent of the business (ownership interest) being valued;
 - ▶ The basis or bases of value;
 - ▶ A specific date of valuation;
 - ▶ Confirmation that no potential conflict exists. Declaration of any previous involvement with the entity or the parties involved;
 - ▶ The valuer's identity and status;
 - ▶ Assumptions, special assumptions and departures from EBVS;
 - ▶ Scope and extent of investigations;
 - ▶ Reliance placed on information provided by the client;
 - ▶ Valuation methodology to be applied;
 - ▶ Content and structure of the Valuation Report;

- ▶ Any restriction placed on publication;
- ▶ The extent to which a duty of care will be provided;
- ▶ Compliance with EBVS;
- ▶ The fee for valuation services.

(see table under 5.8)

3.7. Terms as set out in 3.6 above must be regarded as minimum terms. Valuers are expected to revise and expand terms as appropriate or necessary to reflect the law, custom or the requirements of the professional organisation.

4. Liaison with client's advisers, auditors and others

4.1. The valuer may need to liaise with the client's other advisers to secure necessary information. Where the valuation is required for inclusion in financial statements, it will be important to liaise closely with the auditors to ensure that the work undertaken is what is required, and to ensure consistency and the use of an appropriate basis of value.

4.2. The professional judgement of the valuer will determine whether he/she relies on information provided or disclosed. Terms of engagement agreed must explicitly state what, if any, reliance is placed on information provided by the client, the client's representatives or third parties.

5. Commentary

5.1. Unexpected events such as legal disputes may occur many years after the original valuation instructions have been completed. The historic context and reasoning behind any special terms and conditions may then be difficult to recall unless they were contemporaneously recorded in writing. Such a record will also show if the valuation has been used for purposes other than that for which it was prepared.

5.2. A clear and concise record prepared and agreed in advance of the assignment also ensures that clients and their professional advisers are able to judge whether what they are to receive is what they wanted and expected.

- 5.3. Sub-contracted valuations** – Business Valuers must often rely upon the services of other professionals. An example is reliance upon a professional real estate valuer or plant and machinery valuer to value certain assets owned by a business. Prior approval must be obtained from the client where work is sub-contracted to other specialist valuers or where substantial third party professional assistance is necessary. This approval must be recorded in writing from the client and disclosed in the Valuation Report.
- 5.4. Valuations passed to a third party** – There is a risk that valuations prepared for one purpose may be passed to a third party and used for another unrelated purpose. The terms of engagement must therefore exclude liability of the valuer vis-à-vis third parties and must specify the restricted nature of the valuation which is for the sole purpose of the client.
- 5.5. Valuations not in line with EBVS** – A valuer asked to carry out a valuation on a basis that is not in line with these Standards must advise the client at the beginning of the assignment – as well as during the valuation process if the valuer recognises such situation at that point – that the Report will be qualified to reflect the departure from EBVS.
- 5.6. Valuations carried out with limited information or where special assumptions are necessary** – A situation may arise where there is limited information – which might be very important for the valuation analysis and valuer's judgment – or no access to the company management or owner or restricted time available to the valuer. In such cases, the valuer must ensure that the terms of engagement agreed confirm that the valuation will be conducted with such limitations and the Report shall clearly explain the specific limitations.
- 5.7.** A valuer may need to make **special assumptions** or be required to value on the basis of special assumptions by the client. In such circumstances it is essential that the terms of engagement state clearly that the Valuation Report, and any publication based on it, will set out in clear terms the instructions relating to the valuation, the purpose and context of the valuation, the extent to which enquiries have been restricted, the special assumptions that have been made, the dependence that has been placed on the accuracy of the sources of information used, and the extent of any departure from these Standards.

5.8. Comment on Minimum Terms of Engagement

Terms	Comment
The client's identity	<p>The valuer must ensure that the client is specified. In the event that instructions are provided by a director of a company, it is probably the company that is the client, not the director. Where the valuation is for a potential takeover and the client is a potential buyer who gives instructions to the valuer, the information basis is usually prepared and submitted by the seller (target entity). This needs to be defined in the terms of engagement, unless contact with the seller is prohibited, as it could be in mergers & acquisitions.</p>
Any user of the Report other than the client	<p>If specific circumstances or regulation require having other users of the Valuation Report, apart from the specified client, this needs to be determined and explained. An example is a Report which is also to be made available to the Court or the other party in litigation.</p>
The purpose of the valuation	<p>As the specific purpose of the valuation will determine the basis or bases of value to be adopted, it is important that clarity be provided. It is prudent to state that the valuation will only relate to the specific purpose identified.</p>
The precise extent of the business (ownership interest) being valued	<p>The subject of business valuation could be the 100% ownership interest or specific interest being valued and related ownership rights.</p> <p>It is important to indicate the precise extent of the business/interest being valued: the entire entity or specific interest (majority or minority; number of shares), possible different classes of shares and related ownership rights.</p>

<p>The basis or bases of value</p>	<p>The basis or bases of value that will be reported must be specified.</p> <p>If the valuer uses bases of value not in EBVS 1, as may be determined by the client, the professional body or the law, the valuer shall cite such basis of value and give appropriate interpretation.</p>
<p>A specific date of valuation</p>	<p>The date of valuation must be a specific date, as agreed with the client and stated in the Engagement letter. If the valuation date is not the date at which annual financial statements are published, the company's management should prepare and deliver to the valuer the financial statements at this specific valuation date.</p> <p>If financial statements at the valuation date do not exist and could not be prepared (e.g. the specific date is defined by the Court, the valuation date is set in the past, the client and valuer do not have access to the management, etc.), the valuer might use the latest available financial statements closest to the valuation date, but before this specific date, and should report this limitation as a potential material impact on the valuation result.</p>
<p>Confirmation that no potential conflict of interest exists. Declaration of any previous involvement with the entity or the parties involved</p>	<p>In general, valuers will be able to state that no potential conflict of interest exists that might prevent them from acting independently. If a conflict of interest exists, the valuer must normally decline to act. In cases where a potential conflict exists, the valuer shall give details of the situation in writing to all parties, and state proposed actions to ensure independence.</p> <p>A statement is required as to whether the valuer has had previous dealings with the entity or the parties, irrespective of whether there have been any previous dealings or not.</p>

<p>The valuer's identity and status</p>	<p>Clarify whether the valuer is acting in an external and independent capacity, specifying a corporate or personal persona. Compliance with EBVS's European Business Valuers' Code of Conduct should be confirmed.</p>
<p>Assumptions, special assumptions and departures from EBVS</p>	<p>The basic assumptions and all special assumptions that will be made in preparing the valuation or Valuation Report, which are known at commencement, must be specified, irrespective of whether they are identical to those stated in previous instructions. Reference must be made to any departures from EBVS, setting out the reasoning and justification for departure (<i>see EBVS 1</i>). In the event that some special assumptions or departures are recognised and defined during the valuation process, it will be necessary to confirm the application of such special assumptions or departures with the client in writing.</p>
<p>Scope and extent of investigations</p>	<p>The scope and extent of the investigation to be undertaken by the valuer shall be clearly set out. The following shall be included:</p> <ul style="list-style-type: none"> ▶ The extent of the investigation and various analysis; ▶ Development and analysis of several scenarios of cash-flow projections, if applicable and agreed with the client; ▶ Any reliance on information provided by the client or third parties; ▶ Any information requested but not available at the time of reporting; ▶ The legal or environmental issues that might impact value, with comment as appropriate; ▶ Any requirements determined by third parties or regulation; and ▶ Confirmation that the extent of investigation and specific analysis will be sufficient to enable a fully justified opinion of value to be reported (or a statement that this is not the case).

<p>Reliance placed on information provided by the client</p>	<p>The valuer is not responsible for auditing the financial statements submitted by the client and should rely on them assuming that they are fairly and appropriately presented, without any identified exceptions and in compliance with the relevant accounting standards and regulation. If financial statements at the valuation date are not audited, the valuer shall state that valuation will be based on the non-audited financial statements.</p> <p>If the client has supplied information relating to the business or if the valuer is advised by the client to obtain information from a specified third party, the terms should state that the valuer will rely upon this information and will not seek to verify its accuracy unless client and valuer agree differently.</p> <p>Information not available and known at the valuation date or before, because such information was published or became available after the valuation date, shall not be used in the valuation, unless a special assumption is adopted, in line with the defined terms of engagement.</p>
<p>Valuation methodology to be applied</p>	<p>The valuation approach and methods to be applied by the valuer need to be stated and be in line with subject and purpose of valuation, basis of value, available information and other specifics of the engagement.</p>
<p>Content and structure of the Valuation Report</p>	<p>The client and valuer shall agree on the content and structure of the Valuation Report to be prepared, depending on the agreed scope of work and specific circumstances of the engagement.</p>

<p>Any restriction placed on publication</p>	<p>Depending on the subject and purpose of the valuation, it might be appropriate to state that the content of the Valuation Report is only provided to those to whom a duty of care is owed by the valuer. However, if there are more potential users of the Report, the valuer may state that prior consent in writing will be required for any reproduction or public distribution of the valuation or Report.</p>
<p>The extent to which a duty of care will be provided</p>	<p>The specific identity of the parties to whom a duty of care is owed should be set out. It may be appropriate to specify that no responsibility or duty of care will be accepted concerning any other parties, unless required by law.</p>
<p>Compliance with European Business Valuation Standards</p>	<p>Where the valuation has complied with the requirements of EBVS, this must be specifically stated in the Report, using the title European Business Valuation Standards 2020.</p>
<p>The fee for valuation services</p>	<p>All relevant costs and charges to be borne by the client should be specified. The fee for valuation shall not be contingent on the outcome of the valuation.</p>

6. Supporting the valuation

- 6.1.** A professional valuation relies on the valuer valuing the subject business in its context, researching and verifying all matters with a bearing on the value of the business. The quality of the valuation will, in part, rely on the quality of the information submitted by the client and obtained from public sources. Although valuers analyse and use some of the available information, they are not responsible for its accuracy and completeness.

Market conditions relevant to the subject business shall also be considered and analysed, as their appraisal forms part of the basis on which decisions may be made. Valuers shall retain all information relative to the specific Report submitted.

6.2. Valuers shall follow this non-exhaustive list of factors in the valuation of a business:

- ▶ The rights, privileges, or conditions inherent to the ownership interest;
- ▶ Size of the ownership interest to be valued and its level of control;
- ▶ Previous transactions in ownership interest of the business;
- ▶ History of the business;
- ▶ Current status and prospects of the industry;
- ▶ Regulatory requirements that may affect the business;
- ▶ Assets, liabilities, intangibles, equity and debt of the business;
- ▶ Earnings, cash flows and dividend-paying ability of the business;
- ▶ Market prices of publicly traded stocks or partnership interest, sale prices for business interests in same or similar industry;
- ▶ Other market data, such as cost of capital, rates of return on alternative investments, advantages of control, disadvantages of lack of liquidity, etc.

EBVS 3 The Valuation Approaches and Methods

1. Introduction
2. Purposes of valuation
3. Scope
4. Overview of the business valuation approaches and methods
5. General observations
6. Applications
7. Conclusion on opinion of value

1. Introduction

- 1.1. The appropriate valuation technique depends on the bases of value adopted, the purpose of the valuation, availability of the relevant market data and the nature of the business.
- 1.2. EBVS does not impose any specific valuation methodology, as (unless there is legislation or statute applicable) it is a matter for the professional judgement of the valuer in each case, according to the nature of the business and the context and purpose of the valuation. In addition, methodology can be expected to evolve in the future as a result of many influences, including market behaviour and advances in calculation and analytical tools – it would be inappropriate to attempt to restrict future evolution by insisting on valuers retaining certain of today's recognised methods.

2. Purposes of valuation

Valuers should know the purpose of the valuation to enable them to address all issues germane to the project. The purposes for which the valuation of a company is required include but are not limited to:

- ▶ Sale or purchase of the company;
- ▶ Sale or purchase of a business division;
- ▶ Winding-up of a company;
- ▶ Merger with another company;
- ▶ Sub-division of the company into separate businesses;
- ▶ Financial reporting;
- ▶ Tax purposes;
- ▶ Valuations for legal purposes;
- ▶ Financial restructuring;
- ▶ Non-cash contributions to other companies;
- ▶ Estimation of stock-market quotation.

3. Scope

- 3.1. This Standard refers to methodologies for business valuation for any kind of purpose, as detailed in the following sections.
- 3.2. The intention in this Standard is not to set out rules to be rigidly followed or to attempt to provide a valuation textbook, but rather to express the generally accepted methodologies applied throughout Europe.

4. Overview of the business valuation approaches and methods

- 4.1. In order to perform a business valuation founded on the relevant basis of value, one or more Valuation Approaches should be used.

Valuation Approach – A general way of determining a value of a business, using one or more valuation methods.

- 4.2. The choice of appropriate valuation approach(es) and consequently the appropriate valuation method(s) must be consistent with the purpose of the valuation and with the professional capacity in which the valuer is acting. There are three main approaches used for a business valuation:

- ▶ Market (Comparison) Approach;
- ▶ Income Approach;
- ▶ Asset-based Approach.

- 4.3. Within these three basic valuation approaches, various valuation methods are used, depending on the nature of the business, purpose of the valuation, market characteristics, available data, etc.

Valuation method – The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at the determination of value.

- 4.4.** In the **Market (Comparison) Approach**, the valuation is produced by comparing the subject business with the evidence obtained from market transactions related to similar companies, either publicly traded (comparable) or private companies, that fulfil the criteria defined by the valuer. The Market Approach includes two methods – the Comparable Transactions Method and Comparable Publicly Traded Companies Method.
- 4.5.** The **Income Approach** is used to describe any valuation method whereby the value of the business is determined by capitalising or discounting the estimated future economic benefits to be derived from the business. The most commonly applied method under the Income Approach is the Discounted Cash Flow Method, whilst the Capitalisation Method might be applicable in some cases.
- 4.6.** The **Asset-based Approach**, provides an indication of value based on the valuation of all assets and liabilities of the business at the valuation date.

Valuation technique – Describes how to perform the steps of an appraisal method. It is a specific analytical process of data treatment, conducted within a valuation method.

5. General observations

- 5.1. Business to be valued** – Depending on the purpose of valuation, the subject of the valuation will be the entire enterprise or participating interests (full ownership, controlling or minority shareholding interests) in the company.
- 5.1.1.** The valuation of the business undertaking or equity interest in the business must take account of, inter alia, buy/sell agreements, stock transfer restrictions, restrictive clauses in articles of association or corporate charter or partnership agreement, whether the interest valued be majority or minority interest, and other similar features or factors that may have an influence on value.
- 5.1.2.** In the valuation process, it is necessary to consider the ownership interest that is the subject of valuation and the attached ownership rights. Depending on whether the minority or majority ownership interest is being valued, the application of a control premium or discount for lack of control may be appropriate depending on the valuation methods applied (*see EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).

5.1.3. The value of a business is usually expressed by reference to Equity Value or Enterprise Value, as follows:

- ▶ **Equity value** is the estimated net value, available to all of the company's shareholders;
- ▶ **Enterprise value** is the sum of the company's equity, plus interest-bearing debt less excess cash and cash equivalents, if any;
- ▶ Interest-bearing debt includes both long term and short term debts, unless the short term debts are included in the working capital and in such case, are not part of Enterprise value. The cash and cash-equivalents shall be deducted only if they are excess cash, otherwise they will be part of the working capital.

5.2. **The importance of analysing the business and market** – Before applying one of the relevant methods, it is important to understand the subject business, its historical performance, core activity, capacities, customers and suppliers, political and macroeconomic environment (economy), specific industry and relevant market.

5.3. **Business information** – The valuer should obtain from the client documents and data necessary for the valuation assignment which, depending on the purpose of the valuation, will include some or all of the following:

- ▶ Identification and characteristics of the business ownership interest or security to be valued including rights, privileges and obligations, factors affecting control and any agreements restricting sale or transfer;
- ▶ Nature, history and outlook of the business;
- ▶ Historic financial statements;
- ▶ Management Reports;
- ▶ Business, preference, convertible or other securities;
- ▶ Prior transactions involving beneficial interests in the business, preference, convertible or other securities;
- ▶ Information on the management team and personnel (stock options, particularly variable compensation packages and personnel contracts);
- ▶ Detail of customers and suppliers (including contracts);
- ▶ Production systems;
- ▶ Information on the intangible assets (patents, inventions, formulas, processes, designs, patterns, know-how, trademarks, names or brand names, copyrights, databases, etc.);
- ▶ Details of competitors;
- ▶ Sector benchmarking;

- ▶ Nature and dynamics of industries which have or may have an impact on the business;
- ▶ Economic factors affecting the business;
- ▶ Capital markets information, e.g. available rate of return on alternative investments, stock market transactions, and mergers and acquisitions;
- ▶ Market demand for products;
- ▶ Management forecasts;
- ▶ Impact of potential changes in international convention or EU or national legislation;
- ▶ Other information.

The valuer must indicate the sources of information consulted and shall document and retain all information and workings that are relied upon in formulating her/his valuation and advice.

5.4. According to EU Accounting Rule 7(Budget Execution Accounting) December 2011: Property, Plant and Equipment, assets are defined as:

"Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity."

5.5. Operating and non-operating assets – The valuations are carried out on the basis of the value of the business as a whole. It is important to distinguish between:

- ▶ **Operating assets** – Assets necessary for the operation of the business. They must be valued as part of the business as whole;
- ▶ **Non-operating assets** – Assets surplus to the core business. If it is defined by the terms of engagement, they must be valued at their net realisable Market Value and added to the Market Value of the core business, as obtained by the valuation method applied. If the valuation of non-operating assets is not part of the valuation engagement, it shall be presented as a limitation in that specific case. Some examples of non-operating assets are surplus land, marketable securities, buildings rented to third parties, excess equipment, investments in related parties, etc.

5.6. The analysis of financial statements for valuation purposes – As a part of the valuation process, it is important to analyse and if necessary, to adjust the financial statements of the subject business, and if needed, to adjust the financial statements of comparable companies, in order to have a consistent basis for comparison. Examples of adjustments could be to include potential liabilities related to

litigation, or to exclude extraordinary items in order to prepare a reasonable basis for the projections, or to exclude or value separately the non-operating assets and related other non-operating items, etc. Some of the key objectives of financial analysis are:

- ▶ Understanding of the interconnections of the data in the profit and loss statements, the balance sheets and the cash flow statement, from which the valuer can derive trends over time, risks inherent in the subject business operations and the likely projections for future operations;
- ▶ Mark-to market assessment of risk and key value parameters;
- ▶ Adjustment of historical financial statements for valuation purposes, to estimate the economic abilities of and prospects for the business. The valuer should be careful in making adjustments to the historical financial statements and they should be discussed with the client, fully described and supported in the Valuation Report.

The valuer should analyse financial statements in monetary terms and relative terms. Relative terms include percentages – such as each balance sheet expressed as a percentage of total assets, and each income statement item expressed as a percentage of total revenues in the profit and loss statements.

6. Applications

6.1. Introduction

This section deals with the most common methods of business valuation throughout Europe, based on one or more valuation approaches discussed above.

Unless there is applicable law, valuers should choose the method or methods that, in their opinion, are the most appropriate to the business being valued, the purpose of the valuation and available data, so as to produce the most reliable value result.

6.2. Valuation methods within the Market (Comparable) Approach

- 6.2.1. The Market Approach compares the subject business to similar businesses, business ownership interests and securities that have been sold on the market. The Market Approach should be applied if comparable transactions of companies and ownership interests or publicly traded companies are similar to the subject business, based on the criteria defined by the valuer, and if appropriate data is available and reliable.

- 6.2.2.** The three most common sources of data used in the Market Approach are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which controlling or minority interests are bought or sold and evidence of prior transactions in the ownership of the subject business. Accordingly, the sources of input data define whether the Comparable Transactions Method or the Comparable Publicly Traded Companies Method will be used within the Market Approach.
- 6.2.3. The Comparable Transactions Method** is based on transactions involving sale, merger or acquisition of businesses (or business ownership interests) that provide a reasonable basis for comparison to the characteristics of the business (or business ownership interest) being valued. If appropriate, the valuer may also consider the prior transactions with the subject business (or ownership interest) as the comparable.
- 6.2.4.** It should be noted that comparable transactions involve a specific buyer and a specific seller, therefore the information regarding both the buyer and seller and their specific motivations might be crucial in the selection of reliable comparables. However, if multiples of several transactions are within reasonable range, they probably represent the perception of market participants e.g. the Market Value.
- 6.2.5.** As in most cases the comparable transactions involve the sale of an entire business or the controlling interest in the companies, the application of a discount for lack of control should be considered (*see EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).
- 6.2.6. The Comparable Publicly Traded Companies Method** is based on transaction data with shares of the companies traded in the public securities markets that provide a reasonable basis for comparison to the characteristics of the company (or ownership interest) being valued.
- 6.2.7.** A significant advantage of this method is the availability of the comparable publicly traded company data, as the stock prices for the comparables can be obtained at the valuation date, and the financial information relevant for adjustments can be obtained close to the valuation date.
- 6.2.8.** The drawback of this method is that the underlying data are predicated upon sales of individual securities sold in a public stock exchange and typically reflect transactions with minority ownership interests. Therefore, to apply these data to majority interest in a privately held subject company valuation, additional considerations on control premiums might be needed (*see EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).

- 6.2.9.** The Market Approach in general is more applicable with data from a developed and liquid market. The ideal situation would be to have evidence of recent market transactions involving identical businesses to the subject company, but this is hardly ever the case. Therefore, if there is insufficient transactional information available in that industry, it may be necessary to select transactions involving other companies involved in similar lines of business, or in businesses having an underlying similarity to the subject company in terms of relevant characteristics such as markets, products, growth trends, size, life cycle and other relevant factors.
- 6.2.10.** As every business is unique in terms of the activity, size, business segments, market, financial performance, risks, growth, etc., the valuer may have to make several different adjustments to the valuation multiples obtained from comparables in order to apply them to the subject business.
- 6.2.11.** The comparison must be made in a meaningful manner and must not be misleading. Factors to be considered in assessing whether a reasonable basis for comparison exists include:
- ▶ The similarity to the subject business in terms of qualitative and quantitative business characteristics;
 - ▶ The amount and verifiability of data on similar businesses;
 - ▶ Whether the exchange prices of similar businesses represent transactions between unrelated and independent parties;
 - ▶ Whether a sufficiently thorough, robust and unbiased search, based on objective criteria, for similar businesses has been carried out.
- 6.2.12.** The comparisons are made through the use of valuation multiples, selected to provide meaningful insight into the value of the subject business, considering all relevant factors. Accordingly, care should be taken with respect to:
- ▶ The selection of the input data used to compute the valuation multiples;
 - ▶ The selection of the time periods and/or the averaging methods used for the input data;
 - ▶ The computation of the valuation multiples, which may be derived by relating prices in comparative transactions to the appropriate financial, operating, or physical input of the comparable companies (or ownership interests) involved in the transactions;
 - ▶ The timing of the sales price data used in the valuation ratios in respect of the valuation date;
 - ▶ How the valuation ratios were selected and applied to the respective data of the subject business.

- 6.2.13.** Judgments have to be made about the selection of relevant valuation multiples, their calculations and adjustments, the timing of the price data in comparison to the valuation date and adjustments of financial statements if necessary in order to create the consistent basis and reliability of available market data.
- 6.2.14.** Depending on the type of ownership interest being valued, the valuer should consider application of Control Premiums and Discounts for Lack of Control (see *EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).

6.3. Valuation methods within the Income Approach

6.3.1. Discounted Cash Flow Method

- 6.3.1.1.** The Discounted Cash Flow Method (DCF Method) is a widely applied valuation method presenting the earning capacity of the subject business. The DCF method is based on present value calculations of expected cash flows projected over a specific period and including terminal value (residual value). The valuer will determine the type of cash flow, a time horizon, assumptions for the projections and an appropriate discount rate.
- 6.3.1.2.** The projected cash flow could be in nominal terms (with inflation included) or real terms (without inflation), pre-tax or post-tax, before or after debt items, depending on various factors, such as the nature of the business, the purpose of valuation, business interest to be valued, available data, etc.
- 6.3.1.3.** The projections shall be based on the analysis of the business, economy, industry, market, historical performance, analysis of financial statements and management plan. The valuer shall present and support the key assumptions used for projections.
- 6.3.1.4.** In the DCF method, free cash flow, to the company or to the shareholders, is estimated each year over an explicit period of time (DCF period). The value of the business is the sum of the Present Value (PV) of the free cash flow over the DCF period, the PV of the terminal value, and adjusted for appropriate balance sheet items at the valuation date.
- 6.3.1.5.** The length of the DCF period in the case of a going concern valuation reflects the time horizon within which the profitability of the company reaches a steady state. The DCF period typically depends on the number of years before the company can obtain a Return on Invested Capital (ROIC) that is superior or equal to the cost of capital. Usually, the time horizon is 5-10 years.

