MAXIMIZING VALUE THROUGH KNOWLEDGE

Business Succession Planning Course

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David P. Adams III

- Founded Adams Capital, Inc. in 1996
- M.B.A. Georgia State University
- B.S.M.E. Georgia Institute of Technology
- Professional accreditations: CPA, ABV, ASA
- Over 20 years of testimony experience

Adams Capital, Inc.

- Independent, third party valuation firm
- We solve problems where valuation matters
  - Accounting compliance
  - Tax compliance
  - Transaction advisory services
  - Dispute resolution
- Experience with over 3,000 transactions

Bacchus Groceries, Inc.

- Why do we need to know the value of BG?
  - Gift
  - Estate
  - What else?

What to value

- Class A
  - $500,000 for 100 shares
- Class B
  - $0 for 100 shares vote on sale only with 80% majority

Estate funding obligation

- BG may need to purchase stock with cash and new debt
- Redemption price
  - Assumed value

Adjustments

- John salary
- Katie CEO
- Susie skimming $25-50,000 per year
- John/Katie joint account

Time frame

- Gift
  - Now
- Estate
  - Unknown
- Trust
  - Katie 40 now 27 = 13 years

A Tactical Approach to Business Valuation

Topics

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- Redemption price – formulas
- Fair Market Value of a non controlling non marketable interest (Discounted price or transfer price)
- Stock or asset sale – what is the difference?
- C to S Conversion valuation – why does it matter?

Standards of Value

- Fair Market Value
- Fair Value (State Rights)
- Fair Value (Financial Reporting)
- Liquidation Value
- Strategic Value

Approaches to Value

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BUSINESS VALUATION SERVICES

	Key Driver	Application
Income	Cash flow or profits, Discount rate	When the target's future performance is expected to differ greatly from its past performance as is the case with start-ups or early stage businesses.
Market	Data on multiples from actual transactions	When information on truly comparable publicly traded companies or recent transactions is readily available.
Asset	Value of individual assets - liabilities	When the assets are the business.

Family Business Planning Model

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The Owner's Plan

The Family Plan

The Company Plan

Hard Side

- **Economic and tax planning**
- **Wealth preservation**
- **Wealth transfer**
- **Charitable gifts**
- **Life insurance**
- **Business valuations**
- **Business structure**
- **Investment portfolio**

Soft Side

- **Board of directors**
- **Family council**
- **Compensation**
- **Shareholder agreements**
- **Roles**
- **Job descriptions**
- **Governance**
- **Fairness**
- **Family mission**
- **Employment rules**
- **Leadership transition**
- **Communication**
- **Conflict management**
- **Personal goals**

Valuation is a Complex Strategic Issue

- Many moving parts

- Economy
- Market(s)
- Industry
- Company
- Management
- Family

- What to Value?
- When to Value?
- How to Value?
- Conflict of Interest
- Discounts?

