

What's Next?

Preserve Company Value with Smart Exit Planning

For many business owners, the majority of their net worth is tied to their businesses. Yet, they often don't have a good understanding of the true value of their company, or of how to convert their ownership interest into cash when they are ready to exit.

Best practices suggest taking steps now to ensure that your company is set up to help meet your future goals. Here are four steps to consider:

1. Set Goals

The first and most important step in exit planning is defining objectives. By focusing on your goals, exit planning becomes easier and more productive. For example, how soon do you want to exit the business? What do you want to do after you leave — retire, start another company or become involved in a charitable endeavor? And how much money will you want or need to pursue these next steps?

It's okay for these plans to change or morph over time, but putting a stake in the ground now is important so that you have something to plan toward.

2. Assess Value

Knowing the current value of your business will help you see where you stand now and how to reach your goal. Consider engaging in a business valuation or market analysis. As part of this assessment, you'll also get a



snapshot of where your business measures up relative to the value drivers buyers look for.

Warning: Even if your company is currently running smoothly and turning a profit, it may not be in great shape to sell — or where you want it to be in terms of value. Don't be disheartened. Many owners are surprised to learn that an objective valuation doesn't match up with their own image of the company.

Take a step back. Your company — your “baby” — may need to be spruced up. Your aim now is to take steps to get the company in the best condition possible, so it's ready for new leadership when you exit.

3. Enhance Value

Value is based partially on risk. The higher the risk, the lower the value. With this in mind, look at the key value drivers in your business — management depth, customer concentration, competitive threats and internal systems, to name a few. What can you do to maximize the company's value by minimizing risk in these areas?

For example, when you leave the company, is your management “bench” deep enough to keep the business profitable and on the right track? If not, now is the time to address the issue. It takes time to choose or locate a viable leader and train him or her in the business.

Similarly, you'll want to scrub the books to ensure that all personal expenses and owner perks are not reflected in the financial statements. This way, you can present the healthiest, cleanest financial picture to potential buyers.

For the same reason, consider extending any expiring contracts and firming up customer and vendor relationships.

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The Divorce Debate

Is Fair Market Value the Right Standard?

Divorces are challenging for all parties involved — including the valuation analyst called upon to assess the business assets associated with a marriage.

Yes, that's right. Business valuation in divorce can be tricky. In fact, it's the subject of ongoing debate in the valuation world. The question on many analysts' minds is: Does divorce need its own distinct standard of value?

The Big Deal

Divorces are handled in state courts. Some states dictate which standard of value should be used, while others suggest no preference at all. Often, fair market value (FMV) is the court's standard of choice, but the courts may use the term "fair market value" in a looser, more colloquial way than valuation analysts do.

Given this vague guidance, many valuation analysts default to FMV, but not all believe that FMV is the best choice.

The International Glossary of Business Valuation Terms defines FMV as "the price at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts."

So, by definition, FMV is a very transactional standard. But many valuation analysts argue that divorce

is far from a typical transaction. They believe that dividing assets in a divorce rarely meets the definition of an arm's length transaction with a willing buyer and seller.



Divorce is far from a typical transaction. Dividing assets in a divorce rarely meets the definition of an arm's length transaction with a willing buyer and seller.

In addition, FMV analysis emphasizes the market approach, which involves using similar "real world" company transactions as guidelines for valuation multiples and prices. Again, analysts believe that the market approach isn't always relevant to divorce because the parties in a divorce are motivated differently than buyers and sellers in a non-divorce transaction.

What's Better?

If FMV isn't on target, what standard should be used? Some analysts believe investment value is a more appropriate standard in cases of divorce.

The International Glossary of Business Valuation Terms defines

investment value as "the value to a particular investor based on individual investment requirements or expectations." This standard reflects the value to a specific buyer given what he or

she is looking to get out of the deal. The pro-investment value analysts believe this definition is more relevant to a divorce.

Several state courts, especially those in California, have established and refined some principles regarding this quandary. Their rulings hinge on the marketability of the business in question. Essentially, the rulings state that, if the business is marketable, fair market value should be used. But if the business is not marketable, investment value is the appropriate standard to use.

For example, say one of the divorcing spouses is a partner in a law firm. If the

firm isn't marketable, which is often the case, investment value would be used as the standard, and a methodology like excess earnings would be used to determine the value. If investment value is used, no marketability discount would be applied.

Will a new standard of value eventually emerge specifically for divorce cases? Given the high stakes and emotions involved, the debate will likely continue. ■

Our experienced valuation analysts can help assess value in divorce cases.

Benchmarking Sets the Bar for Performance

“How am I doing?” That’s the question iconic New York City mayor Ed Koch often asked his constituents throughout his three terms in office. Business owners and executives should be asking a similar question about their companies’ performance and value: “How are we doing compared to our peers?”

Of course, it’s tough to compare privately held companies because they rarely share their financials or key performance indicators. But there are ways around this obstacle. For example, a benchmarking study can be extremely enlightening in terms of illuminating how a specific company is performing relative to other similar businesses.

