



Business valuations – formulas or puzzles?

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Business valuations – formulas or puzzles?

Basics

Business valuations 101

What are they? Who can do them? Standards of value?

Formulas

Three approaches to value

Asset approach, income approach, & market approach

Puzzles

Cross-examining the expert

Art versus science & the real world

Differences

Two experts, one value?

Assumptions, assumptions, & assumptions



Basics

Business valuations 101

- What are they?
 - Privately-held companies
 - Majority versus minority
- Who can do them?
 - No professional license in Florida
 - Uniform Standards of Professional Appraisal Practice (USPAP)
 - AICPA, ASA, IBA, NACVA
 - ABV, ASA, CBA, CVA/AVA
- Standards of value
 - Fair market value
 - Fair value
 - Others



Formulas

Three approaches to value

- Net asset value method
- Liquidation method

Asset approach

- Normalized earnings
- Discount & capitalization rates
- Excess earnings method
- Capitalization of earnings method
- Discounted cash flow method

Income approach

- Direct market data method
- Comparable companies method

Market approach



Puzzles

Cross examining the expert

ART VERSUS SCIENCE

- Experience
- Advocacy
- Bias
- Cost factors
- Site tours, interviews with management, depositions
- Methodologies employed
- Research depth
- Databases
- Reconciliation of values

REAL WORLD

- Practical considerations
- Owner-operated versus outside investors
- Rules of thumb
- Actual transactions
- Structure of an actual sale – can it be done?
- Sanity checks



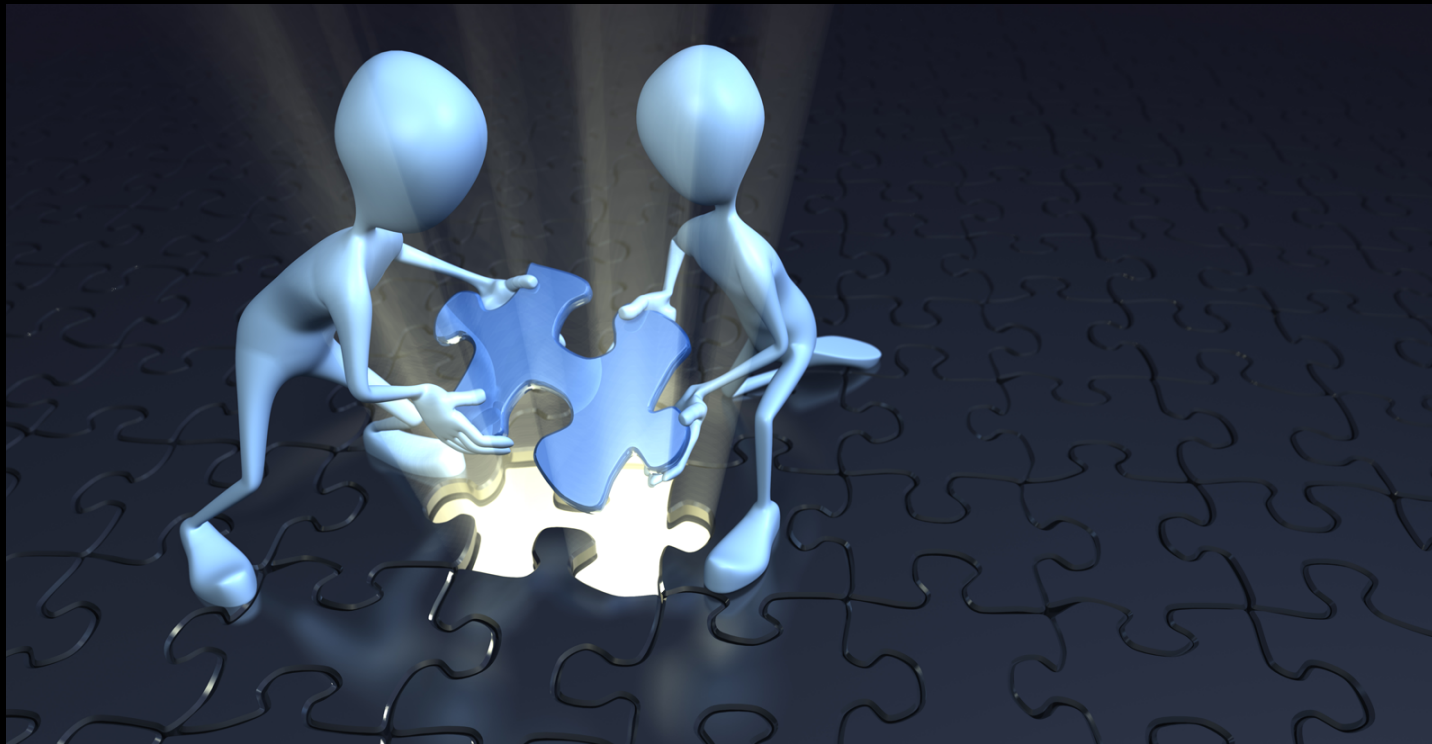
Differences

Two experts, one value?



