Corpus Christi Estate Planning Council

# 8 Ways of valuing a family owned business

*Presented by*

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withum learning

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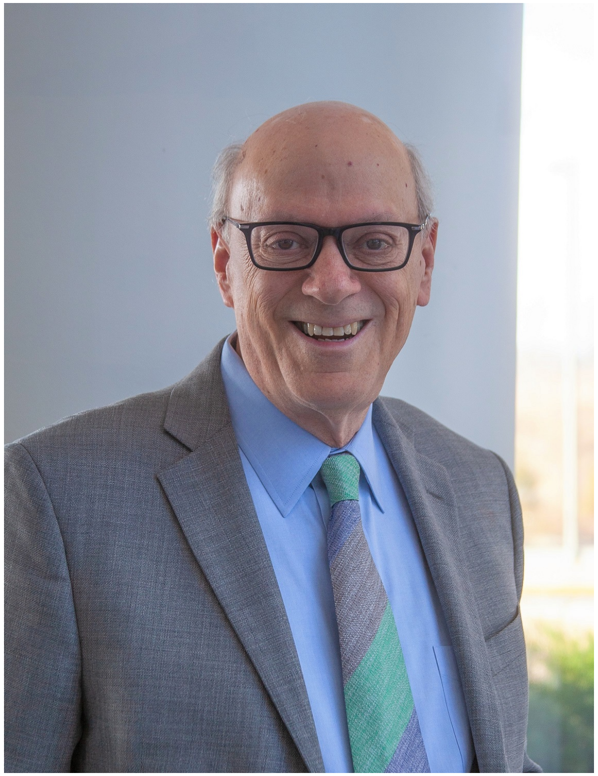
# Edward Mendlowitz, CPA, AEP(Distinguished)



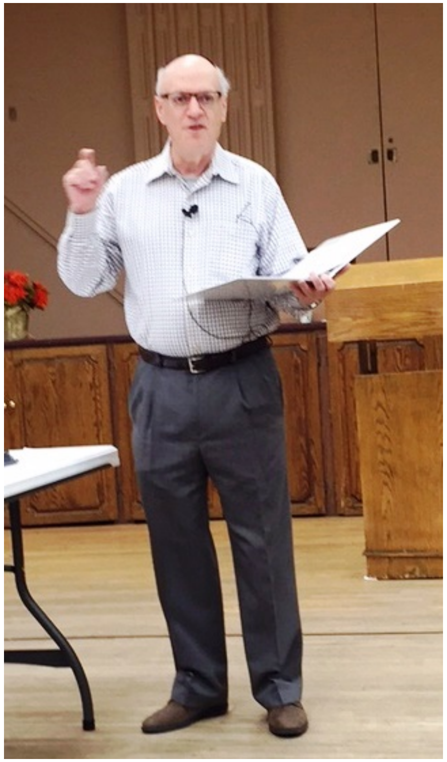
- Partner with WithumSmith+Brown, PC
- One of *Accounting Today's* 100 Most Influential People
- AICPA designations: PFS, ABV, CFF, CITP, CGMA
- MBA Professor at Fairleigh Dickinson University
- Author of 29 professional books
- Developer and presenter of over 350 CPE programs
- Admitted to practice before U.S. Tax Court
- On *BottomLine/Personal* panel of experts
- Practice management techniques have been reported on by *The Wall Street Journal, Journal of Accountancy* and many other publications
- Testified twice before House Ways and Means Committee on tax equity and reform
- Has been a Team Captain and performed peer reviews for over 60 CPA firms
- Best selling author at CPA Trendlines

# Live presentation

These slides accompany a live presentation and have been prepared to facilitate that presentation

The slides do not have everything that will be covered during the program, but will be used in conjunction with the presentation

You are welcome to call me with any questions when you try any of the techniques explained in this program



# Educational use of examples

The examples and discussion in this handout has been prepared and organized to illustrate specific points and methods for teaching purposes.  Nothing herein is fixed or might actually occur in a valuation.

Valuations are prepared based on specific purposes and uses, individual circumstances, the then current economic situation and how the appraiser chooses in those instances to apply his or her knowledge and experience to the project at hand.

# A business' value

A business' value is only exact when it is sold…

…and then only for the circumstances of that sale transaction

Without a sale, the value can only be guessed at.

