



The Advantage

Get the Edge with Intelligent M&A Strategy

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Valuation is More Than Just a Formula

Tom Marx and Paul Cooperstein

An initial offer to buy a business is customarily presented in the form of a Letter Of Intent (LOI). Typically the LOI includes many significant material terms and conditions such as price, asset sale or stock sale, financing conditions, due diligence requirements, noncompetition for the owners and other terms that the offering party considers vital.

The LOI is optimally made after preliminary information has been gathered and intensive analysis and projections have been completed. Determining the offer price is the most difficult aspect of preparing an LOI.

So how do you determine the initial offer price (IOP)?

As a starting point it is essential to recast financial statements to determine what the finances of the business look like without extraordinary expense and income events. Once that is done you can determine a true EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) figure. A comprehensive valuation will then determine valuation from the perspective of several different financial valuation formulas and then average those results (or if appropriate weight them) to determine a value of the business.

From our perspective, once this valuation process is complete the real work begins. The offering price, whether from the buyer or seller, is seldom what the formulas provide. Rather the offering price should always BEGIN with this number and then be adjusted by a variety of considerations. To think that you can determine the true value of a business with a formula puts you in a position to end up with a poor valuation assumption.

We are reminded of the cliché: "An ounce of planning is worth a pound of gold." To make an intelligent determination of an IOP, it is essential to invest the time and resources on the front end to identify and evaluate the intangible elements that can affect the true value of the business.

This is best accomplished by hiring experts to assist you. For example, we have represented sellers who have through our efforts discovered alternative strategies, such as deciding to reject offers to sell their business in favor of a strategy that involves selling an interest to a key stakeholder. By building in future incentives for that stakeholder, the seller is able to leverage this newly hired executive's expertise until the market rebounds and multiples increase. It is an essential advantage to build a team to serve you that understands the variety of possibilities that can influence the value of the business.

Distinguishing Value

The most essential step to assure success in the valuation process is paying attention to what we call the "discovery process." The assumptions that you rely on, the scenarios that you think through and the strategies that you choose to implement in the discovery process are the foundation of your success. The result of faulty thinking may be a failed transaction, and often at an incredible cost of time, energy, money and lost opportunity. There are two intelligent processes that can lead you to success:

Engaging in intelligent strategic conversations among a variety of your constituencies, including your financial and legal advisors, board of directors, industry leaders, top management staff and even your family, is important to the overall process of discovering optimal short and long term concerns that can be taken into account to determine the value of a business.

Well designed scenario planning and mind mapping for the consideration of multiple and alternative "what if" strategies to determine the potential profitability of varying strategies.

The IOP may well be different from the value that you place on the company. ***The value of a particular company depends on that company's ability to realize future results***, which of course are greatly impacted by the strategic opportunities that its managers identify and then choose to engage in.

The value may include the following and is usually based on a strategic plan for the business after the transaction is complete:

- Development of a new product line or supplier relationships
- Development of new marketing initiatives
- Development of new distribution channels
- Decreased operating costs
- Removing a competitor that is a low price leader
- Rollup with related companies

The value is also influenced by intangible assets such as:

- Quality and loyalty of clientele
- Competency of key management
- Operating systems
- Technology systems
- Physical locations and their value
- Proprietary rights such as patents and trademarks, licenses, technology and or training
- Industry trends
- Stand-alone value of the target company
- Acquisition premiums
- Synergies resulting from the combined companies
- Competitive environments
- Seller's objectives and the buyer's objectives
- History and nature of the business
- Economic outlook
- Market value of comparable companies
- Debt and capability to repay debt

A thorough valuation recognizes that financial modeling is not an exact science. The professional appraisal is a base line to the commencement of the discovery process that unleashes all other relevant factors to determine an appropriate offering price and the value of the business at hand. It is in the discovery process that you can unleash all the other relevant factors to determine the value of the business at hand and then craft an appropriate IOP on your way to a successful transaction.