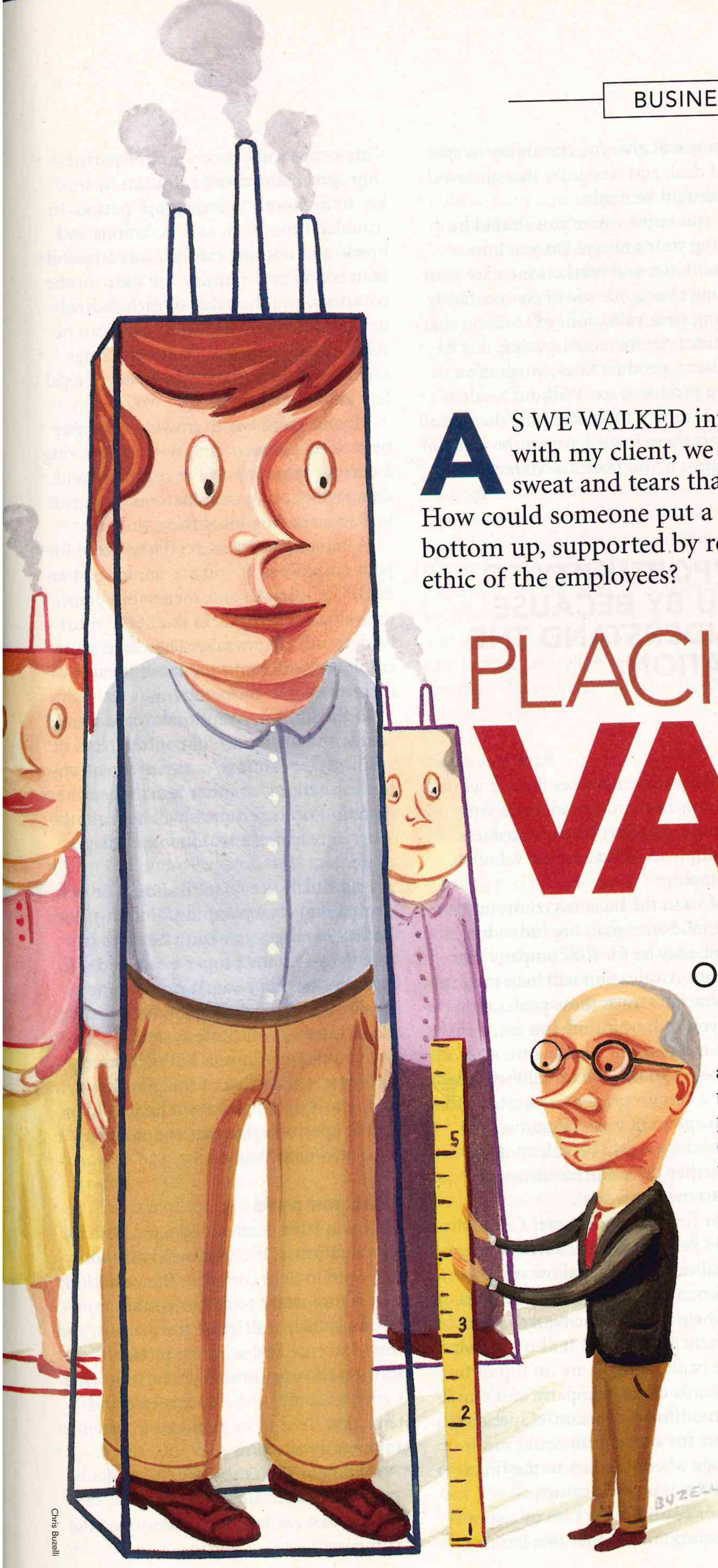

Chris Buzelli

PLACING a VALUE on BUSINESS

AS WE WALKED into a small, confined industrial shop with my client, we immediately recognized the blood, sweat and tears that had been poured into the company. How could someone put a value on this business—built from the bottom up, supported by reputation, goodwill, and the hard work ethic of the employees?