# Valuing a business is an art, not a science

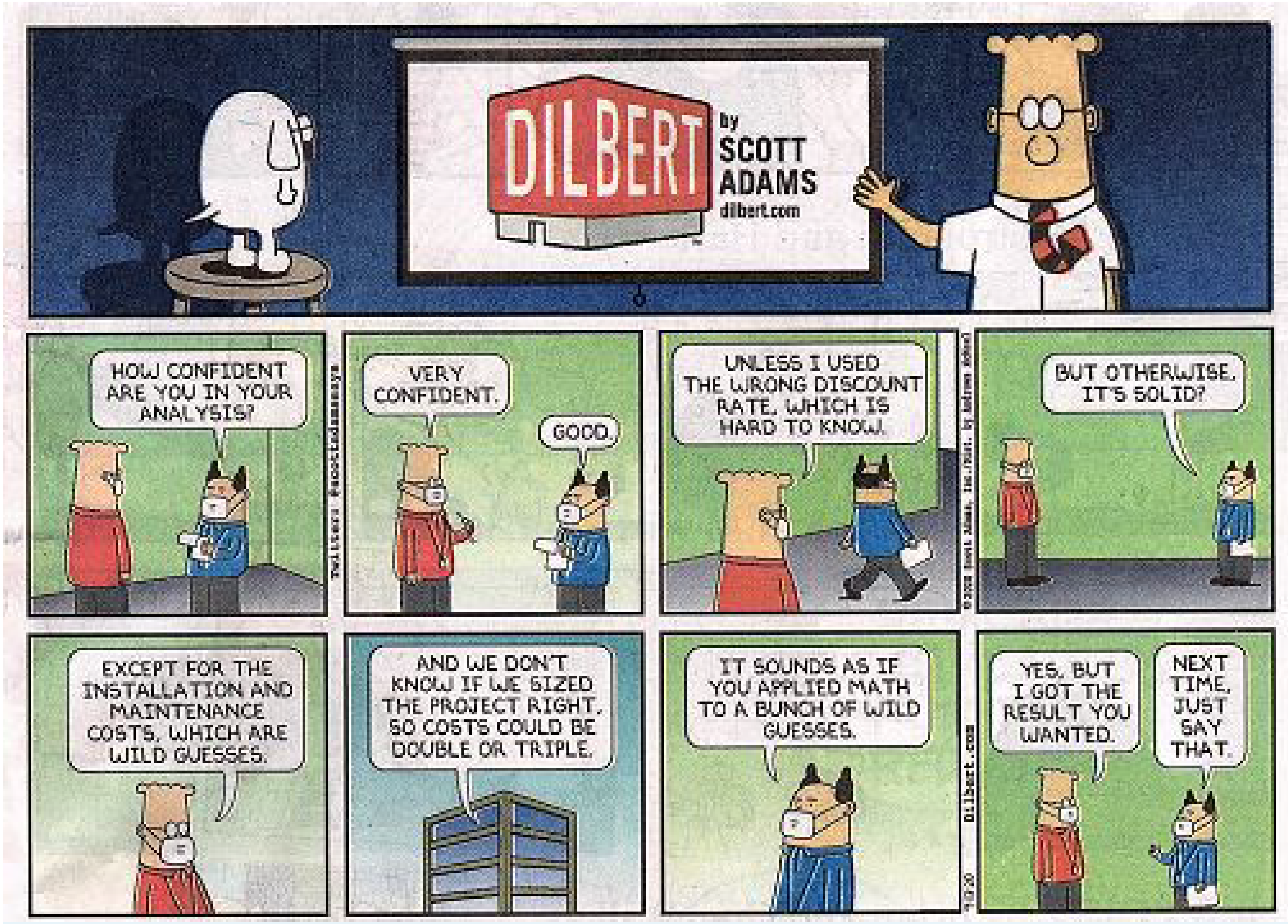
There are a lot of assumptions made when a business is valued or appraised

Some assumptions deal with interest rates and rates of return, how the business will grow, how it can continue to be managed after a sale, the margins and profitability, sales growth, types of customers and sources of supply, ability and longevity of employees, price levels, market share...

…and even the purpose of the valuation…

…and who wants to buy the business.

