

Globalview Advisors

Financial Valuation and Advisory Services

Business Valuation Essentials for Attorneys

**Orange County Bar Association
Business and Corporate Law Section**

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Reasons to Obtain a Business Valuation

- For the purpose of this discussion, business valuations includes:
 - Valuation of total businesses (debt and equity)
 - Valuation of the total equity of an enterprise
 - Valuation of equity interests in an enterprise
 - Intangible asset / intellectual property valuations
- Business valuations are prepared for a variety of purposes
 - Transactions
 - Compliance
 - Litigation

Reasons to Obtain a Business Valuation—Transactions

- Transaction related valuations include:
 - Fairness opinions
 - Solvency opinions
 - Valuation consultation pertaining to potential sale
 - General valuation assistance
 - Value enhancement strategies
 - Other

Reasons to Obtain a Business Valuation—Compliance

- Compliance related valuations include:
 - Tax compliance
 - Estate and gift
 - Corporate restructuring
 - Stock incentive plans (IRC 409A)
 - Numerous other
 - Financial reporting
 - Property tax
 - Other

Reasons to Obtain a Business Valuation—Litigation

- Litigation related valuations include:
 - Disputes
 - Condemnation (eminent domain)
 - Divorce
 - Economic damages
 - Other

Selecting an Appraiser

- In the U.S., there are no licensing requirements for firms or individuals performing business valuations
- The lack of formal licensing requirements led the U.S. Securities and Exchange Commission to raise concerns about the structure of the business valuation industry / profession and the resulting adverse impact on the quality of business valuation services
- There is increasing recognition of the need for competent appraisers with the expertise to complete assignments
 - Newly formed credential – Certified in Entity and Intangible Valuations (CEIV) for individuals preparing financial reporting appraisals
 - IRS guidelines for Qualified Appraiser and Qualified Appraisal
 - Daubert (Kumho Tire) challenges of appraiser qualifications
- Caveat emptor!

Importance of Proper Determination of the Exact Valuation Requirements

- Valuations prepared for a specific purpose should not be used for a different purpose.
 - The assumptions and total equity value conclusion may differ dramatically for a 1 percent common stock interest prepared for gift tax reporting compared to the value of the total equity of the same firm prepared to assist in the possible sale of the entity
- Factors which can lead to dramatic differences in valuation include
 - Inclusion of synergies (strategic vs. financial buyers)
 - Earnings normalization adjustments
 - Treatment of non-operating assets
 - Impact of adjustments for lack of control and marketability
- A valuation prepared for a specific purpose generally can NOT be used for a different valuation purpose.

Business Valuation Basics

- Conceptually, the value of a business is based on the future cash flows from the business. This suggests that a discounted cash flow model is preferred. DCF models can be an area where opinions differ.
- Market Approach is often used despite many challenges:
 - Market approach simplifies valuation into two components - a benefit stream and a multiple
 - Is the firm being valued meaningfully comparable to guideline firms?
Challenges in using public company pricing multiples include:
 - Comparability
 - Potentially wide range of multiples for public firms
 - Public firm stock prices are volatile
 - Acquisitions of businesses can be used. Challenges include:
 - Comparability
 - Potential synergies
 - For acquisitions by private firms, data cannot be confirmed

Challenging Business Valuation Issues

- Review of tax and civil court cases confirms there are many challenging issues impacting the development of valuation estimates
- A few challenging issues include
 - Valuation of early stage firms with potential for rapid growth and high degrees of uncertainty
 - Inclusion of synergies
 - Earnings normalization
 - Selection of “comps”
 - Development of appropriate projections of future cash flows
 - Discount rate development
 - Control and marketability of an equity interest in a firm
 - Numerous other

Valuation Discounts and Premiums

- Equity interests in private companies are often illiquid with limited number of potential buyers (private equity backed firms may be an exception)
- If the equity interest is 100% of the equity of a firm or a controlling equity interest, the potential market would consist of:
 - Strategic buyers (if any)
 - Financial buyers
- Sale of the total equity of a firm could take several months (or longer) to accomplish
- Absent expectations of a future liquidity event, the market of buyers for a small minority interest in a private firm is often very limited
- Risks associated with a minority interest in a private firm include:
 - Potential for actions by the controlling shareholders that reduce the returns to minority shareholders (disproportionate returns)
 - Uncertainty of time until a liquidity event
 - Numerous other

Valuation Discounts and Premiums

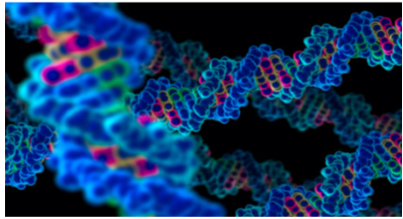
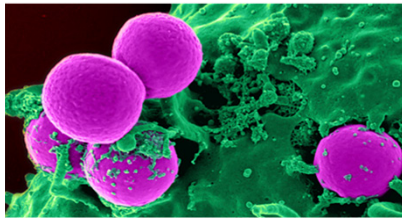
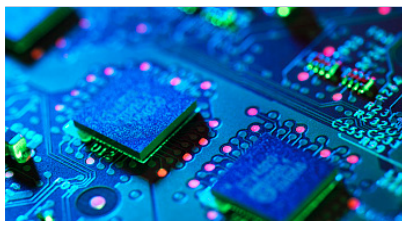
- The potentially reduced value of a minority interest may consider adjustments for
 - Lack of control
 - Change terms of controlling documents
 - Elect / remove management
 - Set policy
 - Determine course of business
 - Determine distribution policy
 - Sell or dissolve entity
 - Limited marketability
 - Distribution levels
 - Potential for phantom income
 - Timing of a liquidity event

