


**UTA 2014 CPE DAY**

August 13, 2014

Business Valuation: What Are We Valuing?




The slide features a dark grey background for the main text. Below the text is a horizontal bar with an orange rounded rectangle on the left and a blue rectangle on the right containing the 'whitleypenn' logo.

**Learning Objectives**

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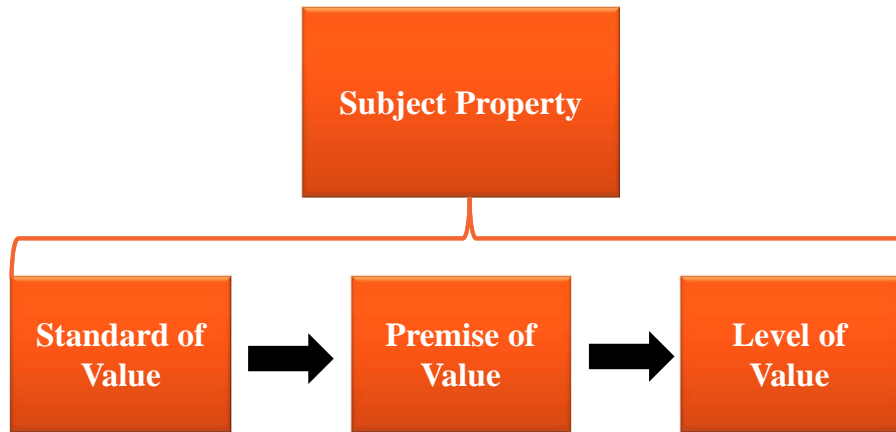
**Raise awareness for the importance of clearly understanding the subject property defined in a business valuation.**

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The slide has a white background. The title 'Learning Objectives' is in orange. Below it is a grey horizontal line with an orange square on the left. The main text is in bold black. The page number '2' is at the bottom left, and the Whitley Penn logo is at the bottom right.

## Business Valuation:



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## What is the Subject Property?



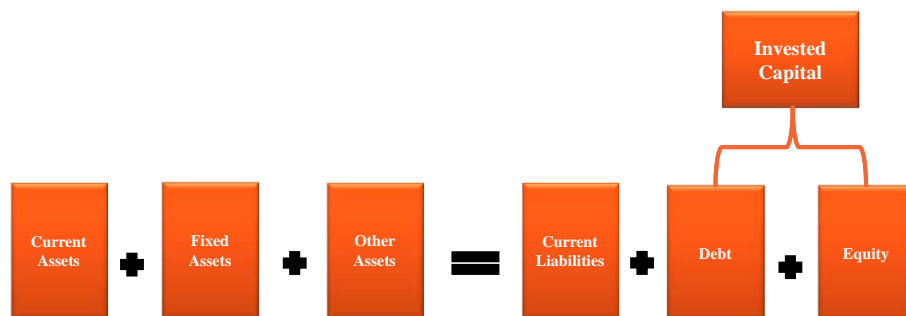
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## Endless Possibilities



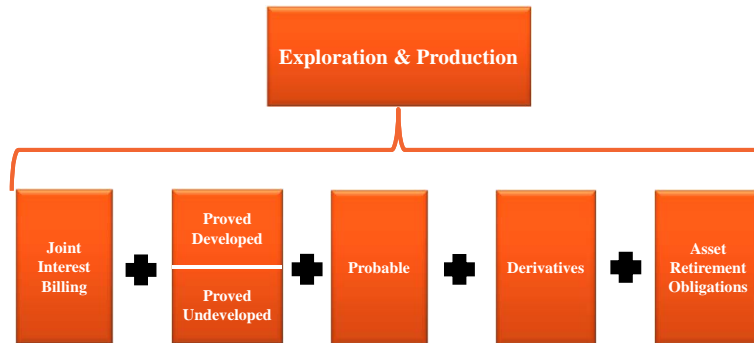
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## Allocation Across Balance Sheet



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## Example: Oil & Gas Assets & Liabilities



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## Business Valuation: What are valuing?