These are all subjective issues


DILBERT
by SCOTT ADAMS
dilbert.com
HOW CONFIDENT ARE YOU IN YOUR ANALYSIS?
VERY CONFIDENT.
GOOD.
UNLESS I USED THE WRONG DISCOUNT RATE, WHICH IS HARD TO KNOW.
BUT OTHERWISE, IT'S SOLID?
EXCEPT FOR THE INSTALLATION AND MAINTENANCE COSTS, WHICH ARE WILD GUESSES.
AND WE DON'T KNOW IF WE SIZED THE PROJECT RIGHT, SO COSTS COULD BE DOUBLE OR TRIPLE.
IT SOUNDS AS IF YOU APPLIED MATH TO A BUNCH OF WILD GUESSES.
YES, BUT I GOT THE RESULT YOU WANTED.
NEXT TIME, JUST SAY THAT.
Dilbert.com

# Types of buyers

An investor

Someone that wants to work in the business

A competitor either to grow itself, close the business or who wants to create a mini-empire in that industry

A supplier

A company that wants to get into the industry or who wants something the company has or who wants to sell to the business' customers

# Purposes of a valuation - partial listing

Give some ownership to an employee

Selling the business OR buying a business

For a personal financial statement or financial plan

Estate and gift tax purposes

In martial separation controversies or for a pre-nuptial agreement

In a business partnership split up OR to establish the value in a buy-sell agreement

To establish a benchmark to measure future growth of business' value

# Types of valuations – partial listing

Fair market value (FMV) – defined on separate slide

Fair value – when all of the rules of FMV are not followed

Fair value - valuing assets on a financial statement

Fair value – in certain forced buy out situations

Standards in a divorce – varies by rules of the state courts where each determines its own rules and methodology

Selling the business - to determine an asking price, a rock bottom value and formulate a negotiation posture

Cost to recreate the business

Liquidation value

Industry standards

Value in a portfolio of similar or diversified investments

To price an initial public offering (IPO) or to sell shares anticipating an IPO

Job value to a buyer that wants to work in the business

Strategic value to a buyer – what owning the business can do for the buyer

# Fair market value – defined

The price at which property would change hands between a willing and able buyer and willing and able seller with neither being under any compulsion to buy or sell and both parties having reasonable knowledge of relevant facts, with both seeking their maximum economic self-interests.

Must be a “hypothetical” buyer and seller that are assumed to be well informed about the property and the market for such property and are willing and able to complete the transaction.

Based on cash payment in full, and

Market exposure for reasonable period

In the absence of anything on the previous slide, a FMV might not be appropriate or able to be performed, and in that case the valuation would be called a “Fair Value” valuation.

Note that I provided three definitions for Fair Value. There are more.

The only definition that really matters is for FMV.

# Factors to consider in a valuation

The reasons for the valuation

The actual buyers and sellers and pressures they have

Family members, employees and other parties of interest

Hidden agendas

Negotiation skills of the parties

Payment terms and periods

Income taxes

Transaction costs

Legal precedents and rulings that guide and establish values

Time constraints

The portion of the business being sold if less than the whole business

Upward adjustments for added value of a small ownership to control or sway control (called a swing vote)

Downward adjustments for a ~~small~~ ownership interest that lacks control or that will have special difficulty in marketing their ownership

<u>This presentation assumes 100% of the business will be sold EXCEPT in the illustration showing the difference in the value between gift and estate tax purposes.</u>

# Illustrations of value under the following ~~8~~ ~~9~~ 10 circumstances

1. Fair market value for estate tax purposes
2. Fair market value for gift tax purposes
3. Buying the business as an investment
4. Selling the business
5. Job value to the buyer
6. Divorce
7. Strategic value
8. Buy-sell agreement
9. For a loan application
10. Personal financial planning

# Fair market value for estate tax purposes

How the business would be valued for estate purposes

Sometimes the value is for estate TAX purposes

Usually there is no estate tax, but the value would be used to transfer the business to various beneficiaries

Sometimes the value is to establish the basis for a later sale

Sometimes the value is to establish the basis for a Section 754 step-up election for greater depreciation deductions by the beneficiaries

# Fair market value for gift tax purposes

When shares of a business are given as gifts

An example would be 33.3% of a business is given as a gift to each of 3 children

# Buying the business as an investment

Cash flow

Risk

Compared to other opportunities

Balance an investment portfolio

# Selling the business

Determine an asking price

Set a rock bottom value

Discover hidden values that someone not working in the business might think is important

Formulate a negotiation posture

# Job value to the buyer

Motive is to get a job

ROI is not as important, but needs to be there at a reasonable amount

# Divorce

Varying methods are used in state courts for matrimonial issues such as:

what a business might be worth in an immediate sale

what it costs to create or to recreate

what it is worth to the present owner

can consider or not consider discounts for partial interests

These are not concepts used in the fair market value method.