- 6.3.1.6. For those companies which, for different reasons, have to cease their activities at a known date in the future, the DCF period equals the remaining operational life.
- 6.3.1.7. The forecast of future cash flows or benefits is subject to many variables. It is therefore appropriate to model different hypotheses for the future business development, depending on the expected changes in critical variables affecting the business. The cash flow forecasts can be built up in stages on the basis of the probable future evolution of the business.
- 6.3.1.8. The valuer must identify the market for the subject business, and have a close understanding of it and of the forces which drive it. The valuer will also need to be aware of any changing cultural aspects, business trends, availability of debt and equity finance, and the economics of supply and demand for the sector; also the extent and distribution of any actual or proposed competition, any possible changes in transport infrastructure, geographical location, or socio-economic profile of the customer base. The Valuation Report will incorporate the above factors in so far as they are relevant to the valuation.
- 6.3.1.9. The DCF valuation will differ depending on whether the objective is to establish the Enterprise Value or Equity Value and will determine the type of cash flow to be projected, as follows:
- ▶ **Free cash flow to the company** (or debt free cash flow) is used for the valuation of Enterprise Value;
 - ▶ **Free cash flow to the firm** is the cash flow to all the company' shareholders. This type of cash flow is used for the valuation of Equity Value.
- 6.3.1.10. **The terminal value** of the company is calculated at the end of the projected cash flow period. The method of calculation will differ depending upon whether the going concern premise is applicable or not, as follows:
- ▶ **Business will continue beyond the forecast period (going concern premise)** – The terminal value is calculated by capitalising the net cash flow for the last year of the DCF period, applying a capitalisation rate (discount rate minus long-term growth), or by multiplying the net operating profit of the last year or of the year n+1 by an appropriate multiplier based on an assessment of the likely industry multiples at this (more mature) stage of the development of the business;

- ▶ **Business is due to cease (not a going concern)** – The terminal value represents the estimated value of the residual net assets which, at the end of the DCF period, could be released and the cash distributed to the shareholders.
- 6.3.1.11.** The discount rate should be consistent with the selected type of cash flow and determined by the most common methods, such as the **Capital Asset Pricing Model** – CAPM (see *EBVGN 2 – Discount Rates in the Discounted Cash Flow Method*). Depending on the type of projected cash flow, with or without debt payment:
- ▶ The cost of equity will be applied in the case of estimating the Equity Value; and
 - ▶ The weighted average cost of capital (WACC) should be applied when estimating the Enterprise Value.
- 6.3.1.12.** The valuer must ensure that the calculation of the free cash flows is consistent with the forecast and expectations of the subject industry, estimates of the future market positioning of the business and that of its main competitors. Valuers have responsibility to assess the risk related to the commercial positioning of the business undertaking and to adjust their discount rate accordingly.
- 6.3.1.13.** Depending on the specific circumstances and uncertainties related to the subject business, industry and economy, the sensitivity analysis may be applied to test the DCF result, which shows how much the valuation result will change depending on the change of key assumptions used in the projections (for example, change of growth rate, margins, discount rate, residual growth, etc.).
- 6.3.1.14.** Apart from the sensitivity analysis, it is also possible to develop several cash flow scenarios (for example, the most pessimistic, most probable, most optimistic), particularly if this type of analysis is stated in the terms of engagement.
- 6.3.1.15.** The sensitivity analysis and development of several cash flow scenarios identify the specific risk factors that contribute the most to the overall risk. There are two general classes of risk to the company, business risk and financial risk:
- ▶ **The business risk** is the uncertainty of income due to fluctuation in sales, gross earnings and the level of the company's fixed operating costs;

- ▶ **The financial risk** reflects the incidence of fixed financial costs, or fluctuating interest rates, and their impact on returns to investors.

Each risk factor should be quantified and comprehensively analysed. Finally, the sensitivity analysis should integrate the probability attached to risk factors and variables derived, inter alia, from evaluation of the business history, systematic and structural elements.

- 6.3.1.16. Depending on the type of ownership interest being valued, the valuer should consider application of Discounts for Lack of Control as well as Discounts for Lack of Marketability (see *EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).

6.3.2. Income Capitalisation Method

- 6.3.2.1. The Income Capitalisation Method is simple in its nature as it does not require forecasting the cash flow into the future. The valuer makes an assumption that adjusted sustainable earnings will be achieved, that no changes will take place in the net working capital and that capital expenditures will equal depreciation, so only replacement capital expenditures will be carried out.
- 6.3.2.2. In the Income Capitalisation Method, a representative or adjusted income level or cash flow is discounted by an appropriate capitalisation rate or multiplied by an income multiple (or capitalisation factor) to convert the income into value. The most commonly used cash flow/earnings based techniques are:
- ▶ Capitalisation of appropriate and maintainable level of free cash flow as described previously;
 - ▶ Capitalisation of adjusted maintainable earnings after tax;
 - ▶ Capitalisation of adjusted earnings before interest and income tax (EBIT);
 - ▶ Capitalisation of adjusted earnings before interest, income tax, depreciation and amortisation (EBITDA).
- 6.3.2.3. The valuer must establish a representative level of one type of earning or cash flow which is sustainable in the future. The essential fact is that these are not the accounting values taken from the profit and loss statement, but rather the value adjusted to reflect economically normal and reproducible future revenues. The adjustments must eliminate the impact of temporary, unrepeatable, or accidental influences on revenues and expenses. Some examples of events that require adjustments are:

- ▶ Increase or decrease in revenues due to some exceptional situation or price fluctuations;
- ▶ Changes in the inventory accounting method;
- ▶ Change in raw material or fuel prices;
- ▶ Change in payroll costs due to changes in employee numbers, legislation or pressure from trades unions, taking into consideration the sustainable level of costs for the future;
- ▶ Changes to depreciation by the additional inclusion of the value of some intangible assets such as patents, employee training expenses, trademarks, etc.;
- ▶ The influence of some non-recurrent factors such as fire, strikes, special penalties, reorganisations, capital gains resulting from the sale of assets etc.;
- ▶ The impact of redundant assets on revenues and costs;
- ▶ The impact of income tax changes.

6.3.2.4. The adjustments should be made for a number of previous financial years (3-5 years). The valuer makes the selection of the adjusted net annual income or cash flow, which is to be capitalised, by deriving this from one relevant year (past, present or future), or alternately by calculating a simple or weighted arithmetical average over the selected period. The important factor is that the business have the capacity to generate profits in the future, usually for an unlimited period of time.

6.3.2.5. The business value is computed by capitalisation of the net adjusted annual income, using a selected capitalisation rate, or by multiplying it by a selected multiplier. The obtained value needs to be adjusted for appropriate balance sheet items at the valuation date.

6.3.2.6. The valuer must select a capitalisation rate or multiplying factor for the annual adjusted income or earnings that is consistent with the normal principles adopted applying the DCF approach. Capitalisation rates and discount rates must be derived from market evidence as accurately as possible and are usually expressed as the rate of return that would be required by investors in a business with the same risk conditions. The capitalisation rate and the discount rate must be consistent with the bases of adjusted annual income used e.g. in nominal or real terms, pre-tax or post-tax, before or after debt payment, etc.

- 6.3.2.7.** Depending on the type of ownership interest being valued, the valuer should consider application of Discounts for Lack of Control as well as Discounts for Lack of Marketability (see *EBVGN 1 – Control Premium, Discount for Lack of Control and Discount for Lack of Marketability*).

6.4. Asset-based valuation methods

- 6.4.1.** The asset-based approach determines a value indication of a business or of a business ownership interest using one or more methods based on the value of the assets net of liabilities.
- 6.4.2.** In essence, the method consists of deducting the net amount of adjusted liabilities from the amount of adjusted assets, to arrive at the adjusted net book value of equity. The scope of analysis may include the valuation of the fixed assets as a part of business valuation that should be defined in the terms of engagement.
- 6.4.3.** The asset-based approach is usually applied in valuation of businesses that derive their revenues from a return on tangible fixed assets, such as real estate holding companies. It is also used for a business appraised on a basis other than going concern and/or with the value of assets in a liquidation exceeding the value of business as a going concern. It can also be used in cases when appropriate market comparable data or reliable data for projections are not available, such as for valuation of start-up businesses or businesses with personal goodwill.
- 6.4.4.** The asset-based approach is generally relevant to the controlling ownership interest valuation, requiring special considerations in valuation of minority interests in an enterprise, unless the law requires the asset based approach to be applied in an equal way for controlling and minority interest, e.g. without adjustments for lack of control.
- 6.4.5.** When carrying out a valuation of an operating business on a going concern basis, the asset-based approach should not be the sole valuation approach used, unless sellers and buyers in the industry customarily use it, or other approaches are not applicable. In such cases, the valuer must follow this approach.
- 6.4.6.** The highest and best use principle requires the valuer to calculate the Liquidation Value of the business in order to ascertain whether or not it would constitute a better option to keep the business in operation. In carrying out a valuation of a business where the value relates to an equity interest that has the option of putting the enterprise into liquidation, the valuer must investigate the possibility that the business may have a higher value on liquidation than it has on the basis of its continuing operation as a going concern, unless there are legal provisions to

the contrary. If valuation on the basis of liquidation of the company is the appropriate basis of valuation, any real estate or personal property to be included in the liquidation should be valued in accordance with the appropriate standard.

- 6.4.7.** When working on the assumption that the company is to go into liquidation, it is necessary to value the assets at their Market Value and to apply deductions for any liquidation costs incurred (such as compensation to be paid to out-going staff, full payment of outstanding debts, the cost of any work to be performed in order to settle and collect receivables, etc.).
- 6.4.8.** Depending on the terms of engagement, the type of the subject business and the valuers' judgement, two general liquidation scenarios of sale of assets can be employed: with assets sold in an orderly sale – given enough time to attract the best possible offers, or in a forced sale – not given enough time to attract the best possible offers.
- 6.4.9.** In the case of an orderly sale, the business would have enough time to maximise the proceeds for its assets in a controlled wind-down. More importantly, the business can still generate income while its orderly closure is occurring, and this income also needs to be taken into consideration in the value estimate.
- 6.4.10.** In the case of a forced sale where the seller is under compulsion to sell, is desperate to sell or a strict time limit is otherwise imposed, a reduction in value reflecting lack of proper marketing and shortened disposal timeline shall be considered.

7. Conclusion on opinion of value

- 7.1.** In some countries it is normal practice or even a legal obligation for some valuation purposes in some instances to value a business using two or more different methods, which therefore give a number of different resulting values. The valuer then considers the various results and makes a professional judgement as to the final value to be reported. In contrast, in other countries the valuer is expected to use just one single method.
- 7.2.** No general rule can be set out as to whether the use of a single method or several methods leads to a more accurate and reliable valuation. However, when valuers have used only a single method it is recommended that they at least check their conclusions against other market indicators, if they exist. For example, where a business has been valued using a method within the income approach, the valuer will often want to compare the resulting value with the indicative value calculating

the valuation ratios (multiples) determined, based on the comparable transactions or the share pricing metrics of publicly traded companies.

- 7.3.** It is the valuer's responsibility to select and apply the appropriate valuation approaches and methods. When more than one approach and method are used, valuers should reach their conclusion of value considering a number of factors, such as basis of value, purpose of valuation, characteristics of the subject business, available data, analysis conducted, sufficiency and reliability of data used in different valuation methods applied. The valuer should reconcile the results obtained by different approaches and methods, check their reasonableness and decide which one provides the more reliable indication of value in order to choose the method which will be the basis for the final valuation result. The valuer must provide the rationale and justification for the valuation methods used and final opinion. The value conclusion reached should be stated and supported in the Valuation Report.
- 7.4.** The final valuation result is usually expressed as a single value. However, depending on the purpose of valuation, the final valuation result (opinion) may be stated as a range of values, if it is defined in the terms of engagement (e.g. for the acquisition process). In such case, it is the valuer's responsibility to make such conclusion within a reasonable range of values and explain the rationale in the Valuation Report.
- 7.5.** The overall valuation conclusion should be consistent with:
- ▶ The basis of value;
 - ▶ The purpose and intended use of the valuation;
 - ▶ The subject of valuation (controlling or minority interest, total equity or specific number of shares, etc.);
 - ▶ All relevant information available at the valuation date, bearing in mind the scope of the assignment.

EBVS 4 Reporting the Valuation

1. Introduction
2. Scope
3. The Valuation Report
4. Valuation review

1. Introduction

The valuation, as determined by the valuer, must be clearly and effectively conveyed to the client and its users. The Valuation Report is the document on which the client will rely in taking decisions. It is therefore important that it be exact. Any caveats and reservations expressed therein must also be exact.

2. Scope

This Standard deals with the Valuation Report in which the valuer informs the client of the value determined.

3. The Valuation Report

3.1. General

- 3.1.1. A **Valuation Report** is a document detailing the scope, key assumptions, valuation methods, and conclusions of an assignment. The Report provides a professional opinion of value supported by a recognised basis or bases of valuation within the framework of European Business Valuation Standards.
- 3.1.2. A Valuation Report must be in writing, prepared and presented in a reliable and comprehensible manner for clients and users. This is appropriate for a Report providing a Market Value and also for Reports concerning all other bases of valuation, as it gives certainty between valuer and client.
- 3.1.3. The Valuation Report must record the instructions for the assignment, the basis and purpose of the valuation, the applied analytical processes, valuation methodology and the results of the analysis that led to the opinion of value.
- 3.1.4. The Valuation Report must provide a clear and unequivocal opinion as to value, at the date of valuation with sufficient detail to ensure that all matters agreed with the client in the terms of engagement and all other key areas are covered.
- 3.1.5. The Report must not be ambiguous, must not mislead the reader in any way or create a false impression.

- 3.1.6.** The Report must be objective. Decisions may be made and finances committed or withdrawn on the strength of it. If the valuer has strong opinions about the merits or weaknesses of the business, these should be expressed in a reasoned and objective way that will enable the reader to understand the conclusions reached.
- 3.1.7.** Where the valuer has been instructed despite a potential conflict of interest, that potential conflict must be stated with a record that it was notified to the client along with details of the measures taken to ensure that the potential conflict did not adversely affect the valuer's objectivity.

3.2. Contents of the Valuation Report

- 3.2.1.** The form and detail of the Report will be a matter for the valuer's discretion but must meet the specific instructions from the client and have regard to the purpose of the valuation and the use that the client proposes to make of it. A Valuation Report must adequately report all matters set out within the terms of engagement (see *EBVS 2, section 3*).
- 3.2.2.** The Valuation Report shall cover the following topics, not necessarily presented in the same way or order:

3.2.2.1. The basis of the instruction and the valuation:

- ▶ **The client and the instruction** – The client's name, details of how the valuer was instructed (it is recommended to include a copy of the terms of engagement as an annex);
- ▶ **Third party reliance** – Where it has been agreed that certain identified third parties will be able to rely on the Report, those third parties should be named;
- ▶ **The business** – The legal name and address of the company whose business is the subject of the valuation;
- ▶ The ownership interest of the business that is being valued (100% equity, or specific number of shares, or % of equity as controlling interest, or % of equity as minority interest, or Enterprise value, etc.);
- ▶ The purpose of the valuation;
- ▶ Requisite basis of value (e.g. Market Value) clearly stated and defined with reference to the appropriate EBVS or to the law or regulation that defines the basis of valuation;
- ▶ **Special assumptions** – The valuer's statement that any special assumptions are to be made (in the sense of EBVS 1);

- ▶ **The date of valuation** – The valuer must indicate which financial statements were used at the valuation date. If financial statements as at the valuation date were not available and the valuer used earlier financial statements, this should be clearly stated in the Report as a significant limitation with a potential material impact on the valuation result;
- ▶ The date of the Valuation Report;
- ▶ The status of the valuer (external or internal and whether or not he/she is considered to be independent);
- ▶ **Involvement of specialist valuers or advisers** – If the author of the Valuation Report has used the services of third party specialists, they must be identified;
- ▶ The valuer's statement that the facts contained in the Report are believed to be true and correct;
- ▶ The valuer's statement that there are no potential conflicts of interest. Where potential conflicts exist, the Report must state that these were brought to the client's attention, contain a copy of the client's written acknowledgement and detail the measures taken to ensure the valuer's objectivity was not affected.

3.2.2.2. Investigations carried out:

- ▶ **Sources of data underlying the valuation** – The valuer shall list the documents received and shall also state, where appropriate, which important documents were not made available. The process of checking information and documents and the results of this work must be explained;
- ▶ Reliance on information obtained from the client and from third parties must be stated;
- ▶ **Limiting conditions** – The valuer must state any scope limitations or other type of limiting conditions which influence the valuation process and valuer's opinion;
- ▶ **Assumptions** – The valuer must state any important assumptions made as regards documents or information that were not available;
- ▶ **Investigations not carried out** – For the avoidance of doubt the Report must state any investigations that were not carried out, the results of which might have an impact on value;
- ▶ **Caveats** – The valuer will typically caveat a number of these items. Caveats must not be used indiscriminately. The valuer must ensure that any caveats used are pertinent to the business and the valuation;

- ▶ The valuer must highlight the fact that valuation does not include the auditing of financial data provided by the management and, therefore, that the valuer does not take any responsibility for its accuracy and completeness.

3.2.2.3. The business description:

- ▶ General information such as address, date of establishment, legal form and changes over time, etc.;
- ▶ Type of business activity;
- ▶ Historical performance trends overview;
- ▶ Products and services portfolio;
- ▶ Customers and suppliers;
- ▶ Business assets, divided between operating and non-operating assets;
- ▶ Sources of financing, key financial liabilities.

3.2.2.4. The legal aspects:

- ▶ Ownership structure;
- ▶ The rights, privileges, or conditions that attach to the ownership interest;
- ▶ The legal restrictions and conditions that arise through the laws of the country in which the business exists, including availability and status of certificates and licences required by authorities to run the business (if any);
- ▶ Binding contracts, influencing the business development prospects, including licence agreements on use of intangible property;
- ▶ Pending litigation;
- ▶ Taxation issues;
- ▶ Environmental, labour relations, etc., specific issues.

3.2.2.5. Competitive and strategic analysis:

- ▶ General economy trends overview;
- ▶ Industry and sector analysis;
- ▶ Market and competition analysis;
- ▶ Other relevant market information.

3.2.2.6. Historical financial performance analysis:

- ▶ Analysis in terms of amounts in specific currency;
- ▶ Analysis in terms of percentages;
- ▶ Analysis in terms of financial ratios;
- ▶ Identification of any extraordinary and/or non-recurring items.

3.2.2.7. Reasoning for the choice of the valuation approach(es) and method(s) appropriate for the subject business

3.2.2.8. The valuation:

- ▶ **Methodology** – Brief description of selected valuation approach(es), method(s) and valuation techniques;
- ▶ **Key assumptions** – Such as assumptions for projections, market trends, inflation, debt requirements and credit conditions, etc. The valuer shall explain the choice of these key inputs with reference to the appropriate analyses being conducted and presented in the Valuation Report;
- ▶ **Special assumptions** – If a special assumption has been made (such as going-concern assumption, obtaining of additional production capacities, necessary certificates and permits, etc., non-existent at the valuation date), or is required due to the characteristics of the business (such as sale of non-operating assets, debt restructuring, etc.), each of these assumptions must be explained in detail, including the way the valuer has treated these items as regards the inputs adopted and how they are related to the valuation;
- ▶ Value determinations, presented in an unambiguous way;
- ▶ The adopted premiums or discounts;
- ▶ In the case of application of several valuation approaches or methods, the checking of the results and the logic behind the reconciliation of the various valuation estimates to a single value must be stated;
- ▶ Where a recent transaction has occurred involving the subject business or a provisionally agreed price has been disclosed to the valuer for its sale, the Report must state the extent to which that information has been accepted as evidence of value;
- ▶ **Valuation uncertainty** – In those cases where there is a high level of uncertainty about the future development and projections or discount rates or other key facts, which are relevant for the income approach, the valuer must explain the assumptions related to the uncertainty and apply the sensitivity analysis if the final value is based on the income approach.

3.2.2.9. The final value conclusion:

- ▶ The reported final value must be clearly and unambiguously stated, together with confirmation that sufficient investigation has been undertaken to justify the opinion of value reported;
- ▶ The conclusion should include a statement that the valuation is valid at the valuation date indicated and for the purpose stated;
- ▶ **Currency** – The reported value must clearly indicate the currency that has been used for the valuation. If the value is reported in a currency other than the currency of the country in which the business is situated, the currency conversion rate applied must be indicated;
- ▶ **Limitations on investigations and information** – Where investigations or information have been less complete than the valuer would normally wish, and where fuller information could potentially lead to a revision in value, this must be emphasised in the conclusion of the Report;
- ▶ **Limitations on use of the Report** – The valuer may wish to state any limitations on the use of the Report as regards publication, third party reliance, etc.;
- ▶ Statement that the client accepts the first draft of the Valuation Report;
- ▶ The Valuation Report must be signed and dated by the valuer who conducted the valuation and by a representative of the valuer's company, if a representative of such company signed the engagement letter.

3.2.3. Special issues – In some cases it may be necessary to refer to the special issues which would usually have been recorded within the terms of engagement, for example:

- ▶ The business is valued on a stand-alone basis, without valuation of the subsidiaries, or valuation of the non-operating assets, which are included in the Report at their book value, including any potential or actual impact on value of these items at the specified date of valuation;
- ▶ Any special or synergistic value that may exist and whether such value is available only to the current owner or whether it would pass to a new owner in the event of the transfer of the business;
- ▶ Any unusual market conditions at the specified date of valuation and whether any valuation uncertainty relating to the projections or market conditions or other specified factors has been taken into account or ignored in reaching an opinion of value; and

- ▶ Any recent or proposed changes to the business, the immediate or local environment or legislation that might have an impact on value, and where such an impact is reported, the extent of that impact. Matters that might be included within this category include potential loss or gain of permits, changes in tax regulations, etc.
- 3.2.4.** Valuers must confirm whether in undertaking the valuation they have become aware of matters that could affect the value reported. Such matters might include pending litigation, or pending expiry of the certificates and licences required by authorities to run the business.
- 3.2.5.** Where the market for the business being valued is affected by unusual uncertainty and this is relevant to the valuation, valuers must proceed with caution, comment on the issue to the client and make appropriate statements in their Reports.
- 3.2.6. Length of validity of the reported value** – Generally speaking, valuations are prepared with reference to a specific date of valuation. As such, strictly speaking the value may not be the same the day after the date of valuation. Nevertheless, clients may expect to be able to rely on a valuation for a certain period following the date of valuation. Therefore, the valuer must state that the valuation is valid at a specific date of valuation only.
- 3.2.7.** All Valuation Reports must include a statement to the effect that the valuer who signed it is responsible for the valuation to the client and has conformed to the requirements of these European Business Valuation Standards. The valuer must state the extent of, and reasons for, any departure from these Standards or state why any key part of the valuation process has been omitted.

4. Valuation review

- 4.1.** A valuation review is an assessment of another valuer's Report, not a revaluation, taking the form of a Valuation Review Report.
- 4.2.** The review objectives are to:
- ▶ Provide an assessment of the compliance of the valuation work under review with European Business Valuation Standards;
 - ▶ Examine the documents relied on and assess their proper and accurate use;
 - ▶ Identify any nonconformities and their impact on the conclusions.

- 4.3.** Apart from the elements needed to achieve the review objectives, **the Valuation Review Report shall state at least:**
- ▶ The identity of the client and other intended users;
 - ▶ The intended purpose of the review, and intended use of the review results;
 - ▶ The professional independence requirements based on which the reviewing valuer shall express an unbiased opinion with no influence whatsoever from any third party;
 - ▶ Whether or not discussions with the original valuer have taken place;
 - ▶ The assumptions and special assumptions in the valuation review.
- 4.4.** The **scope of the review work** must be clearly stated, in a manner that must not be misleading to either the contracting parties or any independent competent third party having legitimate access to the contract that covers the scope of work.
- 4.5.** The **Review Report** must be clearly presented and must contain sufficient information so as not to mislead the client and the intended users about the review results.
- 4.6.** The **reviewing valuer** must be:
- ▶ A valuer who possesses a very high level of professional knowledge and technical skill;
 - ▶ Independent from the valuer who originally performed the valuation;
 - ▶ In possession of (at least) all the facts and information relevant to the business on the date of valuation on which the first valuer relied. If the reviewing valuer does not have this information, or only partially, this must be clearly stated.
- 4.7.** The **requirements to be met by the reviewing valuer:**
- ▶ The reviewing valuer must assess compliance with the valuation standards effective at the valuation date;
 - ▶ Whilst reviewing valuers may refer to sections of the reviewed Report deemed relevant in backing up their assessment, they must specify to what extent they relied on the reviewed Report under special assumptions.

II.

European Business
Valuation Guidance
Notes

EBVGN 1 Control Premium, Discount for Lack of Control and Discount for Lack of Marketability

1. Introduction
2. Definitions of premiums and discounts
3. Scope
4. Application of premiums and discounts

1. Introduction

- 1.1. The business valuation result, obtained by applying specific valuation approaches and methods, will represent the value of a specific ownership interest, controlling or non-controlling, at marketable or non-marketable level. Different valuation methods, applied in one valuation engagement, might result in different levels of control and marketability. In order to reach the level of specific ownership interest, it might be necessary to adjust the preliminary valuation result by applying appropriate premiums or discounts.
- 1.2. Depending on the purpose of the valuation, its subject will be the entire business (100% ownership), a controlling interest or a minority shareholding interest in the company. Therefore, it is necessary to consider and understand the relevant ownership interest, the attached rights and the level at which control is obtained. Based on such facts and the valuation approaches and methods applied, the valuer must consider whether specific premiums or discounts are applicable.
- 1.3. During analysis of the nature of the ownership interest which is the subject of valuation, the valuer must also understand the level of its liquidity (marketability). In general, the greater the liquidity of the business (ownership interest), the greater the value. Thus, it might be necessary to adjust the valuation result obtained to a lack of marketability.
- 1.4. It is the valuer's responsibility to follow the changes in the market and in valuation practice related to the application of premiums and discounts, to use appropriate sources and adjust the valuation result if necessary.

