

VALUATION BASICS FOR ATTORNEYS




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TODAY'S OBJECTIVE

-  **Overview of Business Valuation Basics**
-  **Understanding of the Concepts behind the underlying valuation conclusion**
-  **Why different values can be arrived at for the same entity.**

BUSINESS VALUATION IS AN EVOLVING AREA

- 📄 1975 - Maybe 3 inches of shelf space needed to hold a complete library
- 📄 1980's - Finance Structures brought to bear in valuation
- 📄 Today - Greater Body of Knowledge and accepted Standards.

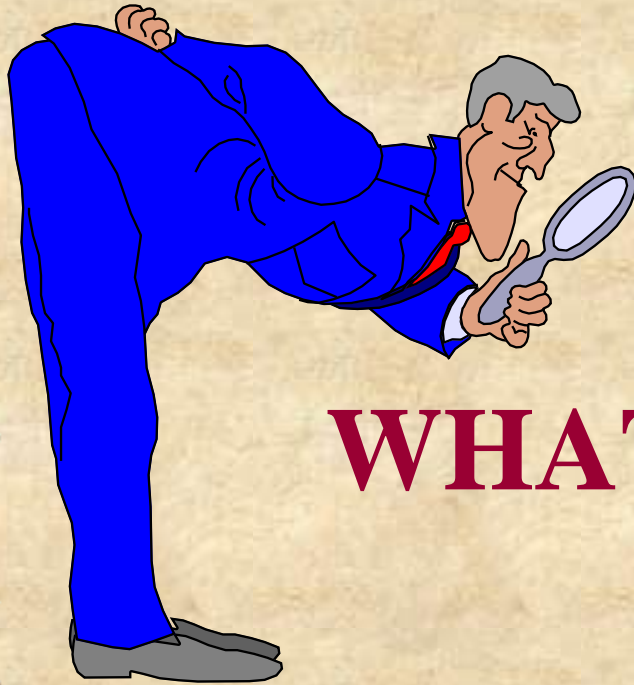
GENERAL THEORY OF VALUATION

Value =

Expected Future Returns
x Required Rate of Return

THE THEORY OF SUBSTITUTION

**Reward Must Equal Perceived Risk
or the Investment will Flow to an
Alternative**



WHAT IS VALUE?

Beauty is in the Eye of the Beholder
Different People will look at Value
Differently

PURPOSE OF VALUATION MAY IMPACT ULTIMATE CONCLUSION OF VALUE

Divorce

Estate

Shareholder Disputes

Transactional

STANDARDS OF VALUE

 Fair Market Value

 Fair Value

 Investment Value

 Liquidation Value

 Book Value

VALUATION METHODS

Cost Methods

- Replacement, Net Asset Value

Income Methods

- Capitalization or Discounting of Earnings/Cash Flows

Market Methods

- Guideline Companies

EXCESS EARNINGS METHOD

☞ Derived from ARM 34

- Used to value goodwill for liquor manufacturers during prohibition

☞ IRS calls this the method of last resort

- Also called the Formula method, See Rev. Rul 68-609. IRS warns of blindly using formula.

☞ Most Widely Used and Abused methodology today

DISCOUNTED CASH FLOW (EARNINGS)

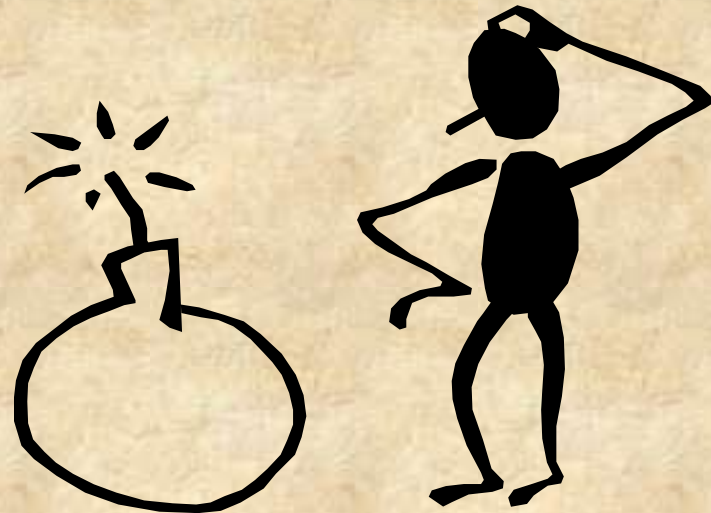
- 📄 Theoretically - the Best Method
- 📄 Most Widely used in Actual Transactions
- 📄 Major Flaw - The ability to predict the future cash flows
- 📄 Additional Flaw- Majority of Value can be found in the “Terminal Value” of the Entity.

MARKET “GUIDELINE COMPANY” METHOD

- ☞ The Larger the Company - The Better the “guideline” data may be.
- ☞ Can be used for smaller companies
- ☞ Many Sources for information
 - Pratt’s Stats
 - IBA Data Base
 - Done Deals
 - Biz Comps

BE CAREFUL WITH STATISTICS

Unless You Know the Terms of the
Sale, the Statistical Information may
be very misleading



WHY IS THE AREA OF BUSINESS VALUATION SO DIFFICULT?



WHAT IS THE BENEFIT STREAM?

Buying a Job

- Major Truth - Not many small businesses really have a fair market value other than liquidation

Impact of Owner on Business

- Can this business really survive without the skills of the owner

What is the Actual Benefit available to a passive owner?

DETERMINING THE RATE OF RETURN

Risk Free Rate

- US Treasury Rates

Equity Risk

- Stocks vs Bonds

Size Risk

- Bigger really may be better

The Economy

Industry Risk

Specific Company Risk

- Unique issues to the company being valued

Growth

Other Factors

WHAT ARE THESE DISCOUNTS/PREMIUMS?

Minority

Marketability

Control

Built in Tax Costs



THE STANDARDS YOU NEED TO BE AWARE OF

 USPAP

 Rev.Rul. 59-60

 ASA

 IBA

 NACVA

 Pratt's "Body of Knowledge"

QUESTIONS?

