

10 THINGS TO KNOW ABOUT BUSINESS VALUATION

By Kelly Skarda, Valuation Director
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1 WHY ARE BUSINESS VALUATIONS NEEDED?

SELLING A COMPANY | Business valuations help determine an appropriate asking price when a company's owners decide to sell.

ESTATE AND GIFT TAX | Estate planners rely on business valuations when considering the tax impact on asset transfers.

MARITAL DISSOLUTION | Frequently, one of the assets included in the marital estate is interest in a closely-held business. A valuation determines the value of the business for the divorce proceedings.

BUY/SELL AGREEMENTS | Buy/Sell agreements allow one stockholder to acquire another stockholder's interest. They can provide for a smoother transfer of ownership.

es in financing.

MARKET APPROACH | Evaluates a company based on completed transactions of comparable companies.

ASSET APPROACH | Measures the fair market value of a company's assets, less its liabilities. Frequently used for underperforming companies, this approach is not appropriate for companies with high intangible value.

2 WHAT IS USPAP? WHAT ARE BUSINESS VALUATION STANDARDS?

In addition to standards set by organizations such as the Institute of Business Appraisers (IBA) and American Society of Appraisers (ASA), qualified business appraisers follow the Uniform Standards of Professional Appraisal Practice (USPAP). This is recognized as the official source of appraisal standards in North America.

Adherence to standards reinforces a business appraiser's expertise and the credibility of their work. Appraisers who fail to perform their work in accordance with USPAP standards are subject to criticism and may have difficulty defending their conclusions in litigation.

3 HOW DO BUSINESS APPRAISERS DETERMINE VALUE?

Business appraisers use three primary approaches to determine a company's value:

INCOME APPROACH | Weighs the expected benefits from investing in the company against the required return for assuming the risk and uncertainty associated with it. This approach can account for changes in revenue growth, working capital needs, future capital expenditures, and differ-

4 IS THE DATE OF A VALUATION IMPORTANT? DO BUSINESS VALUATIONS EXPIRE?

A business valuation is the estimated value of a company at a specific point in time. The value of a company can vary at different points in time due to internal and external factors. Since a business valuation is based on a specific point in time, the valuation does not expire, however, the derived value may no longer be appropriate the older the valuation report gets.

5 CAN A BUSINESS HAVE MORE THAN ONE VALUE?

Yes. A business can have multiple values at a single point in time. Value is determined by the price a hypothetical, ready and willing buyer will pay for a business. As such, a business may have different values to a willing buyer with no synergistic benefits versus a strategic acquirer that could realize enhanced value.

6 HOW DO I JUDGE A BUSINESS APPRAISERS QUALIFICATIONS?

Professionals in varying occupations may claim to be business appraisers, but only accredited business appraisers have the training and expertise needed to provide accurate and defensible business valuation reports. The Certified Business Appraiser (CBA) and Accredited Senior Appraiser (ASA) designations are the most prestigious in the business appraisal industry. They require more training and experience than the Certified Valuation Analyst (CVA) and Accredited in Business Valuation (ABV) designations.

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7 HOW DO I CRITIQUE A BUSINESS VALUATION

A valuation without a reasonability test is open to criticism, rebuttal, and rejection. One critique is a purchase price justification test, which confirms whether a lending institution could finance the company at its estimated value to a qualified buyer with a reasonable equity stake. This test confirms whether a business's cash flow can finance the acquisition debt, pay applicable taxes, and provide a return to the investor.

8 WHAT INFORMATION IS NEEDED TO PERFORM A BUSINESS VALUATION?

The following documents are necessary to provide an accurate valuation: profit and loss statements, balance sheets and tax returns for the last four to five years; interim profit and loss statements and balance sheets for the current year; copies of any forecasts or projections. Other documents commonly requested include: information that describes the company's services and/or products, list of significant assets and inventory, details of any liabilities, and reports by other professionals and consultants.

9 WHAT ELSE CAN OWNERS USE A BUSINESS VALUATION FOR?

Business valuations provide business owners with useful information such as where the risks are in their business, how the company's financial performance compares to its peers, where the value of the business is coming from and ways to increase that value. Business owners commonly use business valuations as a tool to enhance the operational and financial performance of their company.

10 HOW MUCH DOES A BUSINESS VALUATION COST

Most certified business appraisers quote a project fee or an hourly rate, with outside expenses billed separately. Depending on the scope of the valuation, a valuation can cost anywhere from \$5,000 to \$20,000.