Santa Barbara Valuations

BUSINESS VALUATION PROCESS

Partners with: The Mentor Group

The scope of a valuation project and its fee depend on business complexity, level of analysis required and the efficient delivery of information to the analyst. Each project is unique because each business is unique, and the valuation process itself has hundreds of possible paths to the conclusion.

STEP 1: PRELIMINARY DISCUSSION & CONTRACT

We first start with a conversation where the need and work parameters are fleshed out with the client. The working relationship between the client and the valuator is then described in a written contract called an engagement agreement. The engagement agreement describes the scope of work to be done, the obligations of each party, the fee, and other important elements.

STEP 2: SCOPE OF WORK

Although each project is unique, the engagement agreement generally follows this pattern:

1. Client – the person(s), company or law firm that owns the report
2. Purpose – whether for determining tax, to settle a dispute or to sell
3. Premise of Value – Fair Market Value or Investment Value
4. Subject to be Valued – the business or asset holding entity
5. Interest to be Valued – the whole company, a block of shares or the asset value

The work involved rises with business complexity, dollars at risk, and whether the report is expected to be challenged by the IRS or an attorney in litigation. In "high-scrutiny" cases, we complete a site visit and increase the research. Specialty reports on CEO salaries may be added, for example.

In situations where an owner simply wants the minimum, we can 'run the numbers' and provide a value range. This is not an SBV 'opinion of value', but gives an owner or trustee a basis upon which they can base their opinion of value.

STEP 3: RETAINER FEE

The analyst will review the tasks to be completed and prepare the Engagement Agreement and set the fee. We strive to set fixed fees, but this is not always possible. Some engagements will have a variable fee based on an hourly rate because it is difficult to identify the time that will be needed to compete the work.

We also take steps to ensure that the results of the report are not contingent on payment, and will require payment before shipping the report. Payment of the retainer may be for the full amount or split into two payments.

Once the client agrees, executes the contract and pays the retainer, we proceed to information gathering.

STEP 4: INFORMATION GATHERING

We collect information through a questionnaire and information request, which the client then prepares. It usually takes a client 2-3 hours to gather documents and complete the questionnaires.

Small businesses – single owner with one general line of business will supply:

1. Detailed financial statements, and any 'footnotes' for the past 3-5 years
2. Tax returns, past 3-5 years
3. A budget for the current year income and expenses
4. Data on owner compensation
5. Descriptions of the history of the business, its products and services, its customer base and the competitive landscape

Start-up, complex or large businesses need the following additional items:

1. Management Bios
2. Reports on distinct operations or markets served which require a separate analysis
3. Number and types of equity classes
4. Resolutions among debt and equity holders
5. Comprehensive Business Plan or detailed projections

STEP 5: MANAGEMENT INTERVIEWS AND SITE VISIT

The interview is where the valuator tries to get an understanding of business that is not clear in the financial statements and initial questionnaire responses. NACVA and USPAP standards do not require a business valuator to actually visit the business' facility, and this is most often done by written questionnaire, email and telephone.

We typically ask questions about the business itself, its industry, organizational structure, marketing activities, customers and risk factors. A portion of this discussion will involve the company's historical financial performance and future prospects.

For "high-scrutiny" projects, an on-site visit and face-to-face interview is completed. A site visit allows the valuator to make certain qualitative judgments about the business, its management, company culture, controls and condition of the assets. The increased familiarity that comes with a site visit refines the subjective portions of the business assessment and improves credibility for defending the value opinion.

Depending on the level of confidentiality surrounding the engagement, the client may not grant access to management. In other cases, the client and company owner are different, and the owner won't grant access. In these cases, we do our best to find answers through other sources.

STEP 6: PRELIMINARY ANALYSES

The aim of the preliminary review is to formulate additional relevant questions for management. After obtaining the client inputs, the valuator performs initial analyses and prepares follow-up questions. Usually, the valuator conducts some independent research of the business' industry, economic drivers, and other issues at this stage.

STEP 7: VALUATION ANALYSES

The valuator now integrates the data, results of the interviews and independent research to determine how these factors impact the company. The appropriate valuation methodologies are finalized and the development of the opinion of value begins.

Sometimes the valuation may require different analyses than originally foreseen. If this occurs under a fixed price contract, and requires a material amount of extra work, the valuator will contact the client to discuss the path forward to a valid conclusion.

SBV uses multiple valuation methodologies when possible. Each yields a different indication of the value of the ownership interest. Using their experience and judgment, the valuator reconciles these different indications of value to arrive at a base opinion.

The last step for a 100% ownership interest at Fair Market Value is to adjust for the actual assets and liabilities of the subject company held on the date of valuation. If the report is for a partner dispute, divorce or exit of a shareholder, another step in the process evaluates the effect of existing ownership. Variables such as company credit rating, indebtedness, entity type and equity structure are relevant to value. If the interest being valued is less than 100%, let's say 10% of the company, a discount analysis is completed, which is almost as demanding a valuation project as the base value determination.

STEP 8: REPORT ISSUANCE AND FOLLOW-UP

The final stage of the engagement is for the valuator to issue their report. The valuation will usually be documented in a detailed written report that will typically be about 100 pages plus appendices. These reports are issued in electronic form, but printed and bound copies are available for an added fee.

When stipulated in the scope of work, the report may be issued in draft form to allow the client's professional advisors to review the facts outlined in the report before it is finalized.