2. Definitions of premiums and discounts

- 2.1. **Control** is the power to direct the management and policies of a business enterprise. Generally, an ownership interest greater than 50% of the voting interest in a business enterprise is considered as a controlling (majority) interest, but it might be defined differently by local regulation or the company's statutes. This may lead to a situation where effective control over the company can be obtained with less than 50% of the voting rights. Even if one person owns more than 50% of the voting rights and has operational control, there may be certain actions, such as winding up the business (i.e., putting everything in order before the business assets are realised so that the company can be dissolved), that may require more

than 50% affirmative vote, and may require an affirmative vote of a larger majority or of all owners.

2.2. Control premium is defined by the International Glossary as:

"An amount or percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control."

2.3. Discount for Lack of Control (DLOC) (also called 'Minority Discount') is defined by the International Glossary as:

"An amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control."

2.4. Liquidity is the ability to readily convert an asset, business, business ownership interest, or security into cash without significant loss of principal. In general, for listed companies, the ownership interest is more liquid than for privately held companies.

2.5. Discount for Lack of Marketability (DLOM) is defined by the International Glossary as:

"An amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability."

3. Scope

3.1. EBVGN 1 applies to the valuation approaches and methods which give a valuation result in accordance with the level of ownership interest which is the subject of the valuation, as defined by the valuation assignment.

3.2. This Guidance Note provides additional commentary on EBVS 3 The Valuation Approaches and Methods. Their application depends directly on the type of subject ownership interest and the valuation methods applied.

- 3.3. The valuer must be able to understand the nature of the ownership interest and apply appropriate premiums or discounts if necessary, in order to adjust the valuation result obtained and reach the valuation conclusion at the appropriate (non) controlling and (non) marketable level of the subject ownership interest.
- 3.4. The applied premiums and discounts must be clearly stated and explained in the Valuation Report, when presenting the results obtained by each valuation method and reporting the final value conclusion.

4. Application of premiums and discounts

- 4.1. Each valuation method will result in a specific level of value: controlling or non-controlling interest, marketable or non-marketable interest, depending on the assumptions and comparables used.
- 4.2. In general, if the valuation method results in a non-controlling level of value, the application of a control premium will be required in order to derive the valuation conclusion at a controlling ownership interest. If the valuation method gives a controlling level of value, in order to reach the value conclusion at non-controlling level, the application of Discount for Lack of Control (DLOC) will be necessary.
- 4.3. The amount of the **control premium** that an acquirer would likely pay to gain control of the company primarily depends on whether the buyer is able to enhance its value. In most cases, a control premium is necessary when the target company's cash flows and profits are not being maximised. If a company is properly run, and new ownership would not create additional value, a control premium will be unnecessary.

The size of the control premium a potential new owner is willing to pay depends on the incremental value that can be generated in the company based on possessing a controlling interest. It is influenced by several factors, such as the potential for increasing the value of the company, competition from other buyers, as well as the views and financial needs of the current stockholders. This control premium can be substantial when the controlling ownership enables a change of business strategy with significant positive impact on financial performance, market share, future growth, acquisition and merger deals, etc. The valuer should distinguish the factors which influence the control premium from the synergy premium factors, such as additional value created by crucial intellectual property, generation of new technology, or other assets that an acquirer wishes to own.

- 4.4.** The main reason for the **Discount for Lack of Control (DLOC)**, is that a minority shareholder does not usually have the ability to make management decisions such as the determination of management compensation and bonuses, amendment of articles of association, acquisition and liquidation of assets, dividend policy, sale of the company, election of the majority of the Management Board, etc.
- 4.5.** When determining the discount for lack of control, a number of considerations need to be taken into account, including:
- ▶ **The size of the ownership interests** – Usually the greater the size of the minority shareholding, the lower the discount from a control level;
 - ▶ **The relationship between shareholders** – In cases in which the company is controlled by a group of minority shareholders who act and vote in concert, it may appear that there should be no minority discount applied to the value of the shares of a member of that group, if the group collectively controls the company;
 - ▶ **The special provisions of the shareholders' agreement** – If the shareholders' agreement contains provisions ensuring the liquidity of a minority interest (such as the option to sell the shares to existing shareholders or mandatory buy-back obligation of the company), the discount may be reduced;
 - ▶ **Provisions contained within the articles of incorporation of the company providing protection to minority interests** – These protections represent reduced risk, and therefore reduce the discount;
 - ▶ **Discounts implicit in prior sales of minority shareholder interest** – Discounts applied in the prior sales of the minority shareholder interest can be used as precedents to argue the appropriate discount for the subject minority shares;
 - ▶ **Existing dividend policies and past history of dividend payouts** – The regular distribution of dividends in the preceding years may indicate both expected return on investment and reduced risk associated with the minority shareholding, thereby reducing the discount.
- 4.6.** Lack of marketability is usually associated with a non-controlling interest in a closely held business, which cannot be sold quickly and is therefore worth less than a non-controlling interest in a publicly held company with shares traded on a stock exchange. Therefore, the non-controlling, marketable interest usually relates to a minority interest in public companies, while a non-controlling, non-marketable interest is recognised in closely held companies.

- 4.7.** In general, interests in publicly traded companies are worth more than interests in identical privately held companies because they can be sold immediately to realise gains and avoid losses. Minority interests in private companies require greater discounts because the period of time needed to sell the position is potentially much longer than for the controlling interest in the same company.
- 4.8.** For some purposes of valuations and bases of value, some national regulations and case law might prohibit the application of premiums and discounts. In such cases, the Valuation Report must contain an explanation of the specific situation and of the reasons for not adjusting the valuation result by appropriate premiums and discounts.
- 4.9.** **The Comparable Transactions Method** is typically based on transactions in entire businesses or controlling ownership interests, and therefore, this method results in a control value. If the valuation assignment requires estimating the controlling ownership interest, no adjustments are needed. However, if the subject of valuation is a minority interest, the Discount for Lack of Control (DLOC) is necessary.
- 4.10.** Depending upon whether the comparable transactions used in the valuation refer to public or private companies, the valuation result will be at marketable or non-marketable level. If the subject of valuation is a non-marketable ownership interest and comparable transactions used in the valuation relate to the acquisition of privately held companies, the result obtained will be at the non-marketable level and application of a Discount for Lack of Marketability (DLOM) will not be required.
- 4.11.** **The Comparable Publicly Traded Companies Method** is based on transaction data in shares of the companies traded in the public securities markets, presenting a high level of liquidity of such shares (high marketability level), but also a lack of control, since it reflects the price of minority holdings. Therefore, the application of this method will result in a non-controlling, marketable ownership interest.
- 4.12.** If the subject of valuation is a minority, non-marketable ownership interest, the use of the comparable publicly traded companies method will only require the application of the Discount for Lack of Marketability (DLOM). However, if the assignment defines the control ownership interest to be valued, the valuation result must be adjusted (increased) by an appropriate control premium.
- 4.13.** The level of result obtained by the **Discounted Cash Flow Method or Income Capitalisation Method** is normally at the control level since the assumptions for projections and management plan always reflect the control shareholding strategy.

- 4.14.** If a non-controlling ownership interest is to be valued, the adjustments to cash flows that can only be implemented at the controlling level will not be applied, and the result of the discounted cash flow method or income capitalisation method will be a non-controlling level of value.

- 4.15.** The **Asset-based Valuation Methods** by their nature, are relevant to the controlling ownership interest valuation, as they relate to the businesses which derive their revenues from a return on assets and in which the asset strategy is driven by the company's management. The application of this method might include the analysis of highest and best use and consideration of the going concern or liquidation scenarios, which are also subject to control power and management decision process.

- 4.16.** In view of the main characteristics of the asset-based valuation methods, where the valuation result represents a controlling level, a Discount for Lack of Control (DLOC) should be considered when valuing a minority interest using these methods.

- 4.17.** If an investment holding business is to be valued, the liquidity of the investments held (both quoted and unquoted), and the size of the interest may be relevant and appropriate discounts should be considered.

EBVGN 2 Discount Rates in the Discounted Cash Flow Method

1. Introduction
2. Scope
3. Commentary on discount rates
4. Capital Asset Pricing Model (CAPM)
5. Build-up method

1. Introduction

- 1.1. The discount rate is one of the essential inputs of the Discounted Cash Flow (DCF) method and is used to discount the projected cash flow to the present value at the valuation date. It is defined by the International Glossary as "*a rate of return used to convert a future monetary sum into present value*".
- 1.2. In general, the discount rate reflects the time value of money and the risk of the returns on the specific investment. The higher the risk of investment, the higher the expected return.
- 1.3. Depending on the type of the projected cash flow, either the discount rate will be calculated as the cost of equity which is applicable for the valuation of equity value, or the weighted average cost of capital (WACC) will be used for the valuation of enterprise value (see EBVS 3).

2. Scope

- 2.1. EBVGN 2 provides guidance in determining the discount rate in applying the DCF method in business valuation, covered by EBVS 3 The Valuation Approaches and Methods, section 6.3.
- 2.2. There are different methods for determining the discount rate, such as the Capital Asset Pricing Model (CAPM), a Build-up method, a Dividend Growth Model, the Arbitrage Pricing Theory (APT), etc. This Guidance Note provides commentary on the application of the CAPM method to estimate the market-based discount rate. This is the widely applied method in European business valuation practice, and is also recognised by IFRS 13 Fair Value measurement.
- 2.3. EBVGN 2 also contains commentary on the application of the build-up method, relevant if there are insufficient appropriate market inputs to apply the CAPM method.

3. Commentary on discount rates

- 3.1. The discount rate should be consistent with the type of projected cash flow, in terms of the same currency, pre-tax or post-tax projections, expressed in nominal terms (with inflation) or in real terms (without inflation), including or excluding debt in cash flow projections. For instance, nominal after-tax cash flow should be discounted by an after-tax discount rate which includes the effect of inflation.
- 3.2. The sources and data used to determine the market-based discount rate need to be available to market participants at the valuation date, meaning that the valuer cannot consider information published after the valuation date.
- 3.3. Selection of the appropriate inputs for the discount rate will depend on the basis of value defined by the terms of engagement. If the valuer needs to estimate the Market Value of the business, the discount rate should be based on market inputs and reflect the market participant's view on different types of risk. In estimating the investment value of the business, the discount rate will reflect the specific rate of return expected by the particular investor.
- 3.4. Generally, investors select between alternative investments considering their different risk profiles and rates of return. In portfolio theory, two types of risks are recognised, defined by the International Glossary as follows:
 - ▶ **Unsystematic Risk** is the portion of total risk specific to an individual security that can be avoided through diversification. It represents the risks of investing in a specific industry or company on the assumption that a rational investor will invest in a portfolio of stocks or various companies from different industries, in order to reduce these risks by diversifying;
 - ▶ **Systematic Risk** is the risk that is common to all securities and cannot be eliminated through diversification. Since this kind of risk involves the broad economy, such as recession, high inflation, war, etc., it cannot be avoided by investing in a diversified portfolio of stocks. The measure of systematic risk is the beta coefficient, showing the tendency of a stock's price to correlate with changes in a specific market index.
- 3.5. Since the projection of future cash flows always includes a certain level of uncertainty in terms of amount, growth, timing, etc., the valuer must exercise judgment on whether to reflect risks in the projected cash flows and therefore, to not include the specific company risks in the discount rate, or alternatively, to express the additional risk by adjusting the market-based discount rate.

- 3.6.** The projected cash flows are normally considered to be less risky if they are contractually based or projected as the most likely cash flow. Alternately, it is possible to reflect various levels of uncertainty by projecting different future scenarios and then deriving the probability-weighted cash flows. The valuer should determine an appropriate discount rate and make adjustments for additional risks or uncertainty if necessary, depending on the type of projected cash flow used in applying the DCF method in business valuation.

4. Capital Asset Pricing Model (CAPM)

- 4.1.** The Capital Asset Pricing Model (CAPM) is a part of capital market theory and the most common method used in European business valuation practice to determine the discount rate.

4.2. Cost of equity

- 4.2.1.** If cash flow projections are based on the net after-tax equity basis, e.g. including interest and debt payments in the cash flow, the discount rate is to be determined as the cost of equity capital and the valuation result will be at the equity marketable level.
- 4.2.2.** In accordance with CAPM, the basic formula for cost of equity calculation is the following:

$E(R_i) = R_f + \beta \times ERP$, where:

$E(R_i)$ = cost of equity

R_f = risk-free rate

β = beta

ERP = equity risk premium (or market risk premium)

- 4.2.3.** As the CAPM is part of capital market theory, securities are deemed to be held in a perfectly diversified portfolio, which is not the case in business valuation, where the subject of valuation is a particular business interest. Therefore, the CAPM formula needs to be adjusted by adding the specific risk known as an "alpha" factor (α), changing the basic formula to:

$E(R_i) = R_f + \beta \times ERP + \alpha$, where:

$E(R_i)$ = cost of equity

R_f = risk-free rate

β = beta

ERP = equity risk premium (or market risk premium)

α = alpha (specific risk)

4.3. Risk-free rate

- 4.3.1.** The starting point in calculation of the cost of equity is to determine a risk-free rate at valuation date. The risk free rate is defined as the rate of return available in the market on an investment free of default risk.
- 4.3.2.** The risk-free rate normally increases in a period of increased inflation expectations, increasing the cost of equity, and normally decreases when inflation expectations decrease. In cases in which projections and discount rate need to be expressed in real terms, the risk-free rate should be adjusted by deduction of the long-term inflation rate.
- 4.3.3.** Government bonds are widely recognised as representing minimum risk. An example is long-term AAA-rated Euro government bonds with different maturities. In business valuation, it is common practice to use risk-free bonds with 10-year or 20-year maturities. The reason for using longer term bond yields is because such yields more closely match the time period of the investment being valued.
- 4.3.4.** The risk-free rate can be derived in different ways depending on the currency in which the projections are made and available data for such currency. For active and liquid local markets with regular issuance of long term government bonds for 10 or more years, available close to the valuation date, such bonds can be a good representative of the risk-free rate in local currency or Euro. If local government bonds are not long-term and/or are not published regularly, the common practice in Europe is to derive the risk-free rate starting with 10-year or 20-year German bonds and increase the yield to redemption by the appropriate country risk premium, as relevant for the subject of the valuation. If projections are in local currency, than additional adjustments of the risk-free rate in Euro are necessary to take account of different inflation rates between Euro and local currency.

4.3.5. The country risk premium can be derived by regressing the local country's equity market returns against the market returns of a country with a developed capital market. The valuer could use various sources for the country risk premium which are widely recognised and updated, or could calculate a country risk premium by comparing long-term German bonds, government bonds of the subject country and government bonds of other countries with similar credit rating, adjusted for differences.

4.4. Equity (market) risk premium

4.4.1. A return over and above the risk-free rate, the Equity Risk Premium – ERP (or Market Risk Premium) is recognised as a rate of return reflecting the additional risk of equity instruments. It may be based on the historical returns sometimes used to indicate a market expectation of future long term returns.

4.4.2. If historical returns are used to measure future returns, the ERP is calculated by the following formula:

$ERP = E(R_m) - R_f$, where:

ERP = equity risk premium

$E(R_m)$ = historical return on a fully diversified portfolio of equity securities, each year from 1926–today

R_f = the rate of return expected on a risk-free security, representing the historical income return on government bonds over a specific period. This rate of return corresponds to the year of $E(R_m)$

4.4.3. There are a number of available studies on ERP measurement using different sources. When using any of these sources, the valuer must understand how the source has calculated the ERP.

4.4.4. Research shows that ERP follows the business cycle. The ERP can be calculated as a long-term average over the business cycle or based on current stock market levels. The reason for relying on long term data is better stability of returns over such period, including effects of extraordinary events (economic crisis, world war, recession, etc.) and more accurate calculations due to more numerous observations. On the other hand, the most recent history reflects actual returns and excludes extraordinary events which significantly changed the economy and investor's expectations. In addition, valuers should be aware that selection of different time periods can lead to different results – e.g. returns from 1900-1950 give a lower ERP than returns from 1950-2000.

4.4.5. Apart from using historical data, the ERP can also be calculated as an implied risk premium, derived from the market's expected return in the future.

4.5. Beta

4.5.1. Beta is another component of CAPM, representing the measurement of systematic risk. Beta is a function of the relationship between the return on an individual security and the return on the market as measured by a broad market index.

4.5.2. For the market index as a whole, the average beta, by definition, is 1.0, based on the investor's assumption that all unsystematic risk can be eliminated by holding a perfectly diversified portfolio of securities.

4.5.3. If a stock tends to have a positive excess return greater than the market, above the risk-free rate, and a negative excess return greater than the market, below the risk-free rate, then the stock's beta is greater than 1.0. Conversely, if the difference between the stock's return and the risk-free rate tends to be less than the difference between the market return and risk-free rate, the stock's beta is less than 1.0.

4.5.4. Securities with betas higher than 1.0 are considered as more risky than the market in comparison to securities with betas less than 1.0, which have systematic risks lower than the market.

4.5.5. In business valuation, beta is measured by regression of the excess returns on a subject company against the excess returns on the market over a certain period of time, usually three to five years. If the subject company is not traded on the stock market, the published betas of similar companies whose shares are traded on a stock exchange market may be used (such companies are known as A-listed or guideline public companies). It is a valuer's responsibility to make an appropriate judgment when selecting the period of beta measurement depending on market circumstances and available data.

4.5.6. In order to derive the most relevant beta factor for the business, the valuer will normally select the most similar guideline public companies in the same industry using the same criteria as for the market approach (*see EBVS 3 – The Valuation Approaches and Methods, section 6.2.9*) and select beta from the peer group. In that way, the same group of public companies will be used for the application of the comparable publicly traded companies method and for the calculation of the discount rate in the DCF method, improving consistency between two valuation methods.

- 4.5.7.** The published beta, based on the price of the stock traded, is called 'levered' beta, because it reflects the actual financial leverage and tax regime of the guideline public company. In order to obtain the beta representing the industry target capital structure, the published beta needs to be unlevered, to get an asset beta, and then re-levered with the industry-representative capital structure or company capital structure.
- 4.5.8.** One of the possible ways to calculate an unlevered beta is with the following formula:

Unlevered β = Levered β / (1 + (1-t) x (D / E)), where:

Unlevered β = Unlevered Beta

Levered β = Levered Beta

t = Guideline Company Corporate tax rate

D = value of debt in Guideline Company capital

E = value of equity in Guideline Company capital

- 4.5.9.** The next step is to apply a levered beta to the subject company, based on its tax rate and capital structure of the industry-representative capital structure or company capital structure, by applying the next formula:

Levered β = Unlevered β x (1 + (1-t) x (D / E)), where:

Unlevered β = Unlevered Industry Beta

Levered β = Levered subject Company Beta

t = Subject Company Corporate tax rate

D = value of debt in Subject Company capital

E = value of equity in Subject Company capital

4.6. Specific risk

- 4.6.1.** The basic CAPM formula for the cost of equity calculation is based on the risk-free rate and equity risk premium adjusted by beta, all of which are related to the general economy of the country. Such cost of equity will be appropriate for a large public company. If the subject of valuation is a small closely held company, then an additional risk premium (specific risk) is required.

- 4.6.2.** The specific risk factor reflects a difference in risk between the large public company and small closely held company, which is primarily related to size, but some other specific risk components, such as liquidity, operating or business risk, may also be justified. As noted above, this premium is also required due to the absence of diversification for most investors in small closely held companies.
- 4.6.3.** Size premium, as a difference in returns between large and small companies, is measured by different studies, through historical returns on the market. Valuers should exercise their own judgment on whether to apply a size premium, since size premium studies have been subject to much criticism with commentators noting that the premium has not been readily apparent since 1980. As a result, a small size premium is not applied in some countries.
- 4.6.4.** In addition to the size risk, it may be appropriate to incorporate in the specific risk other particular business related factors, if they are not already captured by cash flow projections or by a discount for lack of marketability (*see EBVGN 1*). The valuer should be careful to avoid double counting e.g. if some uncertainty factors are already included in the projections, they should not be included as additional specific risk components in the discount rate. Also, if some assumptions used for projections are more optimistic from the market participant's view and not tested through multiple scenarios, such investment specific factors may be captured in a higher discount rate. Examples are higher growth, profitability, dominance of one or a limited number of customers or suppliers, etc.

4.7. Weighted average cost of capital

- 4.7.1.** If cash flow projections are based on the invested capital cash flow, e.g. without debt payment in the cash flow, the discount rate should be determined as the weighted average cost of capital (WACC) and the valuation result will be at the invested capital level (enterprise value).
- 4.7.2.** WACC is defined by the International Glossary as *"the cost of capital (discount rate) determined by the weighted average, at Market Value, of the cost of all financing sources in the business enterprise's capital structure"*.

4.7.3. The basic formula to calculate an after-tax WACC is presented below:

WACC = (E/V x Re) + ((D/V x Rd) x (1 - t)), where:

E = Market Value of the firm's equity

D = Market Value of the firm's debt

V = total value of capital (equity plus debt)

E/V = percentage of capital that is equity

D/V = percentage of capital that is debt

Re = cost of equity

Rd = cost of debt

t = Corporate tax rate

- 4.7.4.** The common valuation practice in WACC calculation is to apply the representative industry capital structure based on the analysis of publicly traded companies in the same industry, as representative of the optimal capital structure. However, as previously mentioned for beta factor (*see above 4.5.6*), it is generally more relevant for the subject business to select an industry capital structure from the peer group of guideline publicly traded companies, rather than to rely on general indicators by using databases based on a wider list of companies.
- 4.7.5.** If the subject of valuation is a minority interest, the valuer should consider whether to use the subject company capital structure or representative industry capital structure in the WACC calculation. If applying an industry capital structure, an appropriate discount for lack of control should be applied in the DCF method, since minority shareholders cannot change the capital structure, and the company will usually have a different capital structure.
- 4.7.6.** In estimating the cost of debt capital for WACC calculation purposes, the Market Value of debt should be applied. This might be different from the company's book amount of debt. It is common valuation practice to use the average interest rate in the local market as published by the central bank. However, if the company conducts business activities in various markets and could potentially raise debt in several countries, the valuer needs to consider several options and make a judgment as to which one will be appropriate in the specific case, being careful to calculate the cost of debt and the overall discount rate in the same currency.

5. Build-up method

- 5.1.** A discount rate can be determined on the basis of the build-up method; this is less used in business valuation practice but could be applicable if there are no appropriate market data for beta, or there is no appropriate peer group, which is not required in this method.
- 5.1.1.** The formula for the build-up method is similar to the adjusted cost of equity calculation using CAPM, as modified to include specific risk factors. However, the build-up method excludes the beta factor, as follows:

$E(R_i) = R_f + ERP + \alpha$, where:

$E(R_i)$ = cost of equity

R_f = risk-free rate

ERP = equity risk premium (or market risk premium)

α = alpha (specific risk)

- 5.1.2.** The risk-free rate and equity risk premium are calculated in the same way as explained in EBVG 2, sections 4.3. and 4.4.
- 5.1.3.** The specific risk considerations are presented above within the CAPM method, part 4.6. Since the beta factor is not included in the build-up method, the systematic risk must be captured, usually by inclusion of an industry risk factor. Nonetheless, both the size premium risk and the specific risk associated with the business of the company should be considered and included in the appropriate way.
- 5.1.4.** As noted in the cost of equity calculation using CAPM, the valuer must be careful to avoid double counting some uncertainty risks, and must establish whether they are already adjusted in the cash flow projections, or if not, must make own judgment and estimate which type of specific risks need to be captured and at what level.
- 5.1.5.** In practice, the build-up method is usually used for estimating the value of smaller closely-held companies, with simple capital structures, largely equity financed and with lower business risks.

EBVGN 3 Valuation of Intangible Assets

1. Introduction
2. Scope
3. Commentary on intangible asset categories
4. Data, documentation and information sources
5. Usual bases of value
6. Income Approach
7. Market (Comparison) Approach
8. Asset-based Approach
9. Reconciliation processes
10. Legal aspects in valuation of intellectual property

1. Introduction

- 1.1. Intangible assets are assets that manifest themselves by their economic properties; they do not have physical substance but grant rights and privileges to their owner and usually generate income or other benefits for their owner. The value of intangible assets can be categorised as arising from rights, relationships, synergy of grouped intangibles and intellectual property rights.
- 1.2. The intangible assets created through the processes of innovation represent a major share of the value of today's businesses. The intellectual property (IP) rights associated with those assets are the legal underpinning for potential returns on investment in that innovation.
- 1.3. Intangible asset valuations may be required for a number of possible purposes including acquisitions and disposals of businesses or parts of businesses, mergers, sales of intangible assets, loan guarantees, obtaining licences, establishing royalty payments, litigation, setting of compensation to the rightsholder for the damages as a result of the infringement, etc.
- 1.4. As most intangible assets, and IP in particular, are by their nature innovative and therefore different, each valuation case requires investigation, rather than an automatic calculation. As a result, IP valuation of a company's assets is an opinion, at a particular point in time. There are many factors involved and evidence can have a substantial impact on value conclusion.

