



Business Valuation 101

Brad L. Bailey, CPA,
MT, ABV-Tax Partner
Blbailey@becpas.com
804-897-4700





Agenda

TOPICS TO COVER

- Asset Approach
- Income Approach
- Market Approach
- Value for Contractors
- ESOP

Company History

Brown Edwards is a full-service regional accounting firm with offices in Virginia, West Virginia, and Tennessee, and is included in Inside Public Accounting's list as one of the top 100 firms in the United States and included on the 2021 Inc. 5000 list of Fastest-Growing Companies. We are proud to support a wide-range of industries throughout the Mid-Atlantic, including automobile dealerships, construction, credit unions, education, employee benefits, energy, financial institutions, healthcare, manufacturing and distribution, state and local government, real estate and not-for-profit organizations.



Approaches to Business Valuation

- Introduction / Overview
- No single formula or approach can be used
- Appraiser and valuers have agreed upon generally accepted approaches and methods for valuing closely held companies
- Purpose of valuation-IRS, Divorce, compensation transaction, merger
- Standard of value; fair market value (discounts), investment value (no discounts), intrinsic value, strategic value





Did you know....

- Small businesses make up 99% of all firms and provide 48% of jobs nationally. Baby boomers own about half of all privately held companies with employees in the United States. The 2.4 million business owners who belong to this aging demographic (1/3 of whom have already passed 65) will need to develop sound and sensible exit strategies.
- Only 20% of businesses listed for sale ever sell. This percentage is likely to decline in coming years as boomer enterprises flood the market at a record pace.
- Only about 15% of privately held companies are passed down to a second generation.

Business Transition Statistics

- 85% of business owners have no written transition plan.
- 49% have done no planning at all.
- 40% have no plans that cover illness, death or forced exit.
- 40.3% of family business owners expect to retire. Less than half of those expecting to retire in the next 5 years have selected a successor.
- 43% of family-owned businesses have no succession plan in place.
- Nearly 70% of family businesses would like to pass their business on to the next generation. Only 30% will actually be successful.





Asset Approach

- Balance sheet approach that Company value is based on the Company assets less liabilities of company
- Methods Include:
 - Book Value
 - Adjusted Book Value
 - GAAP based balance sheet, adjusted to market value
 - Liquidation
- For Virginia divorces, the Courts use the asset approach as the floor value



Asset Approach – Good, Bad, & Ugly

- **Good**
 - ✓ Asset heavy industry
 - ✓ Conservative value
- **Bad**
 - ✓ Ignores cash flows to shareholders
 - ✓ Intangible asset valuation-goodwill, customer list
 - ✓ Warranty claims, contingent liability
 - ✓ Negative net worth due to owners compensation, prior stock redemptions
- **Ugly**
 - ✓ Value of company at a “certain point in time”
 - ✓ Does not measure potential future cash flows of a Company



Income Approach

Measures the value of a business by considering the economic income or future benefit stream generated by the business over a period of time (usually 5 years for a business cycle)

Methods Include:

- Discounted cash flow method
- Capitalized cash flow method
- Excess cash flow method



Income Approach – Good, Bad, & Ugly

- **Good**

- ✓ Looks at investor/owner cash flow
- ✓ Excess value over assets of company is considered goodwill

- **Bad**

- ✓ Volatile earnings of company make modeling difficult and subjective
- ✓ Does not measure backlog, built in gain of assets
- ✓ Normalization adjustments can be subjective

- **Ugly**

- ✓ Owners can have multiple duties, salary adjustments
- ✓ Owners argue “one time” expenses, bad decisions, etc.

Market Approach

Similar to the finding Comparables in the real estate market, this approach involves finding companies or transactions in companies that are similar enough to the subject to provide guidance to valuing the subject company.

- **Methods Include:**

- Previous stock transactions of the Company Stock
- Sales of similar companies
- Sales of larger privately held companies or public companies

Market Approach – Good, Bad, & Ugly

- **Good**
 - ✓ Recent multiples show purchaser multiples in real time vs. hypothetical buyer IRR
 - ✓ Actual market multiples can be obtained from independent sources
- **Bad**
 - ✓ Multiples can be overstated based on strategic purposes
 - ✓ Need to have sufficient data for analysis
 - ✓ Market database does not tell whole story! (low value, high comp)
- **Ugly**
 - ✓ Geographic considerations, stale/old data
 - ✓ Comparable comps are difficult to find for diversified business
 - ✓ I.e., internet sales pet items vs. Amazon reseller
 - ✓ Data needs to be refined to remove unlike data
 - ✓ I.e., restaurant with bar vs. dinner

Value Beyond the Numbers

- Supplier relationship and terms
- Work force quality and depth
- Market Speciality
- Earnings and Cash flow
- Customer list and diversification
- Quality contracts
- Customer demographics
- Infrastructure including process, cost control
- Fixed assets
- Company culture
- Warranty
- Quality of work

Value Drivers for Contractors

- Bank relationship, insurance and bonding
- Expertise and reputation
- Customer base (large, small, recurring)
- Joint venture relations
- Receivables and retainage
- Permanent Work force
- Land holdings and future projects
- Permits

How Can I Increase my Business Value?

- Determine what you are best at and delegate and manage the rest of the process.
- Read, Read and Read
- Select and train key employees; don't hire too many friends or family
- Revenue should be trending upward
- 50% of advertising is wasted, you just don't know which half.
- Remove extravagant expenses
- Focus on a cash flow budget and set goals
- Don't sweat the small stuff
- Protect yourself from fraud, time wasters
- Analyze your process and jobs to determine why you did not achieve budget
- Technology forces us to rethink our business approach; embrace these changes



Any Questions?