Far-reaching wealth implications

Determining Value

- What is to be valued?
  - Business enterprise
  - Assets
  - Equity

- What is to be excluded?
  - Real estate

Valuation Drivers

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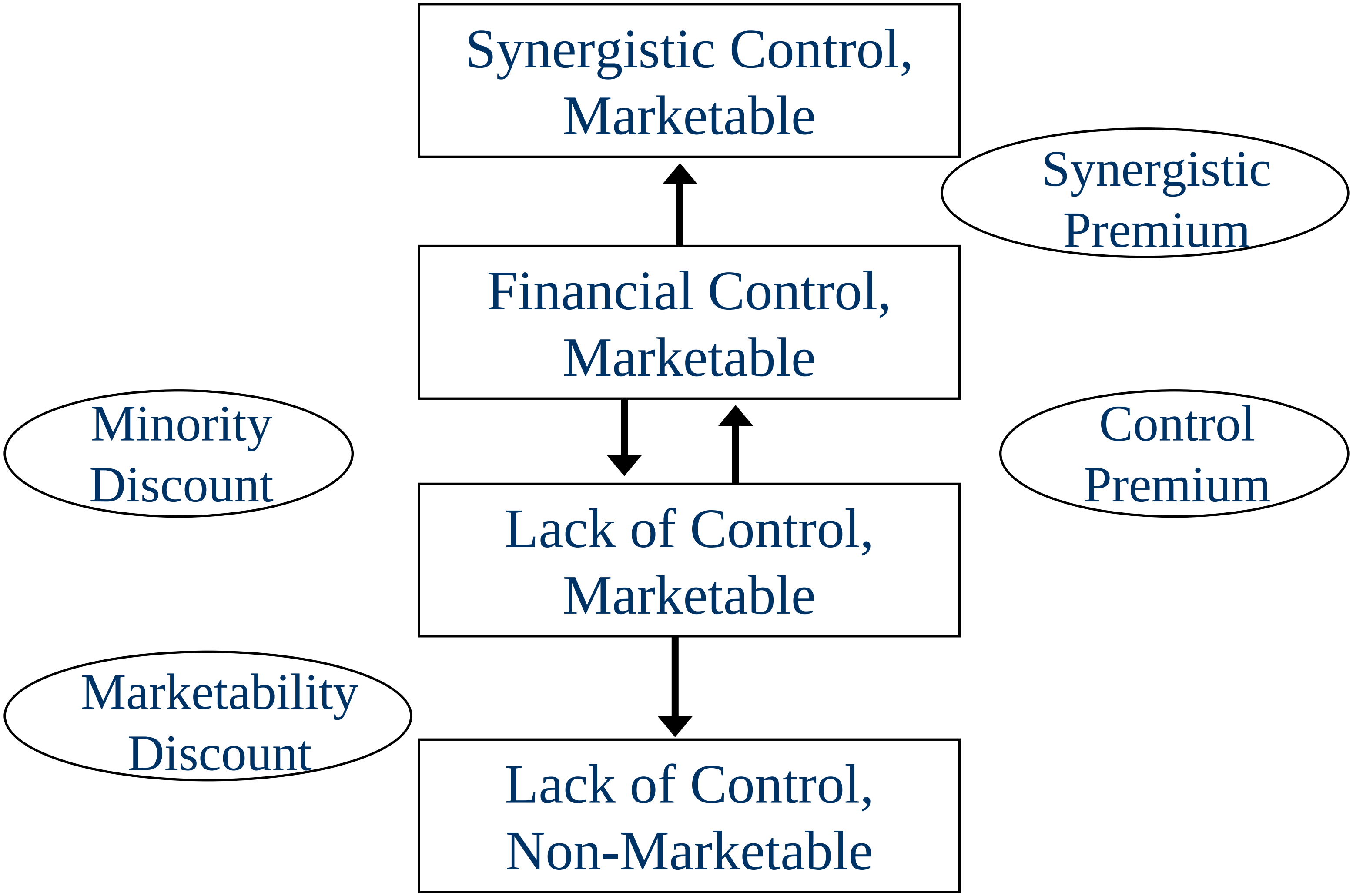
- Access to Financials
- Appropriateness
- Asset Complexity
- Asset Concentration
- Asset Liquidity
- Asset Stability
- Assets
- Assignee
- Complexity
- Control
- Country/Sovereign
- Dividend/Distribution Policy
- Ease of Management
- Exchange Rate
- Expected Cash Flows
- Expected Growth Rate
- Harvest Costs
- Historical Performance
- Holding Period
- Investment Fit
- IPO Costs, Potential
- Leverage
- Liquidation Costs
- Management Capability
- Management Experience
- Management Fees
- Management Stability
- Market
- Minority
- Non Systematic Risk
- Personal Fit
- Purpose
- Redemption Policy
- Reliability of Financials
- Restrictions
- Return Capital Appreciation
- Return Dividend
- Return Income
- Sales Commissions
- Systematic Risk
- Tax Capital Gains
- Tax Income
- Tax Transfer
- Taxable Income vs. Cash Flow
- Transferability
- Unsystematic Risk
- Volatility

Different Levels of Value



Discounts

- Discounts are not inventions of appraisers. They are demonstrated in the market place and in a large and respected body of published research.
- These adjustments have rather imprecisely been called a discount.
- Discounts are not part of a “scheme” to unfairly value business interests.
- The sole purpose is to make the appraiser’s estimate of value accurate.

