Santa Barbara Valuations

BUSINESS VALUATION PROCESS

Partners with: AMERICAN ValueMetrics

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 permutations in its path to 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 estimated time frame, 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, Fair Value and 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
6. Scope of Work – defines what the valuator will do
    a. Current date or retrospective date
    b. Business analyses to be completed
    c. Classes of equity and debt to be valued
    d. Partial Interests analyses if needed
    e. Professional Standards to be met
    f. Exclusions to keep costs down
    g. Need for Draft Review Cycle

The work required rises with business complexity, high dollar deals, and whether the report is expected to be challenged by others such as the IRS or an opposing attorney in litigation. In these "high-scrutiny" cases, we increase the precision of input data with additional research. For example, a free salary survey on surgeons is replaced with a specific fee-based report on thoracic surgeons in Orange County, California. And, we always want to conduct a site visit in these cases.

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 2-4 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 years
2. Tax returns, past 3 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 for the next three to five years
6. Objective management assessments of their company's strengths and weaknesses; industry competition; product life cycles; and external factors impacting growth and/or operating profitability.

STEP 5: PRELIMINARY ANALYSES

The primary aim of the preliminary review is to help the valuator formulate relevant questions for the management interview. After obtaining the necessary inputs, the valuator reviews and performs initial analyses to help prepare follow-up questions with the owner and/or key members of management. Usually, the valuator conducts some independent research of the business' industry, economic drivers, and other issues at this stage.

STEP 6: 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 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 and condition. 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 owner are different, and the owner won't grant access. In these cases, we do our best to find answers through other sources.

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 business assessment is completed, 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.

If the valuator uses multiple valuation methodologies, 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 is to adjust for the actual assets and liabilities of the subject company held on the date of valuation. 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 written report that will typically be 50 to 100 pages plus appendices. Today, 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.

Once the client and their advisors have reviewed the report, a follow-up opportunity is offered to address any questions they may have about the valuation report.