

EMPIRE

VALUATION CONSULTANTS

*Specialists in
Financial Valuations*



Basics of Business Valuation

VEOC June 9, 2010

Chuck Coyne, ASA

Managing Director

Empire Valuation Consultants, LLC

61 South Main Street, Suite 201

West Hartford, CT 06107 (860) 233-6552

E-mail: ccoyne@empireval.com

Website: www.empireval.com

Regulatory Framework

- Employee Retirement Income Security Act (ERISA)
- Department of Labor (DOL)
- Internal Revenue Service (IRS)
- ESOP Plan Document

Regulatory Framework

An ESOP Appraisal must satisfy two regulatory authorities:

- Internal Revenue Service
- Department of Labor

Regulatory Framework

ERISA Section 402(18) “Adequate Consideration”

In the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

Proposed DOL Regulations

- Adequate Consideration = Fair Market Value
- Determined in Good Faith
- As of the Date of the Transaction
- Reflected in Written Documentation of Value

Proposed DOL Regulations

Factors to Be Considered in Value of Security with No Market:

- Nature and History of Business
- General and Specific Economic Outlook
- Book Value and Financial Condition of the Business
- Earning Capacity of the Company
- Dividend-Paying Capacity of the Company
- Goodwill or Other Intangible Value
- Market Price of Similar Publically-Traded Securities
- Marketability of the Securities
- Control Premium

Proposed DOL Regulations

Contents of Written Document

- Summary of Appraiser's Qualifications
- Purpose for the Valuation
- Full Description of Asset being Valued
- Valuation Methods Used and Why
- Valuation Factors Considered
- Effective Date of Value Opinion
- Signed and Dated

Fair Market Value

The price at which an asset would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties are able, as well as willing, to trade and are well informed about the asset and the market for such asset.

IRS Revenue Ruling 59-60

- Nature and History of Business
- General and Specific Economic Outlook
- Book Value and Financial Condition of the Business
- Earning Capacity of the Company
- Dividend-Paying Capacity of the Company
- Goodwill or Other Intangible Value
- Price, Size, and Type of Interests Sold Previously and of Interests Being Valued
- Market Price of Similar Publically-Traded Securities

Case Law

“Pure heart and an empty head are not enough”

An independent appraisal is not a magic wand that a fiduciary may simply wave over a transaction to insure that their responsibilities are fulfilled. It is a tool and, like all tools, is useful only if used properly. To use an independent appraisal properly, ERISA fiduciaries need not become experts in the valuation of closely-held stock – they are entitled to rely on the expertise of others... However, as the source of the information upon which the expert's opinions are based, the fiduciaries are responsible for insuring that information is complete and up-to-date.

Donovan v. Cunningham, 716F.2d 1455 (5th Cir. 1983)

EMPIRE

VALUATION CONSULTANTS

The Valuation Process

- Phase I
 - Perform Due Diligence (tour facilities, interview management, etc...)
 - Completion of the valuation questionnaire
 - Meet with ESOP fiduciaries
 - Provide preliminary value
- Phase II
 - Update value prior to transaction
 - Complete Fully Documented Valuation Report