Each state sets its own rules and methodology, and Judges decide the value in part by using their feelings, experience and judgment

# Strategic value

What owning the business can do for the buyer

Examples are location of business, products that expand buyer’s product line or entre to a special customer or type of customer

A strategic buyer will pay the price based on “asking” price if it is significantly lower than what they would pay

The strategic buyer will also pay the price they are pushed to pay if it is lower than what it would otherwise cost them to get into that space plus the time it would take

# Value for a buy-sell agreement

A buy-sell agreement is mandatory if there is more than 1 owner

A buy-sell agreement is the Will for the business

Buy-sell agreements can have different values for death, disability, retirement, quitting, imprisonment, losing a license to practice, personal bankruptcy or other situations

Either party can be the seller or buyer

Default value: The price either owner would be willing to sell their share for or willing to write the check for the other's share under the price and **terms** agreed to

# Value in a personal financial statement for a bank

Need a realistic justifiable value with a clear easily understandable explanation of the basis for it

# Value in a financial plan

Why is a value needed?

Is the value for family's guidance, owner's own ego or to get a ballpark of the net worth while planning an estate

Which is more important to the owner and their family – asset values or cash flow?

When someone retires, do they live off asset values, or cash flow? Usually the cash flow is what is important, not the asset values

The value of a business is not exact, or definite, can quickly change and is illusory

# Benchmark company used in discussion

On the following slides is the benchmark company that will be used for the illustrations to impart how a business could be valued. Some of the illustrations are exaggerated to better explain the issues

There are four sections of the illustrations:

1. Definitions
2. A summary financial statement for the past five years and a projection for the current and next year (7 years are presented)
3. Normalized net income – this is the company's net income adjusted for items that would not be repeated or appear with a different owner
4. 10 Separate calculations of the business' value. Each will be accompanied by a discussion

# Definitions

Weighted average of net income: When the net income of multiple years are used, an average is determined assigning a greater weight to the more recent years

Rate of return for an investor: The percentage pre-tax income an investor would want to earn on their investment

Value based on rate of return: Divide the net income by the rate of return to get the value.  For a 20% desired rate of return and a $100,000 profit the business would be worth $500,000.  $100,000 ÷ 20% = $500,000

Risk: Making an investment involves assessment of the risk which would typically be reflected in the rate of return

Rate of return multiple: This is 1 (or 100%) divided by the desired percentage rate of return. For a 20% return you would divide 1 by 20% getting 5. So the multiple is 5. To get the value you would multiply the net income by 5 (or whatever the multiple is)

Rate of return used in illustrations: The first illustration shows the business' value using rates of return ranging from 14% to 33%. For the other illustrations I used 20% or a multiple of 5 to determine the value. This was done to facilitate the discussion

Terms: Payment terms are an essential part of the business' value and are usually negotiated separately from the value. No price is valid until the terms have been agreed upon. Sellers usually want all cash and buyers want to spread the payments over as long a period as possible

Earnout: This is a contingent portion of the purchase price. When a business is experiencing rapid growth and the price is based on future increased profitability then an earnout might be in order. This is where additional amounts are paid if certain targets are met. These targets are usually based on profit but can also be based on other criteria such as sales, new client growth or key employee retention. Earnouts usually cover the first three years after the sale but can be longer or shorter based upon circumstances.

