

# What Is Your Business Worth?

How to Value Your Business  
And Other Valuation Considerations

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# Today's Agenda

- Background
- What is a Business Valuation?
- Reasons for a Valuation
- Getting Started
- Normalizing Adjustments
- Sanity Checks
- Taxes
- Oversights
- Examples

# What is a Business Valuation

- Short Answer – Determining how much a business is worth
- Unlike valuing real estate or a public company – there is no public database to determine prior transactions
- There are different approaches and techniques to valuing a business but the end result should always be the same – how much is my business worth and why should someone invest money in a business rather than somewhere else.
- Historical data is important but how the Company is expected to perform in the future is what matters most

# Business Valuation Purposes – Non Tax Related

- Buy/Sell Agreements
- Exit Strategy
- Sale/Purchase
- Formalize Who Will Own and Control the Business
- Merger/Acquisition
- Mezzanine Financing
- SBA Loan
- Dissolution of Marriage
- Goodwill Impairment Testing
- Shareholder/Partner Dispute
- Litigation Support – Damages/Lost Profits/Business Interruption



# Business Valuation Purposes – Tax Related

- Gifting
- Estate Purposes
- ESOP
- Support for Step Up in Basis
- Determine Amount of Business Coverage
- Stock Options
- Restricted Stock Units

# Levels of Value

- Strategic Control
  - These buyers can (and do) pay more for companies as they can realize synergies (eliminating expenses and cross-selling)
- Financial Control
  - Buyers acquire companies based their ability to extract reasonable rates of return
- Marketable Minority (freely tradable) – Public Company stock
- Nonmarketable Minority Interest – Minority owner in a private company

# Standard of Value – Fair Market Value Approaches

- Fair Market Value – “The price at which a property would change hands between a willing buyer and willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell and both parties have reasonable knowledge of the relevant facts.” (IRS Revenue Ruling 59-60)
- Fair Value – Used in Divorce and Shareholder/Partner disputes

# Valuation Approaches

- Asset Approach
  - - Based on a Balance Sheet
  - - Historical vs. Adjusted to Fair Market Value
- Income Approach
  - - Based on Income or Cash Flow Statements
  - - Apply a Risk Factor (Discount Rate or Capitalization Rate)
- Market Approach
  - - Value Based on Transaction of Comparable Companies or Publicly Traded Company Information



# Getting Started

- Engagement Letter – Describe scope of engagement
- Obtain Documentation:
  - - Financial Statements (Audit, Review, Compilation)
  - - Tax Returns
  - - QuickBooks/Accounting file or General Ledger
- Management Projections (Discounted Cash Flow).....
- Balance Sheet/Profit & Loss should be on accrual basis
- Site visit and Business Interview
- Interview Questions (Operating history, owner duties, workforce, customer base, suppliers, lawsuits, non-compete agreements, offers to buy or sell)

# Common Normalizing Adjustments – Income Statement

- Owner's Compensation and Perks
- Personal Expenses
- Unreported Income
- Related Party Activity
- Fair Market Rent
- Depreciation/Amortization
- Non-Essential Expenses (Travel, Meals, Charity, etc.)
- Non-Recurring Items (Legal Fees)
- Unusual and/or Extraordinary Items

# Common Normalizing Adjustments – Balance Sheet

- Excess Cash
- Excess Working Capital
- Obsolete Inventory
- Excess capacity (fixed assets)
- Deficiency in Working Capital
- Related Party Debt
- Unrecorded liabilities

# Sanity Check

- Market Approach – Wouldn't it be nice if there was a “Zillow” for businesses!! Well there is – it's just not public information
- Value Based on Transactions of Comparable Companies or Publicly Traded Company Information
- DealStats/BizComps
  - - Industry
  - - Location
  - - Size
  - - Revenue

# DealStats

*Where does DealStats get its information from:*

- (1) the BVR Contributor Network;
- (2) BVR personnel perform research at the Security and Exchange Commission's (SEC) website and collect details on acquisitions; and
- (3) BVR personnel perform research at the System for Electronic Document Analysis and Retrieval (SEDAR) website and collect details on acquisitions.

NOTE: The BVR Contributor Network consists of business brokers, M&A advisors, and other business transaction specialists who have been involved in business transfers and who contribute details on their closed deals to *DealStats*.

