

Do you know what your business is worth?

Tulane Family Business Center

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Why do you need to know?

- A) Sale to a third party
- B) Estate and gift taxes
- C) Sale to employees or Employee share ownership plans (ESOP)
- D) Buy-Sell Agreements
- E) Executive compensation (options/SARS)
- F) Stock repurchase or recapitalization
- G) Transfers/sales among family members
- H) Raising expansion capital

2



What is value?

- Fair market value
- Investment value
- Book value
- Liquidation value

3



What factors effect value?

- The nature of the business and the history of the enterprise from its inception.
- n The economic outlook in general and the condition and outlook of the specific industry in particular.
- n The book value of the stock and the financial condition of the business.
- n The earning capacity and the dividend-paying capacity of the company.

4

Factors (continued)

- n Whether or not the enterprise has goodwill or other intangible value.
- n Previous sales or offers to purchase
- n The market price of stocks issued by publicly traded companies and acquisition prices of companies in the same or a similar line of business

5

Steps in the Valuation Process

- n Gather Company data
- n Site Visit
- n Research economic and industry information
- n Analyze company financial statements
- n Tests of Valuation
- n Discounts, Premiums and Value Conclusion

6

Adjustments to Financial Statements

- n Balance Sheet
 - n Non-Operating Assets
 - n Market Value versus Book Value
- n Income Statement
 - n Non-recurring items
 - n Add backs
 - n Deducts
 - n Tax Adjustments

7

EBITDA

Earnings before interest expense, taxes, depreciation and amortization


Net income
+ interest expense on long term debt
+ income taxes
+ depreciation and amortization
EBITDA

8

Approaches to Business Valuation

- i. Asset-Based Approach
- ii. Market Approach
- iii. Income Approach

9

 **Approaches to Business Valuation**

I. Asset-Based Approach

- n Adjusted Book Value Method
- n Liquidation Value Method


10

 **Approaches to Business Valuation (Cont.)**

II. Market Approach

- n Previous Sales of or offers for the Company's Stock
- n Sales of Similar Companies
- n Sales of Stock of Publicly Traded Companies
- n Rules of Thumb

11

 **Approaches to Business Valuation (Cont.)**

III. Income Approach

- n Capitalization of Earnings Method
- n Discounted Cash Flow Method
- n Leveraged Buyout

12



Correlation and Conclusions

	<u>Minority</u>	<u>Control</u>
Approach		
Asset		Liquidation
Market	Public Company	Merger
Income	DCF	LBO

13

	Reported	Adjusted	Market Value Adjusted
Cash	100,000	100,000	100,000
Marketable securities portfolio	750,000	(750,000)	0
Accounts receivable	500,000	500,000	500,000
Inventory	300,000	300,000	300,000
Total Current Assets	1,650,000	900,000	900,000
Property Plant & Equipment	1,000,000	1,000,000	1,000,000
Accumulated Depreciation	(600,000)	(600,000)	
Net PP&E	400,000	400,000	500,000
Hunting Camp	50,000	(50,000)	0
TOTAL ASSETS	2,100,000	1,300,000	1,800,000
Accounts payable	400,000	400,000	400,000
Accrued Expenses	100,000	100,000	100,000
Total Current Liabilities	500,000	500,000	500,000
Long term debt	300,000	300,000	300,000
Total Liabilities	800,000	800,000	800,000
Equity	1,300,000	500,000	1,000,000
TOTAL LIABILITIES & EQUITY	2,100,000	1,300,000	1,800,000

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	Reported	Adjusted
Revenue	2,000,000	2,000,000
Cost of Revenue	1,000,000	1,000,000
Gross Margin	1,000,000	1,000,000
Operating Expenses		
Owners salary	300,000	(200,000)
Owner Salaries	500,000	500,000
Rent	50,000	50,000
Depreciation	50,000	50,000
Interest Expense	2,100	2,100
Hunting camp expenses	5,000	(5,000)
Other Expenses		
Total Operating expenses	907,100	702,100
Investment Income	30,000	(30,000)
Pre tax Income	122,900	297,900
Income Taxes	49,160	119,160
Net Income	73,740	178,740
Depreciation	50,000	50,000
Capital Expenditures	(50,000)	(50,000)
Change in Working Capital	(15,000)	(15,000)
Free Cash Flow after tax	58,740	163,740
Net Income	73,740	178,740
Interest Expense	2,100	2,100
Income Taxes	49,160	119,160
Depreciation	50,000	50,000
EBITDA	175,000	350,000

