

**Valuation in a Business Exit**  
**Lorman Education Services**

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Vanessa B. Claiborne, CPA/ABV, ASA

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**Chaffe & Associates, Inc.**  
201 St. Charles Ave., Suite 1410  
New Orleans, LA 70170  
504-524-1801  
504-524-7194 fax  
vbrown@chaffe-associates.com  
[www.chaffe-associates.com](http://www.chaffe-associates.com)

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<p><b>Exit Strategy</b></p> <p>A) Sale of Company.</p> <p>B) Fairness opinion.</p> <p>C) Estate or donations.</p> <p>D) ESOP.</p> <p>E) Buy-Sell.</p>	<p><b>Standard of Value</b></p> <p>A) Strategic/Financial.</p> <p>B) Fairness from a financial perspective.</p> <p>C) Fair market value-Control or marketable, minority.</p> <p>D) Fair market value.</p> <p>E) By agreement but IRS disregards if related parties and not FMV.</p>
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**Fair Market Value**

The amount at which the capital stock of the company would change hands between a willing buyer and a willing seller, each having reasonable knowledge of the relevant facts, neither being under any compulsion to act.

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## Strategic Value

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

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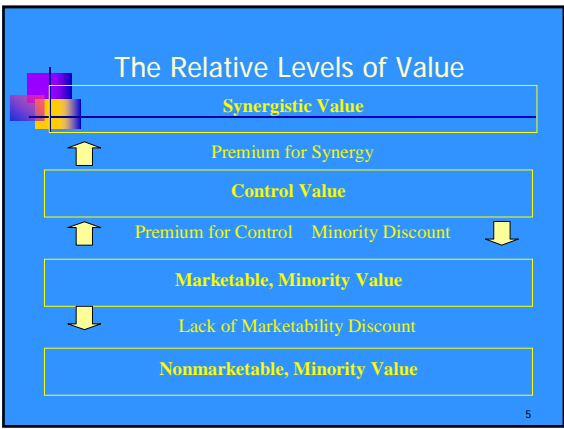
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## IRS Revenue Ruling 59-60

The following factors, although not all-inclusive, are fundamental and require careful analysis in each case:

- n 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 of the company.
- n The dividend-paying capacity of the company.

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## IRS Revenue Ruling 59-60

- n Whether or not the enterprise has goodwill or other intangible value.
- n The price, size, and type of interests sold previously and the size and type of the interests to be valued.
- n The market price of interests or stocks issued by companies in the same or a similar line of business and actively traded in a free and open market, either on an exchange or over-the-counter.

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## 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

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## 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

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## EBITDA

Earnings before interest expense, taxes, depreciation and amortization

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

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## Total Enterprise Value

- n ("TEV") = equity + long term debt
- n Pricing multiple = (Equity + LT debt)/EBITDA
- n Equity = pricing multiple x EBITDA – LT debt.

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## Approaches to Business Valuation

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

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## Approaches to Business Valuation

I. Asset-Based Approach

- n Adjusted Book Value Method
- n Liquidation Value Method

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## 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

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## Approaches to Business Valuation (Cont.)

III. Income Approach

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

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## Correlation and Conclusions

	<u>Minority</u>	<u>Minority</u>
<b>Approach</b>		
Asset	Public Company	Liquidation
Market	Capitalization of Cash	Merger
Income	Flow	LBO

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Universal ManuServe, Inc.					
Balance Sheet as of December 31, 2004					
	Reported		Adjusted for Market comparison		
				Tangible Operating Assets Adjusted to Market values	Other Assets Adjusted to Market values
Cash	1,000,000		1,000,000	1,000,000	
Marketable securities	5,000,000	(5,000,000)	-	-	5,000,000
Accounts receivable	3,000,000		3,000,000	3,000,000	
Widget inventory	6,000,000		6,000,000	6,000,000	
Capitalized R&D	-	500,000	500,000	(500,000)	
				-	-
Equipment, net	4,000,000		4,000,000	(1,000,000)	3,000,000
Hunting camp	50,000	(50,000)	-	-	500,000
Beach condo	200,000	(200,000)	-	-	800,000
				-	-
				-	-
<b>TOTAL ASSETS</b>	<b>19,250,000</b>	<b>(4,750,000)</b>	<b>14,500,000</b>	<b>(1,500,000)</b>	<b>13,000,000</b>
Accounts Payable	1,500,000		1,500,000	1,500,000	
Accrued Expenses	500,000		500,000	500,000	
Current Liabilities	2,000,000		2,000,000	2,000,000	
Long term debt	5,000,000		5,000,000	5,000,000	
<b>TOTAL LIABILITIES</b>	<b>7,000,000</b>		<b>7,000,000</b>	<b>7,000,000</b>	
<b>EQUITY</b>	<b>12,250,000</b>	<b>(4,750,000)</b>	<b>7,500,000</b>	<b>6,000,000</b>	<b>6,300,000</b>
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>19,250,000</b>	<b>(4,750,000)</b>	<b>14,500,000</b>	<b>-</b>	<b>13,000,000</b>