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# DealStats Example

(In Millions)

Acquirer	Target	Closing Date	AUM (Billions)	Market Value of Invested Capital	Trailing Revenue	Trailing EBITDA	MVIC / Revenue	MVIC / EBITDA
Company 1	Target 1	4/1/2015	\$1.6	\$39.7	\$10.4	\$5.2	3.8	7.6
Company 2	Target 2	12/18/2012	\$8.9	\$27.8	\$23.8	\$3.0	1.2	9.2
Company 3	Target 3	10/1/2014	\$15.6	\$66.7	\$20.9	\$1.8	3.2	NM
Company 4	Target 4	3/5/2014	\$7.5	\$59.7	\$25.6	\$5.5	2.3	10.8
Company 5	Target 5	12/19/2012	\$1.5	\$7.1	\$6.8	-\$0.1	1.0	NM
Company 6	Target 6	12/13/2011	\$15.0	\$28.5	\$19.7	\$2.2	1.4	13.0
Company 7	Target 7	4/29/2016	\$2.0	\$18.7	NR	\$3.0	NR	6.2
Company 8	Target 8	11/18/2010	\$1.1	\$12.0	\$4.2	\$0.9	2.9	13.6

NR = Not Reported

NM = Negative or Not Meaningful.

High	3.8	13.6
Mean	2.3	10.1
Median	2.3	10.0
Low	1.0	6.2

Subject Company	\$20.0	\$290.0	\$100.0	\$32.0	2.9	9.0
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# Adjusted Net Asset Method

	<u>Reported</u>	<u>Non-Operating Adjustments</u>	<u>Normalization Adjustments</u>	<u>Adjusted</u>
<b>Assets</b>				
<b>Current Assets</b>				
Cash and Cash Equivalents	\$ 70,417	\$ -	\$ -	\$ 70,417
Accounts Receivable	-	-	61,766	61,766
Prepaid Payroll	(3)		3	-
Due from FITC	278		(278)	-
Due from Bank	1,184		(1,184)	-
Due from Related Party	58,100		(58,100)	-
<b>Total Current Assets</b>	<b>129,976</b>	<b>-</b>	<b>2,207</b>	<b>132,183</b>
<b>Fixed Assets</b>				
Depreciable Assets	134,214	-	(84,214)	50,000
Less: Accumulated Depreciation	(123,751)	-	123,751	-
<b>Net Fixed Assets</b>	<b>10,463</b>	<b>-</b>	<b>39,537</b>	<b>50,000</b>
<b>Intangible Assets</b>				
Intangible Assets	336,300	-	(336,300)	-
Less: Accumulated Amortization	(130,294)	-	130,294	-
<b>Net Intangible Assets</b>	<b>206,006</b>	<b>-</b>	<b>(206,006)</b>	<b>-</b>
<b>Total Assets</b>	<b>\$ 346,445</b>	<b>\$ -</b>	<b>\$ (164,262)</b>	<b>\$ 182,183</b>

# Adjusted Net Asset Method

## Liabilities & Equity

### Liabilities

#### Current Liabilities

Accounts Payable	\$ 8,060	\$ -	\$ -	\$ 8,060
Payroll Liabilities	9,469			9,469
Loan to Related Party	5,000	(5,000)		-
Due to Franchise	97,000			97,000
EIDL Loan	8,031	-	-	8,031
Due to Bank	38,288	(38,288)	-	-
<b>Total Current Liabilities</b>	<b>165,848</b>	<b>(43,288)</b>	<b>-</b>	<b>122,560</b>

#### Long-Term Liabilities

Long-Term Debt	-	-	-	-
<b>Total Long-Term Liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

#### Total Liabilities

<b>165,848</b>	<b>(43,288)</b>	<b>-</b>	<b>122,560</b>
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### Equity

Capital Stock	100	-	-	100
Additional Paid-in Capital	-	43,288	(164,262)	(120,974)
Retained Earnings	180,497	-	-	180,497

#### Total Equity

<b>180,597</b>	<b>43,288</b>	<b>(164,262)</b>	<b>59,623</b>
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#### Total Liabilities & Equity

<b>\$ 346,445</b>	<b>\$ -</b>	<b>\$ (164,262)</b>	<b>\$ 182,183</b>
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# Capitalization of Earnings (No real growth)