Alternatives to a straight purchase payment: Leases for equipment or premises, royalty arrangements, consulting agreements and continuing to pay certain expenses on behalf of the seller

# Benchmark income statement

| COMPANY FINANCIAL REPORT | | Projected 20X7 | Projected 20X6 | Actual 20X5 | Actual 20X4 | Actual 20X3 | Actual 20X2 | Actual 20X1 |
|---|---|---|---|---|---|---|---|---|
| **Sales** | | **1,800,000** | **1,200,000** | **800,000** | **550,000** | **500,000** | **450,000** | **400,000** |
| *Sales increase %* | | *50.0%* | *50.0%* | *45.5%* | *10.0%* | *11.1%* | *12.5%* | |
| **Cost of sales** | | **576,000** | **456,000** | **352,000** | **269,500** | **255,000** | **238,500** | **220,000** |
| **Gross profit** | | **1,224,000** | **744,000** | **448,000** | **280,500** | **245,000** | **211,500** | **180,000** |
| *GP %* | | *68.0%* | *62.0%* | *56.0%* | *51.0%* | *49.0%* | *47.0%* | *45.0%* |
| **Operating expenses** | | | | | | | | |
| Owner's salary and benefits | | 400,000 | 300,000 | 150,000 | 78,000 | 78,000 | 78,000 | 78,000 |
| Medical insurance for owner's family | | 35,431 | 32,210 | 29,282 | 26,620 | 24,200 | 22,000 | 20,000 |
| Selling and marketing expenses | | 108,000 | 72,000 | 48,000 | 25,000 | 14,000 | 8,000 | 4,500 |
| Shipping costs | | 54,000 | 36,000 | 24,000 | 16,500 | 15,000 | 13,500 | 12,000 |
| Product and marketing consultants | | | | 70,000 | 30,000 | 30,000 | | |
| All other expenses | | 115,151 | 104,683 | 95,167 | 86,515 | 78,650 | 71,500 | 65,000 |
| **Total operating expenses** | | **712,583** | **544,893** | **416,449** | **262,635** | **239,850** | **193,000** | **179,500** |
| Net income before taxes | | 511,417 | 199,107 | 31,552 | 17,865 | 5,150 | 18,500 | 500 |
| Taxes | | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net income** | | **511,417** | **199,107** | **31,552** | **17,865** | **5,150** | **18,500** | **500** |

# Normalized net income

| | | Projected | Projected | Actual | Actual | Actual | Actual | Actual |
|---|---|---|---|---|---|---|---|---|
| **NORMALIZED NET INCOME** | | **20X7** | **20X6** | **20X5** | **20X4** | **20X3** | **20X2** | **20X1** |
| | | | | | | | | |
| **Net income per Company** | | **511,417** | **199,107** | **31,552** | **17,865** | **5,150** | **18,500** | **500** |
| | | | | | | | | |
| **Add or subtract non "normal" amounts** | | | | | | | | |
| Medical insurance for owner's family | | 35,431 | 32,210 | 29,282 | 26,620 | 24,200 | 22,000 | 20,000 |
| Product and marketing consultants | | | | 70,000 | 30,000 | 30,000 | | |
| | | | | | | | | |
| Adjustment for owner's "excess" salary | | | | | | | | |
| Add back owner's salary and benefits | | 400,000 | 300,000 | 150,000 | 78,000 | 78,000 | 78,000 | 78,000 |
| Less reasonable owner's salary and benefits | | (250,000) | (200,000) | (125,000) | (90,295) | (85,995) | (81,900) | (78,000) |
| | | | | | | | | |
| **Adjusted normalized net income** | | **696,849** | **331,317** | **155,834** | **62,190** | **51,355** | **36,600** | **20,500** |
| Less income taxes (30%) | | (209,055) | (99,395) | (46,750) | (18,657) | (15,407) | (10,980) | (6,150) |
| | | | | | | | | |
| **Normalized net income** | | **487,794** | **231,922** | **109,083** | **43,533** | **35,949** | **25,620** | **14,350** |