Universal ManuServe, Inc.			
Income Statement for the year ended December 31, 2004			
	Reported		Adjusted for Market comparison
Revenue	15,000,000		15,000,000
Cost of Goods Sold	8,000,000		8,000,000
Gross Profit	7,000,000		7,000,000
Operating Expenses			
Sam Reggio Compensation	100,000	(100,000)	-
Marie Boudreaux Compensation	50,000	(50,000)	-
R&D expenses	500,000	(200,000)	300,000
Frank Boudreaux compensation	1,000,000	(750,000)	250,000
Hunting camp expenses	30,000	(30,000)	-
Condo expenses	30,000	(30,000)	-
Other operating expenses	5,500,000		5,500,000
Total Operating Expenses	7,210,000		6,050,000
Operating Income	(210,000)		950,000
Investment Income	250,000	(250,000)	-
Pretax Income	40,000		950,000
Income taxes	7,200		370,500
Net Income	32,800		579,500
Depreciation	500,000		500,000
Interest Expense	350,000		350,000
EBITDA	890,000		1,800,000

MARKET APPROACH			
Merger Comparison			
	Merger		Control
	Comps	Univ Manu	Value
Price/Earnings	17.00	579,500	9,851,500
Price/Revenue	0.70	15,000,000	10,500,000
Price/Equity	1.20	7,500,000	9,000,000
TEV/EBITDA	8.50	1,800,000	10,300,000
	less debt	5,000,000	
Conclusion			10,000,000

Public Co Comparison			
	Public Co		Control
	Comps	Univ Manu	Value
Price/Earnings	15.00	579,500	8,692,500
Price/Revenue	0.55	15,000,000	8,250,000
Price/Equity	1.30	7,500,000	9,750,000
TEV/EBITDA	8.00	1,800,000	9,400,000
	less debt	5,000,000	
Conclusion-comparable value			9,000,000
Size discount	20%		
Conclusion			7,000,000

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INCOME APPROACH			
Capitalization of Cash flow			
5 year average cash flow	1,350,000		
Capitalization rate:			
Risk free rate	6.00%		
Equity premium	7.00%		
Size premium	5.00%		
Company specific premium	3.00%		
Total discount rate	21.00%		
Long term growth rate	2.00%		
Capitalization rate	19.00%		
5 year average cash flow	1,350,000		7,105,263
Capitalization rate:	19.00%		

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ASSET APPROACH	
Liquidation of Operating Assets	
Balance Sheet as of December 31, 2004	Operating Assets Adjusted to Market values
Cash	1,000,000
Accounts receivable	3,000,000
Widget Inventory	6,000,000
Equipment, net	<u>3,000,000</u>
TOTAL ASSETS	13,000,000
Accounts Payable	1,500,000
Accrued Expenses	500,000
Long term debt	5,000,000
Liquidation costs	1,200,000
Corporate Income taxes on gain	
TOTAL LIABILITIES	8,200,000
Proceeds to distribute	4,800,000

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

### Minority Discount

A minority interest in a closely held corporation is generally held to be worth less than its proportionate share of the value of all the outstanding shares. This is because minority shareholders generally cannot control the company. The magnitude of a minority discount depends on the shareholder's ability to exercise any or all of a variety of rights typically associated with control.

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## 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.

- Non-ESOP Shares-Minority blocks of non-ESOP stock typically have a discount in the 25% to 45% range.
  - Control blocks of stock are generally more readily marketable than minority blocks.
- ESOP shares have a put right. The effect of this put option is generally to improve the marketability and liquidity of the security.
  - Marketability discounts for ESOP shares typically range from 0% to 15%.

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## Conclusion

- Determine purpose(s)
- Define standard(s) of value
- Normalize income stream & Balance sheet
- Market research

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