2. Scope

- 2.1. EBVGN 3 provides commentary on the various categories of intangible assets, different valuation methods and their application in the valuation of intangible assets in line with European valuation practice.
- 2.2. The valuation of intangible assets is complicated by the fact that no two intangible assets are the same. This is inherently the case when intellectual property is protected by rights such as patents and trademarks, where a requisite for obtaining such rights is that the intangible asset does not already exist. This uniqueness of intangible assets makes comparison with other intangible assets difficult, thereby limiting the usefulness of comparison-based valuation methods. As a result, valuations are often based on assumptions about the intangible asset's future use,

what important milestones will be met and what management decisions will be taken.

- 2.3.** Although many of the principles, methods, and techniques of intangible asset valuation are similar to other fields of valuation, intangible assets valuation requires special education, training, skills, and experience.

3. Commentary on intangible asset categories

3.1. Definition of intangible assets and associated rights

- 3.1.1.** According to EU Accounting Rule 6, the definition of intangible assets for the purpose of financial statements is:

"An intangible asset is an identifiable non-monetary asset without physical substance."

- 3.1.2.** An asset is identifiable if it either:

- ▶ Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- ▶ Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

- 3.1.3.** From the accounting perspective, according to IAS 38 Intangible assets, there are two recognition criteria of such assets which must be met, as follows:

- ▶ *"It is probable that the expected future economic benefits that are attributable to the asset will flow to the entity;"* and
- ▶ *"The cost of the asset can be measured reliably."*

- 3.1.4.** Intangible assets are recorded in the balance sheet at their acquisition cost, if the above two criteria are fulfilled. However, if an intangible asset is acquired in a business combination, the acquisition costs will be estimated and recorded at fair value, in line with IFRS 3 Business Combination.

- 3.1.5. Intangible assets are not physical in nature and represent certain legal rights and economic benefits that accrue to the owner. They are held for use as part of production or other process, or for letting to other parties, or for administrative purposes.
- 3.1.6. Rights exist according to contract, written or unwritten, of economic benefit to the parties. Examples are, among others, supply, distribution and purchase contracts.
- 3.1.7. Relationships between parties may be non-contractual, and may be short-lived, but can nevertheless have great value to the parties. Examples are an assembled workforce, customer relationships, supplier relationships, distributor relationships, and structural relationships between parties.
- 3.1.8. The capacity of an entity to control the future economic benefits or service potential from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits or service potential in some other way.

3.2. Classification of intangible assets

- 3.2.1. Intangible assets, whether or not recorded in the company's balance sheet, can be classified into two main categories:
 - ▶ Identifiable intangible assets; and
 - ▶ Goodwill, as a part of business (unidentifiable intangible assets).

The above classification and identification as intangible assets will have a crucial importance for the valuation process.

- 3.2.2. Intangible asset valuations are conditioned by the existence of specific attributes of intangible assets, such as:
 - ▶ Intangible assets are separately identifiable from other assets, i.e. the future economic income attributable to the asset can be sold, rented, exchanged or distributed;
 - ▶ They are owned or controlled by the business, i.e. the business can obtain the future economic benefits flowing from the intangible asset and restrict access of third parties to those benefits;

- ▶ They are acquired or, in the case of internally generated intangible assets, produced by an event which occurred at a specific time; they have a limited useful economic life;
- ▶ They generate some measurable amount of economic benefit to their owner; and
- ▶ They enhance the value of tangible assets with which they are associated.

3.3. Identifiable intangible assets

3.3.1. Generally, this category includes intellectual property defined in Article 2 of Regulation (EU) No 608/2013:

- ▶ A trade mark;
- ▶ A design;
- ▶ A copyright or any related right as provided for by national or Union law;
- ▶ A geographical indication;
- ▶ A patent as provided for by national or Union law;
- ▶ A supplementary protection certificate for medicinal products;
- ▶ A supplementary protection certificate for plant protection products;
- ▶ A Community plant variety right;
- ▶ A plant variety right as provided for by national law;
- ▶ A topography of semiconductor product as provided for by national or Union law;
- ▶ A utility model in so far as it is protected as an intellectual property right by national or Union law;
- ▶ A trade name in so far as it is protected as an exclusive intellectual property right by national or Union law.

3.3.2. The Intellectual Property (IP) and Intellectual Property Rights (IPRs) definition is provided by the World Intellectual Property Organization (WIPO):

"IP refers to creations of the mind: inventions, literary and artistic works, and symbols, names, images, and designs used in commerce. IP is divided into two categories: Industrial property, which includes inventions (patents), trademarks, industrial designs, and geographic indications of source; and Copyright, which includes literary and artistic works such as novels, poems and plays, films, musical works, artistic works such as drawings, paintings, photographs and sculptures, and architectural designs. Rights related to copyright include those of performing artists in their performances, producers of phonograms in their recordings, and those of broadcasters in their radio and television programs."

3.3.3. Business also employs identifiable intangible assets other than the intellectual property which is the subject of valuation:

- ▶ Trained and assembled work forces;
- ▶ Favourable labour agreements;
- ▶ Affiliation agreements;
- ▶ Favourable leases;
- ▶ Favourable insurance contracts;
- ▶ Favourable supply contracts;
- ▶ Employment contracts;
- ▶ Covenants not to compete;
- ▶ Customer relationships;
- ▶ Permits;
- ▶ Technical libraries and newspaper archives; and
- ▶ Other items.

3.3.4. Identifiable intangible assets can be valued individually, if it is possible to attach a finite or indefinite economic life to them and if they produce quantifiable benefits for the business over this period.

3.3.5. Identifiable intangible assets can also be valued collectively, as a part of a business. These relate to the internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance, as the expenditure on their development cannot be distinguished from the cost of developing the entity's operations as a whole. According to EU Accounting Rule 6, they are not recognised in financial statements as intangible assets.

3.4. Goodwill

3.4.1. IFRS 3 defines 'goodwill' as:

"An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized." IFRS also states that the goodwill is "the difference between the acquirer's interest in the net amount of identifiable assets acquired and the cost of the business combination. After initial recognition it is carried at cost less accumulated amortisation and impairments."

- 3.4.2.** Goodwill which attaches to a business is included in the transaction price of that business, and is transferred with the business when it is sold. On the other hand, personal goodwill attached to the person running the business is not transferred in sale and is therefore not included in the value of the business, except if it is stipulated in the sale purchase agreement that the seller continues to work in the business after the sale for an agreed time period.
- 3.4.3.** The goodwill, as a part of the business combination, in accordance with IFRS 3, is a residual amount after the total business value is allocated to all identifiable assets (intangible, tangible and current assets) minus all liabilities at acquisition date.

4. Data, documentation and information sources

- 4.1.** Valuers of intangible assets frequently have to rely upon information received from a client or from a client's representatives. The source of any such data relied upon for the valuation must be cited by the valuer in oral or written Reports, and the data must be verified wherever reasonably possible.
- 4.2.** The valuer must ensure that all data sources used are reliable and appropriate to the valuation undertaking. In many instances it will be beyond the scope of the valuer's assignment to perform a complete audit of secondary or tertiary data sources. Accordingly, the valuer must take such reasonable steps to verify the accuracy and reasonableness of data sources as are customary.
- 4.3.** Issues that must be considered by valuers of intangible assets include:
- ▶ The nature and history of the intangible assets. Since value resides in the benefit of future ownership, history is important in that it is a guide to the potential future economic benefits accruing from ownership of the intangible assets;
 - ▶ The rights, privileges or conditions that are attached to the asset. The ownership rights will be set out in legal documentation and whoever owns the interest is bound by this documentation. There may be rights and conditions contained in an agreement or exchange of correspondence. These rights may or may not be transferable to a purchaser;
 - ▶ The remaining useful life and/or legal life of the intangible asset;
 - ▶ The earnings capacity of the intangible asset and the associated risk;
 - ▶ Identifying and separating the economic benefits of a specific intangible asset might be very difficult and sometimes impossible;

- ▶ The economic outlook may affect the value of the intangible asset, as may the political outlook and government policy. Matters such as exchange rates, inflation and interest rates will have a different impact depending on the particular sector of the economy; the economic health and outlook of the specific industry may affect the value of the intangible asset.
- ▶ Prior transactions (if any) in the intangible asset may need to be taken into account;
- ▶ Other market data i.e. rates of return on alternative investments, etc.;
- ▶ The market prices for acquisition of similar intangible assets. Often adequate information is difficult or impossible to obtain, particularly details of transactions. While the actual transaction price may be known, the valuer may not know of any warranties and indemnities given by the seller, what terms were given or received, or what impact taxation planning had on the transaction.

5. Usual bases of value

- 5.1. The appropriate basis of valuation of any type of intangible asset depends on the purpose of the valuation and upon the functional and economic status of the intangible asset.
- 5.2. Where a Market Valuation is required, the valuer should adopt the normal Market Value definitions, processes, and methodologies as set out elsewhere in EBVS 2020. When the terms of engagement mean that a value basis other than Market Value is needed, the valuer must clearly identify the basis of valuation, define such basis and take necessary steps to distinguish the appraisal from a Market Valuation.
- 5.3. The bases of value other than Market Value applicable in valuation of intangible assets are:
 - ▶ Fair Value of an individual intangible asset for financial reporting purposes in accordance with IAS 38 or IFRS 3 within the purchase price allocation engagement;
 - ▶ Value in use of an individual intangible asset (or group of assets) or Goodwill as a part of an impairment test in line with IAS 36, which defines the value in use as *"the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life"*.

- 5.4.** In any circumstances in which a valuer is requested to provide valuations on a basis other than Market Value, the valuer shall proceed only if that valuation is not in breach of the law and will not be misleading.

6. Income Approach

- 6.1.** The Income Approach estimates the value of an intangible asset or interest in an intangible asset by calculating the present value of anticipated future benefits. In theory, income can be defined in various ways but in practice, the category of income adopted for the valuation is usually gross income, net operating income, net income before tax, net income after tax, operating cash flow or free cash flow.
- 6.2.** The different valuation methods will depend on:
- ▶ The nature of the intangible asset which is the subject of valuation; and
 - ▶ The nature and sustainability of the income.
- 6.3.** When applying the Income Approach, the value of the intangible asset may be materially impacted by the estimation of its remaining economic life. Therefore, the valuer must consider key characteristics of the asset, market demand and trends, any legal limitations and different economic factors which might influence the period over which the asset will generate the income.
- 6.4.** The principal intangible asset valuation methods under the Income Approach are:
- ▶ Relief-from-royalty method, sometimes referred to as royalty savings method;
 - ▶ Excess earnings method;
 - ▶ Premium profits method, sometimes referred to as incremental income method;
 - ▶ Greenfield method.
- 6.5.** The discount rate applicable to the intangible asset should reflect the risk associated with the revenues it generates. If the subject of valuation is the primary intangible asset of the business, usually the weighted average cost of capital (WACC) will be calculated (*see EBVGN 2*) and if necessary, adjusted for additional risk depending on the type of intangible asset.

- 6.6.** If the valuation engagement includes estimation of different types of assets (intangible, tangible and current assets), such as purchase price allocation, apart from determining WACC, it will be necessary to calculate the weighted average return on assets (WARA) for each type of asset and reconcile with WACC.
- 6.7.** WARA is calculated based on the valuation of each asset class, a rate of return determined for each asset class adjusted for specific risk and the percentage share of each estimated asset class in the total net assets. The typical asset classes for WARA analysis include the fixed assets, net working capital, goodwill and identifiable intangible assets (e.g. trade name, customer relationship, R&D, patent, assembled workforce, etc.).
- 6.8.** When estimating a specific risk for each asset class, the valuer should analyse the overall portfolio from the market participant's view point, in order to come to a reasonable scale of risks. For instance, net working capital and fixed assets are usually less risky than intangible assets in general. Also, R&D brings higher risk than customers' contracts, a trade name or patented technology in use.
- 6.9.** One of the components of the valuation method under the income approach is the calculation of the tax amortisation benefit (TAB). This is applicable if the amortisation of the acquisition cost of the intangible assets is deductible for tax purposes. The estimation of TAB should be applied according to the law, if such amortisation benefit exists. The TAB increases the value of the subject asset and if the tax amortisation period is shorter, the asset will be worth more, all other things being equal.
- 6.10. The relief from royalty method** addresses the deprival value of the intangible asset. Based on this theory, the value of the intangible asset is equal to the capitalised amount of the royalties that would be payable if the intangible was not owned but had to be licensed on market terms from a third party.
- 6.10.1.** The relief from royalty method is usually applied for the valuation of trademark and trade names, patents, some kinds of technology, or other types of intangible assets that can be licensed separately and earn royalty income.
- 6.10.2.** The primary steps involved in applying this method are to:
- ▶ Estimate the remaining economic life of the intangible asset or, based on its specific characteristics, conclude that it has an indefinite life;

- ▶ Define assumptions and project the revenue stream expected to be generated by the asset until the end of its economic life or, if the asset has an indefinite life, include a terminal period in the projections;
- ▶ Estimate any expenses that might be directly associated with the asset (e.g. maintenance, administrative, etc.);
- ▶ Determine the appropriate royalty rate and apply to the projected gross or net revenue, depending on whether projections include expenses and whether the royalty rate obtained is at the gross or net level;
- ▶ Apply an income tax rate and obtain the after tax royalty saving stream;
- ▶ Determine an appropriate discount rate for the asset;
- ▶ Discount the projected aftertax royalty savings, add the terminal value (if included in projections), and add the tax amortisation benefit (TAB) in order to derive the value of the subject intangible asset.

6.10.3. The essential input is the determination of a royalty rate that is comparable and applicable to the subject intangible asset, particularly the rights of ownership in comparison to the rights under a licence contract, used as a comparative source for the royalty rate. The valuer needs to carefully read licence contracts selected from appropriate databases and understand what the comparable royalty rate includes and the basis on which it is calculated (gross/net revenues, net profit, etc.).

6.10.4. The most appropriate source for the royalty rate would be other licence agreements of similar types of intangible asset. If the subjects of collected licence contracts are not similar enough to the subject of valuation or/and the valuer would like to check the royalty rate obtained, the rule of thumb known as "25% Rule" of operating profit can be applied.

6.11. The **excess earnings method** determines the value of the intellectual property by capitalising the additional profits generated by the business owning the property over and above those generated by similar businesses which do not have the benefit of the property.

6.11.1. This method is often applied to valuations used in financial reporting when there is a requirement for the acquirer to allocate the overall price paid for a business between tangible assets, identifiable intangible assets and goodwill as unidentifiable asset. In practice, it is usually applied for primary income generating intangible assets that might be customer-related intangibles or key technology.

- 6.11.2.** The excess earnings method can either be applied using several periods of forecast cash flows – the 'multi-period excess earnings method' or using a single period of forecast cash flows – the 'single-period excess earnings method'. In practice, the multi-period excess earnings method is more commonly used because an intangible asset will normally bring monetary benefits over an extended period.
- 6.11.3.** The key steps in applying the excess earning method include to:
- ▶ Identify the most important intangible assets for generating the company's income to be estimated by the excess earnings method;
 - ▶ Identify all other intangible and tangible assets necessary to support the generation of income by primary intangible assets, known as contributory assets (trade name, patent, licence, etc.), or tangible assets (working capital);
 - ▶ Conduct an analysis of the relevant business similar to the analysis undertaken for the DCF method of business valuation (see *EBVS 3*);
 - ▶ Project future revenues driven by the primary asset and supporting assets known as contributory asset charges over the period of the remaining economic life of the subject asset;
 - ▶ Project expenses that are directly caused by the primary intangible asset revenue and related contributory assets, considering only operating costs which are necessary for the existing subject asset (for instance, the valuer must not include marketing or R&D expenses which will be necessary to attract new customers, but are not required to retain the existing customers, which are part of subject customer-related intangible asset);
 - ▶ Determine the discount rate for the primary intangible asset and after-tax rate of return for each contributory asset;
 - ▶ Calculate the contributory asset charged and deduct from the projected income (excess earnings) generated by the primary intangible asset;
 - ▶ Calculate the present value of the projected excess earnings by discounting the appropriate discount rate;
 - ▶ Add the tax amortisation benefit if applicable to get the value of the subject intangible asset.
- 6.11.4.** Since the excess earnings method can be used for the valuation of primary intangible assets, all other types of identifiable intangible asset will need to be estimated by other valuation methods. Each contributory asset contributes to the income and therefore, the contributory asset charges are usually calculated as a percentage of revenues.
- 6.12.** The **premium profits method** (also known as the incremental income method) is a variation on the excess earnings method and is often used to value brands in the

consumer products sector where it is common for a branded product to be more expensive than an unbranded equivalent.

- 6.12.1. The premium profit level is calculated as the difference between the operating profit generated by using the subject intangible asset (for instance, selling products with a strong brand) and the operating profit without having such assets (selling products without such a brand).
- 6.12.2. The value of this additional profit projected over the remaining economic life or indefinite life of the brand, net of the marketing and other brand support costs incurred to achieve this revenue, and discounted to the present value provides a value for the brand. A drawback of this method is that it is very difficult these days to find a truly unbranded product.
- 6.12.3. The premium profit could also be driven by cost savings generated by the subject intangible assets in comparison to the business that does not use such assets.
- 6.13. **The greenfield method** (also known as the build-out method) is similar to the excess earnings method. The key difference is the assumption that the owner of the intangible asset does not have any other relevant business assets at the valuation date. Therefore, the necessary tangible assets or other intangible assets should be bought, built or rented.
- 6.13.1. After the projection of the revenues and expenses generated by the subject intangible asset, the overall investments required to acquire the necessary assets for the business need to be deducted from the projected cash flow. It is often used for the valuation of franchise agreements or broadcast licenses.

7. Market (Comparison) Approach

- 7.1. The Market Approach compares the subject asset to similar intangible assets or interests in, or securities backed by, similar intangible assets that have been sold on the market.
- 7.2. The two most common sources of data used in the Market Approach are markets in which there is trade in ownership interests of similar intangible assets, or there have been prior transactions in the ownership of the subject intangible asset. There must be a reasonable basis for comparison, with reliance being placed upon comparable intangible assets in the same industry or business as the subject

asset or ones that respond to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading.

- 7.3.** When historic comparable transactions are used to provide valuation guidance, adjustments may need to be made for the passage of time, and for changed circumstances in the economy.
- 7.4.** The following are the basic elements of comparison that must be considered when selecting and analysing sales transactions:
- ▶ The legal rights of intangible property ownership conveyed in the transaction;
 - ▶ The existence of any special financing terms or arrangements. Whether the elements of an arm's-length sale exist;
 - ▶ The economic conditions existing in the appropriate secondary market at the time of the sale transaction;
 - ▶ The industry or business in which the intangible asset was, or will be, used;
 - ▶ The functional characteristics of the assets;
 - ▶ The technological characteristics of the assets;
 - ▶ The economic characteristics of the assets;
 - ▶ The inclusion of other (non-intangible) assets in the transaction.
- 7.5.** Although the number of transactions dealing solely with the sale of intangible assets (as opposed to the entire business) is increasing, the number of obtainable benchmark prices is still limited. Further, even where reliable transaction data are available, the characteristics of intangible assets vary considerably and it is hard to adjust benchmark values to reflect the differences between the different assets. In addition, the value of an intangible asset can be very dependent on who is using the asset, and how it is being used. Therefore, not only are data on the sale of intangible assets uncommon, but care must be exercised when using a benchmark value for an intangible asset, as the price paid in one context may not be representative of the value of the same asset in a different context.

8. Asset-based Approach

- 8.1.** There are two main asset-based methodologies that can be applied to valuing intangible assets: historical cost and replacement cost. Both methodologies seek to aggregate the costs incurred in developing the intangible asset. Historical cost reflects the initial cost incurred in creating the intangible asset, whereas replace-

ment cost quantifies the estimated cost of replacing the intangible asset or creating an equivalent asset.

- 8.2.** While the historical cost-based method may satisfy the criteria of objectivity, consistency and reliability, its use has a fundamental drawback: there is not necessarily a correlation between expenditure on an asset and its subsequent value.
- 8.3.** The replacement cost method overcomes these difficulties to some extent. The problem of translating a historical cost into a current cost does not arise, since this method is based on current prices. It can, however, introduce an additional practical obstacle in that estimating the costs of recreating the intangible asset can be subjective if no market benchmarks are available.
- 8.4.** The valuer needs to identify and apply the appropriate form of obsolescence – functional, regulatory, technological or economic – to the intangible asset value that has been adduced by the above methods.
- 8.5.** In general, the asset-based approach is likely to produce the least realistic indication of the value of intangible assets and so it is used when the income or market approaches are not applicable. In practice it is usually applied for valuation of internally developed software, technical and laboratory documentation, assembled workforce.
- 8.6.** One important factor that influences the value of intangible assets when applying the asset-based approach, particularly when estimating obsolescence, is the remaining useful life. There are several techniques for analysing remaining useful life for intangible assets, such as:
 - ▶ Remaining legal life (according to the contract or legal protection);
 - ▶ Remaining physical life (due to the age);
 - ▶ Remaining technological life (when the current technology is likely to become obsolete);
 - ▶ Remaining economic life (end of profit generation).

When applying the asset-based approach, the valuer must consider all these measures of remaining useful life in the analysis of different types of obsolescence.

9. Reconciliation processes

- 9.1.** The reliability of the final value of the intangible asset will depend upon:
- ▶ The basis of valuation adopted;
 - ▶ All relevant information available at the valuation date bearing in mind the terms of engagement;
 - ▶ The selection of the appropriate methods, which depends on the judgment of the valuer, considering the characteristics of the subject asset and available data.
- 9.2.** The valuer must provide the rationale and justification for the valuation methods used, reconciling the difference between results obtained by applied methods and making the final valuation conclusion.

10. Legal aspects in valuation of intellectual property

- 10.1.** When carrying out valuations of intellectual property, it is of particular importance that the valuer be fully aware of all legal aspects, protected status, copyright, patents, licensing agreements, or third party claims.
- 10.2.** When valuing intellectual property, which uses a right under licence, the valuer will also need to consider all the contractual stipulations, which, inter alia, affect rent or royalty payments.
- 10.3.** The registration, protection and transmission of intellectual property rights are subject to national and EU laws and international agreements. The valuer must consider all the relevant legal factors from the above that might impact the value of the subject assets.

III.

Business Valuation and Sustainability

- 1. Introduction**
- 2. Sustainability**
- 3. Sustainability and Business**
- 4. Valuation and Sustainability**

1. Introduction

- 1.1.** In addition to and building on the normal concerns about financial quality of a business as a going concern, the twin pressures of developing public policy and practical economics mean that many businesses and those concerned with them are paying greater attention to a range of resource issues, covered by the concept of sustainability. It can be expected that both regulation and market sentiment will make these issues of resource efficiency, environmental performance and sustainability increasingly important to those running, investing in and lending to businesses and so, where relevant, to their valuation.
- 1.2.** Businesses may have a variety of motives for considering sustainability in general or specific aspects of it, such as energy efficiency or reducing waste. These may range from personal commitment to cost-cutting, from complying with regulation to seeing it as an advantage with customers, supporting or building reputation or brand value.
- 1.3.** This changing context with developing market expectations, affecting both trading performance and balance sheet values, poses challenges to many established businesses but also offers opportunities to other businesses, both existing and new. These effects may be directly ones of changing markets and cost structures or more specific concerns about individual business' reputation and brand value as particular sustainability issues come under scrutiny. The increasing expectation that businesses will account for and report on their sustainability performance can prompt both internal review and external challenge. Some business partners, investors, lenders and others, including employees, may look to meet rising standards with regard to sustainability and expect similar standards from those with whom they deal.

- 1.4.** It is very clear that these issues are evolving, not only with greater scientific knowledge and the experience of policy but also the much enhanced focus on climate change mitigation and adaptation. For mitigation, several EU member states have adopted the target of reducing greenhouse gas emissions to “net zero” by 2050 and this theme has now been taken up by the European Commission which brought forward in December 2019 a European Green Deal with 49 proposals for using regulation, trade and investment policy to cut carbon emissions. Adaptation is about resilience in the face of climatic change, whether that be flooding, extreme heat, water shortage or storm. Both those pressures and the gathering momentum of policy interventions in response seem likely to drive major changes. As the incoming President of the Commission, Ursula von der Leyen, told the COP25 climate change conference:

“Our goal is to be the first climate neutral continent by 2050. If we want to achieve that goal, we have to act now.”

- 1.5.** Illustrating those challenges for business and properties used by business:

- ▶ As seen in areas from Venice and the Elbe catchment to the lower Danube and the French Mediterranean coast, built property with people’s lives, businesses and investments may be at risk from flooding whether from sudden storms, widespread rainfall or rising sea levels with consequent effects on development potential;
- ▶ Periods of extreme heat result in increasing mortality, make many buildings uncomfortable for use and increase the risk of landscape-wide fires;
- ▶ Heat and water shortage constrain both development and food production as well as imposing stress on forestry;
- ▶ Some land use patterns in Europe result in serious soil erosion with resulting problems;
- ▶ Globally, such changes drive hardship and pressure for migration.

That has led to financial authorities developing approaches from the Task Force for Climate-related Disclosure to warnings of the risk of mis-pricing assets that might prove to be unsustainable as current trends unfold. This in turn may influence the approaches taken by investors and lenders and so affect both the cost and availability of funds to a business and the value of assets, such as property, in its balance sheet.