Market Approach

	Multiple	Company A	Value
Price/Revenue	0.50	2,000,000	1,000,000
Price/Earnings (PE)	8.00	178,740	1,429,920
Price/Equity	2.00	500,000	1,000,000
Total Enterprise Value/EBITDA	4.00	350,000	1,400,000
less long term debt			(300,000)
			1,100,000
Conclusion of Value			1,250,000

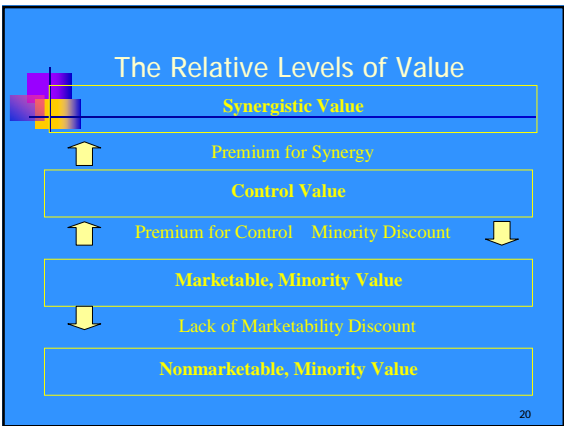
Income Approach

		Present Val	Present Value
		Factor	
Free CFAT			
Year 1 (1)	176,839	0.83	146,148
Year 2	190,986	0.68	130,446
Year 3	206,265	0.56	116,431
Year 4	222,766	0.47	103,922
Terminal Value (2)	1,234,247	0.47	575,785
			1,072,733
Assumptions:			
Short term growth rate		8.00%	
Long term growth rate		2.50%	
Discount rate		21.00%	
Capitalization rate (Discount rate - Long term growth rate)		18.50%	
(1)	163,740 x	1.08 =	176,839
(2)	222,766 x	1.025 =	228,336
			divided by
			=
			18.50%
			1,234,247

Asset Approach

	Market Value	Liquidation Cost	Total
Cash	100,000	0	100,000
Accounts Receivable	500,000	(50,000)	450,000
Inventory	300,000	(75,000)	225,000
PP&E at Market Value	900,000	(90,000)	810,000
TOTAL ASSETS			1,585,000
Less Liabilities			(800,000)
Net Proceeds			785,000

Conclusion and Reconciliation		
	Minority	Control
Market Approach Mergers		1,250,000
Income Approach Discounted Cash Flow	1,072,733	
Asset Approach Liquidation		785,000
Conclusions:		
Control Value		1,200,000
Minority discount	10.42%	
Marketable, Minority Value		1,075,000
Lack of Marketability discount	30.00%	
Nonmarketable, Minority Value		752,500



Synergistic Premium

- Reflects the value to a specific buyer
- Synergistic buyer can pay more due to perceived earnings benefits from a merger
- Not appropriate consideration in determining "fair market value"

What Discounts/Premiums Apply in Valuing Shares in a Closely-Held Company

Control Premium/Minority discount

- Appoint or remove management or determine their compensation;
- Set policy or change the course of business;
- Acquire or liquidate assets;
- Make acquisitions of other companies;
- Liquidate, dissolve, sell, or recapitalize the company;
- Registering the company's stock for an initial public offering;
- Force the sale of the stock to the Company (stock redemption);
- Determine the amount and timing of any dividends to shareholders or
- Amend the Articles of Incorporation.

22

Marketability Discount

- Securities of privately owned companies are not readily tradable on an established exchange and may require a discount for their lack of marketability.

23

Conclusion

- There are numerous reasons to know the value of your business
- "Value" depends on the purpose of the valuation

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24
