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Southeast Estate Planning Council of Denver

Business Valuation and Succession Planning

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May 11, 2010



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Goals of this Session

- Obtain insight into valuation issues relating to succession planning
- Gain knowledge of succession planning for the continuity of the business
- Understand how a closely-held business is valued and importance of proper valuation
- Answer questions regarding business valuations and succession planning



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Uses of Business Valuation Reports

- ◉ Sale of a business
- ◉ Mergers or acquisitions
- ◉ Divestiture and spin-offs
- ◉ Initial public offerings
- ◉ Allocation of acquisition price
- ◉ Adequacy of life insurance
- ◉ Litigation support
- ◉ Bankruptcy and foreclosure
- ◉ Insurance claims



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Uses of Business Valuation Reports (cont.)

- ◉ Eminent domain
- ◉ Buy/sell agreements
- ◉ Succession planning
- ◉ Gifting programs
- ◉ Estate and gift taxes
- ◉ Financing proposals
- ◉ Employee stock ownership plans (ESOPs)
- ◉ Charitable contributions
- ◉ Fairness opinions



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Planning Team

- Business owner
- Accountants
- Attorneys
- Insurance agents
- Financial consultants and planners



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Transferring the Business

- Who the owner wants to transfer the business to vs. reality:
 - Family/children
 - Co-owners
 - Key employees
 - Third parties



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Family Issues

- ◉ Fairness to family
- ◉ Family council
- ◉ Differing family member goals
- ◉ Lack of succession planning



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Consequences of Improper Valuation

- ◉ IRS penalties
- ◉ Creation of unwanted debt
- ◉ Forced sale
- ◉ Improper sales price
- ◉ Improper risk management



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STEP 1: Define the Valuation Assignment

- Purpose
- Define standard of value
 - Fair market value
 - Investment value
 - Fair value
- Define premise of value
 - Going concern value
 - Liquidation value
 - Control vs. minority



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STEP 1 (cont.)

- Identify business interest being valued
 - Class of stock
 - Percent of equity value
 - Assets included



STEP 2: Gather Data

- The Nature of the business and its history
- The economic outlook
 - General economy
 - Specific industry
- Book value and financial condition of the business



STEP 2 (cont.)

- ◉ Earnings capacity of the company
- ◉ Goodwill or other intangible value
- ◉ Dividend paying capacity
- ◉ Sales of stock in the past
- ◉ Market price of similar public corporations



STEP 3: Analyze Data

- Adjustments to the financial statements
 - Current value of tangible assets
 - Unrecorded liabilities
 - Shareholder advances and loans
 - Excess compensation
 - Personal expenses of shareholder
 - Rent below or above market rates
 - Non-operating income and expense



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STEP 3 (cont.)

- ◉ Ratio analysis compared to industry
- ◉ Economic environment
- ◉ Industry condition
- ◉ Competition
- ◉ Specific company strengths and weaknesses



STEP 4: Develop Cap/Discount Rates

- ◉ Discount rate: “A rate of return used to convert a series of future income amounts into their present value” - Future
- ◉ Capitalization rate: “A divisor (multiplier) used to convert a defined stream of income based upon historical trends to a present indicated value” - Historical
- ◉ Methods of determining
 - Capital asset pricing model (CAPM)
 - Weighted average cost of capital (WACC)
 - Build-up methods



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STEP 5: Define Earnings

- ◉ Operating income
- ◉ Pretax income
- ◉ Simple cash flow
- ◉ Cash flow available to owner



STEP 6: Consider Valuation Approaches

○ Assets (Cost)

- Book value
- Adjusted book net assets

○ Income approaches

- Capitalization of earnings/cash flow
- Discounted future earnings/cash flow
- Price earnings



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STEP 6 (cont.)

○ Market approaches

- Comparable sales of other similar companies
- Prior sale of company stock
- Market data from public companies
- Rules of thumb



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STEP 7: Arrive at a Conclusion

- Reconcile differences between indicated value
- Select a single value
- Control premium
- Marketability discount
- Minority discount
- Other discounts
 - Key person discount
 - Blockage discount
- Apply sanity check



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Full Written Reports (Formal)

- ◉ Purpose of valuation
- ◉ Approach to valuation
- ◉ Statement of limiting conditions
- ◉ Enterprise background and description
- ◉ Ownership and structure



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Full Written Reports (cont.)

- ◉ Industry
- ◉ Market
- ◉ Economic consideration
- ◉ Financial review
- ◉ Nature of security
- ◉ Valuation methodology
- ◉ Conclusion
- ◉ Appendix



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Thank You!

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