

Value Added

Insights and Updates on Business Valuation

About Value Added

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Power Points

(Recent Axiom Speaking Engagements, Press Releases, and Publications)

- **MassMutual Blue Chip Fly-in**

Dr. Feldman spoke on "Business Valuation as a Catalyst to Business Owner Planning" (5/04)

- **National Financial Partners (NFP)**

Dr. Feldman presented seminars on utilizing Axiom's services to facilitate business owner planning at NFP's Spring Marketing Conference (3/04)

- **New England Conference of Financial Professionals**

Dr. Feldman spoke on "What Financial Advisors & Business Owners Need to Know About Business Valuation" (2/04)

Check the What's New and Valuation Library at www.axiomvaluation.com for links to most of these citations.

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Marketability Discount Wars

An age old question in estate planning is: What is the maximum size of the marketability discount that can be applied to shares of closely-held firms and minority interests of family limited partnerships (FLPs) and limited liability corporations (LLCs)? The greater the discount, the lower the value of the taxable estate and the more wealth that can be passed on to future generations.

The IRS has a different point of view on these matters. It wants discounts to be as low as possible, making the taxable estate as large as possible. The war with the IRS on the size of the marketability discount has been going on for generations.

An important force that will dominate the debate is the application of scientific principles to the determination of the size of the marketability discount, and the inability of traditional business appraisers to either understand the nature of this research or how to apply its results. The upshot is that traditional busi-

ness valuation appraisers are finding it increasingly difficult to defend what they do in tax court, and more often than not they are on the losing side.

The IRS is keenly aware that the number of gift tax, estate and other business transition related tax returns will explode over the next 10 years. Given the amount of wealth at stake, the Service fully understands that the professional appraisal community is under more pressure than ever to maximize the value of marketability discounts employed. Identifying the misapplication of the marketability discount is a growth industry for the IRS. If your expert is not prepared to handle what the IRS has in store, then it is time to reconsider how you should best protect your client.

The central question for many valuation professionals is how to defend itself in court against the IRS's academic experts that rely upon academic research and statistical modeling? There is much at stake and

traditional valuation practitioners are losing the early battles, and this is not likely to change any time in the future. The bottom line is that marketability discounts that exceed 20% are "red flags" for the IRS.

The battle lines are being drawn around the scientific evidence, and traditional valuation professionals are generally not trained to deal with the mathematical and statistical models that IRS academic experts are offering up as support for significantly lower discounts. The IRS and the tax courts have come to realize that the traditional valuation approach to marketability discounts suffers from serious "small sample bias" and thus has limited credibility as to the robustness of the evidence presented. The academic expert, on the other hand, references peer reviewed research, complex statistical models that are inherently objective and certainly consistent with the scientific method.

Industry Rules of Thumb: Danger in Simplicity

Axiom recently completed an analysis of price to sales ratios for private company transactions within 40 major U.S. industries. The analysis demonstrated two key points:

1. There is no "average" firm within any industry;
2. Reliance on "Rules of Thumb" can be disastrous for owners.

Owners of private firms often hear Rules of Thumb within their industry. One commercial printer may tell another that firms transact at 1 times annual sales or a car dealer may hear at a convention that dealerships sell at 3 times earnings. Although some of these multiples may, in fact, be based upon actual industry data, others have little, if any, basis in reality. Most significantly, however,

even those rules of thumb that are based upon industry data are actually medians or averages and simply represent a calculation based on many transactions. Accordingly, they do not represent an actual firm that traded in the market place at the given price.

Our research demonstrated that, regardless of the average P/S ratio, the actual transactions making up the average were incredibly dispersed from high to low. Thus, in an industry like fabricated metals, one popular database shows 62 recent transactions (excluding two transactions that had price to sales multiples of over 3) with sales prices relatively evenly distributed from a low of 8% of annual sales to a high of

1.4 times annual sales. For a firm with \$5 million in annual sales, that shows a range in value of \$400,000 to \$7 million.