Discount for Lack of Marketability

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- A **lack of marketability** is defined as the absence of a ready or existing market for the sale or purchase of the securities being valued.

- A **discount for lack of marketability** is a means of adjusting valuations based on publicly traded interests and reflecting the lack of a ready market for the securities being valued.

Factors Affecting Marketability

- Size of the interest
- Dividend payment history
- Holding period
- Presence of a buy/sell agreement
- Presence of any type of restrictive agreement
- Prospect of an initial public offering
- Presence of potential buyers for the subject interest

Discount for Lack of Control

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- A **lack of control** is defined as the level of risk assumed by a non-controlling shareholder of the entity being valued.
- A **discount for lack of control** is a means of adjusting valuations based on recent acquisition prices paid above and beyond the market capitalization of an entire entity.

Factors Affecting Control

- Controlling shareholders have the ability to:
  - Determine compensation
  - Appoint management
  - Set policies and change operations
  - Acquire or sell assets or businesses
  - Take the company public
  - Pay dividends
  - Make acquisitions
  - Block any of the above actions

Levels of Control

Control Interest

100% Ownership

Ownership sufficient to liquidate, merger, etc.

51% operating control

Control Interest

Lack of Control Interest

50% - 50% ownership

Less than 50%, but the largest block of stock

Less than 50%, but with swing vote powers

Less than 50%, but with cumulative voting powers

Pure minority interests

More than 50%, but behind voting class or GP

Minority Interest

Valuation Date: November 30, 2009

Income Approach - Discounted Cash Flow Method

Fair market value of the equity on a non-controlling, markc

Less: Discount for lack of marketability (2)

Fair market value of the equity on a non-controlling, non-n

Market Approach - Guideline Company Method

Fair market value of the equity on a non-controlling, markc

Less: Discount for lack of marketability (2)

Fair market value of the equity on a non-controlling, non-n

Market Approach - Similar Transactions Method

Fair market value of the equity on a controlling, non-markc

Less: Discount for lack of control (5)

Fair market value of the equity on a non-controlling, non-n

Concluded Value

Concluded fair market value of the equity on a non-control

Total shares outstanding (7)

Concluded fair market value of one share of common equit
on a non-controlling, nonmarketable basis

Total diluted shares outstanding (8)

Concluded fair market value of one share of diluted commo
on a non-controlling, nonmarketable basis

Book Value (for comparison purposes only)

uity

Price of Equity	Enterprise Value	Revenues	EBITDA	%	Net Income
226,200,000	226,200,000	228,880,000	64,970,000	28.4%	(173,180,000)
407,750,000	508,770,000	555,520,000	44,000,000	7.9%	16,790,000
135,080,000	78,170,000	81,200,000	5,600,000	6.9%	(6,950,000)
103,830,000	105,600,000	318,000,000	9,360,000	2.9%	4,020,000
519,670,000	412,860,000	201,080,000	(14,320,000)	-7.1%	(18,430,000)
94,220,000	40,260,000	46,670,000	(11,910,000)	-25.5%	(11,560,000)

