



# 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

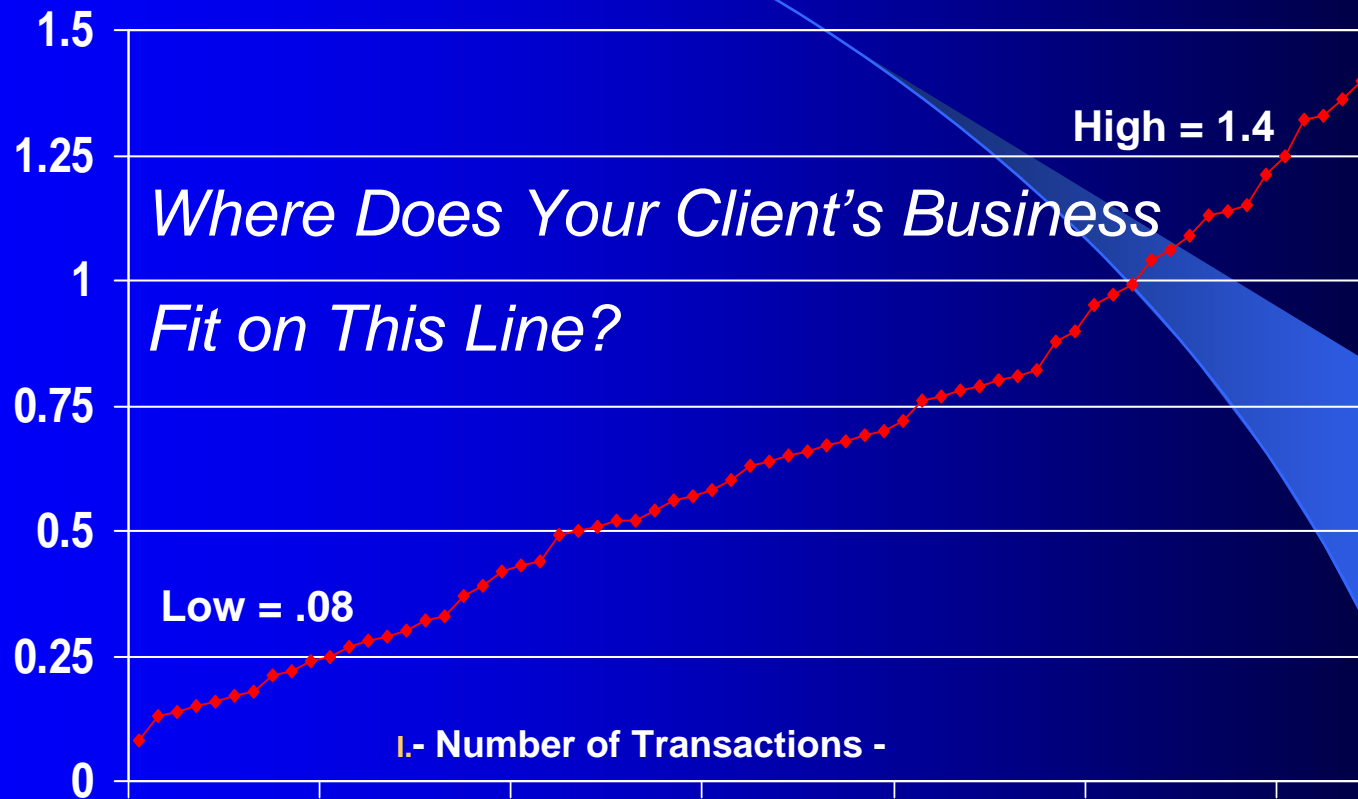
- IRS 409A
- Buy-Sell Agreements
- Business Owner Transition Tidal Wave for “Not Hot” Companies

# 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