Not for the faint of heart, valuation takes your blood, sweat and tears and gives it back in dollars, cents and selling prices

By **Bart Basi**, *CPA, attorney at law* and **Roman Basi**, *MBA, attorney at law*

The owner/seller asked how a valuation of his company could be determined—what would be needed, and what to expect in terms of cost, time frame, and future valuation needs. We had been hired to value the company for the buyer. It helped to explain the importance of a valuation, the documents and information that would be required in order to complete the valuation, and what he could expect from a valuation.

In this two-part article, we will address those same issues regarding valuations, and identify the major components of a valuation. Part I will present the various purposes of a valuation, and what you need to have one completed. Part II will discuss the qualifications of an appraiser, how the valuation is done, and what to expect from the results of the valuation.

The purpose of a valuation

There are many different purposes for which you may want to have your company valued. First and foremost is that you may be contemplating selling your company and have no idea of the actual value. A valuation will establish a range in which you can feel comfortable knowing that this is the average price a willing buyer would purchase the business for in this economy. Without a competent valuation, if you sold too quickly, you would be forever wondering whether the price you sold for was too low.

In reverse, if the company is taking too long to sell, your hindsight may ask you if the price is too high. A valuation will cure this second-guessing by giving definitive benchmarks from which to guide your decision-making process. You can leave the transaction feeling that you made a competent decision and one that was economically feasible.

No one is willing to buy a company that has not determined a value. The valuation step in the process of selling your company is the most crucial element of a profitable transaction.

Another reason for a valuation is if you are purchasing a business. If purchasing another company, the selling party may not have done a valuation, or you may not agree with the one that was done. A valuation is done to provide you with a benchmark from which to compare the prospective purchase. If you are still in the market for a strong company, but have not yet identified a potential target, having a valuation of your own company will give you the ability to spot a good deal, and recognize that an investment should be made.

Do you know where you should be spending your money? Do you know what activities and markets increase your company's value the most? By constantly updating your valuation, you will be able to monitor the increase in value, due to advertising, product lines, integration of existing products, etc. Without a valuation, it is difficult to determine the overall net effect these items have on the value of a business. If you notice a characteristic that substantially increases the net worth of the company, you can increase your attention to that part of your business and multiply its effects on the value of your company.

DON'T LET THE OPPORTUNITY TO SUCCEED PASS YOU BY BECAUSE YOU FAILED TO UNDERSTAND THE VALUE OF A VALUATION.

All of us in the business community have a goal. Some goals are individual, and some may be for the company that we operate. A valuation will help to keep you on track to reach these goals, and inform you of how far off you are, or how close you are to reaching the end point. Your goal may be to sell the company for a certain price in a number of years; by updating your valuation on a regular basis, you will be able to determine whether the value has increased enough to meet this goal.

Is your financing adequate? Could it be better? Perhaps a lower interest rate, or additional capital would allow you to obtain certain projects. A current valuation can help to show the banker your actual financial position. It also can help show the bank that you are on top of the current status of the company, and that it is being monitored constantly. Spending a few dollars for a valuation could mean real savings when it comes to the financial capabilities of your company.

Another reason is the case of a company dissolution. Whether this has to do with a corporation, or a simple partnership agreement, a valuation can be the key to a smooth "winding up" period. In troubled times such as dissolutions and break-ups, nothing can be more stressful than trying to determine the value of the company, and the value of each individual owner. Arguments over value can be substantially reduced resulting in huge savings for the company in terms of legal fees and wasted time.

If your company is growing, you may be seeking partners and investors. Having a current valuation of the company, and comparing it to past valuations, is a great tool in attracting investment dollars.

A valuation also is an effective tool for your employees. If you are thinking of an ESOP (employee stock ownership plan), the value of the stock in the ESOP must be determined annually. Therefore, your employees will know the current value of their interest in the company.