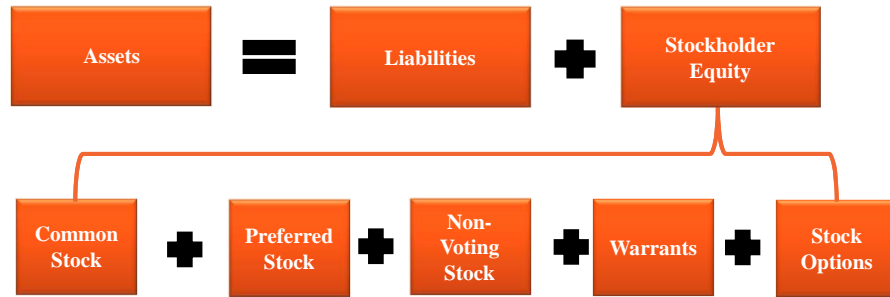
### Equity Investments:

- Corporation
- Partnership
- Limited Liability Companies
- Other

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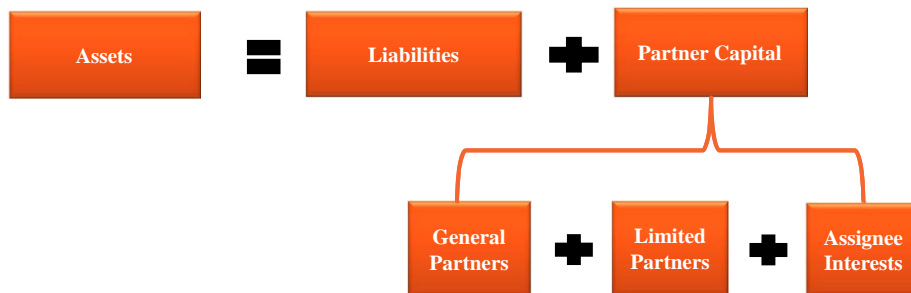
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## Equity: Corporation



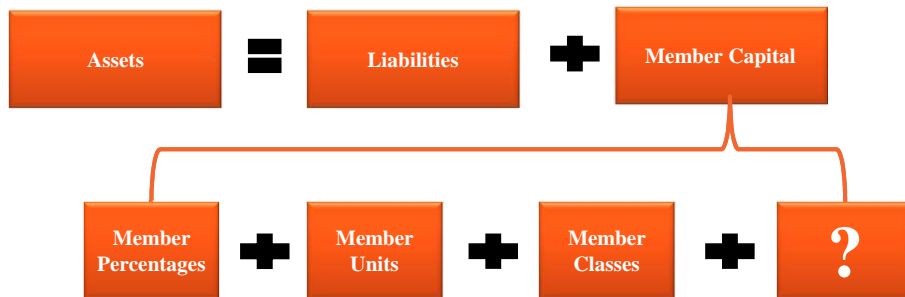
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## Equity: Partnerships



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## Equity: Limited Liability Companies



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## Equity: Other Ownership Interests

### Legal:

- Derivatives
- Residential Profit Units (RPU)
- Convertible Debt Instruments

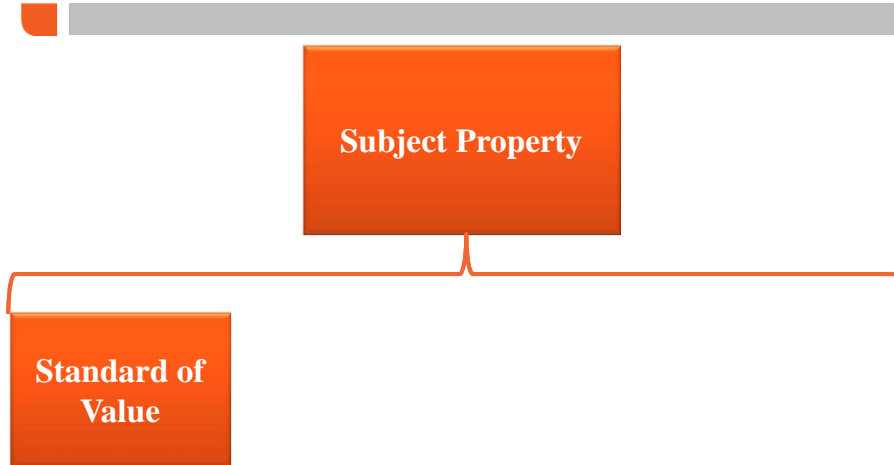
### Employment:

- Phantom Stock
- SARs
- Profit Interest

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## What Are We Valuing?



