

Strafford

Presenting a live 110-minute teleconference with interactive Q&A

Valuation Challenges With \$10 Million-and-Under Businesses

Avoiding Mistakes With Built-In Gains and Taxes, Misuse of Market Data
and Other Small Business Complexities

THURSDAY, AUGUST 8, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

David Coffman, CPA, President & CEO, **N.J. Business Valuations**, Seaside Park, N.J.

Troy C. Patton, CPA/ABV, Managing Partner, **Patton & Associates**, Indianapolis

Please refer to the instructions emailed to the registrant for the dial-in information, including options for phone or Web sound for one or multiple listeners. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

Tips for Optimal Quality

Options

You can listen to the audio for this program both via the phone and the Web. However, if you listen via the Web, and more than one person is in the room, you must have a proctor to verify your attendance. Consult your dial-in instructions for more details.

Sound Quality

Call in on the telephone by dialing **1-866-570-7602** and enter your PIN when prompted.

If you have any difficulties during the call, press *0 for assistance. You may also send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

Attendees must stay on the line throughout the program, including the Q & A session, in order to qualify for full continuing education credits. Strafford is required to monitor attendance.

Record verification codes presented throughout the seminar. If you have not printed out the “Official Record of Attendance,” please print it now (see “Handouts” tab in “Conference Materials” box on left-hand side of your computer screen). To earn Continuing Education credits, you must write down the verification codes in the corresponding spaces found on the Official Record of Attendance form.

Please refer to the instructions emailed to the registrant for additional information. If you have any questions, please contact **Customer Service** at **1-800-926-7926 ext. 10**.

Program Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides and the Official Record of Attendance for today's program.
- Double-click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Valuation Challenges With \$10 Million-and-Under Businesses

August 8, 2013

David Coffman, CPA, N.J. Business Valuations
dave@business-valuation-expert.com

Troy C. Patton, CPA/ABV, Patton & Associates
tpatton@pattonandassociates.com

Today's Program

Overview

[David Coffman and Troy Patton]

Slide 8 - Slide 21

Reasons for a Valuation

[Troy Patton]

Slide 22 - Slide 24

Common Mistakes in Small Business Valuations

[Troy Patton]

Slide 25 - Slide 35

Common Mistakes in Smaller Business Valuations

[David Coffman]

Slide 36 - Slide 53

Remedies to Common Mistakes

[Troy Patton and David Coffman]

Slide 54 - Slide 55

Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS' FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

David Coffman, CPA, N.J. Business Valuations

Troy C. Patton, CPA/ABV, Patton & Associates

OVERVIEW

Statement on Standards for Valuation Services (SSVS) No. 1

The statement, which is effective for valuation engagements accepted after Jan. 1, 2008, is expected to achieve 10 benefits.

Statement on Standards for Valuation Services (SSVS) No. 1

Expected Client Benefits

- Clients can reach a clear understanding with the valuation analyst regarding the level of valuation service to be performed. The statement provides for well-defined alternative types of valuation development analyses.
- Clients can reach a clear understanding with the valuation analyst regarding the type of valuation report (that is, engagement deliverable). The statement provides for several well-defined types of valuation reports.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Expected Client Benefits

- As it is described in the valuation report, the valuation analysis should be replicable. That is, the client (or other report reader) should be able to (1) replicate the valuation approaches, methods and procedures and (2) duplicate the value conclusion.
- There should be transparency in the valuation analysis and in the valuation report. This transparency should increase the client's confidence in the valuation process and in the value conclusion.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Expected Client Benefits

- Clients should benefit from both increased consistency and comparability between different analysts' valuation reports.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Expected Member Benefits

- The statement provides professional guidance as to generally accepted “best practices” within the valuation community. Clients can reach a clear understanding with the valuation analyst regarding the type of valuation report (that is, engagement deliverable). The statement provides for several well-defined types of valuation reports.
- In defending the valuation work during a contrarian challenge (for example, by the IRS, a regulatory agency, an opposing expert witness or a litigation cross-examination), the member will have the assurance that his or her analysis and report are prepared in accordance with the statement.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Expected Member Benefits

- Members may rely on the statement for professional guidance with regard to what are (and are not) considered generally accepted valuation approaches.
- Members may rely on the statement for professional guidance with regard to the type of documents and documentation (both financial and nonfinancial) that should be considered in the valuation process.
- The Pension Protection Act of 2006 requires members who perform certain tax-related valuations to comply with “generally accepted appraisal standards.” Compliance with the statement allows the member to meet the IRS requirements.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Two Types of Engagements

- A Valuation Engagement
- A Calculation Engagement

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Valuation Engagement

- Valuation Engagement: The individual performing the valuation is free to apply the valuation approaches and methods he or she deems appropriate. The results are expressed as a conclusion of value –either as a single amount or as a range of values.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Valuation Engagement - minimum information

- The nature of the subject interest.
- The scope of the valuation engagement.
- The valuation date.
- The intended use of the valuation.
- The applicable standard of value.
- The applicable premise of value.
- The assumptions and limiting conditions.
- Any applicable government regulations or other professional standards.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Calculation Engagement

- **Valuation Engagement:** The individual performing the valuation and the client agree on the valuation approaches and methods to use and the extent of procedures the person performing the valuation will perform to calculate the value of the subject interest. The results are expressed as a calculated value—either as a single amount or as a range of values. A calculation engagement does not include all of the procedures of a full valuation engagement. The resulting value may be different.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Valuation Engagement - minimum information

- The identity of the client.
- The identity of the subject interest.
- Any ownership control and/or marketability elements of the subject interest.
- The purpose and intended use of the calculated value.
- The intended users of the report and the limitations on the report use.