- 1.6.** While promoting adaptation and resilience in the face of those challenges, policy makers are emphasising measures for climate change mitigation, many bearing on business, including:
- ▶ Any measures to reduce or charge for the use of carbon or support carbon sequestration to remove carbon from the atmosphere;
 - ▶ The development of renewable energy;
 - ▶ Improved energy efficiency in buildings and business activity;
 - ▶ Measures to decarbonise transport or improve air quality, such as travel restrictions, potentially changing values by location or the effect on operations.
- 1.7.** Wider issues around other environmental themes from biodiversity to the quality of air and water are all now feeding into the discussion of sustainability, the optimal use of resources for the future.
- 1.8.** The emphases between the issues involved will change as legislation and market sentiment develop. While they may often still be externalities in economic terms, not influencing values, regulation (including taxation) and new markets such as for carbon are likely to increase the impact of these issues, partly to address the problems posed for policies by externalities. Thus, while the market may often not have taken significant account of many of these issues, it seems increasingly likely that it will. As specific issues crystallise and become understood, so they become part of standard practice.
- 1.9.** The increasing salience of energy issues, driven by cost, resource issues and now climate change concerns, gives a good example of this evolution. The introduction of gradually strengthening regulation (such as the now re-cast EU Energy Performance of Buildings Directive with its Energy Performance Certificates (EPCs) and other tools) will lead to more sensitivity concerning energy performance and efficiency. This means that labelling and certification systems using independent information will be used more often and regulations become more strict. There may be subsidies for investment in sustainability or penalties, perhaps through the tax system, for less environmentally beneficial activity. These all have their effect on behaviour by internalising negative external effects. As and where such rules and any differences between more and less compliant businesses come to matter to parties such as owners, managers, investors, lenders, employees and others, then the market will take that into account, alongside all other factors, in values. It may well be that concerns over water scarcity and quality or other matters will follow a similar path.

- 1.10. Many of the issues covered by sustainability involve a long term perspective, such as expectations as to energy prices or handling environmental risk, while the necessary specific information may often be uncertain and the analytical tools still developing. However, those limitations do not make the questions any less important.
- 1.11. Valuers must act within the limits of their professional skills and current market expectations. This may mean that they will need to call on relevant expertise, certification and Reports as to aspects of the sustainability of a business rather than be expected to prepare them personally. This follows existing practice regarding environmental issues such as the assessment of contamination, asbestos, flood risk or soil erosion for which valuers need to be able to understand what the specialist reports might mean and judge what weight to give to them. Valuers can only value on the basis of the market as it is, not hypothesise about the future. This section of EBVS is offered to assist valuers' awareness of and sensitivity to these issues and so their understanding of markets as they evolve.

2. Sustainability

- 2.1. At a general level, sustainability is the capacity to endure. While this section focuses on the environmental aspects of sustainability, it also has economic and social dimensions and many of the issues of economic sustainability may already be material to valuations. Indeed, economic concepts such as sustainable profit or sustainable cash flow long pre-date the current uses of the word. Resilience is the capacity to withstand, absorb and recover from shocks – sometimes described as the ability to *"bounce back better"*.
- 2.2. As pressures on resources and natural systems have grown, so attention has focused on the extent to which this capacity can be protected by intervention and management. The focus on environmental constraints has led to one definition of sustainability as improving the quality of human life while living within the carrying capacity of supporting ecosystems.
- 2.3. **Sustainable Development** – That approach already implies the problems of reconciling sustainability with any action or change. The concept of *"sustainable development"* was promoted by the World Commission on Environment and Development (the Brundtland Commission) which reported in 1987. It has since been a key component in many policy discussions on economic, social and environmental

issues. In its Report, *Our Common Future*, the Brundtland Commission defined it as:

"development which meets the needs of current generations without compromising the ability of future generations to meet their own needs."

The Brundtland Commission's proposals were approved by the United Nations Conference on Environment and Development at Rio de Janeiro in 1992 leading to both national and international attention, including the United Nations Commission for Sustainable Development.

- 2.4.** It has proved to be an enduring, broad but vague, portmanteau concept. Its formulation does not arbitrate between economic, environmental and social objectives where they conflict. Indeed, as the emphasis between these objectives will vary between parties and situations as well as over time, this very fluidity may assist its general acceptability, if not its robustness. No more precise definition has emerged and it will have different practical connotations for different people, in different contexts and over time.
- 2.5.** With the developing momentum of such policy discussions, sustainable development may be best understood as a process rather than a defined end, that process currently being increasingly influenced by concerns over climate change and resources.
- 2.6.** A variety of tools and concepts has evolved to consider environmental issues for property, including Life Cycle Assessment, Cradle to Cradle, Ecological Footprint Analysis and green buildings. More widely, the use of concepts such as carbon footprint, Natural Capital and Ecosystem Services play a part in policy and public choice, influencing private behaviour. In varying ways, they consider the impact of development on the environment and ecological systems over time, with greater efficiency in the use of resources and less degradation of the environment, developing resilience and adaptability and with concerns about social equity. These are measured through a growing range of audits, procedures and indicators all trying to capture aspects of the larger concept and influence decisions and so increasingly bearing on markets and so businesses. This is not only through public policy and regulation but also by market perceptions and the demands of investors, businesses and their customers.

- 2.7.** One challenge in analysing this is to understand for each case whether addressing sustainability adds or subtracts value. It can be seen as a cost and a restriction. Equally, economic opportunities can be seen in green growth with its accompanying technical innovation, while meeting standards may protect or enhance value. Once a regulatory or market standard is seen as the norm, then failing to meet it may see the values of non-compliant properties penalised.
- 2.8.** At the larger level, it has been conventional to see economic growth as a challenge to environmental concerns but there is evidence (sometimes summarised in the Environmental Kuznets Curve) that higher levels of economic development can see reduced environmental degradation, perhaps partly as resources are then available to tackle the issues that are then of increasing concern and also as the nature of economic activity and the technology used changes. This transition with rising economic activity appears to reduce local externalities first, with more dispersed externalities being addressed at higher income levels. As techniques to reduce degradation are developed so it becomes easier for others to adopt them.
- 2.9.** Increasing knowledge, sophistication and scientific advance also open up new challenges – few would have been troubled by CO₂ emissions forty years ago – but also new ways of mitigating and adapting to them.
- 2.10.** As the concepts become clearer in practice and guidance develops, so they are likely to create intangible assets which will themselves need valuation where they can be separated from the underlying asset.
- 2.11.** These developments naturally become a topic for exploration by the valuation profession. The Vancouver Valuation Accord of 2007 was an early international forum for discussing the valuation issues associated with the sustainability debate: *"a commitment by valuation standards organizations globally to begin the process to embed sustainability into valuation and appraisals"*, to make it a mainstream consideration.
- 2.12.** *"Carbon Footprint"* – Some businesses, perhaps especially those facing consumers, wish to explain their environmental impact, making a marketing virtue of reducing it, both for reputation today and for managing reputational risks in the future as well as related benefits in efficiency and potential cost reduction. One of the measures for this is the volume of carbon assessed as used in the operations of a business. For manufacturing businesses, that will include the carbon emitted in making, packaging, transporting and storing goods but applies more broadly to businesses in the service and primary sectors of the economy. That will typically require meeting an externally verifiable standard or a certification.

2.13. Use of Materials – More generally for any business this is related to a wider consideration of the sustainable use of raw materials with their environmental impact, with everything potentially at issue from the effect on rain forests (as with the use of palm oil) to the single use of plastics. This inter-relates with the increasing policy focus on achieving a “*circular economy*” in which used materials and residues are no longer waste but are used as a recyclable raw material, keeping resources in use as long as possible with least going to landfill. As well as focusing attention on current operational processes and design issues, this will both challenge and provide opportunities for businesses in sectors from construction to IT.

2.14. Waste and Pollution – The EU's Waste Framework Directive 2008/98 established a five-stage waste hierarchy for member states to implement, based on life cycle analysis and reducing the volume of materials finally removed from the system by disposal which is to be seen as a last resort:

- ▶ **Prevention of waste** – preventing and reducing waste generation;
- ▶ **Re-use and preparation for re-use of waste** – giving the products a second life before they become waste;
- ▶ **Recycling waste** – any recovery operation by which waste materials are reprocessed into products, materials or substances whether for the original or other purposes. It includes composting but does not include incineration;
- ▶ **Recovery from waste** – including some waste incineration;
- ▶ **Disposal of waste** – processes to dispose of waste, such as landfill, incineration, pyrolysis, gasification and equivalent solutions.

This has led to the EU's Circular Economy Action Plan of March 2019 which is to form a key part of proposed European Green Deal.

2.15. The proposed European Green Deal carries forward existing concerns about pollution of the environment, including that by industry, with a “*zero pollution action plan for air, water and soil*”.

2.16. Natural Capital and Ecosystem Services Valuations – A growing body of work, at first for determining and applying economic and environmental policy but now coming to bear on markets, business and management, is developing approaches to put values on such resource and environmental issues as:

- ▶ Pollution, energy and materials;
- ▶ Environmental protection and resource management;

- ▶ Natural resource assets;
- ▶ Valuation of non-market flows and environmentally adjusted aggregates.

Noting the existing guidelines for integrating ecosystem services into decision making, the European Union Green Deal proposes that *"All EU policies should contribute to preserving and restoring Europe's natural capital"*.

- 2.17.** The underlying model is to see the stock of nature, whether recognised by markets or not, as natural capital giving rise to services from food to the quality of air and water, from cultural landscapes to soil quality and pollination. Eroding natural capital diminishes the stock of nature; generating more ecosystem services may augment it. While typically discussed in terms of land and property management, there may be more value at stake in the efficiency of business processes, such as the reduction of waste as part of the move to a circular economy. For businesses with a public profile, tackling such issues will be a part of their presentation to their marketplaces, part of managing their reputation.
- 2.18.** The developing exploration of these concepts as tools for public policy choices and also for private transactions to place values, agreed between buyers and sellers, on achieving environmental outcomes may begin to bring market mechanisms to this area and so potentially aid resolution of the many current externalities.
- 2.19.** Such approaches, commonly developed from an environmental economics background but using words recognisable to valuers, tend to identify values that can be on very different assumptions from those required by the valuation profession's standards and which might not always be objective. The resulting assessments, commonly reflecting externalities and often very sensitive to changes in assumptions, can nonetheless be useful for public policy, according to the realism of their assumptions and rigour of their analysis, but will not be either a Market Value or a fair value.
- 2.20.** Such values assessed for Natural Capital seem best understood as representing the Investment Value (see *European Valuation Standards, EVS 2*); the worth to society (or another interested party) of what is being measured. That helps policy makers make choices, when ranked against the costs of options, and so inform them as buyers, acting for society, seeking changes in behaviour in the private sector. Those more economics-based ecosystem valuations appear of greater relevance for comparing options using relative values, rather than identifying absolute values.

- 2.21.** Where that leads to purchase of public goods, whether directly by state agencies or by other bodies such as companies acting in this area for their own objectives, it sees the emergence of transaction prices where it is mutually beneficial to buyers and potential providers of such services to come to an agreement. Those prices may become analogous to Fair Value, and even in time to Market Value, as a greater body of experience and comparables accumulates.

3. Sustainability and Business

- 3.1.** Especially since the 2015 Paris Agreement on climate change, work on sustainability is increasingly driven by climate concerns with a focus on energy and carbon issues.
- 3.2.** Even with the increasing prominence of climate change as a source of policy concern, energy costs may only form some 1% of some businesses' operating costs, while staff costs may account for as much as 85% of the operating costs of an office tenant. Such ratios have limited the impact of energy issues but could equally suggest that the aspects of the building that influence the working environment and so the comfort of employees may have a perhaps unrecognised importance, though this may vary over the economic cycle.
- 3.3.** For those owners and businesses that make purely commercial judgments, the necessary investment has to show an acceptable return. It may be that investment in improving building equipment (such as heating, ventilation, air conditioning or for chilling) may not appear justified by the financial benefits of the improved energy efficiency but may offer other returns in terms of staff recruitment or retention.
- 3.4.** As businesses choose or are increasingly expected to operate in ways more sensitive to these issues, their owners and customers may tend to demand more relevant credentials to prove this. For larger businesses, such credentials might include:
- ▶ The increasing expectation on them to report on their performance in this area;
 - ▶ Demonstrations of Corporate Social Responsibility (CSR);
 - ▶ A Carbon Reduction Commitment (CRC);
 - ▶ **Accreditation according with ISO 14001** – the international standard for environmental management systems or **EMAS**, the EU-wide Eco Management and Audit Scheme.

A tangible example of such commitment by either party may be the use of "green leases".

3.5. "Green Finance" – 34 central banks and financial supervisors, representing the supervision of two thirds of the global systemically important banks and insurers, created the Network for Greening the Financial System (NGFS) in 2017 which has agreed to:

- ▶ Integrate the monitoring of climate-related financial risks into day-to-day supervisory work, setting expectations that finance considers the financial risks from climate change, embedding an awareness of risks;
- ▶ Ease access to data on climate-related risks;
- ▶ Build capacity and knowledge on managing climate-related risks across the financial system.

It encourages the development of metrics and classification systems to identify which economic activities contribute to the transition to a green and low-carbon economy, supporting financial actors to make sustainable investment and lending decisions. As the Governors of the UK and French Central Banks set out in a joint letter of April 2019 with the chair of the NGFS, the aim is to avoid:

"A climate-driven "Minsky moment" – the term we use to refer to a sudden collapse in asset prices."

3.6. The incoming President of the European Central Bank, Christine Lagarde, has said that the ECB's Strategic Review in 2020:

"... will include the immense challenge that climate change is addressing to each and every one of us, wherever located, and whatever our mission and duties ... we will take up the fight that is taken up by the European Commission and I hope other European institutions, and see where and how we can participate in that particular endeavour."

Statement and Press Conference, 12th December 2019

While monetary policy itself might only have a limited direct role, the financial markets influenced by the authorities offer a major influence over business, transmitting signals to all players. As an example, significant weather events can create large losses for insurers whose investments play a large part in financial markets. Raising a broader awareness of risk may prompt a closer attention to pricing for risk, whether to income or to asset values, by lenders and investors. The ECB's tools for this include:

- ▶ Banking supervision, by raising awareness of risk so that banks manage them;
- ▶ Financial stability, communicating the risks posed to the financial system by climate change;
- ▶ Some investment in green bonds.

3.7. The European Commission launched its Action Plan on Financing Sustainable Growth (the Action Plan) in March 2018 with three broad aims:

- ▶ To re-orient capital flows towards a more sustainable economy;
- ▶ To maintain sustainability in risk management;
- ▶ To foster transparency and long-termism.

The EU's institutions have gone further in discussing the possibility of a "green supporting factor" to adjust the capital requirements imposed on "climate-friendly" lending, in the same way that they had provided favourable treatment for lending to small and medium sized business after the 2008 financial crisis.

3.8. The international Task Force for Climate-related Financial Disclosure (TCFD), now with supporters across banks, asset managers, pension funds, insurers, credit rating agencies, accounting firms and shareholder advisory services with balance sheets totalling over \$ 120 trillion, has a critical role in this. It is driving climate disclosure by business as part of financial decision making at this level with the bearing that will have on businesses, including:

- ▶ Physical risks from the exposure of mortgage books to flood risk and the impact of extreme weather events on sovereign risk;
- ▶ Transition risks including exposures to carbon-intensive sectors and lending with new sustainability requirements.

The work of the TCFD is also intended to provide markets with the information that will enable the effective and dynamic allocation of capital where it will best support value creation. Defining, identifying and assessing risks helps the allocation of financial resources to finance resilient and sustainable development.

3.9. These trends are being transmitted through the financial system. The IMF's financial stability Report now includes a chapter on sustainable finance, including this view:

"The potential impact of climate risks is large, non-linear and hard to estimate. Losses from climate-related risk affect the financial system directly and indirectly

through lower economic growth and tighter financial conditions. Insurance claims from natural losses have already quadrupled since the 1980s."

In 2017, One Planet brought together a group of wealth funds, including Kuwait Investment Authority, with \$ 15 trillion of assets and the aim of integrating climate change into portfolios. There is a growing recognition that these issues may affect the way that allocations of capital continue to move between sectors, assets and locations, leaving some "stranded" while driving new approaches to infrastructure and the use of land.

3.10. Financial data agencies, such as MSCI, are now collecting and analysing climate data as part of the service they offer with Remy Briand, MSCI's head of ESG, saying:

"We believe climate change will become one of the most important investment factors over the long term. Institutional investors should be able to analyse the exposure of their portfolios to climate risk while also being able to report on their climate strategy."

Environmental Finance, Autumn 2019

Credit rating agencies are now taking greater interest in these topics. In 2018, Moody's identified 11 sectors, including shipping, steel and car making, seen as at risk of a downgrade in ratings because of concerns about carbon emissions while Fitch has introduced "relevance scores" to show how its credit rating decisions are influenced by such factors. They also see this in a broader context of the ability of a business to manage new risks, with Moody's advising:

"A strong financial position and low financial leverage are important characteristics for managing these environmental and social risks."

https://www.moody's.com/research/Moodys-changes-ExxonMobils-outlook-to-negative-PR_413126, 19th November 2019

Currently uncrystallised environmental liabilities (such as contamination of land) may in some cases prove significant in comparison to a company's balance sheet. Both credit rating agencies and banks may look at the exposure of a business to such potential policy measures as carbon taxes or other regulatory interventions. This then becomes a further pressure on companies to produce data on their environmental performance in making representations to lenders, investors and others.

3.11. These developing trends in "green finance", including "green mortgages", will be further driven by the work of the United Nations, with its Sustainable Development Goals, in the Principles for Responsible Investment, supported by thousands of

investors and now also developed as the Principles for Responsible Banking, with its influence on governments as well as the banks that are signatories to it. It promotes the incorporation of environmental, social and corporate governance (ESG) issues into company policies and practice, offering a series of toolkits for this. Its declaration requires companies to look to their *"investment service providers (...) to integrate ESG factors into evolving research and analysis"*.

- 3.12.** The necessary standards are being developed for data to answer the problems of credibly measuring and verifying environmental performance. In particular, the EU is developing its Green Taxonomy (as well as a Green Bond Standard) for classifying green investments to indicate companies' progress in transition, improving their environmental performance, as well as whether they are of the highest standard or not. While the Green Taxonomy's criteria for sustainable development are still to be drafted, it appears that they will focus on carbon neutrality and the use of renewable energy technology. The development of these approaches and their effects on investors and lenders will in turn influence how property and other markets evolve, with the risk of more expensive or reduced access to funds for companies seen as performing poorly.
- 3.13.** Corporate Social Responsibility (CSR) describes companies' voluntary choice to integrate the consideration of social and environmental issues into their daily business to demonstrate ethical behaviour and improve social conditions. This may include considering:
- ▶ Inputs, such as raw materials, energy, water;
 - ▶ Processes, such as environmentally friendly production and associated waste; and
 - ▶ Publicity, such as community relations.
- 3.14.** While voluntary, an increasing number of companies accept CSR as an element in business plans and annual company statements. In some cases, it may be seen as a proxy for quality and good, sensitive management. It may be that the largest companies will be legally required to report on these matters. In some countries, the law already regulates the presentation of non-financial performance indicators.
- 3.15.** While seen by some businesses as a chore imposed by regulation, distracting from a focus on shareholder value, with the resulting Reports read by few, such approaches as CSR and climate-related disclosure are part of changing expectations and can:
- ▶ Drive processes of internal review;

- ▶ Be useful in readiness for future demands and further government influences on markets and businesses;
- ▶ Offer material for responding to external challenge; and
- ▶ Prepare for conversations with those funding the business.

3.16. A CSR policy may be driven by a company's strategic plan, its corporate risk strategy, the needs for grants and funding or pressure from investors, customers and others. A clear statement of the company's rationale will be needed for any appraisal of its impact. More generally, it may be associated with concern to reduce reputational risk and include control of its supply chain.

3.17. Some companies encompass the ecological, social and economic aspects of sustainability in the concept of the "*Triple Bottom Line*", analysing and reporting performance under each heading. This is, of necessity, a permanently evolving approach and indeed sustainability could be extended to consider technical and functional quality.

3.18. Environmental Management Systems (EMS) offer tools for businesses to consider sustainability issues by seeking continuous improvement on the basis of the four stages of planning:

- ▶ What is to be done;
- ▶ Do it;
- ▶ Check that it was done; and
- ▶ Act to make improvements.

Throughout considering the impact on the environment and the activity that causes that change. It may assist businesses in looking at cost savings, managing legal, financial and reputational risks (including the identification of prospective legal requirements), marketing opportunities and the expectations of stakeholders. It can start from reviewing the current position (as a baseline) which may show that much has already been done without having thought of it as "*environmental*" and then developing an environmental policy to drive the future process.

3.19. ISO 14001 sets standards for these by which businesses can then be audited. These cover five aspects or stages:

- ▶ Environmental policy;
- ▶ Planning of action;
- ▶ Implementation and operation of project;

- ▶ Checking and corrective action;
 - ▶ Management review.
- 3.20.** The Eco Management and Audit Scheme (EMAS), developed by the European Commission for companies and other organisations to evaluate, report, and improve their environmental performance, offers a European standard that is voluntary but once adopted is subject to mandatory auditing (unlike ISO 14001). As some of its requirements are supported by legislation (EU Regulation 1221/2009 as amended by 2017/1505), it may be more demanding than ISO 14001 to which it is essentially similar. A business is to identify its direct and indirect environmental impacts and assess their significance. Internal audits must cover the management of the issue, performance in doing so and compliance and there is an external audit on a three year cycle.
- 3.21. Life Cycle Costs** – There is increasing discussion of judging the sustainability of a project or asset across its whole life cycle together with its associated externalities. Concern over greenhouse gas emissions often points to making the best of existing buildings in preference to demolition and replacement.
- 3.22.** Life Cycle Cost Analysis (LCCA) calculates the present value of all costs for the whole remaining life of a building, including construction, operation, maintenance and end-of-life costs. Such approaches may not yet capture all the externalities that can be involved. Some European countries have national standards and guidelines for carrying out LCCA while the international standard is ISO 15686-5 Buildings and constructed assets – Service life planning – Part 5: Maintenance and life cycle costing set the frame. However, ISO 15686-5, does not prescribe a common format for this analysis, allowing different approaches in practice.
- 3.23.** A move to life cycle assessment may move the balance towards property renovation from building anew, given the embedded costs of construction even with ultra-low carbon concrete and steel.
- 3.24. "Green Buildings"** – With property occupation part of the activity of a business, a "green" or "sustainable building" is one that is identified as using resources such as energy, water, materials and land more efficiently than buildings constructed to existing minimum standards. It may produce less waste and fewer emissions and potentially offers a better internal working environment, benefitting health, comfort and usefulness with fewer contaminants despite being more airtight. As sustainability expects that the needs of the present should not compromise the ability of future generations to meet their own needs, green buildings should

also take social, ecological and environmental issues into account. That broader definition includes external effects and the impact across generations and so the property's life cycle.

- 3.25.** With a variety of standards and green certification schemes, the EU is developing its Level(s) approach as a common and structured basis for reporting on the sustainability of buildings. For property rented by a business, the concept of a "green lease" has developed, generally offering reduced energy and other occupation costs in the hope of a higher rent.
- 3.26.** Policies and expectations for sustainability continue to change and develop. Thus, mandatory standards for new buildings imposed through development control or building regulations systems may well increasingly focus on ever more demanding low energy or passive house standards and the use of renewables, as well as more general sustainability criteria. In some areas, these regulatory requirements may either replace voluntary green building rating tools or encourage more ambitious voluntary ratings.

4. Valuation and Sustainability

- 4.1.** A valuer can only provide an opinion of value on the basis of evidence, reflecting the experience of the marketplace. That opinion cannot state that something should have a value or that a current value might not be sustained in the future, just that it has a value assessed from a judgment of the available data. That opinion is to be supported and prepared so that, within the limits of the available evidence, the client can rely on it for the purpose for which the valuation was instructed.
- 4.2.** There can be no general rule as to any typical pattern of premiums or discounts accounting for environmental issues. Even where such issues are significant in the marketplace, much will turn on factors such as the state of the market, transparency of information, location, sector, exposure to environmental risk in the region, and consumer awareness. Ultimately, within any regulatory framework these are issues of supply and demand and so may be influenced by changes in the patterns of demand by businesses, investors and, beyond them, consumers.
- 4.3.** Markets may in time differentiate between the values of businesses on environmental grounds. Those identified as having a higher performance may begin to attract an additional value in some markets, whether by increasing profits or warranting lower capitalisation rates. While this may apply for a while, it may then be that as the market begins to expect such standards or regulation requires

them, that premium could be replaced by a discount for other businesses seen to have poorer performance. Throughout, there is the risk to a favoured business of something damaging its reputation and so its value. Such changes will be phenomena of the market place and there cannot be any general rule for the impact of these issues on business returns and values.

- 4.4.** The issues on which the concept of sustainability focuses may or may not be relevant to that opinion of value, according to the nature of the business or its assets, the relevant circumstances and the behaviour of prospective buyers. Thus, their relevance may turn on several factors including the extent to which the issues:
- ▶ Are not externalities but relevant to the price someone will pay;
 - ▶ Are of interest as incentives or deterrents to buyers.

In essence, it is a question of how far the evidence shows that a willing, knowledgeable and prudent bidder will take them into account when considering buying a particular business.