While some executives attempt benchmarking studies on their own, it is often helpful to have a third party involved. Accountants and valuation analysts have access to subscription-only databases that can illuminate a variety of ratios. Moreover, it takes knowledge and experience to interpret this data and tweak it to match a specific company’s economic, regional and industry characteristics.

Data Sources

Trade periodicals and industry associations are a great source of helpful data. They often gather and sell benchmarking information for subscribers and

members. The data is typically blind — users can’t tell which company it came from — and often well-targeted in terms of company size, revenues, region, products or services.

In addition to industry resources, valuation analysts use guideline transaction databases to gather data points. Some of the most useful include:

EDGAR – The Electronic Data Gathering, Analysis and Retrieval (EDGAR) system was established by the Securities and Exchange Commission (SEC) to allow access to the filings of public companies. While many companies listed in EDGAR are too large to compare to closely held target businesses, EDGAR also contains smaller filings. Much can be gleaned from these smaller companies’ proxy statements, including excellent trend information and executive compensation figures.

CompuStat – The S&P CompuStat database includes data on tens of thousands of companies. Hundreds of financial ratios, including profitability and relative market performance numbers, are of special interest for benchmarking.

BizComps – These studies are based on small business sales transactions. Deals are sorted by industry, and records reflect revenue and cash flow multiples.

Pratt’s Stats – With financial details on more than 16,000 private company deals, this database includes up to 88 data points with six valuation multiples and 13 financial ratios. It also has notes on most sales transactions, including data on non-compete agreements.

IBA Database – The Institute of Business Appraisers maintains a database of more than 34,000 small and mid-size closely held business sale transactions. The database contains 15 asset fields and 16 income statement fields.

Mergerstat – These studies include merger and acquisition data, management buyouts and certain asset sales. They offer industry information by size, premium and transaction multiples.

Analysts typically use information from a variety of these databases for benchmarking. Based on the target company and its operations, the analyst can help owners figure out how they’re doing relative to competitors.

Benchmarking is valuable in many arenas, but it’s especially helpful for strategically setting goals and determining progress on an ongoing basis. ■

We conduct benchmarking studies for many clients. Contact us for assistance.

Preserve Value with Smart Exit Planning

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4. Implement a Strategic Plan

Enhancing the company’s value to meet your long-term objectives won’t happen overnight. This is especially true if your goal is to sell the company to an outside buyer, who will likely have higher expectations than a buying team of employees or family members.

Create a strategic plan, including an exit timeline, to address each value driver and how to tune up each element for an eventual sale. Schedule periodic check-ins with your advisory team — your accountant, attorney, financial planner and insurance advisor — to ensure that you stay on track.

Always keep your exit planning goals in mind, but don’t be afraid to tweak them. After all, planning what’s next is a big step, and you’re entitled to dream big about the next phase of your life.

Remember, exit planning is a process. Time is on your side, so try to start planning a few years out. ■

Our firm can help build business value in conjunction with exit and succession planning. Call us today for more information.



- Business Valuation Services
- Litigation Support Services [Expert Witness]
- M&A Transaction Support [Due Diligence]
- Economic Damages
- Intangible Asset / Intellectual Property Valuations
- FAS 141/142 Valuation Services
- Fraud / Forensic Investigations
- Business / Financial Advisory Services

For more information, please contact:



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Tax Court Case Illuminates Latest on FLPs

A recent tax court case has resulted in a win for the heirs of a wealthy Pennsylvania patriarch, underscoring the viability and value of a family limited partnership (FLP) done right.

The case, Estate of Black, involved an FLP set up by Samuel Black, who had acquired millions of dollars in stock during his tenure with Erie Indemnity Company. His family placed almost all of their Erie shares into the FLP, and Black's son became the managing partner of the FLP prior to his father's death. When Black died, his interest in the FLP was worth about \$165 million.

After the estate filed its tax returns, the IRS disallowed the FLP, claiming that the FLP did not have a bona fide

business purpose. The IRS claimed the FLP was instead created primarily for tax-avoidance purposes.

The estate's attorneys claimed that the FLP had a legitimate non-tax purpose, and asked the court to consider Black's intent in setting up and maintaining the FLP. Black's family and business circumstances — a son with an iffy marriage, a bankrupt father-in-law with a big loan to repay, two lazy grandsons, and discord between other Erie shareholders — caused Black to put strict limitations on the FLP that supported the estate's claim.

For example, the partnership agreement included significant restrictions on stock transfers, and the stock in

the FLP was largely untouched by the partners. Also, the elder Blacks did not rely on the FLP for living expenses.

In addition, the FLP protected the son's stock during his divorce, and prevented the grandsons from reaching their stock. The FLP kept the stock consolidated and, thus, protected the family's influence on the Erie board.

Taking all of this into consideration, the tax court ultimately ruled that the FLP indeed had a bona fide business purpose. Score one for the taxpayer! ■

Call us for information about setting up a family limited partnership.



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