What's Your Closely Held Business Worth?

By Harold G. Martin, Jr., MBA, CPA, ABV, ASA, CFE

Have you ever been asked the value of your business? Many owners of closely held businesses oftentimes cannot answer this question since their stock is not traded on a public exchange and there is no readily available pricing information. Owners are often required to place a value on their ownership interest. Here are examples that are encountered with some frequency:

- Preparing an estate plan - Will there be adequate funds in the estate to pay estate taxes?
- Negotiating a sales price - How do you obtain the most favorable price and minimize taxes?
- Creating buy/sell agreement between owners – What "triggering events" should be defined in the agreement and how should the buy/sell price be determined?
- Transferring stock to a child – How do you establish a strategy in order to minimize gift taxes?
- Insurance for redeeming a deceased shareholder's stock – What is sufficient coverage?
- Employee Stock Ownership Plans (ESOPs) – Is an ESOP transaction a feasible exit strategy?
- Divorce – What is the value of an ownership interest in divorce?

What is Value?

The definition of value depends on the context in which it is being used - the purpose of the valuation. It is important to note that *the same company may have different values for different purposes*.

The Appraisal Process

As the first step in a valuation project, you will need to select a qualified business appraiser. Just as you would seek out a specialist to perform a critical medical procedure as opposed to a general practitioner, you should select a specialist in the field of business valuation. Considering that you have invested a lifetime in building your business and its value may be your most significant asset, you should hire someone with the requisite expertise and experience. Look for a professional who appraises businesses on a full-time basis and possesses credentials such as the American Institute of CPA's *Accredited in Business Valuation (ABV)* or the American Society of Appraisers' *Accredited Senior Appraiser (ASA)* designation.

Once you have engaged an appraiser, he should meet with you at the company's location to conduct a site visit. The appraiser should also request that you provide selected financial and operational information to facilitate analysis of the company's performance. The appraiser may adjust the company's financial information to derive financial statements that represent the company's "true" economic performance.

The appraiser will next assess alternative approaches and select the most appropriate approach(es) for valuing the company. Alternative approaches include *income*, *market*, and *asset* approaches. The selection of an approach is dependent upon such criteria as the nature of the business, the consistency of its cash flows, projected financial performance, and the availability of required data.

After valuing the company using one or more of the approaches, the appraiser will assess whether any required premiums or discounts (e.g., lack of control/minority interest and lack of marketability) are required and apply these as appropriate. The appraiser must then reconcile the values derived using the alternative valuation approaches and calculate the value (or range of value) of the applicable ownership interest(s).

The appraiser may communicate the results of the valuation in the form of an oral or written report. If the report is written, it may be a summary report or a more comprehensive narrative report.

All valuations do not necessarily require completion of all steps as the scope of the appraiser's work is dependent upon such considerations as the intended purpose of the valuation, the applicable professional standards to which the appraiser is subject, and the scope negotiated by the parties.

Harold G. Martin Jr., MBA, CPA, ABV, ASA, CFE, is the Principal-in-Charge of Business Valuation Services for Keiter, Stephens, Hurst, Gary & Shreaves, P.C. Keiter Stephens is a full service CPA firm with offices in Richmond, and Charlottesville, Virginia. Clients include closely held businesses and their owners in numerous industries. For further information, please visit their website at www.kshgs.com or contact Mr. Martin by phone at (804) 273-6240 or e-mail at hmartin@kshgs.com.