- 4.5.** This may also be influenced by market circumstances. Where there is a strong market with a limited supply of businesses, the market may not particularly distinguish between properties on sustainability grounds. However, as these issues come to matter to buyers and occupiers and as more businesses meet currently recognised sustainability criteria, so the market may differentiate on this point, perhaps especially when market sentiment is weak.
- 4.6.** There may be particular classes of bidders to whom sustainability issues may be more important. Most obviously these will include those for whom the ethical aspects matter more, whether out of personal conviction or under the rules of a specific investment fund. Some may be temperamentally interested in innovation – “*early adopters*” or see it as giving them a commercial advantage. Others may see building a reputation as developing resilience against shocks and protecting value.
- 4.7.** Others may see them as criteria relevant to potential future movements in values. They may think that businesses meeting particular standards are more likely to rise in value or that businesses failing to meet them are at greater risk of standing at a discount to a future market. Only the future will prove whether they were right or wrong, whether about the future reactions of markets or the specific criteria they have selected. Where such purchasers have chosen the right criteria and markets prove to move as they expect, then they may outperform the general market whether by buying advantageous businesses or selling ones at greater risk from environmental factors. Markets may, of course, move in unforeseen directions or regard other factors as relevant. The story of sustainability has seen the

emphasis move between particular issues over time, with climate change related concerns now more likely to be dominant.

- 4.8.** Where markets do move towards a greater appreciation of sustainability, whether only, say, for energy or a wider range of issues, then it will be relevant to the assessment of Market Value. In practice, analysing this may often not be a matter of general sustainability, but of appraising the role of specific issues (such as energy) which may interact with operational costs or be currently salient issues in the market place.
- 4.9.** Many may say that they would prefer to invest in businesses that meet a stated standard, but, as can often be seen in such matters, this may be less evident from actual behaviour. It can be hard to tell from market evidence of actual transactions where traditional factors may often appear to explain the outcome. However, the rise of ethical investment funds and policies may give this outlook increasing force in the market place.
- 4.10.** Conversely, as legislation, market sentiment and perhaps taxation increasingly enforce sustainability issues, so the costs of compliance and improvement for many existing businesses may adversely affect their values.
- 4.11.** *"Green Value"* – The concept of *"green"* or *"ethical"* value is sometimes invoked though it can just mean that the *"sustainable"* qualities of businesses may be reflected in their value. While there are no commonly accepted definitions for these and the varied approaches reflect the concerns of the particular parties involved, concern about the risk of *"greenwashing"*, the presentation of investments as more green than is warranted, has led the EU to develop its Green Taxonomy to validate such claims.
- 4.12.** **Approaches** – While ever greater attention is being focused on sustainability issues, it is often commented that they may often not be reflected in Market Values. However, as any one issue becomes of general concern to buyers, so it just becomes part of the general matrix of factors underlying Market Value. Moreover, as some studies show from analysis of larger data samples for transactions, the effects may be subtle but pervasive, not distinct in themselves and possibly only driven by a fraction of buyers or tenants but sufficient to affect values. The effect may, of course, not be that of a premium over other businesses, but that less compliant businesses may be at a discount.

- 4.13.** Sustainability, energy efficiency and green features can only be reflected in the valuation where this is supported by observable market evidence. There is no reason to assume that meeting or failing to meet any aspect of sustainability will automatically and of itself see a premium or discount in the value of a business. The impact of a feature may vary over time, between different sectors, uses or regions.
- 4.14.** All existing valuation methods – whether direct value comparison, income or working from the balance sheet – are suitable for the valuation of businesses. Comparable transactions are often the best proof of the market's willingness to pay for certain features, such as sustainability.
- 4.15.** One practical problem is that sustainability issues do not exist in isolation but, as noted above, will overlap with other factors. For example, energy efficiency might be a virtue, a cost saving, allow a higher quality of working environment and be an aspect of a forward-looking business with greater resilience to current changes. Taken on its own, energy efficiency might not be the decisive factor in value.
- 4.16.** As a practical profession, valuation turns on observation and appraisal. In present circumstances, considering sustainability issues in relation to a business requires careful analysis. It may only rarely be that sustainability issues as a generality will be relevant, but more often that specific issues and particularly, specific standards will be of concern. Standards, certification and rating regimes can summarise and encapsulate information on, say, energy in ways that the market may more easily take into account. It thus becomes more important to know how to:
- ▶ Identify, describe and assess the relevant sustainability characteristics of businesses;
 - ▶ Interpret and judge assessments of them;
 - ▶ Consider whether they are already taken into account so far as they are relevant to value;
 - ▶ Select the appropriate way to take any remaining points into account without double counting.
- 4.17.** Once relevant factors are identified and appraised in this way they can, in principle, be taken into account for valuations in just the same way as any other specific factors. They do not require new valuation methods but rather calm, practical assessment under the terms of the valuation basis instructed. They will need to be covered in the Valuation Report to the extent and in the manner that is appropriate.

- 4.18.** The extent to which the Report refers to sustainability will be a matter of judgment in the circumstances. This will in part reflect the extent to which sustainability issues are relevant to the value and in part the interests of the client. These two points come together where a client interested in sustainability issues instructs a valuation on the basis of Investment Value.
- 4.19.** Any recognised certification or rating awarded to the business should usually be reported.
- 4.20.** Where sustainability issues are relevant to the valuation of a business, the valuer will have to collect appropriate information, appraise it and take it into account in the Valuation Report, either as aspects within the usual structure of the Report or as separate sections, with or without appendices, according to the case. The diversity of businesses and developing nature of sustainability combine to mean that no general check list can be readily appropriate, let alone exhaustive, for this. However, it may, according to the business in question, be relevant to consider some or all of the following possible points as well as others that those points, the business or the valuer's experience might prompt.
- 4.21.** An initial check list of possible points for sustainability review of a business, covering current operations, attention to costs and preparing for the future:
- 4.21.1. Finance, risks and overall sustainability**
- ▶ Is the business financially robust for what it may need to do?
 - ▶ Are its operations vulnerable to climate change or other environmental problems such as flooding, landscape fire or avalanche?
 - ▶ Is the business vulnerable to changes in climate or environmental public policies?
 - ▶ Is the business activity vulnerable to changing public sentiment or market expectations on these grounds?
 - ▶ Are its supply chains vulnerable?
 - ▶ Do these changes offer opportunities to the business?
 - ▶ Are there any objective ratings for sustainability, energy or water efficiency, waste management or other factor?
 - ▶ Is any business property held on a "green lease"?

4.21.2. Energy

- ▶ What is the energy performance certificate rating of its buildings and what might be done to improve it?
- ▶ Is the energy plant or equipment for processes, heating, cooling or other purposes efficient?
- ▶ How would it be replaced?
- ▶ Is energy consumption monitored?
- ▶ What measures are taken to save energy?
- ▶ Are there realistic plans with targets to reduce it?
- ▶ Are renewable sources of energy used?

4.21.3. Water

- ▶ What is the supply? Is it dependent on licences?
- ▶ Is the water plant or equipment efficient?
- ▶ How would it be replaced?
- ▶ Are water consumption and discharge monitored?
- ▶ What measures are taken to save water?
- ▶ Are those factors used to set realistic reduction targets?
- ▶ Is rainwater harvested?

4.21.4. Waste

- ▶ Is the waste hierarchy applied?
- ▶ Are recyclable materials or food waste segregated?
- ▶ Are waste streams monitored?
- ▶ Where does the waste go after collection?
- ▶ Are those factors used to set realistic reduction targets?
- ▶ What measures are taken to reduce waste?
- ▶ Is there contamination of land?
- ▶ Is there asbestos in buildings?

4.21.5. Procurement

- ▶ Are locally or ethically produced goods and services used where possible?
- ▶ Are goods preferred with minimal packaging?
- ▶ Is the re-use and recycling potential for purchased goods considered?

4.21.6. Materials and storage

- ▶ Are fuel, oil and other potentially hazardous liquids stored in secure bunded tanks?
- ▶ Are any flammable materials kept well away from sources of ignition?
- ▶ Are staff trained to manage materials, with accurate records being kept?
- ▶ Are deliveries made to a secure and covered area away from surface water drains?
- ▶ Are potentially harmful chemicals kept in secure storage facilities?

4.21.7. Transport

- ▶ Is business travel minimised by using video conferencing, phone calls or email?
- ▶ Is there a fleet management system that reduces mileage?
- ▶ What use is made of electric or hybrid vehicles?

4.21.8. Staff

- ▶ Are staff fully engaged with the environmental policies?

4.21.9. Compliance and emergency response

- ▶ Does the business have the appropriate licences or permits for its activities?
- ▶ Is it compliant with environmental legislation?
- ▶ Does it have an incident response plan in case of a spillage or incident?
- ▶ Are staff trained in how to respond to a pollution or other incident?

4.21.10. Products

- ▶ Is the life cycle of products considered at the design stage?
- ▶ Is recyclability and re-use potential built in at the design stage?
- ▶ Is the carbon footprint of products assessed?
- ▶ Does the business work with its supply chain to reduce environmental impacts?

4.21.11. Accountability and communication

- ▶ Are details of environmental performance published?
- ▶ Are they communicated through the website, blogs/social media, newsletters, conferences, trade forums or in other ways?
- ▶ What engagement is there with stakeholders or the local community?

4.22. The combination of policy concerns over climate change, resource efficiency and the natural environment, requiring progressive change over the coming years, is increasingly relevant to business decisions and so valuations. Some businesses threatened by the effects of climate change or unable to meet new standards may lose value; others may find value in new opportunities. The expectations of markets will take such factors into account where customers and funding see them as relevant, whether in response to physical facts, sentiment, legislation or taxation. The valuer's task in appraising a business is to understand and interpret these issues, where relevant, and the market's reaction to them, applying professional judgment to the evidence available in finding the value of a business at a given time to enable a client to take informed decisions.



IV. European Business Valuers' Code of Conduct

TEGOVA expects valuers in its member associations to adhere, as a matter of personal responsibility, to this Code which is founded on:

- ▶ The principles of professional behaviour; and
- ▶ The expectation of clients that a valuation will be prepared professionally by a qualified valuer.

Valuers are to uphold and demonstrate professional standards in their work and so safeguard the trust placed in them by clients to whom a duty of care is owed, by regulatory authorities and, more generally, by society.

This TEGOVA Code embeds the values of:

- ▶ Fairness;
- ▶ A proper professional respect for others and for standards;
- ▶ Responsibility and trustworthiness.

Such professional standards extend beyond the requirements of law (which bear on all persons) and require a duty of care to the client and respect for others, acting to the best of the valuer's ability without discriminating against individuals in respect of their nationality, ancestry, race or social origin, colour, religion, belief or political opinion, marital status, gender, gender expression or sexual orientation, age or disability.

A breach of this Code may give rise to disciplinary action by the relevant member association.

The Code

- A.** The valuer must act with honesty, integrity and diligence at all times with a duty of care to the client and otherwise with attention, competence and respect for all parties.
- B.** The valuer must exercise professional judgement objectively and independently in undertaking work and, as relevant, honour the duties of a professional to a court, tribunal or equivalent forum.
- C.** The valuer must maintain a level of professional knowledge and technical skill that is at least that required by the professional valuation body of which the valuer is a member, keeping up to date with professional matters and relevant current developments so as to be competent in professional practice.
- D.** The valuer must accept the client's commission only if he/she has the professional skills, knowledge and competence appropriate to the task undertaken. The valuation work must meet the requirements of a professional service. Professional service determines that the skill, knowledge and competence of the valuer must be appropriate to the type and scale of valuation, with any factor which could compromise an objective assessment being disclosed.
- E.** The valuer must be transparent and accountable to clients in undertaking professional work for them.
- F.** The valuer must avoid all conflicts of interest and must inform the client in writing when one arises and before issuing the Valuation Report.
- G.** The valuer must not disclose privileged or confidential information.
- H.** The valuer must have or be subject to a procedure for handling complaints that may be made concerning professional conduct and must advise clients in writing of its existence.
- I.** The valuer has a duty to provide the national professional valuation body with any significant factual information that reasonably suggests that another member of that body may have violated its Code of Conduct.

Where a valuation must be signed in the name of a valuation company rather than by a named individual valuer, this Code applies to the company and also to any individual employed by the company to undertake valuation work.

V.

European Union
Legislation and
Business Valuation

- 1. General Introduction**
- 2. Valuation for EU Company Law**
- 3. Valuation of Credit Institutions**
- 4. Valuation of Insurance and Reinsurance Institutions**
- 5. Valuation for Investment Funds**
- 6. Valuation for Taxation Legislation**
- 7. Valuation for Transfer Pricing**
- 8. Valuation for State Aid Rules**
- 9. Valuation for Enforcement of Intellectual Property Rights**
- 10. Valuation for Insolvency Proceedings or Restructuring Plans**
- 11. Schedule of EU Legislation**

Caution – This text is prepared as a brief, general review of EU legislation as it may apply to business and/or business valuation. It offers signposts for, not guidance on, what are often complex technical subjects. Most of the legislation under review has been made by Directives. This means that Member States will generally have used their own legislation to implement it. Likewise, many provisions of Regulations may be incorporated and/or supplemented in national legislation. It is thus likely that there will be local features of significance as well as interactions with other domestic law.

The present text is intended to offer general assistance to business valuers in their professional capacity – not in any other role, including the ownership of business – and is based on an understanding of the law as at 1 January 2020. Where an issue is relevant to a valuation, the valuer is advised to seek further specific information or advice on appropriate points.

1. General Introduction

- 1.1. **European Union (EU) legislation and business valuation** – From its creation the EU has sought to promote the internal market in goods, services, labour and capital and to enable fair competition. This has had an important impact on businesses. In particular, there have been a series of Regulations and Directives creating minimum standards for business across the EU. A central aim restated in each of these legislative acts is to reduce the barriers to freedom of establishment of businesses in the EU through a process of harmonising the basic laws. In some cases, they make specific provisions for valuation of businesses as whole, as well as of separate business assets.
- 1.2. **Scope of EU legislation** – Throughout the past decades, the EU has been very active in setting minimum standards to companies covering issues such as formation, capital and disclosure requirements, rules on takeover bids for public limited companies, mergers and divisions, minimum rules for single-member private limited liability companies, financial reporting and accounting and easier and faster access to information on companies. In addition, business and business valuation may also be impacted by specific EU legislation, e.g. in financial services, State aid and IP.
- 1.3. The harmonisation of the national rules on **company law** covers various matters.
- 1.4. For a long time EU law mainly concentrated on regulating listed companies, including financial institutions and insurance undertakings. For instance, Regulation 1606/2002 requires listed companies to prepare their consolidated accounts

taking into account the fair Market Value of their business assets in accordance with the International Financial Reporting Standards (IFRS).

- 1.5. In recent years, the EU has recognised that small and medium-sized enterprises (SMEs) are the backbone of Europe's economy and enabled these companies to operate throughout the Union under a uniform legal framework. Directive 2013/34/EU, known as the "*Accounting Directive*", reduces the administrative burden for small companies with a simplified reporting regime for SMEs and a very light regime for micro-companies with less than 10 employees. This Directive not only sets out general financial reporting principles, such as consistent application of accounting policies and measurement bases from one year to the next to be applied to limited liability types of companies in the EU, but also presents several definitions essential for business valuation.
- 1.6. Other instruments focus on specific legal entities and/or transactions. For instance, Regulation 2157/2001 sets out a statute for a European Company (Societas Europea or 'SE') and requires, inter alia, an independent expert to certify that the company has assets at least equivalent to its capital in the case an SE is willing to convert into a public limited liability company. Directive 2017/1132, as amended by Directive 2019/2121, sets the statutory requirements towards limited liability companies and lays down rules on cross-border conversions, mergers and divisions. It requires a valuation by an independent expert for considerations other than in cash before the company is incorporated or is authorised to commence business. Regulation 1435/2003 on the Statute for a European Cooperative Society (SCE) lays down a similar requirement. Directive 2004/25/EC sets out minimum standards for takeover bids (or changes of control) involving securities of EU companies.
- 1.7. Although income and corporate taxes are not harmonised, national **tax rules** must respect EU legislation. In this context, reference can be made to Directive 2016/1164 that imposes an exit tax on taxpayers transferring their tax residence, business or assets to a low-tax jurisdiction. The amount of the exit tax is equal to the Market Value of the transferred assets at the time of exit of the assets, less their value for tax purposes. This valuation is to be made on the basis of the arm's length principle.
- 1.8. The arm's length principle is also becoming increasingly important in the context of the application of the **State aid rules**. In accordance with the State aid framework, the transfer of assets at a value that is higher than the 'market price' can be qualified as State aid. In this context, the Court of Justice of the European Union (CJEU) has developed the so-called "*private vendor test*" to assess whether a sale carried out by a public body involves State aid, considering whether a

private vendor, under normal market conditions, could have obtained the same or a better price.

- 1.9.** The financial crisis revealed a significant lack of adequate tools at Union level to deal effectively with unsound or failing **credit institutions and investment firms**. Because many Member States had to inject public money into their banking systems to rescue banks, Directive 2014/59/EU aims to avoid 'bail-outs' that involve the use of taxpayers' money in future cases of bank failure and establishes common European rules for the recovery and restructuring of failing banks.
- 1.10.** Commission Delegated Regulations 2016/1075 and 2018/345 supplementing Directive 2014/59/EU recognise valuation as critical to resolution execution. These Regulations also lay down a number of specific provisions as regards the qualifications of the valuer, the criteria the valuer shall consider when performing the valuation and the contents of the Valuation Report.
- 1.11.** To support the resolution authorities in the context of valuation, the European Banking Authority has developed a Handbook on valuation for purposes of resolution providing a non-exhaustive overview of selected aspects of valuation methodologies that could be used when conducting the valuation in accordance with the EU legal and regulatory framework.
- 1.12. Nature and impact of EU legislation** – Most of the EU legislation under review in the following sections has been made by Directives which Member States must implement into their legislation.
- 1.13.** In particular, once a Directive is agreed it is binding as to the result to be achieved within the time specified by that Directive. The effect of a Directive will, thus, depend on how it is drafted. For instance, in **Commission v UK (C-56/90)** the CJEU has ruled that where a Directive prescribes a specific outcome, such as a particular quality of bathing water, that outcome has to be achieved. In such a case, it is not sufficient for a Member State to take all practical steps. Conversely, when a more general 'framework' Directive does not specify outcomes so closely, the compliance with that Directive and its assessment may turn more on the approach the Member States have taken.
- 1.14.** In some cases, the European requirements will interact with other existing domestic regimes or be implemented alongside other domestic measures. In this context, the CJEU ruled in **Marleasing (C-106/89)** that national legislation must, as far as possible, be interpreted *"in the light of the wording and the purpose of*

the directive in order to achieve the result pursued by the latter". Moreover, while EU Regulations apply directly in Member States, they are frequently covered by domestic legislation, supplying further operational matters to ensure an effective implementation.

- 1.15.** In view of these elements, much of this common framework and increasing influence is not directly evident to many who are active in their local marketplaces. However, although much EU legislation is applied through national laws, that does not detract from the EU's key role as the source of much that affects the valuation of businesses.
- 1.16.** **EU legislation and the EBVS** – The current standards provide a brief description of the main policy areas and instruments that, directly or indirectly, have an impact on business and/or business valuation. With the range of EU legislation, that has grown and seems likely to develop substantially, this text can of course not be exhaustive in its review of the Directives and Regulations affecting the valuation of specific businesses, but outlines the most significant areas.

2. Valuation for EU Company Law

2.1. Valuation for statutory needs under EU company law

- 2.1.1. Limited liability companies** – The statutory requirements towards limited liability companies are set by Directive 2017/1132, which codifies and replaces a series of previous directives on certain aspects of European company law, such as:
- ▶ Disclosure of information on companies in business registers;
 - ▶ Capital maintenance;
 - ▶ Divisions of companies;
 - ▶ Mergers within one country;
 - ▶ Cross-border mergers.

This Directive has been amended by Directive 2019/2121 to also include new rules on cross-border conversions, mergers and divisions.

- 2.1.2.** Article 1 of the Directive lays down measures in order to have equivalent safeguards for the protection of the interests of shareholders and third parties, in respect of the following:

- ▶ Establishing public limited liability companies and maintaining and modifying their capital;
 - ▶ Disclosure requirements for public and private limited liability companies in general and for branches opened in a Member State by public and private limited liability companies governed by the law of another Member State or by equivalent non-EU companies;
 - ▶ Mergers of public limited liability companies within a Member State;
 - ▶ Cross-border conversions, mergers and divisions of limited liability companies.
- 2.1.3.** The safeguards required by the Directive include the issuance of a Report by one or more experts on any consideration other than in cash before the company is incorporated or is authorised to commence business (*Article 49*). Likewise, where shares are issued for consideration other than in cash, an expert Report has to be drawn up before the increase in capital is made (*Article 70*).
- 2.1.4.** Such Reports require the involvement of valuers or 'experts' defined as (*Article 49(1)*):
- ▶ Independent of the company;
 - ▶ Appointed or approved by an administrative or judicial authority;
 - ▶ Either natural persons or legal persons and companies and firms under the laws of each Member State.
- 2.1.5.** The experts' Report shall (*Article 49(2) and (3)*):
- ▶ Contain at least a description of each of the assets comprising the consideration as well as of the methods of valuation used;
 - ▶ State whether the values arrived at by the application of those methods correspond at least to the number and nominal value or, where there is no nominal value, to the accountable par and, where appropriate, to the premium on the shares to be issued for them;
 - ▶ Be published in the manner laid down by the laws of each Member State.
- 2.1.6.** In addition, the independent experts shall examine the draft terms of merger and division and draw up a written Report to the shareholders, indicating whether in their opinion the share exchange ratio is fair and reasonable (*Articles 96 and 142*). Their statement shall (*Article 96(2)*):
- ▶ Indicate the method or methods used to arrive at the share exchange ratio proposed;

- ▶ State whether such method or methods are adequate in the case in question, indicate the values arrived at using each such methods and give an opinion on the relative importance attributed to such methods in arriving at the value decided on;
 - ▶ Describe any special valuation difficulties which have arisen.
- 2.1.7. The new rules for cross-border conversions, mergers and divisions of limited liability companies laid down by Directive 2019/2121 provide the requirement of an independent expert Report, as follows:
- ▶ In case of cross-border conversion (*Articles 86f and 86s*);
 - ▶ In case of cross-border merger (*Articles 125 and 133a*);
 - ▶ In case of cross-border division (*Articles 160f and 160t*).

In each case, the expert's opinion must be *"impartial and objective, and [...] given with a view to providing assistance to the competent authority in accordance with the independence and impartiality requirements under the law and professional standards to which the expert is subject"*.

- 2.1.8. Several options are made available to undertakings of at least two Member States which wish to set themselves up as an SE: merger, establishment of a holding company, formation of a subsidiary or conversion into an SE. The SE must take the form of a company with share capital representing a minimum amount of EUR 120 000.
- 2.1.9. The Regulation requires the opinion of an independent expert in following procedures of formation and winding up of an SE:
- ▶ Article 22: to examine the draft terms of merger and draw up a single Report to all the shareholders in the case of an SE formation by merger (expert to be appointed by a judicial or administrative authority in the Member State of one of the merging companies);
 - ▶ Article 32(4): to examine the draft terms of formation and draw up a written Report for the shareholders of each company in the case of a formation of a holding SE (expert to be appointed by judicial or administrative authority in the Member State to which one of the companies promoting the operation or the proposed SE is subject);
 - ▶ Article 37(6): to certify that the company has net assets at least equivalent to its capital plus those reserves which must not be distributed under the law or the Statutes in the case of conversion of an existing public limited liability company into an SE (expert to be appointed by a judicial or administrative authority in the Member State to which the company being converted into an SE is subject);

- ▶ Article 66(5): to certify that the company has assets at least equivalent to its capital in the case an SE is going to be converted into a public limited liability company (expert to be appointed by a judicial or administrative authority in the Member State to which the SE being converted into a public limited liability company is subject).
- 2.1.10. European Cooperative Society (SCE)** – Regulation 1435/2003 on the Statute for a European Cooperative Society (SCE) puts in place a legal statute for the SCE. It enables a cooperative to be established by persons resident in different Member States or by legal entities established under the laws of different Member States. With a minimum capital of EUR 30 000, these new SCEs can operate throughout the Union with a single legal personality, set of rules and structure.
- 2.1.11.** The Regulation requires the opinion of an independent expert in following procedures of formation and winding up of an SCE:
- ▶ Article 26: in the case of formation by merger, the law applicable to the mergers of public limited liability companies concerning the rights and obligations of experts shall apply by analogy to the merger of cooperatives;
 - ▶ Article 35(5): in the case of conversion of an existing cooperative into an SCE, when one or more independent experts appointed or approved by a judicial or administrative authority in the Member State to which the cooperative being converted into an SCE is subject shall certify *mutatis mutandis* that the share-exchange ratio of the subscribed capital and the amount of any cash payment is respected;
 - ▶ Article 76: in the case of conversion of an SCE into a cooperative, when one or more independent experts appointed or approved, in accordance with the national provisions, by a judicial or administrative authority in the Member State to which the SCE being converted into a cooperative is subject, shall certify that the latter has assets at least equivalent to its capital.
- 2.1.12.** The law applicable to public limited liability companies in the Member State where the SCE has its registered office, concerning the appointment of experts and the valuation of any consideration other than cash, shall apply by analogy to the SCE (*Article 4(6)*).
- 2.1.13. Takeover bids** – Directive 2004/25/EC on takeover bids aims to establish minimum guidelines for the conduct of takeover bids involving shares admitted to trading on a regulated market established in the EU. It sets minimum standards for takeover bids or changes of control and aims to protect minority shareholders, employees and other interested parties. One of the measures implemented by the Directive to protect minority shareholders is that anyone gaining control of a company must make a bid at an "*equitable price*" at the earliest opportunity to all holders of securi-

ties (*Article 5(1)*). An "equitable price" is defined as "the highest price the offeror paid for the securities during a 6- to 12-month period prior to the bid" (*Article 5(4)*).