	2017	2018	2019	2020	2021
<b>Revenue</b>	\$ 421,201	\$ 790,744	\$ 1,077,130	\$ 738,289	\$ 741,189
<b>Operating Profit</b>	\$ 64,752	\$ 133,717	\$ 243,323	\$ 151,121	\$ 70,869
<b><u>Adjustments:</u></b>					
Depreciation - As Reported	1,813	6,551	325	325	39,625
Depreciation - Estimated Capital Expenditures	(1,500)	(1,500)	(1,500)	(1,500)	(1,500)
Amortization	7,121	7,121	7,121	22,421	22,421
Auto Expense	26,442	24,836	23,490	24,269	26,658
Insurance - Auto	4,009	3,242	3,356	5,217	6,126
Charitable Contributions	1,541	1,970	985	750	400
Professional Fees - Non-Recurring	-	-	-	-	5,495
Cash Income	5,000	5,000	5,000	5,000	5,000
Officer Compensation	70,800	68,900	86,100	106,100	106,000
Payroll Taxes	5,664	5,512	6,888	8,488	8,480
Reasonable Officer Compensation	(125,000)	(173,408)	(178,771)	(184,300)	(190,000)
Payroll Taxes - Officer Comp.	(10,000)	(13,873)	(14,302)	(14,744)	(15,200)
PPP Loan Forgiveness	-	-	-	(37,135)	-
Travel	1,260	2,110	1,776	-	2,536
Meals and Entertainment	2,249	4,815	6,547	4,531	2,712
Other Expense	-	5,135	-	-	-
<i>Adjustments Subtotal</i>	(10,601)	(53,588)	(52,985)	(60,578)	18,753
<b>Adjusted Income</b>	\$ 54,151	\$ 80,129	\$ 190,338	\$ 90,543	\$ 89,622

# Discounted Cash Flow – Growth Expected

	<u>TTM 6/22</u>	<u>TTM 6/23</u>	<u>TTM 6/24</u>	<u>Terminal</u>
<b>Revenue</b>	\$ 954,545	\$1,061,072	\$1,131,103	\$1,165,036
<i>Percent Change</i>	<i>N/A</i>	<i>11.2%</i>	<i>6.6%</i>	<i>3.0%</i>
<b>Income before Other Expenses</b>	\$ 219,291	\$ 232,838	\$ 248,206	\$ 255,143
Operating Profit %	23.0%	21.9%	21.9%	21.9%
<b><u>Adjustments:</u></b>				
-				
Reasonable Officer Compensation	(100,000)	(111,160)	(118,497)	(122,051)
Payroll Taxes - Reasonable Officer Compensation	(8,000)	(8,893)	(9,480)	(9,764)
<i>Adjustments Subtotal</i>	<u>(108,000)</u>	<u>(120,053)</u>	<u>(127,976)</u>	<u>(131,816)</u>
<b>Adjusted Income</b>	<u>\$ 111,291</u>	<u>\$ 112,786</u>	<u>\$ 120,229</u>	<u>\$ 123,327</u>



# Discounted Cash Flow (Considerations)

- Reliability of Projections
- Factor in working capital needs
- Factor in Increased Fixed Asset Additions
- Need to get to a terminal value

# Risk Factors

- Customer Base (diverse or a few large customers)
- Slow Paying Customers
- Suppliers
- Industry
- Workforce
- Debt
- Gross Margins
- Lawsuits

# Common Oversights

- Not tax affecting or flawed methodology
- Not performing sanity checks
- Inadequate company specific risk
- Books not on accrual basis
- Ignoring industry benchmarks
- Discounted Cash Flow Errors

# Tax Talk

- Tax Cuts and Jobs Act (TCJA) – Values of business have increased due to decreased C-Corp tax rates and Qualified Business Income (QBI) Deductions for Pass-Through Entities (S-Corporations and Partnerships).
- Sellers – Prefer stock sales. Capital gain tax treatment and liability goes away
- Buyers – Prefer asset sales as they get stepped basis for purchase price. In a stock sale, the basis of seller would continue on.
- 338(h)(10) election – Stock sale treated as asset sale for tax purposes.

# Closing the Deal

- Final Adjustments (Any holdbacks)
- Employment Agreements
- Noncompete Agreements
- Asset vs. Stock Sale
- Purchase Price Allocation
- Sufficient Working Capital
- Closing and Funding



# Quality of Earnings

- Detailed Analysis of Revenue and Expenses
- Assess the:
  - - Sustainability and accuracy of  
Historical Earnings  
Achievability of Future Projections

Applicable to BOTH Buyer and Seller

# Examples

# Final Notes

- It's not over till it's over
- No matter the reason for a valuation – DON'T DO THIS ALONE!!
- A traditional CPA or Accounting firm might not have valuation experience
- Valuation experts and Attorneys need to be involved
- No two companies are exactly the same
- Just like a house – it's only worth what someone is willing to pay

Questions?



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