



The Value of Your Company

Several events can signal the need for a comprehensive or partial business valuation: succession or estate planning, the death of a partner or shareholder, borrowing or debt restructuring, decisions on employee stock ownership plans, to name a few.

A comprehensive valuation also helps owners understand a company's place in the market: opportunities and threats, industry trends, changes in demand and promising directions for research and development.

Most companies have only a feel for their industry position and the maturity level of their products — fundamental questions for their future. It may be wise to develop one product, discontinue another or spin off a third. But when? Where's the maximum value? A valuation — of the company or of the line in question — helps answer these questions.

Quantity and Quality

The value of a business is based on both quantitative data and a qualitative assessment.

- To gauge the quantitative value of holdings, shareholders in a public company multiply stock price by number of shares. Owners of privately held companies often look only at net income and the cash they could pull out.
- The qualitative aspect of value concerns the future viability of a company. Is it a thriving concern, reduced to a fire sale or somewhere in between, anticipating several good years before its technology edge disappears, and then liquidation?

Standards of Value

There are various standards for determining value. The choice of one over another is driven by the reason for the valuation.

- *Fair market value* is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.
- *Fair value* is what's prescribed by recent accounting standards, or what a court deems it to be.
- *Liquidation value* involves either an orderly or forced liquidation of assets.
- *Investor value* may include premiums that certain investors would pay — for example, to achieve unique production synergies.

Approaches to Valuation

Depending on these premises and standards, one or another valuation approach will prove most effective. By current professional standards, a comprehensive valuation tests all before choosing one.

- The *cost approach* subtracts the market value of liabilities from assets. This approach is most commonly used by companies with large tangible assets, and which add little or no value to their products or services from labor or intangible assets.¹
- The *income approach* reveals the present value of a company's anticipated economic benefit. For example, a company's aging press brakes may have little market value, but may be perfectly suited to certain profitable work.
- The *market approach* compares a company to others that are similarly situated in terms of size, location, capital structure, markets and product lines. That information is easier to find for public companies, but it may be difficult to compare such companies to small private concerns.

To understand the selection of the appropriate approach, consider the following scenario. If the purpose of the valuation is to value a minority interest, the cost approach might assign a high value to a 20 percent minority interest, due to the company's extensive assets. But if the minority shareholder can't force a liquidation, the cost approach may be deemed inappropriate. The minority interest shareholder may only have access to dividends and/or distributions when declared by a controlling interest, and therefore an income approach may result in a better determination of value of subject minority interest.

Finally, by setting valuation standards in buy-sell agreements and conducting periodic valuations, a company can head off the kind of exit disagreements that lead to litigation. In this regard, short-cut formulas may be easier to write, but professionally-prepared appraisals can minimize disputes and enable all concerned to move on.

To discuss your valuation options, please contact Bob Power at 814-724-5890.