# #1. Fair market value for estate purposes: Value using last 5 years' actual amounts

| **SAMPLE ILLUSTRATION using trailing 5 years' amounts** | | **Actual** | **Actual** | **Actual** | **Actual** | **Actual** |
|---|---|---|---|---|---|---|
| | | **20X5** | **20X4** | **20X3** | **20X2** | **20X1** |
| | | | | | | |
| **Normalized net income** | | **109,083** | **43,533** | **35,949** | **25,620** | **14,350** |
| Weight given to this year | **15** | 5 | 4 | 3 | 2 | 1 |
| Calculation | **892,985** | 545,417 | 174,133 | 107,846 | 51,240 | 14,350 |
| | | | | | | |
| **Weighted average normalized net income (892,985 ÷ 15)** | **59,532** | **59,532** | **59,532** | **59,532** | **59,532** | |
| **Expected annual return by purchaser (5 diff. %)** | 14.3% | 16.7% | **20.0%** | 25.0% | 33.3% | |
| **Value of company** | **416,727** | **357,123** | **297,662** | **238,129** | **178,599** | |
| Expected return as a multiple of normal. net inc (1 ÷ 20% =5) | 7 | 6 | **5** | 4 | 3 | |

# #2. Fair market value for gift tax purposes: Value using last 5 years' actual amounts

| | | |
|---|---|---|
| **SAMPLE Fair Market Value of a Minority Interest** | | |
| | | |
| **Value of company using 5 multiple value from prior illustration** | | **297,662** |
| **Valuing a 33.3% interest in company** | | **99,211** |
| | | |
| **Less discount for minority interest lack of control** | **20.0%** | **(19,842)** |
| | | **79,369** |
| **Less disc for difficulty in marketing the minority interest** | **20.0%** | **(15,874)** |
| | | |
| **Discounted value of a 33.3% interest in company** | | **63,495** |
| **Total value of 3 separate 33.3% equal shares** | | **190,485** |
| | | |
| **Reduction in value if 3 equal owners, valued separately** | | **107,177** |
| **Percentage reduction in value** | | **36.0%** |
| | | |
| *All discount percenatges are for illustration purposes only* | | |

# #3. Buying as an investment
# Using projected and last 4 years' actual

| SAMPLE using projected 20X6 and not earliest year | | | Projected | Actual | Actual | Actual | Actual | |
|---|---|---|---|---|---|---|---|---|
| | | | 20X6 | 20X5 | 20X4 | 20X3 | 20X2 | |
| | | | | | | | | |
| **Normalized net income** | | | **231,922** | **109,083** | **43,533** | **35,949** | **25,620** | |
| Weight given to this year | | 15 | 5 | 4 | 3 | 2 | 1 | |
| Calculation | | 1,824,059 | 1,159,609 | 436,334 | 130,600 | 71,897 | 25,620 | |
| | | | | | | | | |
| **Weighted average normalized net income** | | **121,604** | | | | | | |
| **Multiple of expected annual return** | | **5** | | | | | | |
| **Value of company** | | **608,020** | Compare this to $297,662 in previous illustration | | | | | |

# #1 and #3 on same slide

## Notice difference of dropping earliest year and adding projected (current) year

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **SAMPLE ILLUSTRATION using trailing 5 years' amounts** | | | | **Actual** | **Actual** | **Actual** | **Actual** | **Actual** |
| | | | | **20X5** | **20X4** | **20X3** | **20X2** | **20X1** |
| | | | | | | | | |
| **Normalized net income** | | | | **109,083** | **43,533** | **35,949** | **25,620** | **14,350** |
| Weight given to this year | | | **15** | 5 | 4 | 3 | 2 | 1 |
| Calculation | | | **892,985** | 545,417 | 174,133 | 107,846 | 51,240 | 14,350 |
| | | | | | | | | |
| **Weighted average normalized net income (892,985 ÷ 15)** | | | **59,532** | **59,532** | **59,532** | **59,532** | **59,532** | |
| **Expected annual return by purchaser (5 diff. %)** | | | 14.3% | 16.7% | **20.0%** | 25.0% | 33.3% | |
| **Value of company** | | | **416,727** | **357,123** | **297,662** | **238,129** | **178,599** | |
| Expected return as a multiple of normal. net inc (1 ÷ 20% =5) | | | 7 | 6 | **5** | 4 | 3 | |
| | | | | | | | | |
| | | | | | | | | |
| **SAMPLE using projected 20X6 and not earliest year** | | | **Projected** | **Actual** | **Actual** | **Actual** | **Actual** | |
| | | | **20X6** | **20X5** | **20X4** | **20X3** | **20X2** | |
| | | | | | | | | |
| **Normalized net income** | | | **231,922** | **109,083** | **43,533** | **35,949** | **25,620** | |
| Weight given to this year | | 15 | 5 | 4 | 3 | 2 | 1 | |
| Calculation | | 1,824,059 | 1,159,609 | 436,334 | 130,600 | 71,897 | 25,620 | |
| | | | | | | | | |
| **Weighted average normalized net income** | | **121,604** | | | | | | |
| **Multiple of expected annual return** | | **5** | | | | | | |
| **Value of company** | | **608,020** | Compare this to $297,662 in previous illustration | | | | | |

