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<u>Business Valuation Issues in the Estate Planning Process</u>

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I. Estate Planning for the closely-held business owner generally requires some form of business valuation work

A. Often the single largest estate asset.
B. This asset is not liquid (not readily marketable).
C. Requires some form of an exit planning strategy.
D. Benefits of a business valuation:
   i. Quantifies the estimated valued (which may or may not meet owner expectations);
   ii. Provides qualitative and quantitative analysis, as to business operations, and a general SWOT analysis;
   iii. Opportunity to leverage gifting through appropriate discounts.

E. Types of business valuation reports

i. A detailed report or a summary report;
ii. A calculation report;
iii. Generally, a detailed report is recommended for gift tax purposes, in order to meet the adequate disclosure rules under IRC Section 6501 (c) (9).

II. Current Tax Headwinds

A. IRS Proposed Regs. Under Code Section 2704.
B. Possible repeal of the federal estate tax (but not necessarily the federal gift tax).

III. Exit Planning Strategies

A. Preparing the business owner from a financial and an emotional perspective.

B. Gifting to family members at discounted values:

   i. Requires an overall family plan utilizing the professional advisors

C. Sale to Other Equity Holders

   i. Shareholders, members, partners;

   ii. The professional and financial advisors play an important role;

   iii. Buy-Sell Agreement in place and current;

      a. Proper funding mechanism or workable terms.

D. ESOP as an Exit Strategy
   i. Feasibility Study;
      a. Profitable company with good cash flow;
      b. Sufficient payroll;
      c. Debt capacity;
      d. Solid successor management team;
      e. Generally more than 25 employees at least $5M in revenues.

E. Sale to an Outside Party
   i. Requires assistance of professional advisors;
   ii. May require business broker, business intermediary, investment banker;
   iii. Generally a three to five year preparation period is advisable

IV. Valuation of Financial Practices

(good reference book - *Buying, Selling, & Valuing Financial Practices* by David Grau, Sr., J.D., published by Wiley Financial Services).

A. CPA Firms - generally 75% to 125% of annual revenues. Multiple depends on the underlying quality of the client base. Generally includes a three to five year payout based on client retention.

B. Investment Advisory Firms - often percent of assets under management.

Key Ratios for Investment Advisory Firms

The largest database of sales transactions involving investment advisory firms is maintained by FP Transitions, an Oregon firm that has done over 8,000 valuations of these businesses since 1999, in addition to doing appraisals, the firm is also a broker of financial services practices.

During a recent BVR webinar, Warren Burkholder, a valuation consultant with the firm, shared with the audience some key ratios developed from the database, which contains 880 private-company transactions and calculates 130 data points on each one. The ratios (see table below) are sales price (SP) over revenue (Rev), assets under management (AUM), recurring revenue (Rec Rev), and discretionary earnings (DE).

	SP/Rev	SP/AUM	SP/Rec Rev	SP/DE
Count	457	444	304	327
Median	1.73	0.01	2.33	2.47
Average	1.67	0.02	2.22	2.77
Min	0.08	0.00	0.00	0.33
Max	3.45	0.28	8.01	24.48
25th%	1.30	0.01	1.95	1.87
75th%	2.05	0.02	2.55	3.11

C. Insurance Agencies
   i. Property and Casualty - generally 150% to 200% of recurring revenues. Generally three-year payout based on retention.
   ii. Life Insurance Agencies - lower value depending on recurring revenues.
D. Law Practice - Valuing law practices can vary widely depending on the practice area and recurring revenues, if any.