Intellectual Property Challenges

- Previous slides noted many challenges for the valuation of a business
- Intellectual property represents a share of a business and the valuation of IP reflects a similar or greater degree of uncertainty
- Challenges include
 - IP is one of many assets that drive the cash flows of a business – how are the business cash flows allocated to different asset classes (working capital, fixed assets, IP and other intangible business assets)
 - If IP is early stage, there is greater uncertainty with future cash flows and generally less market data upon which to base a valuation
 - If IP has significant value to potential market buyers, determining the cash flow impact to those buyers (and the amount they would pay) is challenging
 - Limited transaction evidence

Valuation Profession Developments

- As noted previously, a new designation, *Certified in Entity and Intangible Valuations (CEIV)*, was first offered in mid-2017.
- As part of the development of the CEIV, two documents with guidance on minimum valuation procedures to perform were issued including:
 - Mandatory Performance Framework (MPF)
 - Application of Mandatory Performance Framework (AMPF)
- The MPF / AMPF include certain minimum work requirements that need to be performed and documented for certain valuations performed for financial reporting.
- Given SEC involvement and involvement of the major valuation professional organizations (AICPA, American Society of Appraisers, Royal Institute of Chartered Surveyors), the relevance of the MPF/AMPF as minimum procedures for valuations prepared for purposes other than financial reporting projects should be assessed.



Questions

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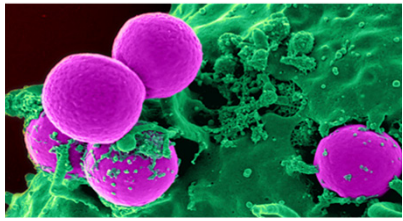
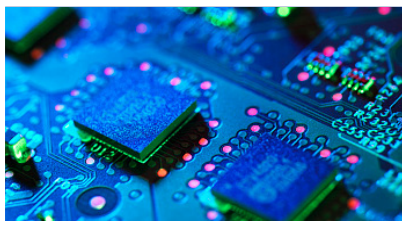


- Ray is a Managing Director in the Irvine, California office of Globalview Advisors. He has over 30 years of financial valuation expertise in the valuation of businesses, securities interests, and intangible assets.
- Ray has performed valuation projects for financial (both US GAAP and IFRS) and tax reporting, transactions, and litigation projects. In addition to performing valuations, Ray has extensive experience in the review of third-party and management prepared valuations.
- Ray has a wealth of experience in a wide range of industries. In recent years, much of his work has focused on technology and Internet firms. Other industries where he has significant project expertise include consumer products, entertainment and media, food services, health care, and manufacturing, in addition to early stage, rapid growth firms.
- Prior to joining Globalview Advisors in 2012, Ray was a Director in the Valuation Services Practice at PricewaterhouseCoopers LLP. He was also a Senior Manager in the Valuation Services Practice at KPMG LLP and KPMG Consulting, Inc., as well as a Manager at Arthur Andersen & Company.
- Ray received his MBA from the University of Southern California and his BS in Business Administration, cum laude, from the University of Kansas. He is an accredited senior Member of the *American Society of Appraisers (ASA)* in the business and intangible assets valuation disciplines as well as Appraisal Review and Management, and is also a Chartered Financial Analyst (CFA).

Cristina Espiritu, Globalview Advisors



- Cristina is a Senior Vice President in our Irvine Office. She has over 10 years of valuation experience and has prepared financial and valuation reports for purposes such as purchase price allocations, intangible asset and goodwill impairment analysis, gift and estate tax planning, goodwill loss, eminent domain, mergers and acquisitions, fairness opinions, lost profit calculations, and economic damages analysis for litigation.
- Cristina has served clients in various industries including computer software and technology, consumer products, energy, life sciences, manufacturing, pharmaceuticals, professional services, real estate, and telecommunications. In addition, she has worked in a variety of legal-related positions for the federal and state governments, non-profit organizations, and private law firms.
- She is currently a Member of the Corporate Partners Committee of the *National Association of Women Business Owners-Orange County (NAWBO-OC)*. Cristina previously served as the Chair of *Women in National Association of Asian-American Professionals Southern California (WIN!-Southern California)*; Vice President of Operations for the *National Association of Asian-American Professionals Southern California Orange County (NAAAP-OC)*; fundraising chair person for the *Junior League of Long Beach*; marketing committee of *Women Helping Women*; and past Board Member of the *Penn State Alumni Law Society*.
- Cristina received both her JD and MBA from Pennsylvania State University and her BA in Psychology, with a specialization in Business Administration, from the University of California, Los Angeles. She has successfully completed the business valuation curriculum of the *American Society of Appraisers (ASA)*.



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