Legislation

Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)

Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees

Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)

Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law

Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions

2.2. Valuation for company accounts

- 2.2.1. Statutory audits** – Companies have to provide a true and fair view of their financial position. The EU has introduced rules to ensure consistent and comparable financial reporting.
- 2.2.2.** Directive 2014/56/EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, sets out the framework for all statutory audits and strengthens public oversight of the audit profession. A statutory audit is a legally required review of financial records. Statutory audits may only be carried out by statutory auditors or audit firms approved by Member States' competent authorities. Member States must keep a public register of these.
- 2.2.3.** Statutory auditors and audit firms should be independent when carrying out statutory audits and conflicts of interest should be avoided. Adequate internal organisation of statutory auditors and audit firms should help to prevent any threats to their independence.
- 2.2.4. Listed companies** – Regulations 1606/2002 and 1126/2008 provide that all consolidated accounts of listed companies must be prepared in accordance with in-

ternational accounting standards. These also include the International Financial Reporting Standards (IFRS).

- 2.2.5. Financial institutions and insurance undertakings** – Directive 2003/51/EC amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. This Directive refers to the “*fair value*” as a general basis of business valuation.
- 2.2.6.** Directive 91/674 on the annual accounts of insurance undertakings explains that in the case of investments other than land and buildings current value shall mean “*Market Value*” (*Article 48(1)*).
- 2.2.7. Companies reporting other than under IFRS** – Directive 2013/34/EU, known as the “*Accounting Directive*”, lays down requirements for the annual financial statements which apply to limited liability companies in the EU. It ensures the clarity and comparability of financial statements other than the IFRS and allows for exemptions or simplifications in financial reporting obligations in many areas for SMEs and micro-undertakings. The main requirements are the following:
- ▶ To ensure the disclosure of comparable and equivalent information, recognition and measurement principles should include the going concern, the prudence, and the accrual bases (*Recital 16*);
 - ▶ The principle of materiality should govern recognition, measurement, presentation, disclosure and consolidation in financial statements (*Recital 17*);
 - ▶ Items recognised in annual financial statements should be measured on the basis of the principle of purchase price or production cost (*Recital 18*);
 - ▶ As systems of fair value accounting provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information, Member States should be allowed to permit or require fair value accounting for assets other than financial instruments (*Recital 19*).

Legislation

Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related Reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

3. Valuation of Credit Institutions

- 3.1. **Banking capital requirements and regulation** – The international Basel agreements seek to impose a prudent framework and so set out a basis for calculating the amount of capital that a lending institution should hold against its liabilities. This framework also provides an approach to assessing values for the physical and financial collateral on which lending has been secured.
- 3.2. The EU has addressed these issues in successive legislation on capital requirements, most recently the Capital Requirements Regulation 575/2013, following the recast Directive 2013/36.
- 3.3. The Capital Requirements regime (now CRD IV) regulates credit institutions and so provides the framework for their operation in the EU's internal market. In doing this, it applies the requirements of the Basel agreements. With its reliance on the valuation of business for this purpose it provides that "*physical collateral other than immovable property*" shall be valued at its Market Value, defined as "*the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction*" ([Article 229\(3\) Capital Requirements Regulation 575/2013](#)).

- 3.4. Recovery and restructuring of failing banks** – Because many Member States had to inject public money into their banking systems in the wake of the 2008 financial crisis, the EU has adopted Directive 2014/59/EU, which establishes common European rules for the recovery and restructuring of failing banks.
- 3.5.** Commission Delegated Regulations 2016/1075 and 2018/345 recognise the crucial role of valuation both before and after resolution and lay down valuation specific provisions:
- ▶ The definitions of "hold value", "disposal value", "franchise value", "equity value" and "independent valuer";
 - ▶ List of qualifications, experience, ability, knowledge and resources the valuer should possess (*Article of 39 of Regulation 2016/1075*);
 - ▶ The general criteria, sources of information and factors the valuer shall consider when performing the valuation (*Article 7 to 12 of Regulation 2018/345*);
 - ▶ Contents of the Valuation Report (*Article 6 of Regulation 2018/345*).
- 3.6.** The Regulations do not deal with valuation methodology but state that *"the valuer shall determine the most appropriate valuation methodologies which may rely on the entity's internal models where the valuer deems it appropriate taking into account the nature of the entity's risk management framework and the quality of data and information available"* (*Article 7(2) of Regulation 2018/345*).
- 3.7.** To support the resolution authorities in the context of valuation, the European Banking Authority has developed a Handbook on valuation for purposes of resolution with a view to operationalising the valuation process. It aims to provide a non-exhaustive overview of selected aspects of valuation methodologies that could be used when conducting the valuation in accordance with the EU legal and regulatory framework, and of the related implementing process.
- 3.8.** Though primarily concentrating on valuation according to the recovery and restructuring of failing banks rules, this Handbook is the first document by EU bodies, containing a description of the recognised business valuation approaches and giving instructions on their application (DCF methodology, Market Value methodology, Adjusted book value based methodology).

Legislation

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012

Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges

Commission Delegated Regulation (EU) 2018/345 of 14 November 2017 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for assessing the value of assets and liabilities of institutions or entities

EBA Handbook of 22 February 2019 on valuation for purposes of resolution

4. Valuation of Insurance and Reinsurance Institutions

- 4.1. The insurance and reinsurance sector is now governed by the Solvency II regime under the framework Directive 2009/138/EC. This Directive requires each institution's Solvency Capital Requirement to be calculated at least once a year. It also provides specific rules for the valuation of assets and liabilities, including technical provisions for the business of insurance or reinsurance.

- 4.2.** The specific rules for the valuation of assets and liabilities are laid down in Article 75(1) of the Directive stating that:

"Member States shall ensure that, unless otherwise stated, insurance and reinsurance undertakings value assets and liabilities as follows:

- (a) assets shall be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction;*
- (b) liabilities shall be valued at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.*

When valuing liabilities under point (b), no adjustment to take account of the own credit standing of the insurance or reinsurance undertaking shall be made."

- 4.3.** Recital 46 of the Directive states that *"valuation standards for supervisory purposes should be compatible with international accounting developments, to the extent possible, to limit the administrative burden [...]"*.

- 4.4.** Directive 2014/51 (Omnibus II) and Regulation 2015/35 (Solvency II Delegated Regulation) amended the Solvency II regime in a number of ways. For instance, Article 9(3) of Regulation 2015/35 provides that, where necessary, Article 75 of Directive 2009/138 prevails over international accounting standards. In addition, Article 2 of the Regulation provides that valuations *"shall be based on the expertise of persons with relevant knowledge, experience and understanding of the risks inherent in the insurance or reinsurance business"* and that valuers have to provide certain qualification proofs.

- 4.5.** The key assumptions underlying the valuation of assets and liabilities of insurance and reinsurance undertakings, as well as approaches to be applied for different classes of assets and liabilities are explained in Chapter II of Regulation 2015/35, stating that insurance and reinsurance undertakings:

- ▶ Shall value assets and liabilities based on the assumption that the undertaking will pursue its business as a going concern;
- ▶ Shall value assets and liabilities in accordance with international accounting standards;
- ▶ Shall value individual assets and individual liabilities separately;
- ▶ Shall follow the valuation hierarchy set out below, taking into account the characteristics of the asset or liability where market participants would take those characteristics into account when pricing the asset or liability at the valuation date, including the condition and location of the asset or liability and restrictions, if any, on the sale or use of the asset;

- ▶ As the default valuation method shall value assets and liabilities using quoted market prices in active markets for the same assets or liabilities;
- ▶ Where the use of quoted market prices in active markets for the same assets or liabilities is not possible, shall value assets and liabilities using quoted market prices in active markets for similar assets and liabilities with adjustments to reflect differences;
- ▶ Use of quoted market prices shall be based on the criteria for active markets, as defined in international accounting standards;
- ▶ When using alternative valuation methods, as little as possible rely on undertaking-specific inputs and make maximum use of relevant market inputs;
- ▶ Shall value the goodwill and intangible assets other than goodwill, unless the intangible asset can be sold separately at zero.

Legislation

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (Omnibus II)

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

5. Valuation for Investment Funds

- 5.1. Different investment funds** – Investment funds are financial products collecting investors' money, and investing the pooled capital through a portfolio of financial instruments. The most common investment funds in Europe are undertakings for collective investment in transferable securities (UCITS) which are sold to retail investors. They are regulated by Directive 2009/65/EC as amended by Directive 2014/91/EU (the "*UCITS Directive*"). Funds that are not regulated at EU level by the UCITS Directive, including real estate funds, hedge funds and private equity funds, are alternative investment funds. They are designed for professional investors

and are regulated by Directive 2011/61/EU on Alternative Investment Fund Managers (the "AIFM Directive").

- 5.2. Valuation for UCITS** – The rules for the valuation of assets and for the calculation of the sale or issue price and the repurchase or redemption price of the units of a UCITS shall be laid down in the national law, in the fund rules or in the instruments of incorporation of the investment company (*Article 85 of the UCITS Directive*).
- 5.3.** In case of merger of UCITS, a depositary or an independent auditor approved in accordance with Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts should draw-up a Report on behalf of all the UCITS involved. This Report should validate the valuation methods of the assets and liabilities of the UCITS and the calculation method of the exchange ratio set out in the common draft terms of merger as well as the actual exchange ratio and, where applicable, the cash payment per unit. In order to limit costs connected with cross-border mergers, it should be possible for the statutory auditor of the merging or the receiving UCITS to draw up a single Report for all UCITS involved in the merger.
- 5.4. Valuation for alternative investment funds** – The AIFM Directive lays down rules for the valuation of assets and the calculation of the net asset value per unit or share of alternative investment funds.
- 5.5.** The main rules of the AIFM Directive are:
- ▶ The process for valuation of assets and calculation of the net asset value should be functionally independent from the portfolio management and the remuneration policy of the AIFM and other measures should ensure the prevention of conflicts of interest and of undue influence on the employees (*Recital 29*);
 - ▶ The valuation procedures shall ensure that the assets are valued and the net asset value per unit or share is calculated at least once a year (*Article 19(3)*);
 - ▶ Subject to certain conditions and qualifications, AIFMs should be able to appoint an external valuer to perform the valuation function (*Article 19(5)*).

Legislation

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

6. Valuation for Taxation Legislation

6.1. Value Added Tax (VAT)

- 6.1.1. VAT Directive** – VAT is a tax on the value added in the supply of goods and services. The current EU legislation is the Seventh VAT Directive 2006/112. This Directive provides a common framework regarding the scope of application (*Articles 1 to 30*), the way VAT is applied (*Article 31 to 92*), the standard rates (*Articles 93 to 130*), the exemptions (*Articles 131 to 166*) and the deductions (*Articles 167 to 192*).
- 6.1.2. Importance for business valuation** – The Directive contains different provisions which are to be considered during the business valuation process due to their impact on cash flows. It is crucial for the businesses performing cross-border activities, as well as for real property based holding and development businesses.
- 6.1.3. While salaries and finance are not subject to VAT, where VAT is levied on a transaction it can be a significant factor in several ways:**
- ▶ While most businesses can recover VAT on qualifying inputs, it is still a pressure on cash flow;
 - ▶ Where a party to a transaction is not registered for VAT it cannot recover it on inputs.
- 6.1.4. Taxable persons and transactions** – VAT is applied to all transactions carried out in the EU for consideration (payment) by a taxable person, i.e. any individual or body that supplies taxable goods and services in the course of business (*Articles 12 and 13*). Imports are also subject to VAT. Taxable transactions include supplies of goods or services within a single Member State, intra-EU acquisitions of goods (goods supplied and dispatched or transported by a business in one Member State to a business in another) and imports of goods into the EU from outside (*Articles 14 to 30*).

- 6.1.5. Transfer of rights, shares and interests** – Member States may consider the transfer of the following rights, interests and shares as a transfer of goods: (i) certain interests in immovable property, (ii) rights in rem giving the holder thereof a right of use over immovable property and (iii) shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof (*Article 15(2)*).
- 6.1.6. Treatment of non-operational business assets** – Article 16 of the Directive stipulates that the application by a taxable person of goods forming part of his business assets for his private use or for that of his staff, or their disposal free of charge or, more generally, their application for purposes other than those of his business, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible. However, the application of goods for business use as samples shall not be treated as a supply of goods for consideration.
- 6.1.7. Cross-border transfer of tangible business assets** – The transfer by a taxable person of goods forming part of his business assets to another Member State shall in principle be treated as a supply of goods for consideration (*Article 17(1)*). However, there are certain exemptions to this rule (*Article 17(2)*).
- 6.1.8. Transfer of a going concern** – Member States may consider the transfer “of a total-ity of assets or part thereof” is not a supply of goods but that instead the new owner is simply treated as the successor of the transferor (*Article 19*).
- 6.1.9. Taxable amount for the sale or disposal of business assets** – According to Article 74 of the Directive, the taxable amount for the sale or disposal of business assets shall be the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time when the application, disposal or retention takes place. This should be considered when valuing businesses with limited lives, whose terminal value constitutes sale of assets proceeds, as well as when applying asset based valuation approaches.

Legislation

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax

6.2. Indirect tax on raising capital

- 6.2.1. Directive 2008/7/EC concerning indirect taxes on the raising of capital prohibits the levying of indirect taxes on certain transactions.
- 6.2.2. However, pursuant to Article 7(1) of the Directive, Member States that charged a duty on capital contributions as at 1 January 2006 may continue to do so under the conditions set forth in the Directive.
- 6.2.3. According to Article 11 of the Directive, one of these conditions concerns the basis of assessment of the capital duty. As regards the following types of capital contributions, the capital duty should be based on the actual value of the assets, after the deduction of liabilities and expenses borne by the company:
- ▶ The formation of a capital company;
 - ▶ An increase in the capital of a capital company by contribution of assets of any kind;
 - ▶ An increase in the assets of a capital company by contribution of assets of any kind, in consideration not of shares in the capital or assets of the company, but of rights of the same kind as those of members, such as voting rights, a share in the profits or a share in the surplus upon liquidation;
 - ▶ The transfer from a third country to a Member State of the centre of effective management of a capital company whose registered office is in a third country;
 - ▶ The transfer from a third country to a Member State of the registered office of a capital company whose centre of effective management is in a third country;
 - ▶ An increase in the assets of a capital company through the provision of services by a member which does not entail an increase in the company's capital, but which does result in a variation in the rights in the company or which may increase the value of the company's shares.

Legislation

Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital

6.3. Corporate tax

- 6.3.1.** In the Action Plan for a Fair and Efficient Corporate Tax System in the EU, the European Commission set out that the EU needs a framework for fair and efficient corporate taxation, in order to distribute the tax burden equitably, to promote sustainable growth and investment, to diversify funding sources of the European economy and to strengthen the EU's competitiveness.
- 6.3.2.** In 2016 the European Commission presented an Anti-Tax Avoidance Package which underlined that "[a] coordinated approach to implementing growth-friendly tax systems and tackling cross-border problems is essential for a well-functioning Single Market".
- 6.3.3.** Directive 2016/1164 preventing corporate tax avoidance contains measures against base erosion and profit shifting (BEPS), i.e. aggressive tax avoidance strategies that are intended to exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. The Directive applies to all taxpayers that are subject to corporate tax in one or more Member States.
- 6.3.4.** The Directive lays down four sets of rules against BEPS:
- ▶ Interest limitation rules: these rules regulate the amount of interest that a taxpayer may deduct;
 - ▶ Exit taxation rules: these rules impose an exit tax when a taxpayer is transferring its tax residence, business or assets to a low-tax jurisdiction;
 - ▶ General anti-abuse rule: this rule obliges Member States to deny taxpayers the benefit of abusive tax arrangements;
 - ▶ Controlled foreign company rules: these rules reattribute the income of a low-taxed controlled foreign subsidiary to its more highly taxed parent company.
- 6.3.5.** Article 5(1) of the Directive provides that the amount of the exit tax is equal to the Market Value of the transferred assets, at the time of exit of the assets, less their value for tax purposes. The notion of "Market Value" is defined as "the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction".
- 6.3.6.** To ensure the effective taxation of profits in the EU, the European Commission and Member States have also taken action through the rules on transfer pricing and the State aid rules.

Legislation

Communication from the Commission to the European Parliament and the Council of 17 June 2015 – A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action

Communication from the Commission to the European Parliament and the Council of 28 January 2016 – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU

Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

7. Valuation for Transfer Pricing

- 7.1. In a world of increasingly integrated national economies, rapidly progressing technology and growing transportation and communication, the role of Multinational Enterprises (MNEs) in international cross-border trade has become ever more important.
- 7.2. As a result of this trend, intra-group transactions have multiplied which, in turn, have brought attention to the prices charged for 'controlled' transactions between various parts of the same corporate group. These transfer prices are not inherently market prices that apply in 'uncontrolled' transactions established between unrelated parties who act independently. As a matter of fact, since MNEs have a financial incentive to allocate as little profit as possible to jurisdictions where those profits are subject to higher taxation, this could lead to exaggerated transfer prices which should not be accepted as a basis for calculating taxable income.
- 7.3. In particular, the definition of transfer prices of intangible assets is a complex issue due to the specifics of transactions involving intangibles. Intangibles are assets that do not have any physical or financial embodiment (e.g. trade secrets, trademarks, copyrights, permits and concessions, customer contracts or the production backlog). This special character makes it difficult to determine their value at the time of a transaction. Moreover, the (re)location of intangible assets is easier than for tangible assets (e.g. machinery or factories). This strengthens the likelihood that intangibles are transferred for less than their Market Value or that the intangible assets are allocated to low-tax environments in transactions that would be unlikely to occur between unrelated parties.
- 7.4. Transfer pricing legislation in the EU is not harmonised.

- 7.5.** The current situation as regards application of the transfer pricing rules is such that all the Member States have adopted or are following the non-binding Transfer Pricing Guidelines of the Organisation for Economic Co-operation and Development (OECD).
- 7.6.** In its decision of 21 October 2010 on State aid SA.38374 implemented by the Netherlands to Starbucks, the European Commission extensively referred to the OECD Guidelines because it believes *"those guidelines are an existing manual in the area of transfer pricing that are the result of expert discussions in the context of the OECD and elaborate on techniques aimed to address common challenges of the application of the arm's length principle to concrete situations"*. This has been confirmed by the General Court in **Netherlands v Commission** (T-760/15 and T-636/16), underlining that the Guidelines *"reflect the international consensus achieved with regard to transfer pricing"*.
- 7.7.** The central concept of the Transfer Pricing Guidelines is the so-called arm's length principle. This principle is set out in point 1.6 of the Transfer Pricing Guidelines that states the following:
- "By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances (i.e. in 'comparable uncontrolled transactions'), the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of the transactions between those members and on whether the conditions thereof differ from the conditions that would be obtained in comparable uncontrolled transactions. Such an analysis of the controlled and uncontrolled transactions, which is referred to as a 'comparability analysis', is at the heart of the application of the arm's length principle."*
- 7.8.** The application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent parties. This so-called *"comparability analysis"* has two key aspects, namely:
- ▶ The identification of the commercial and financial relations between the associated enterprises, the conditions and economically relevant circumstances attaching to these relations in order that the controlled transaction be accurately delineated;

- ▶ The search for comparables, described in point 1.33 of the Transfer Pricing Guidelines as the comparison of *"the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises"*.

7.9. These two aspects are of course closely linked since the delineation of the transaction necessarily has significant consequences on the result of the comparability analysis. The better the facts and circumstances of the transaction and the functions, assets and risks are defined, the more accurate the search for comparables will be.

7.10. The economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between the associated enterprises in order to accurately delineate the actual transaction can be broadly categorised as follows:

- ▶ The functions performed by the parties to the transaction;
- ▶ The contractual terms of the transaction;
- ▶ The economic circumstances of the parties and of the market in which the parties operate;
- ▶ The nature of the goods and/or services supplied.

7.11. As regards the search for comparable data, a balance needs to be found between, on the one hand, care, thought and analysis and, on the other hand, consistency and objectivity. In this context, the EU Joint Transfer Pricing Forum (JTPF) issued a Report on the Use of Comparables in the EU with various recommendations and best practices to increase the objectivity and transparency of comparable searches for transfer pricing. In 2016 the European Commission accepted the Study on Comparable data used for Transfer Pricing in the EU, which provides an overview and assessment of the availability and quality of market data used for transfer pricing purposes in the EU. Furthermore, it assesses and evaluates situations characterising the lack and/or non-reliability of comparable data as well as the situation for pan-European comparable searches.

7.12. The Transfer Pricing Guidelines provide both 'traditional transaction methods' and 'transactional profit methods' that can be used to establish whether the conditions imposed in the relations between associated enterprises are consistent with the arm's length principle. The traditional transaction methods include the comparable uncontrolled price method, the resale price method and the cost plus method,

whereas the transactional net margin method and the transactional profit split method are to be qualified as transactional profit methods.

- 7.13.** Although the Guidelines declare an express preference for traditional transaction methods *"as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are arm's length"*, it is explained that no method is suitable in every possible situation. In particular, the selection of the most appropriate transfer pricing method should take into account a number of factors, such as the appropriateness of the method considered in view of the controlled transaction, the availability of reliable information and the degree of comparability between controlled and uncontrolled transactions.
- 7.14.** In December 2016 the European Commission accepted the Study on the Application of Economic Valuation Techniques for Determining Transfer Prices of Cross Border Transactions between Members of Multinational Enterprise Groups in the EU. This Study provides an overview on how valuation techniques can practically and most efficiently be used for transfer pricing purposes in the EU, particularly for transactions involving intangibles. In the same vein, the JTPF agreed the Report on the Use of Economic Valuation Techniques in Transfer Pricing that provides a comprehensive description of economic valuation techniques for transfer pricing purposes.

Legislation

Study on Comparable data used for Transfer Pricing in the EU (Specific contract no.5 under framework contract TAXUD/2014/CC/126)

Study on the Application of Economic Valuation Techniques for Determining Transfer Prices of Cross Border Transactions between Members of Multinational Enterprise Groups in the EU (Specific contract no.6 under framework contract TAXUD/2014/CC/126)

JTPF Report on the Use of Comparables in the EU

JTPF Report on the Use of Economic Valuation Techniques in Transfer Pricing

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

8. Valuation for State Aid Rules

8.1. With the promotion of an open internal market, the EU has sought to regulate the extent to which governments and public bodies can use subsidy, both express and implied, as a protectionist tool, distorting the free operation of that market. The State aid rules have been a major part of this policy, providing a legal framework in which actions in Member States can be regulated, approved or forbidden.

8.2. In this context, Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) provides the following:

"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

8.3. Valuation and the existence of State aid – Article 107(1) TFEU sets out four cumulative conditions for a measure to be considered as State aid. In particular, the measure must (i) give the recipient an economic advantage, (ii) be financed by the State or through State resources, (iii) selectively favour certain undertakings or the production of certain goods and (iv) distort competition and affect trade between Member States.

8.4. In 2016 the European Commission issued the Notice on the notion of State aid that gives general guidance on all aspects of the definition of State aid. The Notice gives clear guidance on when public spending falls within, and outside, the scope of EU State aid control.

8.5. In the context of business valuation, the main element will be to determine the existence/size of an economic advantage.

8.6. The notion of *"advantage"* is not defined in the TFEU, but the CJEU has ruled that it is to be interpreted in a broad manner. It embraces not only positive benefits, but also interventions which mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect. In short, an advantage within the meaning of Article 107(1) TFEU can be defined as any economic benefit which an undertaking would not have obtained under normal market conditions.

- 8.7. The market economy operator (MEO) test** – Economic transactions carried out by public bodies (including public undertakings) do not confer an advantage, and therefore do not constitute State aid, if they are carried out in line with normal market conditions. To assess whether a range of economic transactions carried out by public bodies takes place under normal market conditions, the European Commission and the CJEU developed the MEO test. The purpose of this test is to assess whether the public bodies acted as a market economy operator would have done in a similar situation. If this is not the case, the beneficiary undertaking has received an economic advantage which it would not have obtained under normal market conditions, placing it in a more favourable position compared to that of its competitors.
- 8.8.** This principle has been developed with regard to different economic transactions. The "*market economy investor principle*" is used to identify the presence of State aid in cases of public investment. The "*private creditor test*" has been developed to examine whether debt renegotiations by public creditors involve State aid, comparing the behaviour of a public creditor to that of hypothetical private creditors that find themselves in a similar situation. Finally, the CJEU has developed the "*private vendor test*" to assess whether a sale carried out by a public body involves State aid, considering whether a private vendor, under normal market conditions, could have obtained the same or a better price.
- 8.9.** The application of the MEO test depends on the available information. In this context, a distinction should be made between situations in which the transaction's compliance with market conditions can be directly established through transaction-specific market data and situations in which, due to the absence of such data, the transaction's compliance with market conditions has to be assessed on the basis of other available methods.
- 8.10.** A transaction's compliance with market conditions can be directly established through transaction-specific market information (i) where the transaction is carried out "*pari passu*" by public entities and private operators or (ii) where it concerns the sale and purchase of assets, goods and services (or other comparable transactions) carried out through a competitive, transparent non-discriminatory and unconditional tender procedure in line with the principles of the TFEU on public procurement. In such cases, if the specific market information concerning the transaction shows that it does not comply with market conditions, it would not normally be appropriate to use other assessment methodologies to reach a different conclusion.
- 8.11.** If a transaction has not been realised through a tender, or if the intervention of the public bodies is not "*pari passu*" with that of private operators, this does not

automatically mean that the transaction does not comply with market conditions. In such cases compliance with market conditions can still be assessed in the light of the terms under which comparable transactions carried out by comparable private operators have taken place in comparable situations (benchmarking) or on the basis of a standard assessment methods (e.g. the internal rate of return or the net present value).