In the unlikely event that a case should arise involving breach of contract, loss of business opportunity, antitrust violations, condemnations, or other legal issues, the valuation of the business will help aid the court in reaching a reasonable damages award.

And finally, a valuation should be performed for estate planning. Not only does the IRS require a valuation be done in order to assess the proper estate and gift taxes, but having a valuation referenced in your will can help to eliminate costly and damaging will contests. It will also give you peace of mind. Rather than trying to guess the value of the gift of your company, the valuation will help to identify the specific value that will now be associated with that gift.

What you need

Once you have determined a purpose for the valuation, it is common to ask, what do I need to help complete the valuation?

It is important to gather certain information to help accelerate the process, and provide a true and accurate picture of the position of your company. The following is a list of some of the documents and items that need to be gathered in order to complete a valuation:

- A statement as to the objective and purpose of the valuation.
- A brief description of the history of the company.

- A separate sheet for each key person in the organization, showing their experience, job description, and position of importance.
- A list of stockholders and the number of shares each individual owns. Include the manner in which the shares were obtained (i.e., gift, purchase, or inheritance).
- A complete set of three years' financial statements, with attachments—including cash flow statements, if available.
- The most current three years' federal tax returns, along with any gift returns.
- A line card or similar document identifying different manufacturing firms and products represented.
- Copies of any contracts with major suppliers.
- Copies of any key documents involving stock certificates, such as buy/sell agreements.
- The front page of any company-owned life insurance policies on the lives of any employees/officers/owners.
- A list of the top 10 key customers (those on a regular basis) of the company.
- Totals from the accounts receivable aging sheets, related to the most current financial statement.
- A list of employee loans and/or stockholder loans, either from the business or to the business. In addition, copies of any loan documents relating to the debts.
- A list of all the equipment owned by the company (even if previously written off) and the fair market replacement value of that equipment. For this, you may use a depreciation list as a guide.
- A summary list of any loan agreements with banks, coupled with copies of loan documents placing restrictions on any transfers of stock and/or borrowing capacity.
- An analysis of the past three years' sales, identifying any unusual and/or one-time sales out of the ordinary course of the business.
- An analysis of the past three years' expenses, identifying the unusual and/or non-recurring expenses.
- A complete list of all family-related benefits from the past three years, broken down by category.
- A current copy of any industry reports in which the company has participated with regard to industry statistics and averages.
- Copies of any local reports and/or publications, indicating business conditions covering the company's market territory.
- Publications and/or reports referencing the market conditions of the customer base of the company. As an example, if you sell to the construction industry, then new construction in your market territories should be identified.
- A list of the top 10 key competitors (those on a regular basis) of the company.
- Pictures that you may have of your facilities and/or operations.
- Copies of any previous valuation reports conducted within the past five years.

These are just some of the documents and items that need to be gathered in completing a valuation. Depending on the purpose of the valuation, this list can be expanded or contracted. It is important to keep in mind that facilitating the valuation will help to provide a complete and accurate picture, as well as reduce the time spent on the project—which will reduce the cost to you.

No easy task

You have just been exposed to the many purposes for which valuations are completed, and what is needed to complete a valuation. Understand that completing a valuation is no easy task. The documents and materials that must be assembled and analyzed are not for the faint of heart. It takes a skilled eye and a trained mind to determine what portions of the company are worth more than others. Hard work and dedication do figure into the final value, and it is these factors coupled with the market that determines the valuation range.

A valuation of your company is one component on the road to success. Don't let the opportunity to succeed pass you by because you failed to understand the value of a valuation.

In the second of this two-part series, we will discuss the qualifications of the appraiser, how the valuation is completed, and what you as a business owner can expect from the valuation. ■

Watch for Part II in an upcoming issue of Industrial Distribution. *If you have any questions or would like more information regarding business valuations, please contact The Center for Financial, Legal, & Tax Planning, Inc. at (618) 997-3436, or via e-mail to b-basi@taxplanning.com.*