BUSINESS VALUATION QUICK REFERENCE

COMMON REASONS FOR VALUATIONS

Buy/Sell Agreements ▪ Estate and Gift Taxes ▪ Mergers and Acquisitions ▪ Succession Planning ▪ Divorce ▪ Shareholder Disputes ▪ Intellectual Property Disputes ▪ Mediation and Arbitration ▪ Business Damages and Lost Profits ▪ Employee Stock Ownership Plans

VALUATION FACTORS

Revenue Ruling 59-60 states that a sound valuation should consider eight factors:

1. The nature and history of the business;
2. The economic and industry outlook;
3. The financial condition of the business;
4. The earnings capacity of the business;
5. The dividend paying capacity of the business;
6. Whether or not the enterprise has goodwill or other intangible value;
7. Sales of stock; and
8. The market price of stocks of corporations engaged in the same or similar lines of business.

VALUATION ORGANIZATIONS

American Institute of Certified Public Accountants (AICPA), Forensic and Valuation Section (FVS)

National Association of Certified Valuation Analysts (NACVA)

The Institute of Business Appraisers (IBA)

American Society of Appraisers (ASA)

CFA Institute

VALUATION METHODS

Adjusted Net Assets—which produces an estimate of value by adjusting the company's assets and liabilities to market value, and subsequently subtracting those liabilities from the assets.

Liquidation Value—which produces an estimate of value by adjusting the company's assets to liquidation value, reducing that number by respective liabilities and income tax implications, and determining cash flow, which will benefit the owner.

Excess Earnings Return on Assets—which determines the company's fair market value by establishing a value for its adjusted net assets and its intangible assets by capitalizing the earnings of the business that exceed a reasonable rate of industry return.

Capitalization of Earnings—which capitalizes some measure of the company's earning capacity at a rate reflective of the return on investment required by the hypothetical investor.

Discounted Future Earnings—which discounts the projected future earnings of the company to determine the fair market value at the valuation date.

Specific Company Transaction Method—which produces an estimate of value by a review of relevant past transactions of the company stock.

Guideline Company—which produces an estimate of value by comparing the company with various valuation of multiples of publicly traded companies.

Merger and Acquisition (Transaction or Direct Market Data) Method—which produces an estimate of value by comparing the company with comparable privately held companies that have been sold.

MAJOR IRS GUIDANCE

Revenue Ruling 59-60—Valuing closely-held business interests.

Revenue Ruling 65-192—Extends 59-60 to all types of business interests and to income taxes as well as gift and estate taxes.

Revenue Ruling 68-609—"Formula method" (excess earnings).

Revenue Ruling 77-287—Valuing preferred stock.

Revenue Ruling 93-12—Allows minority discounts when valuing minority interest of family members in family-controlled businesses.

EXCERPTS FROM THE INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS (IGBVT)

Asset (Asset-Based) Approach—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Business Valuation—the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM)—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization—a conversion of a single period of economic benefits into value.

Capitalization Factor—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalization Rate—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control—the power to direct the management and policies of a business enterprise.

Control Premium—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a noncontrolling interest in a business enterprise to reflect the power of control.

Cost Approach—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital—the expected rate of return that the market requires in order to attract funds to a particular investment.

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Excess Earnings—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

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BUSINESS VALUATION QUICK REFERENCE

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms 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.

Going Concern Value—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Investment Value—the value to a particular investor based on individual investment requirements and expectations.

Key Person Discount—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Marketability—the ability to quickly convert property to cash at minimal cost.

Minority Discount—a discount for lack of control applicable to a minority interest.

Net Book Value—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Nonoperating Assets—assets not necessary to ongoing operations of the business enterprise.

Premise of Value—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Rate of Return—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Residual (Terminal) Value—the value as of the end of the discrete projection period in a discounted future earnings model.

Risk-Free Rate—the rate of return available in the market on an investment free of default risk.

Risk Premium—a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Standard of Value—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Tangible Assets—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Valuation Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

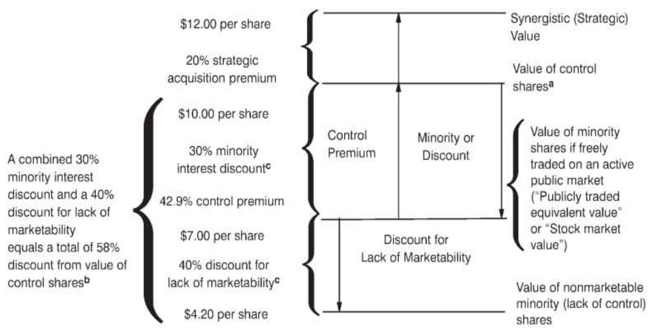
Valuation Date—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method—within approaches, a specific way to determine value.

Valuation Procedure—the act, manner, and technique of performing the steps of an appraisal method.

Weighted Average Cost of Capital (WACC)—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

"LEVELS OF VALUE" IN TERMS OF CHARACTERISTICS OF OWNERSHIP



Note:

a Control shares in a privately held company may also be subject to some discount for lack of marketability, but usually not nearly as much as minority shares.

b Minority and marketability discounts normally are multiplicative rather than additive. That is, they are taken in sequence:

$	10.00	Control Value
–	3.00	Less: Minority interest discount (.30 × $10.00)
$	7.00	Marketable minority value
–	2.80	Less lack of Marketability discount (.40 × $7.00)
$	4.20	Per share value of non-marketable minority shares

c Note that neither the minority/control nor the marketability issue are "all or nothing" matters. Each covers a spectrum of degrees as discussed in the accompanying text.

THE FIRM

Rosenfarb LLC is a firm of leading forensic accounting, valuation and economic professionals that offers financial expertise in litigation, valuation, and investigation to the legal, business, and not-for-profit communities.

Rosenfarb professionals are regularly retained to provide valuation services. Such services include valuing a business, partial business interests, business segments and divisions, and family limited partnership interests (FLPs). Rosenfarb's clients also require valuation of intangible and intellectual assets—such as patents, trademarks, and copyrights. The firm is also often sought for its expertise in performing valuation services in connection with bankruptcies, mergers and acquisitions, and other business scenarios.

The firm recognizes that for effective performance in a litigation setting, a business valuation professional—in addition to having the requisite credentials, education, and experience—must be responsive, agile, and rigorous.

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