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## Standard of Value

### Definition:

- 1) "The type of value being sought" – Shannon Pratt
- 2) "Varies with the situation" – PPC Guide to Business Valuations
- 3) "Defines where to go in an appraisal" – Travis Harms

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## Standard of Value

- **Fair Market Value**

- The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under an compulsion to buy or to sell and both having reasonable knowledge of relevant facts – Treasury Reg.20.2031-1

- **Fair Value**

- Court determines in some states
- “The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date” – FASB ASC 820

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## Standard of Value

- **Investment Value**

- “The value of an asset or business to a specific or prospective owner that considers the owner’s (or prospective owner’s) knowledge, abilities, expectations of risks and earning potential, and other factors” – Shannon Pratt

- **Intrinsic Value**

- “Being desirable or desired for its own sake without regard to anything else”
- Often synonymous to investment value

- Based on the analysis and judgment of others

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## Standard of Value

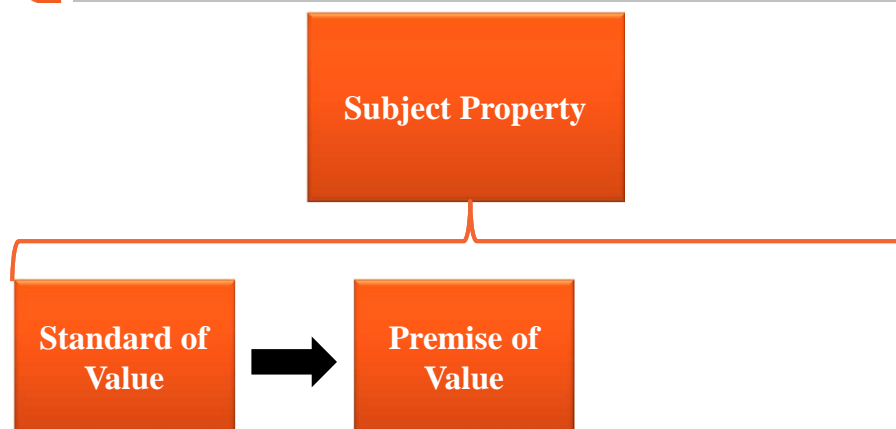
- **Book Value**

- “An accounting term which refers to an asset’s historical cost reduce by any allowances for unrealized losses, depreciation, impairment, and amortization; or, on a company’s balance sheet, its assets less liabilities” – Shannon Pratt
- “The difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet – AICPA

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## Business Valuation: What Are We Valuing?



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## Premise of Value

**“An assumption as to the actual or hypothetical set of circumstances applicable to the subject valuation” – Shannon Pratt**

- **Value in exchange**
  - “The value of the business or business interest changing hands in a real or hypothetical sale; to some extent, fair market value and fair value standards fall under the value in exchange premise” – Shannon Pratt
    - All federal and state tax matters rely on this principal

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## Premise of Value

- **Value to the holder**
  - “The value of a property that is not being sold but instead is being maintained in its present form by its present owner; the property does not necessarily have to be marketable in order to be valuable; to some extent, the standard of investment value falls under the premise of value to the holder, as does, in certain cases, fair value” – Shannon Pratt
    - Financial Reporting
    - A company going private
    - Shareholder dissent/oppression
    - Corporate dissolution
    - Divorce
    - Other Situations

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## Premise of Value

### Most Common Premises of Value:

- **Going Concern Value**

- “The value of a commercial enterprise’s assets or of the enterprise itself as an active business with future earning power as opposed to the liquidation value of the business or of the assets” – Bryan A. Garner

