



Key Issues in Business Valuation and Their Implication for Financial Advisors

A Presentation to the Private Business Group
Partners Financial Fall 2008 Conference

by

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Axiom Valuation Solutions

- Expert Business Valuation Firm
 - Provides valuation services nationwide
 - Standard services covering:
 - Certified, IRS-compliant valuations & ESOPs & 409A
 - Value Estimates – unique offering for planning applications
 - FLPs, LLCs, and other special entity valuations
- Credentials of Dr. Stanley Feldman, Chairman
 - Associate Professor of Finance, Bentley College
 - Past Member of FASB Valuation Resource Group
 - Lead Author
 - *What Every Business Owner Should Know About Valuing Their Business*, McGraw-Hill, 2003
 - *Principles of Private Firm Valuation*, Wiley 2006

Key Issues in Business Valuation

- Valuation for Financial Reporting
- Valuation in Business Disputes
- Business Owner Transition Tidal Wave

Valuation for Financial Reporting

- Financial Accounting Standards Board (FASB)
 - Changing U.S. Accounting Standards to Be Consistent with International Accounting Standards
 - FASB 141/142 – Acquisition Accounting
 - FASB 157/159 – Fair Value – Market Balance Sheet
- IRS 409A – Deferred Compensation
 - Primary Impact on Value of Stock Options in Venture-backed Firms
 - Likely to Have Impact on Phantom Stock, Other Equity Participation Plans, LLC Profit Interests

Valuation for Financial Reporting – Implications for Financial Advisors

- Opportunities for Financial Advisors
 - IRS 409A – Issues of Value for Early Stage Companies Are More Transparent; More Risk to Stock Option Recipients
 - IRS 409A – Other Equity Participation Plans Will Likely Require More Formal Valuation Process
- BOTTOM LINE: Greater Need for Careful Financial Planning
- Risks for Financial Advisors
 - Business Valuation Firms Becoming Busier with VFR; Valuation Prices Likely to Rise

Valuation in Business Disputes

- Most Shareholder Agreements or Buy-Sell Agreements Are Poorly Designed
 - Often Rely upon Old Value
 - Unclear Definition of Value Standard
 - No Definition of Whether Discounts Apply
 - Vague Process for Getting Values and Resolving a Final Value
 - Lack of Clear Process Can Lead to Adversarial Situation Occurring Outside of Legal System

Buy-Sell Agreement Valuations

- Methods
 - Agreed upon Price
 - Formula tied to Revenue or Earnings
 - Valuation Process at Time of Dispute/Departure
- Standard of Value
 - Fair Market Value
 - Fair Value
 - Other
 - Will Depend upon State of Incorporation if Not Clearly Defined in Agreement

Valuation Processes

- Multiple Appraiser Processes –
 - Each Side Hires Expert: Experts Select Third Expert
 - Each Side Hires Expert: CPA or Arbitrator Decides
 - Each Side Hires Expert: Jointly Managed Process
 - Each Side Hires Expert: Baseball Arbitration
- Single Appraiser Process
 - Select Expert in Agreement; Value at Trigger Event
 - Select Expert at Time of Trigger Event

Key Elements to Agreements

- Determination of As of Date for Valuation
- Source of Financials to be Used
- Rules on Sharing Information with Appraisers
- What Valuation Adjustments Allowable
- Process Timeframe
- Standard of Value
- Explicit Statement about Discounts
- Qualifications of Appraiser
- Who Bears the Cost?

Valuation Best Practices

- Agreement Should Require Current Value Determination
- Size of Firm Should Determine Whether to Specify Single or Multiple Appraisal Approach
- Multiple Appraiser Approach:
 - Specify the Process and Value Resolution Carefully
 - Require Information Shared with Both Parties
 - Require Management Interviews Done Jointly
- Spell out Value Standard – Do not Leave to State Law or Judicial Findings
- Specify Timeframe for Payment and Funding Source

Valuation in Business Disputes – Implications for Financial Advisors

- Opportunities for Financial Advisors
 - **Every Multi-Owner Firm Can Benefit from a Review of its Buy-Sell Terms!**
 - Determining Funding Source Should Lead to Current Valuation and Likely Insurance Purchase
 - Knowing Business Value Provides Direct Lead-in to Owner Financial Planning Opportunities
- Risks for Financial Advisors
 - Possible “Resentment” of Lawyer Who Drafted Original Agreement

Business Owner Transition Tidal Wave

- In 2001, I predicted the coming Business Owner Transition Tidal Wave
 - Is Coming Along More Slowly Than Anticipated
 - Reasons:
 - 9/11/2001 and the Subsequent Recession
 - Lack of Effective Succession Planning
 - Changes in the Marketplace
- “Best of Times, Worst of Times” to Sell a Business

Business Owner Transition Tidal Wave

- Best of Times

- Despite Economic Slowing and High Energy Costs, Many U.S. Businesses Are Doing Well
- Private Equity Funds Have More Money Than Good Targets
- Corporate Buyers Also Have Funds for Acquisition
- Targets of Opportunity:
 - Scalable Businesses
 - Solid Management Teams After Founder Departs
 - Defensible Competitive Advantages