Statement on Standards for Valuation Services (SSVS) No. 1 (Cont.)

Calculation Engagement - Analysis should include:

- The valuation date.
- The applicable standard of value.
- The applicable premise of value.
- The sources of information used.
- Valuation approaches and methods agreed on with the client.
- The disclosure of any subsequent events.

Slide Intentionally Left Blank

Troy C. Patton, CPA/ABV, Patton & Associates

REASONS FOR A VALUATION

Valuation Purposes

- Mergers & Acquisitions
- Succession Planning and Buy/Sale of a business
- SBA Lending
- Intangibles - Goodwill (SFAS 141)
- Formula Creation for Purchases
- Minority Interest

Valuation Purposes

- Estate Planning
- Divorce or Marital Value
- C to S Conversion
- Litigation - Shareholder Disputes
- ESOP

Troy C. Patton, CPA/ABV, Patton & Associates

COMMON MISTAKES IN SMALL BUSINESS VALUATIONS

Choosing the Wrong Type of Business Value

- FMV
- Fair Value
- Synergistic Value
- Liquidation Value
- Orderly or Forced

Using the Wrong Valuation Multiples

- Rules of Thumb
- Cost of Capital
- Build Up Method vs. Duff & Phelps
- Market Multiples
- Coverage Ratio and Debt to Equity Checkup

Using an Incorrect Valuation Method

- Asset Approach
- Book Value Liquidation Value
- Income Approach
- Capitalization of Earnings
- Dividend Capacity
- DCF
- Projections - Are they accurate, do we care?

Using an Incorrect Valuation Method (Cont.)

- Market Based Approaches
- Price to Discretionary Earnings
- MVIC to EBITDA
- Price to Sales (Rule of Thumb)

Slide Intentionally Left Blank

Improper Adjustment to Accounting Records

- Normalized Compensation
- Officers/Directors - do they really exist
- Entertainment
- Health Insurance
- Travel
- Accrual vs. Tax

Goodwill

- Tradename
- Customer List
- Value over Physical Assets
- Is the Building Needed
- Enterprise
- Personal
- Does Size Really Matter?

Goodwill

- **Enterprise** - goodwill that is attributable to the business and can be transferred in a sale
- **Personal** - goodwill that is attributable to a persona and cannot be sold

Off Balance Sheet Items

- Assets
- Liabilities
- How is the loan characterized?

Company Specific Risk

- What is it?
- How can we calculate it?
- Are we double-dipping?
- Marketability Discount
- Minority Discount

David Coffman, CPA, N.J. Business Valuations

COMMON MISTAKES IN SMALLER BUSINESS VALUATIONS

Characteristics

Small, Owner-Operated Businesses

- One or small group of owners
- All owners actively work in the business
- Under \$2 million in annual revenue
- Less than 5 employees

Small, Owner-Operated Businesses

How Are They Different?

- Size
- No separation of ownership & management
- Business purpose

Small, Owner-Operated Businesses

How Many are There?

- Non-employers: 22 million
- Less than 5 employees: 3 million
- Total of all businesses: 27 million

Slide Intentionally Left Blank

Not Defining a Hypothetical Sale

- Asset sale
- Majority sold as asset sales
- Entire enterprise
- Typical assets included in sale

Not Defining a Hypothetical Sale

- Buyer
- Another owner-operator
- Fractional interest
- Company or other owners
- Result of sale of entire enterprise

Using Public Company Data

- Why it's not relevant
- Investor vs. owner
- Company
- Management objectives

Using Public Company Data

- Public company guideline method
- Not relevant
- Don't use, but explain why

Using Public Company Data

- Capitalization & discount rates
- Publicly traded securities data not relevant
- Use private company transaction data
- Eliminates need for many valuation adjustments

Using Public Company Data

- Alternate sources of data
- Pepperdine Private Company Cost of Capital Study
- BizBuySell.com
- Private company transaction databases

Using Discounted Cash Flow

- Cash flow projections
- Typically not available
- Require client to prepare?
- Prepared by valuation analyst

Using Discounted Cash Flow

- Are projections relevant
- Sale means change in management
- Hypothetical buyer's objectives

Using Discounts

- Lack of marketability
- Due to use of public company data
- Match marketability of the data to subject
- Rate of return vs. discount

Using Discounts

- Lack or control
- Market for fractional interests
- Company or other owners
- Sale of entire enterprise

Owner's Compensation

- How owner-operators set compensation
- Available cash flow
- Personal requirements
- Owners generally earn less
- Intangible benefits of ownership

Owner's Compensation

- Allocation of cash flow
- Business vs. personal
- Seller's discretionary earnings
- Allocate

Slide Intentionally Left Blank

David Coffman, CPA, N.J. Business Valuations

Troy C. Patton, CPA/ABV, Patton & Associates

REMEDIES TO MISTAKES

Remedies

- Review
- Preparation
- Corrections
- Drafts vs. Final