# #4a. Valued by seller (this could also be used by an investor)

## Used projected year and 2 previous years

| **SAMPLE using projected 20X6 and previous 2 years** | | | **Projected** | **Actual** | **Actual** | | |
|---|---|---|---|---|---|---|---|
| | | | **20X6** | **20X5** | **20X4** | | |
| | | | | | | | |
| **Normalized net income** | | | **231,922** | **109,083** | **43,533** | | |
| Weight given to this year | | 6 | 3 | 2 | 1 | | |
| Calculation | | 957,465 | 695,765 | 218,167 | 43,533 | | |
| | | | | | | | |
| **Weighted average normalized net income** | | **159,578** | | | | | |
| **Multiple of expected annual return** | | **5** | | | | | |
| **Value of company** | | **797,888** | | | | | |
| | | | | | | | |
| **Effect of increasing the multiples (expected return on investment)** | | | | | | | |
| | | | | | | | |
| **Weighted average normalized net income** | | **159,578** | **159,578** | **159,578** | | | |
| **Multiple of expected annual return** | | **5** | **6** | **7** | | | |
| **Value of company** | | **797,888** | **957,465** | **1,117,043** | | | |

# #4b. Valued by seller

## Used 2 projected years equally

| SAMPLE using projected 2 years | | Projected | Projected | | | | |
|---|---|---|---|---|---|---|---|
| | | 20X7 | 20X6 | | | | |
| | | | | | | | |
| **Normalized net income** | | **487,794** | **231,922** | | | | |
| Weight (used average of the 2 years) | 2 | 1 | 1 | | | | |
| Calculation | 719,716 | 487,794 | 231,922 | | | | |
| | | | | | | | |
| **Weighted ave. normalized net inc** | **359,858** | **359,858** | **359,858** | | | | |
| **Multiple of expected ann. return** | **5** | **6** | **7** | | | | |
| **Value of company** | **1,799,289** | **2,159,147** | **2,519,005** | | | | |

# 5. Job value

| SAMPLE using projected 2 years | | Projected | Projected | | | | |
|---|---|---|---|---|---|---|---|
| | | 20X7 | 20X6 | | | | |
| | | | | | | | |
| **Normalized net income** | | **487,794** | **231,922** | | | | |
| Weight (used average of the 2 years) | 2 | 1 | 1 | | | | |
| Calculation | 719,716 | 487,794 | 231,922 | | | | |
| | | | | | | | |
| **Weighted ave. normalized net inc** | **359,858** | **359,858** | **359,858** | **359,858** | | | |
| **Multiple of expected ann. return** | **5** | **6** | 7 | 20 | | | |
| **Value of company** | **1,799,289** | **2,159,147** | **2,519,005** | **7,197,158** | | | |
| **Expected annual ROI** | **20.0%** | **16.7%** | **14.3%** | **5.0%** | | | |

# 6. Divorce (occasionally referred to as “Fair Value”)

| VALUING FOR A DIVORCE (FAIR VALUE) | | Projected | Actual | Actual | Actual | Actual | |
|---|---|---|---|---|---|---|---|
| **Using most current year - projected** | | **20X6** | **20X5** | **20X4** | **20X3** | **20X2** | |
| | | | | | | | |
| **Normalized net income** | | **231,922** | | | | | |
| Multiple | | 5 | | | | | |
| **Value of company** | | **1,159,609** | | | | | |
| | | | | | | | |
| **Value using different multiples** | | | | | | | |
| Normalized net income per above | | 231,922 | 231,922 | 231,922 | 231,922 | 231,922 | |
| Multiple | | 3 | 4 | 5 | 6 | 7 | |
| **Value of company** | | **695,765** | **927,687** | **1,159,609** | **1,391,531** | **1,623,453** | |
| | | | | | | | |
| **Using current and prior year** | | **20X6** | **20X5** | | | | |
| **Normalized net income** | | **231,922** | **109,083** | | | | |
| Weight given to this year | 3 | 2 | 1 | | | | |
| Calculation | | 463,844 | 109,083 | | | | |
| Total of weighted amounts | 572,927 | | | | | | |
| Weighted average (weighted amts / 3) | **190,976** | | | | | | |
| Multiple | 5 | | | | | | |
| **Value of company** | **954,878** | | | | | | |
| | | | | | | | |
| **Usually no discounts are permitted for fractional share ownership, so it is Fair Value, not FMV.** | | | | | | | |