Discounted Cash Flow Method (1)
Valuation Date: November 30, 2009

	For the Years Ending December 31, 2009		2010		2011		2012		2013		2014		2015		R
Annual revenue growth rate	*3.5%*		*23.9%*		*19.8%*		*10.5%*		*9.1%*		*9.1%*		*6.0%*		
Revenues	$ 21,242,279	100.0%	$ 26,329,215	100.0%	$ 31,542,500	100.0%	$ 34,845,250	100.0%	$ 38,018,200	100.0%	$ 41,483,519	100.0%	$ 43,972,530	100.0%	$
Cost of sales	14,928,658	70.3%	19,593,061	74.4%	19,696,754	62.4%	21,158,923	60.7%	22,656,524	59.6%	24,593,483	59.3%	26,069,092	59.3%	
Gross profit	6,313,621	29.7%	6,736,154	25.6%	11,845,746	37.6%	13,686,327	39.3%	15,361,676	40.4%	16,890,036	40.7%	17,903,438	40.7%	
Operating expenses															
Sales and marketing	5,381,607	25.3%	5,602,648	21.3%	5,850,048	18.5%	6,114,268	17.5%	6,368,104	16.8%	6,645,329	16.0%	7,044,049	16.0%	
General and administrative	2,943,015	13.9%	3,180,046	12.1%	3,339,048	10.6%	3,506,001	10.1%	3,681,301	9.7%	3,865,366	9.3%	4,097,288	9.3%	
Research and development	594,490	2.8%	578,350	2.2%	607,268	1.9%	637,631	1.8%	669,513	1.8%	702,988	1.7%	745,167	1.7%	
Total operating expenses	8,919,112	42.0%	9,361,044	35.6%	9,796,364	31.1%	10,257,900	29.4%	10,718,917	28.2%	11,213,684	27.0%	11,886,505	27.0%	
Operating revenue	(2,605,491)	-12.3%	(2,624,890)	-10.0%	2,049,382	6.5%	3,428,427	9.8%	4,642,759	12.2%	5,676,352	13.7%	6,016,933	13.7%	
Indirect expenses															
Interest (income) / expenses	(11,025)	-0.1%	(8,400)	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	
Employee stock expense	539,719	2.5%	581,922	2.2%	581,922	1.8%	290,961	0.8%	-	0.0%	-	0.0%	-	0.0%	
Amortization	610,978	2.9%	720,242	2.7%	720,242	2.3%	100,000	0.3%	-	0.0%	-	0.0%	-	0.0%	
Total indirect expenses	1,139,672	5.4%	1,293,764	4.9%	1,302,164	4.1%	390,961	1.1%	-	0.0%	-	0.0%	-	0.0%	
													16,933	13.7%	
													46,604	5.3%	
													70,329	8.3%	
													70,329		
													00,000		
													99,675		
													-		
													00,000)		
													99,675)		
													-		
													97,802)		
													72,527		
													5.58		
													0.3968		
													58,778		$

Valuation Date: November 30, 2009

Cost of equity
Ke = Rf + Rm + Rs + Rc

Risk free rate (Rf) (1)
Market premium (Rm) (2)
Small capitalization premium (Rs) (3)
Industry-specific risk (Rc) (4)
Company-specific risk (Rc) (5)

Cost of equity (Ke)

After tax cost of debt
Kd = Kb (1-t)

Borrowing rate (Kb) (6)
Tax rate (t) (7)

After tax cost of debt (Kd)

Weighted average cost of capital

Capital Structure (9)	Cost	Weigh Cos
5.0%	6.56%	
95.0%	18.70%	

Sample Company Name — **Schedule 7a**
Fair Market Valuation of One Share of Common Equity
Guideline Company Method
Summary of Current Valuation Multiples (1)
Valuation Date: November 30, 2009

	Mean	Median	High	Low	Coefficient of Variation
EV / Revenue					
LTM	0.8 x	0.8 x	1.2 x	0.7 x	
FY + 1 Year	0.9 x	0.8 x	1.2 x	0.7 x	
FY + 2 Year	0.8 x	0.7 x	1.2 x	0.7 x	
EV / EBITDA					
LTM	11.4 x	10.0 x	22.3 x	3.2 x	
FY + 1 Year	11.0 x	9.1 x	18.5 x	5.4 x	
FY + 2 Year	8.4 x	7.9 x	11.9 x	5.4 x	
Equity / Net Income					
LTM	89.0 x	89.0 x	161.3 x	16.7	
FY + 1 Year	87.9 x	18.3 x	229.0 x	16.4	
FY + 2 Year	86.5 x	16.4 x	229.0 x	14.0	