- 8.12.** The European Commission also issued a Guidance Paper on state aid-compliant financing, restructuring and privatisation of State-owned enterprises. This Guidance Paper provides a basis, which must be complied with when carrying out financing, restructuring and/or privatisation of State-owned enterprises. The Paper explains that when the privatisation is effected by an Initial Public Offering or sale of shares on the stock exchange, it is generally assumed to be on market conditions and not to involve State aid.
- 8.13. Compensation for the provision of a service of general economic interest (SGEI)** – In the *Altmark* judgment (C-280/00), the CJEU made clear that the granting of an advantage can be excluded as regards compensation for costs incurred to provide an SGEI. This exception is however subject to strict conditions. One of these conditions is that the SGEI provider should to be selected following a public procurement procedure to select a tenderer capable of providing the service at the least cost to the community or, in the absence of such procedure, the level of compensation should be determined on the basis of an analysis of the costs which a typical undertaking, well-run and adequately provided with means to meet the public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.
- 8.14.** The European Commission adopted the so-called SGEI Package for SGEI compensations that do not meet this strict condition.
- 8.15.** The *de minimis* Regulation exempts from State aid rules aid of up to EUR 500 000 per company over a three-year period that is granted as compensation for the provision of an SGEI. Compensation of this magnitude is deemed not to constitute State aid because it does not affect competition or trade between Member States.
- 8.16.** As part of the SGEI Package, the Commission also adopted a Decision that exempts Member States from the obligation to notify public service compensation for certain SGEI-categories to the European Commission. The exemption applies to compensations not exceeding an annual amount of EUR 15 million. Hospitals and providers of SGEIs meeting certain social needs (e.g. social housing and

childcare), however, benefit from the application of the Decision regardless of the amount of compensation. Article 5(1) of the Decision sets out that, to be exempted from notification, the amount of compensation may not exceed what is necessary to cover the net cost incurred in discharging the public service obligations, including a reasonable profit, to be calculated under the following rules:

- ▶ The net cost may be calculated as the difference between costs and revenues. Alternatively, it may be calculated as the difference between the net cost for the undertaking of operating with the SGEI on and the net cost or profit of the same undertaking operating without the SGEI;
- ▶ The costs comprise all the costs incurred in operating the SGEI;
- ▶ The revenue shall include at least the entire revenue earned from the SGEI, regardless of whether the revenue is classified as State aid within the meaning of Article 107 TFEU;
- ▶ The notion of "*reasonable profit*" refers to the rate of return on capital that would be required by a typical undertaking considering whether or not to provide the SGEI, taking into account the level of risk. The rate of return on capital means the internal rate of return that the undertaking makes on its invested capital over the duration of the period of entrustment. The level of risk depends on the sector concerned, the type of service and the characteristics of the compensation. Where, by reasons of specific circumstances, it is not appropriate to use the rate of return on capital, Member States may rely on profit level indicators other than the rate of return on capital to determine what the reasonable profit should be, such as the average return on equity, return on capital employed, return on assets or return on sales.

8.17. Finally, the Commission adopted a Framework for assessing large compensation amounts granted to operators outside the social services field. Those cases have to be notified to the Commission and may be declared compatible if they meet certain criteria. The new rules introduce, in particular, a more precise methodology to determine the amount of compensation, a requirement for Member States to introduce efficiency incentives in compensation mechanisms and the requirement to comply with EU public procurement rules.

8.18. Tax rulings – Tax rulings as such are not considered in breach of State aid rules, if the rulings simply confirm that tax arrangements between companies within the same group comply with the relevant tax legislation. However, there will be an advantage in the event the public authorities grant certain undertakings a favourable tax treatment which places them in a more favourable financial position than other taxpayers. In this context, the General Court has confirmed in **Netherlands v Commission** (T-760/15 and T-636/16) that Article 107(1) TFEU allows the European Commission to check whether the pricing of an integrated company corresponds

to pricing under market conditions, in order to determine whether an advantage may have been granted to that undertaking. In addition, the Court made clear that the arm's length principle described in the OECD Guidelines on Transfer Pricing can be used as an instrument for making that comparison.

- 8.19. Valuation and the compatibility of State aid** – Valuation is not only a key factor to determine the existence/size of an economic advantage. In some cases, the valuation of assets may also be important in order to declare State aid compatible with the internal market. For instance, reference can be made to the Communication from the Commission on the treatment of impaired assets in the Community banking sector that sets out criteria for the compatibility of asset relief measures. In this context, the Commission points out that a correct and consistent approach to the valuation of eligible assets is important to prevent undue distortions of competition and to avoid subsidy races between Member States. In addition, it is underlined that the valuation must be based on internationally recognised standards and benchmarks and that, when assessing the valuation methods put forward by Member States, the Commission will consult panels of valuation experts.

Legislation

Treaty on the Functioning of the European Union

Communication from the Commission on the treatment of impaired assets in the Community banking sector

Commission Decision of 20 December 2011 on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest

Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011)

Commission Guidance Paper of 10 February 2012 on state aid-compliant financing, restructuring and privatisation of State-owned enterprises

Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 TFEU to de minimis aid granted to undertakings providing services of general economic interest

Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) TFEU

9. Valuation for Enforcement of Intellectual Property Rights

- 9.1.** According to a Guidance Communication issued by the European Commission, intangible assets account for more than half the value of companies, and their importance is growing. As European companies are increasingly competing on innovation, creativity and quality, intellectual property rights are a strong tool for increasing the competitiveness of all companies, including SMEs.
- 9.2.** Directive 2004/48/EC on the enforcement of intellectual property rights provides for a minimum but standard set of measures, procedures and remedies that allow effective civil enforcement of intellectual property rights. It aims to ensure a high, equivalent and homogeneous level of protection in the internal market by reconciling national legislative systems.
- 9.3.** Article 13 of the Directive states that the Member States shall ensure that the competent judicial authorities, on application of the injured party, order the infringer who knowingly, or with reasonable grounds to know, engaged in an infringing activity, to pay the rightholder damages appropriate to the actual prejudice suffered by her/him as a result of the infringement.
- 9.4.** According to Recital 26 of the Directive, the aim of providing damages is not to introduce an obligation to provide for punitive damages but to allow for compensation based on an objective criterion while taking account of the expenses incurred by the rightholder, such as the costs of identification and research. Article 13(1) of the Directive provides that the judicial authorities shall:
- ▶ Take into account all appropriate aspects, such as the negative economic consequences, including lost profits, which the injured party has suffered, any unfair profits made by the infringer and, in appropriate cases, elements other than economic factors, such as the moral prejudice caused to the rightholder by the infringement; or
 - ▶ Alternatively they may, in appropriate cases, set the damages as a lump sum on the basis of elements such as at least the amount of royalties or fees which would have been due if the infringer had requested authorisation to use the intellectual property right in question.
- 9.5.** Article 13(2) of the Directive further states that where the infringer did not knowingly, or with reasonable grounds know, engage in infringing activity, Member States may lay down that the judicial authorities may order the recovery of profits or the payment of damages, which may be pre-established.

- 9.6.** In November 2017 the European Commission adopted, as part of the IP Package, the Guidance Communication clarifying the provisions of the Directive where there have been differing interpretations in Member States, related to its scope, rules on obtaining and preserving evidence, injunctions, or calculation of damages. This Guidance takes into account the case law of the CJEU and best practice developed in Member States.
- 9.7.** In 2013 the European Commission appointed a panel of intellectual property rights valuation experts drawn from a range of disciplines including those involved with accounting, business valuation, damage award activities and intellectual property rights consulting and litigation. This Expert Group received the mandate to review valuation methods for intellectual property rights and their use, to identify bottlenecks in the valuation methods used for the purpose of a company's financial reporting, access to finance and litigation, to identify good practices and to recommend possible policy actions. The results of this Expert Group are summarised in Final Report of 29 November 2013, which provides valuable advice on the valuation of intellectual property rights.

Legislation

Directive 2004/48/EC on the enforcement of intellectual property rights

Final Report from the Expert Group on Intellectual Property Valuation of 29 November 2013

Guidance Communication on certain aspects of Directive 2004/48/EC of the European Parliament and of the Council on the enforcement of intellectual property rights

10. Valuation for Insolvency Proceedings or Restructuring Plans

- 10.1.** Regulation 2015/848 on insolvency proceedings helps to resolve conflicts of jurisdiction and laws and ensures the recognition of judgments across the EU.
- 10.2.** The relevant rules for business valuation assignments include the following:
- ▶ Once a judgment opening insolvency proceedings in one Member State becomes effective it must be recognised in all other Member States with the same effect;

- ▶ Proceedings take place in the courts of the Member State where the debtor's main interests are centred, and the applicable law is that of the country in which the proceedings take place;
- ▶ If the debtor has a place of operation in another Member State than the one where the debtor's main interests are centred, that Member State may also open insolvency proceedings against the debtor in so far as these 'secondary proceedings' are limited to the assets held in that Member State.

10.3. Directive 2019/1023 on restructuring and insolvency aims to remove obstacles which result from differences between national laws and procedures concerning preventive restructuring, insolvency, discharge of debt, and disqualifications and to ensure that:

- ▶ Enterprises and entrepreneurs that are in financial difficulties have access to effective national preventive restructuring frameworks which enable them to continue operating;
- ▶ Honest insolvent or over-indebted entrepreneurs can benefit from a full discharge of debt after a reasonable period of time, thereby allowing them a second chance;
- ▶ The effectiveness of procedures concerning restructuring, insolvency and discharge of debt is improved.

10.4. Where Member States opt to carry out a valuation of the debtor as a going concern, the going-concern value should take into account the debtor's business in the longer term. This value is, as a rule, higher than the liquidation value because it is based on the assumption that the business continues its activity with the minimum disruption, has the confidence of financial creditors, shareholders and clients, continues to generate revenues and limits the impact on workers (*Recital 49*).

10.5. Judicial or administrative authorities shall decide on the valuation of a business if a dissenting affected party challenges the restructuring plan. For this purpose, judicial or administrative authorities may appoint or hear properly qualified experts (*Article 14*). Where the decision to carry out a valuation is taken, Member States should be able to provide for special rules, separate from general civil procedural law, for a valuation in restructuring cases, with a view to ensuring that it is carried out in an expedited manner (*Recital 63*).

Legislation

Regulation (EU) No 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132

11. Schedule of EU Legislation**11.1. Valuation for Statutory Needs**

Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)

Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees

Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)

Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law

Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions

11.2. Valuation for Company Accounts

Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings

Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC

on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council

Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related Reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts

11.3. Valuation of Credit Institutions

Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012

Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers,

the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges

Commission Delegated Regulation (EU) 2018/345 of 14 November 2017 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria relating to the methodology for assessing the value of assets and liabilities of institutions or entities

EBA Handbook of 22 February 2019 on valuation for purposes of resolution

11.4. Valuation of Insurance and Reinsurance Institutions

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (Omnibus II)

Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

11.5. Valuation for Investment Funds

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

11.6. Valuation for Value Added Tax (VAT)

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax

11.7. Valuation for Indirect Tax on Raising Capital

Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital

11.8. Valuation for Corporate Tax

Communication from the Commission to the European Parliament and the Council of 17 June 2015 – A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action

Communication from the Commission to the European Parliament and the Council of 28 January 2016 – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU

Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

11.9. Valuation for Transfer Pricing

Study on Comparable data used for Transfer Pricing in the EU (Specific contract no.5 under framework contract TAXUD/2014/CC/126)

Study on the Application of Economic Valuation Techniques for Determining Transfer Prices of Cross Border Transactions between Members of Multinational Enterprise Groups in the EU (Specific contract no.6 under framework contract TAXUD/2014/CC/126)

JTPF Report on the Use of Comparables in the EU

JTPF Report on the Use of Economic Valuation Techniques in Transfer Pricing

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

11.10. Valuation for State Aid Rules

Treaty on the Functioning of the European Union

Communication from the Commission on the treatment of impaired assets in the Community banking sector

Commission Decision of 20 December 2011 on the application of Article 106(2) TFEU to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest

Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011)

Commission Guidance Paper of 10 February 2012 on state aid-compliant financing, restructuring and privatisation of State-owned enterprises

Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 TFEU to de minimis aid granted to undertakings providing services of general economic interest

Commission Notice of 19 July 2016 on the notion of State aid as referred to in Article 107(1) TFEU

11.11. Valuation for Enforcement of Intellectual Property Rights

Directive 2004/48/EC on the enforcement of intellectual property rights

Final Report from the Expert Group on Intellectual Property Valuation of 29 November 2013

Guidance Communication on certain aspects of Directive 2004/48/EC of the European Parliament and of the Council on the enforcement of intellectual property rights

11.12. Valuation for Insolvency Proceedings or Restructuring Plans

Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132

MEMBERSHIP OF TEGOVA

Albania

Shoqëria e Vlerësuesve të Pasurive të Paluajtshme (SVP)
Albanian Society of Property Appraisers (ASPA)

Austria

Österreichischer Verband der Immobilienwirtschaft (ÖVI)
Austrian Real Estate Association

Verband Österreichischer Immobiliensachverständiger (ARE)
Austrian Association of Real Estate Experts

Belgium

Union des Géomètres-Experts de Bruxelles (UGEB-ULEB)
Union of Expert Surveyors of Brussels

Bosnia & Herzegovina

Udruženje Ekspertata Iz Oblasti Nekretnina u Bosni i Hercegovini (BHPA)
Bosnian & Herzegovinian Property Association

Udruženje Ovlašćenih Procjenjivača u Bosni i Hercegovini (UOPBIH)
Association of Certified Appraisers in Bosnia & Herzegovina

Bulgaria

Chamber of Independent Appraisers in Bulgaria (CIAB)
Камарата на независимите оценители в България (КНОБ)

Chamber of Professional Valuers (CPV)
Камара на професионалните оценители (КПО)

Canada

Appraisal Institute of Canada (AIC) / Institut Canadien des Évaluateurs (ICE)

Croatia

Hrvatsko Društvo Sudskih Vještaka i Procjenitelja (HDSViP)
Croatian Association of Court Expert Witnesses and Valuers – CACEWaV

Cyprus

Cyprus Valuers Association (CVA)
Σύνδεσμος Επιστημόνων Εκτιμητών Ακινήτων Κύπρου

Czech Republic

Ceska Komora Odhadcu Majetku (CKOM)
The Czech Chamber of Appraisers (CCA)

Denmark

Dansk Ejendomsmaeglerforening (DE)
The Danish Association of Chartered Estate Agents

France

Association Française des Sociétés d'Expertise Immobilière (AFREXIM)
French Association of Property Valuation Companies

Chambre des Experts Immobiliers de France (CEIF-FNAIM)
Chamber of Real Estate Valuers of France

Compagnie Nationale des Experts Immobiliers (CNEI)
National Company of Real Estate Experts

Confédération des Experts Fonciers (CEF)
Confederation of Land Valuers

Conseil Supérieur du Notariat (CSN)
High Council for the Notarial Profession

Institut Français de l'Expertise Immobilière (IFEI)
French Institute of Real Estate Valuation

Syndicat National des Professionnels Immobiliers (SNPI)
National Association of Real Estate Professionals

Union des Syndicats de l'Immobilier (UNIS)
National Union of Property Professions

Georgia

საქართველოს დამოუკიდებელ შემფასებელთა საზოგადოება
Independent Valuers Society of Georgia (IVSG)

Germany

Bund der Öffentlich Bestellten Vermessungsingenieure e.V. (BDVI)
German Association of Publicly Appointed Surveyors

**Bundesverband Öffentlich Bestellter und Vereidigter Sowie Qualifizierter
Achverständiger (BVS)**
Association of Publicly Certified and Qualified Experts

Immobilienverband Deutschland IVD Bundesverband der Immobilienberater, Makler, Verwalter, und Sachverständigen e.V. (IVD)
German Real Estate Professional Association

Greece

Συλλογος Εκτιμητων Ελλαδος (ΣΕΚΕ)
Association of Greek Valuers (AVAG)

Peoplecert Hellas
Certification body

Hungary

Magyar Ingatlanszövetség (MAISZ)
Hungarian Real Estate Association (HREA)

Ireland

Institute of Professional Auctioneers and Valuers (IPAV)

Italy

Associazione Società di Valutazioni Immobiliari per le Banche (ASSOVIB)

Association of Property Valuation Companies for the Banking Sector

CEPAS srl

Certification body

Consiglio Nazionale Geometri e Geometri Laureati (CNGeGL)

National Council of Italian Surveyors

Istituto di Estimo e Valutazione (IEV)

E-Valuations – Institute of Estimation and Valuation

Istituto Italiano di Valutazione Immobiliare (ISIVI)

Italian Institute for Real Estate Valuation

Kosovo

Shoqates se Vleresuesve te Kosoves (SHVK)

Kosovo Appraisers Association (KAA)

Latvia

Latvijas Ipasumu Vertetaju Asociacija (LIVA)

Latvian Association of Property Appraisers

Lithuania

Lietuvos Turto Vertintoju Asociacija (LTVA)

Lithuanian Association of Property Valuers

Mexico

Federación de Colegios de Valuadores (FECOVAL)

Federation of Appraisal Colleges of Mexico

Montenegro

Institut Ovlašćenih Procjenjivača Crne Gore (IOPCG)

Institute of Certified Valuers of Montenegro

Nacionalno Udruženje Procjenitelja Crne Gore (NUPCG)

National Association of Valuers of Montenegro

Udruženje Nezavisnih Procjenjivača Crne Gore (CUP)

Association of Independent Valuers of Montenegro

Netherlands

Nederlands Register Vastgoed Taxateurs (NRVT)

Real Estate Valuers Register of the Netherlands

Nederlandse Vereniging van Makelaars in Onroerende Goederen en Vastgoeddeskundigen (NVM)

Dutch Association of Real Estate Brokers and Real Estate Experts

VastgoedPRO

Association of Real Estate Agents and Valuers of the Netherlands

VBO Makelaar

Dutch Association of Real Estate Agents and Valuers

Waarderingskamer

The Netherlands Council for Real Estate Assessment – NCREA

North Macedonia

Asocijacija na Nezavisni Procenuvaci

Association of Independent Valuers (AIV)

Biro za Sudski Vestacenja (BSV)

Bureau for Court Expertise

Komora na Procenuvaci na Republika Makedonija (KPRM)

Chamber of Valuers of the Republic of Macedonia

Norway

Norsk Takst (NT)

Norwegian Surveyors and Valuers Association

Poland

Polska Federacja Stowarzyszeń Rzeczoznawców Majątkowych (PFSRM)

The Polish Federation of Valuers' Associations (PFVA)

Portugal

Associação Nacional de Avaliadores Imobiliários (ANAI)

National Association of Real Estate Valuers

Associação Profissional das Sociedades de Avaliação (ASAVAL)

Professional Association of Valuation Companies of Portugal

Romania

Asociația Națională a Evaluatorilor Autorizați din România (ANEVAR)

National Association of Authorised Romanian Valuers

Russian Federation

Партнерство Российского Общества Оценщиков (ПРОО)

Partnership of the Russian Society of Appraisers (PRSA)

Российская Коллегия Оценщиков (РКО)

Russian Board of Appraisers (RBA)

Российское Общество Оценщиков (РОО)

Russian Society of Appraisers (RSA)

Serbia

Nacionalno Udruzenje Procenitelja Srbije (NUPS)

National Association of Valuers of Serbia (NAVS)

Slovenia

Slovenski Institut za Revizijo (SIR)

Slovenian Institute of Auditors

Spain

Asociación Española de Análisis de Valor (AEV)

Spanish Association of Value Analysis

Asociación Española de Valoración Inmobiliaria y Urbanística (AEVIU)

Spanish Association of Real Estate and Urban Appraisal

Asociación Profesional de Sociedades de Valoración (ATASA)
Professional Association of Valuation Companies of Spain

Consejo General de la Arquitectura Técnica de España (CGATE)
Spanish General Council of Technical Architecture

Sweden

Samhällsbyggarna-SFF
The Swedish professionals for the built environment

Turkey

Türkiye Değerleme Uzmanlari Birli (TDUB)
Turkish Appraisers Association

Ukraine

Асоціація Спеціалістів Банківської Оцінки України (АСБОУ)
Ukrainian Association of Bank Valuation Specialists

Українське Товариство Оцінювачів (УТО)
Ukrainian Society of Appraisers

United Arab Emirates

دائرة الأراضي و الأملاك دبي
Dubai Land Department (TAQYEEM)

United Kingdom

Central Association of Agricultural Valuers (CAAV)

Institute of Revenues Rating and Valuation (IRRV)

United States

Appraisal Institute (AI)

International Association of Assessing Officers (IAAO)

GLOSSARY OF TERMS

EBVS contains definitions of key business valuation concepts necessary to support practicing valuers and other users of EBVS.

B

Basis of value

A statement of the fundamental assumptions for assessing a value of the subject of valuation for a defined purpose. Should be distinguished from the methods or techniques used to implement a selected basis of value.

Beta

A function of the relationship between the return on an individual security and the return on the market as measured by a broad market index.

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

C

Company

An enterprise constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

Control premium

An amount or percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control.

D

Discount for Lack of Control (DLOC)

An amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability (DLOM)

An amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount rate

A rate of return used to convert a future monetary sum into present value.

E

Enterprise

Any entity engaged in an economic activity, irrespective of its legal form. This includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity.

Enterprise value

The sum of a company's equity, plus interest-bearing debt less excess cash and cash equivalents, if any.

Equity value

The estimated net value, which is available to all of the company's shareholders.

F

Fair Value (for Financial Reporting)

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair Value (for purposes other than Financial Reporting)

The amount that would be received to sell a business in an orderly transaction between identified market participants possessing full knowledge of the relevant facts, making their decision in accordance with their respective objectives.

G

Goodwill

An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

H

Highest and Best Use

The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used.

I

Intangible assets

Identifiable non-monetary assets without physical substance.

Invested capital cash flow

Debt-free cash flow, used for the valuation of Enterprise Value.

Investment value

The value of a business to a particular identified party for investment, and /or operational purposes.

L

Liquidation value

The estimated amount that the dissenting creditors or equity holders could reasonably expect to receive in the event of liquidation of the debtor's business, whether by piecemeal liquidation or by a sale as a going concern, depending on the particular circumstances of each debtor.

Liquidity

The ability to readily convert an asset, business, business ownership interest, or security into cash without significant loss of principal.

M

Market Value

The estimated amount for which the business should exchange on the date of valuation, in a transaction between a willing buyer and a willing seller, acting independently of each other after proper marketing, wherein the parties had each acted knowledgeably, prudently and without being under compulsion.

N

Net equity cash flow

The cash flow to all the company' shareholders. This type of cash flow is used for the valuation of Equity Value.

Non-operating assets

Assets which are surplus to the core business.

O

Operating assets

Assets which are necessary for the operation of the business and must be valued as part of the business as a whole.

P

Participating interest

Rights in the capital of other undertakings, whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the activities of the undertaking which holds those rights.

Property, plant and equipment

Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Q

Qualified Business Valuer

A person of good repute, whether self-employed or employed by a valuation company or other legal entity, who prepares and supervises business valuations and assumes responsibility for them.

S

Systematic risk

The risk that is common to all securities and cannot be eliminated through diversification.

U

Unsystematic risk

The portion of total risk specific to an individual security that can be avoided through diversification.

V

Valuation approach

A general way of determining the value of a business, using one or more valuation methods.

Valuation method

The particular procedure, based on one or more valuation approaches, used by the valuer to arrive at the determination of value.

Valuation review

The assessment of another valuer's Report, not a revaluation, taking the form of a Valuation Review Report.

Valuation technique

A specific analytical process of data treatment, conducted within a valuation method.

Value in use

The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

W

Weighted average cost of capital (WACC)

Cost of capital (discount rate) determined by the weighted average, at Market Value, of the cost of all financing sources in the business enterprise's capital structure.

The European Group of Valuers' Associations unites 72 national valuers' associations from 38 countries representing 70 000 qualified valuers either self-employed or employed by specialist consultancies, private sector companies, government departments or financial institutions both local and international. Its European Valuation Standards (EVS) are cited as reliable standards for the valuation of residential immovable property for mortgage lending purposes in the EU Mortgage Credit Directive and have been given precedence over all other standards by the European Central Bank in successive editions of its Asset Quality Review manual for the updating of banks' real estate collateral values.

Business valuation is prevalent among a number of TEGOVA members with valuation firms or individual valuers often combining real estate and business practice. Responding to increasing member demand, European Business Valuation Standards now provide fundamentals of best practice in business valuation, with a quality that can be relied upon as a common benchmark by valuers, public authorities, investors and the financial industry throughout the European Union and beyond.