# 7. Strategic Value

Usually the asking price is the starting point

It is the seller's job to find out, figure out, detect or imagine the value to the buyer…

…and then push them toward that amount

In these circumstances the seller needs a credible starting point to get the buyer to the table

If there is a strategic value using that as a basis for starting can be done but only if there is a thorough understanding of the situation and careful preparation and presentation of the asking price

# 8. Buy-sell agreement

Each party has to be willing to buy or sell for that price

A lot depends on the type of business, dependence on the owners' efforts, management and relationships and the extent capital is a material factor in operating the business

**A default value** for a buy-sell **only upon death** could be a value based on five times the previous year's cash flow (attributed to the deceased partner's ownership share) with interest at the AFR rate. Note that the payments would not be deductible and would be treated as capital gains by the estate. An alternative is 3 times the cash flow to offset for the tax cost to buyer

# 9. Valuation for a loan application

An amount that is reasonable and can be credibly explained

Be aware that the estimated amounts must come from the client, i.e. loan applicant, and not the accountant

If an accountant estimates the value, they must follow professional standards.  For example, AICPA members must follow SSVS#1. The accountant should have adequate documentation in their file supporting any valuation amount they include in a statement they assist in preparing

Sample wording to accompany the application (or compiled statement) is shown on the following slide

Auto dealership:

Samuel Adams owns 50% of the stock of BTO Company, Inc. which is engaged in the business of retail and wholesale sales, servicing and leasing of new and used vehicles; and has estimated the market value of the Company based on his knowledge of the industry and allocated it to his percentage ownership of the Company.

Commercial real estate:

Samuel Adams owns 25% of an LLC that owns and operates commercial rental real estate and has estimated the value of his interest based on an estimated market value per square foot ($250.00) multiplied by the total rentable square footage (42,500) plus the liquid assets of the LLC ($162,000) and less the mortgage ($4,000,875) and allocated it to his percentage ownership of the LLC.

# 10. Valuation in a financial plan

Why is a value needed?

As an FYI, when a business is sold the seller can expect an annual income, after a brief spending spree, of ±3% of 60% of the selling price. Assuming a 5 multiple, a business with $1,000,000 pretax net income will be sold for $5,000,000. After reducing this by selling costs and taxes the net is $3,000,000, and assuming no selling spree, 3% of $3,000,000 is $90,000. So $1,000,000 annual income is exchanged for $90,000.

Of course, there are many other reasons for selling and that could be a good subject for another time.

# Summary of 10 methods

| Summary of sample valuations | | | |
|---|---|---|---|
| | | | **5 multiple** |
| #1. Fair market value for estate purposes | | | 297,662 |
| #2. FMV for gift tax purposes | | | 190,485 |
| #3. Buying as an investment | | | 608,020 |
| #4a. Valued by seller | | | 797,888 |
| #4b. Valued by seller | | | 1,799,289 |
| #5. Job value, estimate | | | 2,500,000 |
| #6. Divorce | | | 954,878 |
| #7. Strategic value - more than seller's value | | | 2,500,000 |
| #8. Buy-Sell agreement for death buy-out, estimate | | | 1,000,000 |
| #9. Loan application, estimate | | | 1,000,000 |
| #10. Value in a financial plan | | | 1,000,000 |

# Conclusion

Understand the numbers

Understand the business

Understand the valuation process

Understand the purpose and use of valuations

Understand the standard of value

Understand the strategic value to a buyer

Understand that any value is an art and not a mathematical fact

# Do not hesitate to contact me

Contact me with any questions about this program, or with

Practice management issues you might have, or

Any services you believe Withum could help you or a client with.  Use me as a window into Withum and I can match you with the right person to get what you need, done.

## Thank you for attending!

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