- Assumptions, assumptions, assumptions
- Consider?
 - Professional goodwill
 - Personal goodwill (trades)
 - Non-operating assets
 - Shareholder agreement
- Depth of data
- Adjustments
- Market research / databases
- Proper use of discounts / premiums
 - Lack of marketability
 - Minority interest discount
 - Control premium





Balancing the formula & Solving the puzzle

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First Things First: Start with the applicable statute

- A. [Section 61.075, Florida Statutes](#) - Equitable distribution of marital assets and liabilities. The presumption is for equal distribution of marital and assets and liabilities, unless there is a justification for unequal distribution based on several factors including but not limited to : " the desirability of retaining any asset, including an interest in a business, corporation or professional practice, intact and free from any claim or interference by any other party."
- B. [Section 61.075\(7\), Florida Statutes](#) - Valuation Date- The date for determining value of assets and the amount of liabilities identified or classified as marital is the date or dates as the judge determines is just and equitable under the circumstances.

Competent substantial evidence is required to support a business valuation

[Nunez v. Nunez 29 So. 3d 1191 \(Fla. 5th DCA 2010\)](#) (for purposes of dividing marital assets incident to divorce, absent competent and substantial evidence to support valuation of a marital asset, the trial court's valuation constitutes an abuse of discretion; "competent evidence" refers not to the quality of the evidence but rather to its admissibility, whereas "substantial evidence" means that there must be some real, material, pertinent, and relevant evidence having definite probative value.)

[Vacarro v. Vacarro, 677 So.2d 918 \(Fla. 5th DCA 1996\)](#) Reports submitted by former wife were not competent evidence to use in valuation of former husband's business where experts who prepared reports did not consider them as appraisals, but as evaluation of former husband's valuation report.

[Garcia v. Garcia, 25 So. 3d 687 \(Fla. 4th DCA 2010\)](#) - good case to show court in cases involving the valuation of a closely held business when there is a restrictive shareholders' agreement. The trial court's finding that the net asset value methodology for valuing a closely held business was the most reasonable method of determining the value of the former husband's stock and did not err in relying on the former wife's expert's valuation. Former husband argued the former wife's expert failed to ascribe any monetary significance, or "discount" on the net asset value due to a restrictive shareholders' agreement on the valuation of a medical partnership, but the former husband's expert failed to provide such calculation.

Valuation Date: See section 61.075 (7) - within the trial judge's discretion

[Perlmutter v. Perlmutter, 523 So. 2d 594 \(Fla. 4th DCA 1987\)](#). The trial court's determination of the appropriate date for valuation must be on a case-by-case basis. The date chosen must be tailored to the particular facts involved in each case and must reflect the legislative mandate to provide for equitable distribution of the assets of the marital partnership.

Retain an expert to value the business

[Thompson v. Thompson , 576 So. 2d 267, 270 \(Fla. 1991\)](#) ("The determination of the existence and value of goodwill is a question of fact and should be made on a case-by-case basis with the assistance of expert testimony.")

In a dissolution proceeding, awarding a business to both spouses is an error.

[Lift v. Lift, 1 So. 3d 259, 260-61 \(Fla. 4th DCA 2009\)](#) (compelling former spouses to remain in wife's veterinary business together "creates [an] intolerable situation.")

[Manolakos v. Manolakos, 871 So. 2d 258, 260 \(Fla. 4th DCA 2004\)](#) (reversing trial court's order forcing a former husband and wife to remain co-owners in the chiropractic business, despite their objections)

Changes in the economy are not a basis for a new trial

[Mistretta v. Mistretta, 31 So. 3d 206, 208-09 \(Fla 1st DCA 2010\)](#) (projections of future revenues, expenses and income necessarily depend, not only on known or knowable facts already in existence, but also on assumptions about the future that will not always, if ever, be entirely accurate; the unfolding of future events other than as business appraisers assumed is not a basis for a new trial. Better said, "a cloudy crystal ball is not a basis for a new trial.")

Enterprise goodwill and not personal goodwill will be factored in equitable distribution. What is goodwill ?

[Thompson v. Thompson, 576 So.2d 267, 268 \(Fla.1991\)](#) citing [Swann v. Mitchell, 435 So.2d 797 \(Fla.1983\)](#). (" This Court has defined goodwill as the advantage or benefit a business has beyond the value of its property and capital.") **Id.** at 270. Therefore, "for professional goodwill to be marital property it must be a business asset having a value independent of the continued presence or reputation of any particular individual."

[Young v. Young, 600 So.2d 1140, \(Fla. 5th DCA 1992\)](#) citing [Thompson v. Thompson](#), stated that goodwill may be considered a marital asset subject to equitable distribution if there is evidence to support its existence apart from reputation and presence of practicing party and tangible assets. The court established the following: it is incumbent upon the claiming party to produce evidence demonstrating the discrete existence of that goodwill, once done, the exclusive method of measuring the value of that goodwill entails a fair market value approach, i.e. what a willing buyer would pay and what a willing seller would accept, neither under duress. See also [Weinstock v. Weinstock, 634 So.2d 775, \(Fla. 5th DCA 1994\)](#)(none of the comparables used included a situation where the selling professional did not remain with the buyer in the conduct of the professional practice after the closing of the sale).

Additional Resources

Shannon Pratt and Alina V. Niculita, [*The Lawyer's Business Valuation Handbook: Understanding Financial Statements, Appraisal Reports and Expert Testimony*](#), 2d Edition, American Bar Association, Section of Family Law, General Practice, Solo and Small Firm Section (2010).