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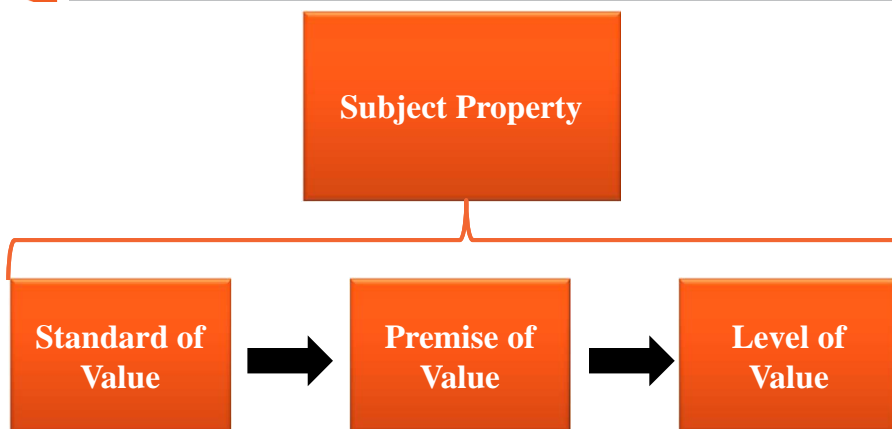
## Premise of Value

- **Liquidation Value**

- “The value of a business or of an asset when it is sold in liquidation, as opposed to be sold in the ordinary course of business” – Bryan A. Garner

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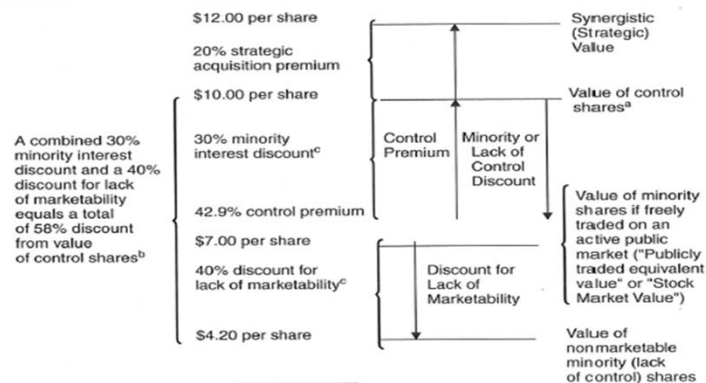
## What Are We Valuing?



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## Level of Value

Exhibit 1.2 "Levels of Value" in Terms of Characteristics of Ownership



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## Level of Value

- **Synergistic Value**

- A premium paid as an element of investment value due to the value of a company to a particular buyer – Shannon Pratt

- **Value of Control**

- The value derived from the power to direct the management and policies of a business enterprise; can also be thought to amount to the amount by which the pro rata value of a controlling interest exceeds the pro rata value of a noncontrolling interest in a business enterprise that reflects the power of control – Shannon Pratt

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## Level of Value

- **Majority Interest**

- An ownership interest greater than 50% of the voting interest in a business – Shannon Pratt

- **Minority Interest**

- An ownership interest less than 50% of the voting interest in a business enterprise – Shannon Pratt

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## Levels of Value?

- **Discount for Lack of Control**
  - An amount of percentage deducted from the pro rate share of value of 100% of an equity interest in a business to reflect the absence of some or all of the power of control – Shannon Pratt
- **Marketability**
  - The right to sell something or, alternatively, when used synonymously with liquidity, the speed with which an asset may be converted to cash without diminishing its value – Shannon Pratt

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## Level of Value

- **Discount for Lack of Market ability**
  - When a stock is not readily marketable (i.e. publicly traded), if it does finally sell, it usually will sell at a significantly discounted price from control value or from an otherwise comparable stock that is publicly traded; the amount of the discount will vary depending on the degree of liquidity attributes and restrictions on sale of the stock – Shannon Pratt

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## Summary



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## Business Valuing: What are we valuing?



# Questions?

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