Business Owner Transition Tidal Wave

- Worst of Times
 - Many Successful Private Firms Are:
 - Owner/Founder Dependent
 - Not Scalable Beyond Local Market
 - Examples:
 - Commercial Construction Firms
 - Electrical/Mechanical/HVAC Contractors
 - Machine Tool/Fabrication
 - Liquidation Firms
 - Private Firms Often Earn Low Returns
 - Could Not Afford Their Current Locations

Business Owner Transition Tidal Wave – Implications for Financial Advisors

- Opportunities for Financial Advisors
 - PE Rejects Can Provide Substantial Value to Sellers
 - These Businesses Often Generate Good Current Income but Not Long-term Asset Value
 - Ownership Transition Realities:
 - Normally Takes Several Years for Seller to Get Paid
 - Higher Risk of Default if Transition Not Successful
 - Requires Careful Tax and Financial Planning
 - Opportunities for Income Deferral

Risks for Financial Advisors

- Some Owners Are “Not Ready for the Truth”

Opportunities for Financial Advisors

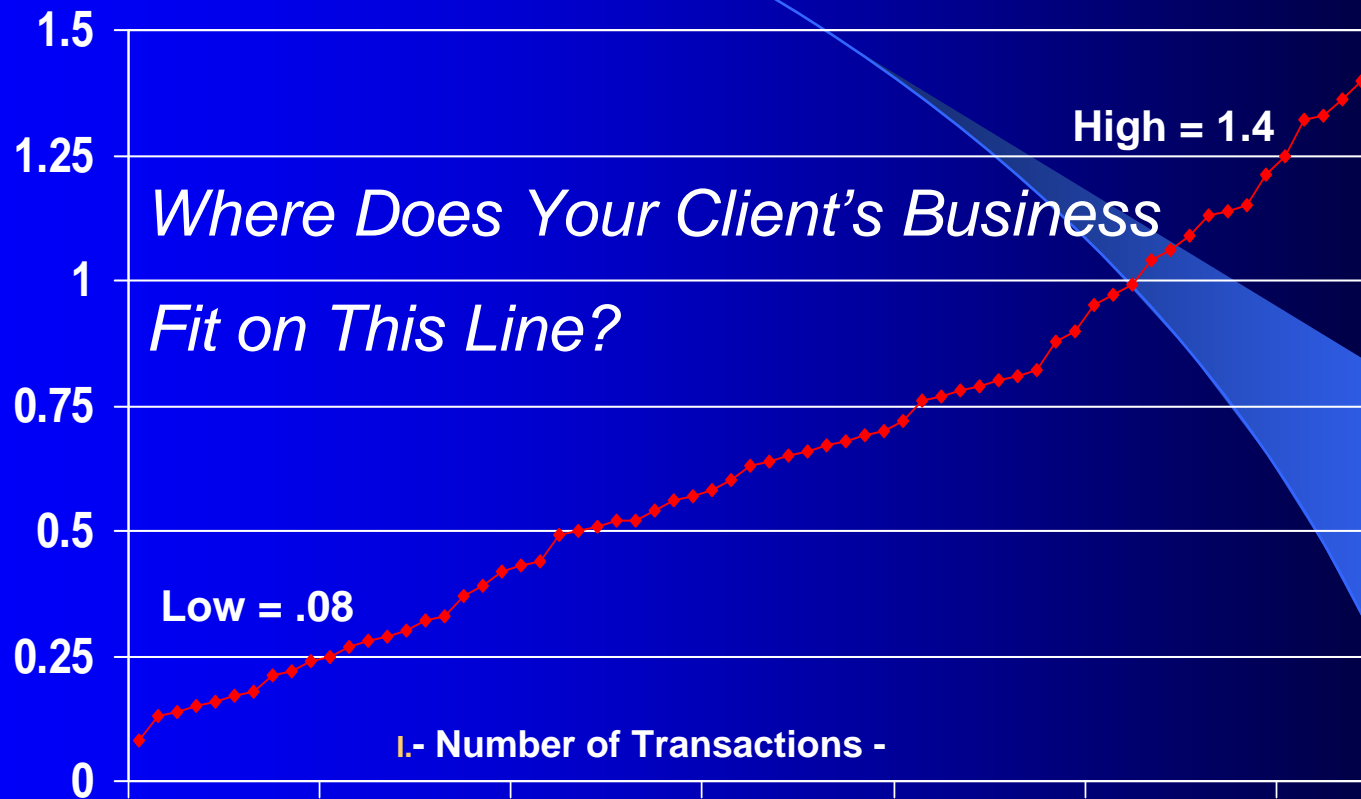
- IRS 409A
- Buy-Sell Agreements
- Business Owner Transition Tidal Wave for “Not Hot” Companies

How Axiom Valuation Is Different

- Valuation is our only line of business
- Non-competitive to Financial Advisors or CPAs
- Investments in Technology and Databases Alters Business Valuation Economics
 - Competitive Prices for Certified Services
 - Unique Value Estimate Offering for Planning Purposes
- **Our Sales Model:** Work jointly with financial advisors, CPAs, and lawyers to achieve win-win-win solutions for their business owner clients

Why Value a Business?

Industry Multiples & Rules of Thumb May Be Extremely Misleading



Example – Metal Fabricator with \$5M Annual Sales

Valuation

\$.4M = Low Firm Value (\$5M Sales x .08 P/S ratio)

\$7M = High Firm Value (\$5M x 1.4)

Source Bizcomps N=62

Owners Must Address Business Life Events