Selected Multiples (2)	**Revenue**	**EBITI**
EV / Revenue	**0.8 x**	
EV / EBITDA		
Equity / Net Income		

622,778 $ 1,74

Sample Company Name — **Schedule 7b**
Fair Market Valuation of One Share of Common Equity
Guideline Company Method (continued)
Current Valuation Multiples (1)
Valuation Date: November 30, 2009

	EasyLink Services International Corporation	NCI, Inc.	Perficient Inc.	QAD Inc.	Mean	Median
Ticker	NasdaqCM:ESIC	NasdaqGS:NCIT	NasdaqGS:PRFT	NasdaqGS:QADI		
LTM as of	10/31/2009	9/30/2009	9/30/2009	10/31/2009		
Stock Price as of 11/30/09	1.86	25.16	8.38	5.55		
Shares Outstanding	26.3	13.5	30.7	31.1		
Market Capitalization	**48.9**	**339.2**	**257.0**	**172.4**		
Plus: Total Debt	27.1	35.6	-	16.8		
Plus: Preferred Stock	0.0	-	-	-		
Plus: Minority Interest	-	-	-	-		
Less: Cash and Equivalents	14.9	3.0	28.5	43.7		
Enterprise Value	**61.1**	**371.8**	**228.5**	**145.5**		
Equity / MVIC	64.3%	90.5%	100.0%	91.1%	86.5%	90.8%
Debt / MVIC	35.7%	9.5%	0.0%	8.9%	13.5%	9.2%
EV / Revenue						
LTM	0.7 x	0.8 x	1.2 x	0.7 x	0.8 x	0.8 x
FY + 1	n/a	0.8 x	1.2 x	0.7 x	0.9 x	0.8 x
FY + 2	n/a	0.7 x	1.2 x	0.7 x	0.8 x	0.7 x
EV / EBITDA						
LTM	3.2 x	9.6 x	22.3 x	10.4 x	11.4 x	10.0 x
FY + 1	n/a	9.1 x	18.5 x	5.4 x	11.0 x	9.1 x
FY + 2	n/a	7.9 x	11.9 x	5.4 x	8.4 x	7.9 x

Sample Company Name
Fair Market Valuation of One Share of Common Equity
Guideline Company Financial Statement Data - QAD Inc. (1)
Valuation Date: November 30, 2009

QAD Inc.
NasdaqGS:QADI

	Fiscal Year Ended 1/31/2007	1/31/2008	1/31/2009	LTM En 10/31/20
Comparative Size				
Total revenues	$ 236	$ 263	$ 263	$
Total assets	227	236	194	
Total market capitalization	262	277	79	
Fiscal year annual revenue growth	*4.5%*	*11.5%*	*0.3%*	
Asset Management Ratios				
Debt-free working capital turnover	15.7	28.8	(95.6)	
Asset turnover	1.0	1.1	1.4	
Liquidity Ratios				
Debt-free current ratio	1.1	1.1	1.0	
Debt-free quick ratio	0.4	0.3	0.3	
Leverage Ratios				

any Name — **Schedul**
ation of One Share of Common Equity
rformance Grants Outstanding
November 30, 2009

nts	Grants (1)	Issued	Vest	Probability of Vesting (2)	Adjusted Gr
	125,000	9/1/2009	1/31/2010	100%	125,
	50,000	9/1/2009	1/31/2010	100%	50,
	50,000	9/1/2009	1/31/2010	100%	50,
	50,000	9/1/2009	1/31/2010	100%	50,
	25,000	9/1/2009	1/31/2010	100%	25,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
	10,000	9/1/2009	1/31/2010	100%	10,
				Total Dilutive Stock	**370,**

Sample Company Name — **Schedul**
Fair Market Valuation of One Share of Common Equity
Latest Twelve Month Calculation (1)
Valuation Date: November 30, 2009