This is not an isolated example, as nearly every one of the 40 industries studied had very significant ranges of value.

We encourage business owners and their advisors to ask those people that offer "Rules of Thumb" what is the source of the information and what are the ranges of actual transaction values.

To obtain the summary table showing the range of multiples for forty industries, visit our Valuation Library at www.axiomvaluation.com.

Hot Links

Websites of Interest to CPAs and
Other Professional Advisors

EdgarScan from PriceWater-
houseCoopers:
Free "Intelligent Interface to
the SEC EDGAR Database"
for public company data
<http://edgarscan.pwcglobal.com/servlets/edgarscan>

Axiom Valuation's Services

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Success Factors In Obtaining SBA Guaranteed Loans

Most professionals have encountered clients who believe that they will easily obtain SBA-guaranteed loans from local lending institution to finance an acquisition, expand their workforce or access additional working capital. Obtaining SBA-guaranteed financing, however, can be very challenging, especially when the financing is to be secured by cash flows, rather than hard assets.

Despite the challenges of obtaining SBA-backed financing on deals that are primarily cash-flow backed, we have seen numerous recent cases where such financing was put in place. In reviewing these cases, several common characteristics concerning successful applicants emerge and should be kept in mind:

1. Applicant experience: The applicants had a proven business track record, either within the particular business and industry or related fields;
2. Applicant preparation: In the successful deals, applicants had strong business plans with well conceived and documented assumptions and analytics;
3. Financial transparency: The tax returns and financial statements were current, complete and easy to understand. Pro-forma financials were equally transparent with well-reasoned assumptions;
4. History of Profitability: Of course, the most important fact that the transparent financials demonstrated is a firm that has a track record of profitability

that can be significantly improved through the financing.

5. Valuation Supporting the Investment Thesis: In every SBA loan made on a cash-flow basis, the SBA requires that the borrower have an independent valuation completed. The valuation will generally have to show a business value several times in excess of the amount sought to be borrowed.

Examples of successful, primarily cash-flow based SBA financings that we have seen include acquisition financing for a small software company, a roll-up of several small printing firms and a re-capitalization for a medical practice. Our experience indicates that cash-flow financing, although more challenging to obtain than an asset-backed loans, can be obtained by successful entrepreneurs who do their homework in the loan process.

Thus, although these would-be borrowers must have realistic expectations, they should be encouraged to pursue financing if they demonstrate the success factors. Please let us know if you have any questions about the ability of one of your clients to obtain SBA or other financing for an acquisition, expansion or other purpose.

Axiom Office Move

We are pleased to announce that, due to the significant growth of our business, we have moved to new offices that can better accommodate our current and future needs for expanded space. Thanks to all of you for all of your business and referrals which have propelled Axiom's dramatic growth over the last two years.

Our new contact information is shown below. Please note that our extension numbers have changed.

201 Edgewater Drive Phone: 781-486-0100 Stan Feldman x 204
Suite 255 Fax: 781-486-0101 Roger Winsby x203
Wakefield, MA 01880

Directions: Our building is in the Edgewater Office Park near the border of the towns of Wakefield and Lynnfield, about 12 miles north of downtown Boston. From Boston, take I-93 North to I-95 North. Take Exit 42—Salem Street/ Wakefield. Turn left onto Salem Street, then take the first left onto Pleasure Island Road, which quickly changes to Audubon Road. A few hundred yards past the Sheraton Colonial, turn right into the Edgewater Office Park driveway. 201 Edgewater is the second building on the right.

Newly Re-designed Axiom Valuation Website

In our continuing effort to make valuation content more accessible to business owners and advisors, Axiom's website recently underwent a complete redesign. The new site organizes information in a more intuitive fashion, permitting users to quickly find the information they are looking for. Please visit the new site and let us know what you think!

www.axiomvaluation.com

Take the Valuation Tour! Check out the Valuation Video Clips!