



## Bankruptcy Valuations Require Specialized Expertise

The dot-coms are gone. The steel industry is in its second cycle of bankruptcy, and the airline industry is not far behind. It looks like bankruptcy valuation experts and the attorneys with whom they work will be busy for a few years to come.

CPA valuation and consulting services are considered to be litigation support services in the bankruptcy process, and are used in both Chapter 11 and Chapter 7 of the Bankruptcy Code. Chapter 11 is a reorganization, in which management continues to run the company while it develops a plan to regroup and settle debts with creditors. Chapter 7 is a liquidation, in which a trustee liquidates the company's assets and distributes the proceeds to creditors.

### Reorganizing an Emerging Company

When a business emerges from Chapter 11, it gets a "fresh start" in terms of its reporting. A valuation expert is typically called upon in this case to determine the business' reorganization value — the proper value for the fresh-start financial statements — as it emerges from bankruptcy. The reorganization value is basically the amount a willing buyer would pay for the company's assets after restructuring. This is essentially the same concept as "fair market value," for an ongoing concern.

The two most widely used methods for determining reorganization value are based on the income and market approaches:

- The *income approach* involves two methods: discounted cash flow and capitalization of earnings. The discounted cash flow method estimates the value of the business by forecasting cash flow and a presumed value after cash flows stabilize, and then discounting these forecasts to present value. The capitalization of earnings method applies a capitalization rate to a single earnings amount

- anticipated to be the future earnings of the business.
- The *market approach*, meanwhile, uses measurements such as the price/earning ratio of comparable companies.

Often, reorganization value is determined by considering several different approaches.

### **Ceasing Operations**

The point of a Chapter 7 bankruptcy is liquidation of the company. Therefore, liquidation value is defined as the value the company's assets would bring if sold — either as a whole or as individual assets — minus certain expenses related to the liquidation. These deductions include administrative expenses, severance pay, taxes on gains from sales of assets, operating costs during the wind-down period, and professional fees, among others.

Liquidation value may be expressed as a single amount or as a range of high and low values.

Bankruptcy rules are extremely specific, and bankruptcy valuation services require specialized knowledge. Because of the complexities of many bankruptcy cases, it is imperative that bankruptcy attorneys and accountants work as a tight technical team.

*Our firm has extensive expertise in valuation services relative to bankruptcy. Please contact us to discuss how we can assist you.*

### **“Failed,” “Bankrupt” or Merely “Troubled”?**

Dun & Bradstreet defines a business “failure” as ceasing operations following an assignment, attachment, foreclosure or bankruptcy, with debts remaining unpaid and losses to creditors. A business that voluntarily compromised with creditors, or one that is involved in a Chapter 11 bankruptcy, is also considered a “failure.”

A “bankrupt” company has filed a petition under the Bankruptcy Code, either to reorganize or liquidate. And a “troubled” company is one that is facing severe financial difficulties that could result in failure or bankruptcy.