	For the Year Ended December 31, 2008		*For the Period Ended September 30, 2008*		*For the Period Ended September 30, 2009*		*For the LTM Ended September 30, 2009*	
Revenues	$ 20,528,948	100.0%	$ 14,599,170	100.0%	$ 16,693,000	100.0%	$ 22,622,778	10
Cost of sales	12,935,509	63.0%	8,314,683	57.0%	10,169,000	60.9%	14,789,826	65
Gross profit	7,593,439	37.0%	6,284,487	43.0%	6,524,000	39.1%	7,832,952	34
Operating expenses								
Sales and marketing	3,522,835	17.2%	2,259,815	15.5%	3,201,000	19.2%	4,464,020	19
General and administrative	3,840,324	18.7%	3,791,452	26.0%	4,215,000	25.3%	4,263,872	18
Research and development	1,216,563	5.9%	1,478,779	10.1%	1,328,000	8.0%	1,065,784	4.
Total operating expenses	8,579,722	41.8%	7,530,046	51.6%	8,744,000	52.4%	9,793,676	43
Net operating income	(986,283)	-4.8%	(1,245,559)	-8.5%	(2,220,000)	-13.3%	(1,960,724)	-8
Other income / (expenses)								
Interest income, net	57,878	0.3%	(12,638)	-0.1%	(7,000)	0.0%	63,516	0.
Other income / (expenses)	8,165	0.0%	-	0.0%	-	0.0%	8,165	0.
Loss on exchange rates	(136,702)	-0.7%	-	0.0%	-	0.0%	(136,702)	-0
Total other income / (expenses)	(70,659)	-0.3%	(12,638)	-0.1%	(7,000)	0.0%	(65,021)	-0
Pretax income	(1,056,942)	-5.1%	(1,258,197)	-8.6%	(2,227,000)	-13.3%	(2,025,745)	-9
Income taxes	665,552	3.2%	-	0.0%	374,000	2.2%	1,039,552	4.
Net income	**$ (391,390)**	-1.9%	**$ (1,258,197)**	-8.6%	**$ (1,853,000)**	-11.1%	**$ (986,193)**	-4
EBIT	(1,114,820)	-5.4%	(1,245,559)	-8.5%	(2,220,000)	-13.3%	(2,089,261)	-9
EBITDA	2,463,894	12.0%	1,257,982	8.6%	544,000	3.3%	1,749,912	7.
Depreciation & amortization	3,578,714	17.4%	2,503,541	17.1%	2,764,000	16.6%	3,839,173	17

Notes:
(1) Provided by Management.
LTM = Latest twelve months
EBIT = Earnings before interest and taxes
EBITDA = Earnings before interest, taxes, depreciation, and amortization

Sample Company Name — **Sch**
Fair Market Valuation of One Share of Common Equity
Discount for Lack of Marketability
Historical Market Volatility
Valuation Date: November 30, 2009

2.0 Years		3.0 Years	
High	76.5%	High	69.0%
Low	52.7%	Low	48.2%
Median	71.4%	Median	64.8%
Mean	68.0%	Mean	61.7%

	EasyLink Services International Corporation		NCI, Inc.		Perficient Inc.		QAD Inc.	
	NasdaqCM:ESIC		NasdaqGS:NCIT		NasdaqGS:PRFT		NasdaqGS:QAD	
Pricing Date	Dividend Adj. Day Close Price	Lognormal Return	Dividend Adj. Day Close Price	Lognormal Return	Dividend Adj. Day Close Price	Lognormal Return	Dividend Adj. Day Close Price	Logno Retu
11/30/2009	$ 1.86	18.9%	$ 25.16	-6.7%	$ 8.38	-6.8%	$ 5.55	2
11/23/2009	1.54	0.0%	26.91	-7.6%	8.97	2.7%	4.37	-
11/16/2009	1.54	2.6%	29.04	1.2%	8.73	4.3%	4.72	
11/9/2009	1.50	1.3%	28.68	9.2%	8.36	3.4%	4.69	
11/2/2009	1.48	-14.4%	26.16	3.0%	8.08	-4.6%	4.51	-
10/26/2009	1.71	-2.9%	25.39	-1.9%	8.46	-1.8%	4.98	-
10/19/2009	1.76	1.1%	25.88	-7.9%	8.61	5.5%	5.11	
10/12/2009	1.74	9.0%	28.00	-2.4%	8.15	2.0%	4.80	-
10/5/2009	1.59	-9.0%	28.69	-1.2%	7.99	-2.6%	4.89	
9/28/2009	1.74	2.3%	29.03	-3.1%	8.20	2.7%	4.57	
9/21/2009	1.70	4.8%	29.95	2.2%	7.98	2.4%	4.53	
9/14/2009	1.62	-0.9%	29.29	1.2%	7.79	0.4%	4.16	
9/7/2009	1.63	-2.8%	28.95	-1.4%	7.76	0.0%	4.08	
8/31/2009	1.68	-1.2%	29.35	-3.5%	7.76	-2.8%	4.06	-
8/24/2009	1.70	-1.2%	30.40	1.5%	7.98	7.7%	4.37	1

