



THE VALUATION E-COLUMN

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What to Expect During the Business Valuation Process

Most closely held businesses are not appraised every year. As a result, owners and managers are not particularly familiar with the business valuation process. An appraiser must therefore start with a detailed discussion of the process itself. This can avoid surprises about such things as the information that has to be gathered for the appraiser, risk factors that may impact value, discounts for lack of control and marketability that may be taken, and the unlikelihood that one appraisal can serve two purposes. There are generally four phases in the business valuation process.

The *introductory phase* is a review of the appraisal needs of the client, such as: What exactly will be appraised and what is the effective date? Why is the appraisal needed? Will the subject interest be a controlling or non-controlling interest? Is the client familiar with the concept of control premiums or discounts for lack of control or lack of marketability? How many classes of stock are there? When is the report required? The purpose of the valuation drives the definition of value and the type of report needed. And of course, the conclusions are different with each definition of value (e.g., investment vs. fair market vs. liquidation value). If the client has any additional objectives for the report, this is the time to discuss them.

During the *engagement phase*, the business appraiser prepares the engagement contract, which documents major points of the valuation assignment, including the effective valuation date, subject interest to be valued, time requirements, fees and retainers. The client executes the engagement contract by signing it and usually enclosing a retainer, thus allowing work to begin.

The *valuation phase* encompasses the gathering of information needed to complete the assignment. The client will need to provide company information such as historical financial statements, tax returns, corporate documents, and answers to a questionnaire. The time spent in this phase facilitates a high-quality valuation. Other information that the appraiser will collect includes industry data, relevant economic information, market data on similar types of transactions, and rates of return available on investments of similar risk. Financial forecasts will likely need to be put together as well. This information is all kept in a comprehensive work file. The appraiser will most likely schedule an on-site visit to meet with company management and appropriate personnel to discuss the company's background, financial management, operations and outlook. This is typically done a couple of weeks into the assignment, so that the appraiser has some familiarity with the business and its environment prior to a visit.

The *report phase* consists of writing the report or providing a verbal report. If it is a formal written report, a written draft of the company's operations and financial analysis may be reviewed by the Company to assure factual correctness and provide any necessary clarifications. To write an effective and comprehensive report, the appraiser is preparing it throughout the valuation process. The report is then finalized and signed. Each full report (typically anywhere from 60 to over 90 pages) consists of several parts, including: definition of the valuation assignment, economic background, industry background, company description, financial analysis, valuation methodologies, adjustments, reconciliation and value conclusion, assumptions and limiting conditions, reference sources, and appendices of relevant exhibits. The report will explain the appraisal process followed, the research performed, the analysis applied, the valuation methods employed, the rates of return and growth developed, discounts applied and the reconciliation of values by the various methods utilized. A summary report (typically 35 to 60 pages) is also available. In the end, the client has not only learned what the business is worth, but has also gained a stronger grasp of the economic and industry environment in which the company operates, the company's strengths, weaknesses, opportunities and threats, its financial performance, and its position in the market. To take full advantage of the process, the client can use the business valuation as a planning and control tool that provides foundation and direction for the company's strategic plan.

Valuations form the foundation for key aspects of business strategic planning, buy/sell agreements, estate planning, financial reporting, litigation, M&A transactions, stock option grants, and succession/exit plans. If we can provide additional information or advice on a current situation, please call us. *Delphi Valuation Advisors, Inc. Values Your Business!*

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