Business Valuation Basics for Attorneys

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HealthCare Appraisers, Inc.
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HealthCare Appraisers, Inc.

- Valuation and consulting firm focused exclusively on the healthcare industry
- Provide services to clients across the nation
- Business and intellectual property valuation
- Compensation and services arrangements
- Advisory and consulting
- Litigation support

Selecting an Appraiser

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What is an Appraiser?

- **Credentialed appraisers**
  - Certified by a professional appraisal organization
  - Met experience requirements
  - Mastered the body of knowledge for an appraisal specialty as evidenced by examinations and/or peer review of work
  - Met education requirements
  - Subject to professional standards and ethics codes
  - Meet continuing professional education requirements
- **Valuation consultants**
  - Expertise and experience in providing valuation services
  - Often provide other forms of consulting services

Credentialing

Business valuation is not subject to licensure, however, several organizations provide education and credentialing of appraisers:

- American Society of Appraisers (ASA or AM)
- National Association of Certified Valuation Analysts (CVA or AVA)
- American institute of Public Accountants (CPA/ABV)
- CFA Institute (CFA)
- Institute of Business Appraisers (CBA or BVAL)

Other Considerations

Even qualified appraisers may have different:

- Industry specific experience
- Project specific experience
- Type of practice
- National or Local firm
- Publications, articles, speaking engagements

BV Professional Standards

USPAP

- Uniform Standards of Professional Appraisal Practice ("USPAP")
- Promulgated by the Appraisal Foundation, which was started by the appraisal profession in 1987
- Standards for appraisal work and reporting
- USPAP compliant appraisal reports required for certain regulatory purposes
- Certain professional organizations require USPAP compliant reports
- Addresses real estate, personal property, and business valuation

Use of Appraisers

- Mergers and Acquisitions
- Financial Reporting
- Succession Planning
- Estate and Gift Tax
- Marital Dissolution
- Shareholder Disputes
- Commercial Litigation (business interruption, lost profits, IP infringement, etc.)
- Valuation Consulting

Valuation Basics

Standard of Value

- **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."

Standard of Value

- **Fair Value**

  "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."

- **Other Standards of Value**
  - Strategic Value (or Investment Value)
  - Liquidation Value
  - Court defined standards

Valuation Approaches

- **Income Approach**
  - A general approach to determining value by drawing reference to the earnings produced by the investment
- **Market Approach**
  - A general way of determining value by drawing reference to the prices at which comparable investments are transacted
- **Asset (or Cost) Approach**
  - A general way of determining value by drawing reference to the underlying assets (or costs thereof) associated with the investment

Income Approach

- **Capitalization of Earnings Method**
  - A method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.
- **Discounted Cash Flow (DCF) Method**
  - A method within the income approach whereby earnings are projected over a discrete forecast period and then discounted to their present value using a risk adjusted required rate of return

Required Rate of Return

- Estimated based on the perceived risk of the investment relative to alternative investments
- More risk = Higher rate of return
- Typically estimated using a Build-up approach or the Capital Asset Pricing Model (CAPM)
- Rates of return must be specific to the investment type and measure of earnings.

Market Approach

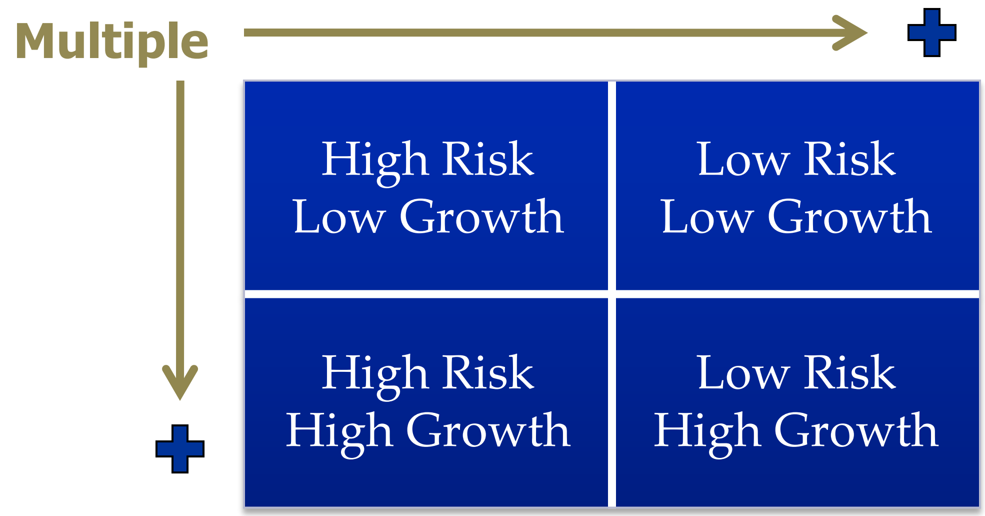
- **Merger and Acquisition Method**
  - A method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.
- **Guideline Public Company Method**
  - A method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Finding Comparables

- Often VERY difficult to find true comparables
- Items that should be considered:
  - Geography
  - Product diversification
  - Revenue
  - Profitability
  - Growth Prospects / Capacity limitations
  - Age and Quality of Facility / Equipment
  - Competition
  - Breadth and depth of Management
  - Access to Capital

A Word of Caution

- Use of "Market Multiples" can be misleading
- A multiple is a function of both RISK and GROWTH



Asset Approach

- **Adjusted Net Assets Method**
  - A method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values.
- **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.

Asset Approach

- Typically used for:
  - Start up businesses
  - Marginally profitable or poorly managed businesses
  - Asset holding companies

The use of an Asset Approach does NOT result in Liquidation Value.

Valuation Discounts

- **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. (i.e. the ability the ability to quickly convert the property to cash at an ascertainable price with minimal cost)

Synthesis & Conclusion

- Appraiser considers all valuation approaches deemed relevant.
- Discounts applied as appropriate given the level of value yielded by the valuation approach(es) and the subject interest.
- Concluded value may be a result of one or a combination of several values yielded by the approached employed.
- Trying to emulate a hypothetical negotiation - focus on the values expected to be most relevant to a buyer and seller .

Questions?

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