

PROFESSIONAL VALUATION SERVICES

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Why Is a Business Valuation Necessary?

Business interests Often Represent a Significant Asset

Business valuations are performed because ownership interests in privately held companies often represent a significant portion of one's estate and/or portfolio. The value, or worth, of an interest in a privately held company, as opposed to stock in a public company, is usually unknown because there is no active market to sell or trade that interest from which to ascertain or approximate value. Value determinations are most commonly needed to calculate estate tax upon death, split up family assets in a divorce, or negotiate value in a purchase, sale or merger of a business enterprise. Besides these, there are many other reasons why a holder of an interest in a privately held company might require a business valuation.

The more common ones are:

- Adequacy of Life Insurance
- Buy/Sell Agreements
- Charitable Contributions
- Disruption of a Business
- Dissenting Shareholder Actions
- Eminent Domain
- Employee Stock Ownership Plans (ESOPs)
- Gifting Programs
- Gift Taxes
- Initial Public Offerings (IPOs)
- Obtaining Financing
- Partner Disputes
- Split-ups/Spin-offs
- Succession Planning

A Value Added Service

Possibly one of the best reasons for obtaining a business valuation is to use it as a management tool. A prime objective for every business enterprise, large or small, is to improve and maximize its value to the owners. This is a necessary business requirement in order to justify the investment of time and, more particularly, capital. A properly

prepared business valuation provides management with insightful information that helps identify company strengths and weaknesses that affect value, allowing management to more effectively focus their energies in places that matter. A business valuation, prepared periodically, also serves as a measurement tool that helps owners assess overall success and management effectiveness. Many business owners believe the value of their business is net profit, or gross sales, multiplied by some industry rule of thumb. This is simply not the case. In fact, the application of an industry rule of thumb formula often results in a value determination that differs greatly from the actual value that could be determined by a qualified business valuation professional.

Accurate Value Determination

The result of an inaccurate value determination, regardless of whether it is high or low, generally leads to undesirable consequences. For instance, if the value is too high, estate taxes will be too high; savvy investors or prospective buyers will usually disregard a value that appears too high. If the value is too low, you can be sure savvy investors or prospective buyers will recognize it and take advantage. Likewise, if you are on the other side of the dispute in a dissenting shareholder action or divorce, you certainly want to know you are receiving a fair value for your interest.

Careful Analysis

Determining the true value of a business enterprise requires a careful analysis of two primary components that make up value: tangible assets such as real estate, machinery, and furniture used by the business and various intangible assets such as the business goodwill. Other intangible assets might include customer lists, trademarks, copyrights, distribution rights, a superior management team, non-compete agreements, physical location, special processes, and name recognition. Quite often, the value of a company's intangible assets is much greater than the tangible assets. Valuing intangibles, however, is where one needs the services of a qualified business valuation professional: it requires a careful analysis of many aspects of a business enterprise and requires skills acquired through specialized training and experience.

Understanding the Business

To properly value intangibles, the valuator must acquire a thorough understanding of every aspect of the enterprise dynamics, including management capabilities, company strengths, weaknesses and vulnerabilities, the competitive environment, overall expectations for the marketplace, and future economic prospects for the industry. All of these elements affect the risk of an ownership interest in a particular enterprise, and risk affects value. Additionally, the valuator must analyze the financial health of the enterprise and assess its future profit potential. Generally, profitability translates into intangible value and/or goodwill. As such, a key part of the valuator's analysis will focus on determining a company's true profitability. Common adjustments might include adding back to profits the amount for excess officers' compensation over and above the average for the industry, excessive depreciation on assets aggressively written-down, and non-recurring charges to expense, to name a few.

Sorting Through a Complex Process

After a thorough analysis of the company's dynamics and financial health, the valuator must select the most appropriate methodology from among the many utilized by the valuation industry and apply a series of calculations and formulas to arrive at the ultimate conclusion of value. Overall, the process is quite complex and time consuming. However, this is what is necessary to determine the true value of a business.

What Is Important in Selecting a Valuation Professional?

A valuation professional should be able to demonstrate knowledge and competence in valuing business enterprises. Competence is achieved through education, training and experience. Of the utmost importance is one's affiliation with a recognized valuation organization such as the National Association of Certified Valuation Analysts (NACVA). Members of NACVA are required to adhere to industry standards in performing valuation services and communicating their conclusions of value. Standards are intended to assure users the service they receive meets an industry acceptable level of care, due diligence, thoroughness and quality, and the valuator adheres to ethical guidelines in the performance of his or her engagements.

For more information about our
valuation services contact:

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