Stock or Asset Sale

ADAMS CAPITAL INC. BUSINESS VALUATION SERVICES

- Sellers generally prefer to sell Stock
  - Contractual liabilities only
  - Capital gains tax rates (for individuals)
  - No basis step up for buyer (potentially with 338h10 election)
- Buyers generally prefer to buy assets
  - Leaves unknown liabilities with seller
  - Attractive step up in tax basis
- Pricing differential may lead to indifference

C to S Conversion

- Conversion made to eliminate double taxation of C corporation
- IRS requires measurement of double tax on conversion
  - Appraisal is optimal measurement method
- Sale within 7 year window after conversion will trigger double taxation as if C corporation

C to S Conversion (Tax answer)

- Benefits to conversion include: elimination of double taxation – which is especially punitive in case of sale of business and in likely scenario of increased tax rate on qualified dividends from C starting in 2011 (end of Bush tax cut period). Other benefits for S corporations are:
  - For non-inventory taxpayers, ability to use cash method of accounting no matter your sales volume.
  - Profits that are left in the business of an S corporation, increase the tax basis of the owner’s stock (and lower gain on subsequent sale. No true for C).
  - S corporations are more forgiving in case of owner’s nondeductible personal expenses that may be paid by company (Such expenses if not booked as a loan from company would be classified as nontaxable distribution from S vs. taxable compensation or dividend from C).
  - Tax planning for a C will be more costly than S as issues of “reasonable” compensation are more likely to be challenged by IRS in a C.
- The “built-in gains” on conversion is best documented by an appraisal of the overall business, but would have to be pushed down to the individual assets, should any asset be sold or disposed of during the built-in gains period (see below).
- Sale triggering built-in gains would include sales within a 7 year period of conversion (used to be 10 years).

Valuation Summary

- Different values for different purposes
- Assets are easier to buy than stock
- I would rather sell stock than assets
- Tax impacts behavior
- Individual preferences take time to understand and will lead to conflict

My Experiences with Lawyers

Clients are People

- Be a friend/confidant
- Choose clients carefully
- Keep in touch
  - Hint: They are no longer a client if you have not spoken in a year
- Be involved
  - Understand family dynamics
- Make it easy
  - …for your client to achieve their goals – deal maker

Lawyers: Makers or Breakers of Enterprises

- Will you be a deal maker or a deal breaker?

- Which type of attorney do you believe will have a more successful career?

- How will you impact the market?

Somebody Has to be in Charge of a Transaction

ADAMS CAPITAL INC. BUSINESS VALUATION SERVICES

- Your client is probably the worst choice
- Associate with a transaction professional
- You really can be most effective by being:
  - An advocate
  - Practical
  - Focused

Lawyers Cannot Ignore Math

- Know your numbers; or
- Associate with someone who does
- Clients who think they know what their businesses are worth are usually wrong
  - Sometimes high, sometimes low
- Do not trust your client’s math

Value Chain of Business Events

Data
$30

Information
$100

Knowledge
$300

Decisions
$1000

Success

- Less time working
- Working on matters of personal interest
- Making more money
  - …probably not charging by the hour

Thanks!

Questions or Comments?