The Valuation Process

Fairness Opinion

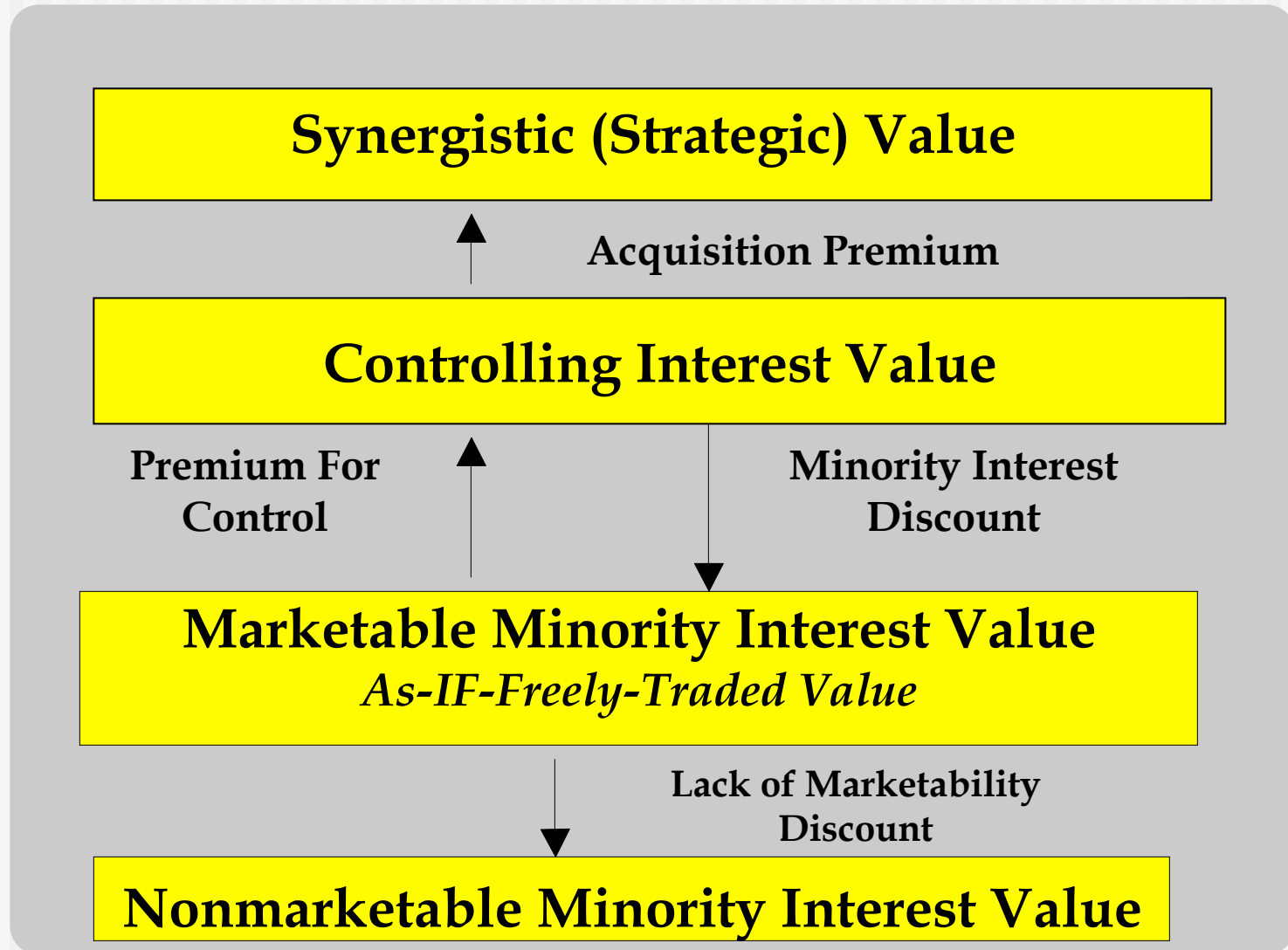
- If required, provide “fairness opinion” to Trustee – is the “total transaction” fair from a financial point of view?

Total transaction may include review of:

- Financing terms
- Management employment contracts
- Management “perks” and benefits
- Building leases
- Control premium paid

Provide annual update valuations

Levels of Relative Value



Valuation Approaches

- Income Approach
 - Capitalization of Net Cash Flows
 - Discounted Future Cash Flows
- Market Approach
- Asset-Based Approach

Income Approach

Capitalization of Net Cash Flows

Determine normalized cash flows available to shareholders

- Adjust for non-recurring and non-operating items
- Determine trends
- Use weighted or straight average cash flows

Income Approach

Determine Capitalization Rate

- Build-up Model
- Capital Asset Pricing Model (“CAPM”)

Income Approach

Discounted Future Cash Flow

- Project future cash flows (typically five years)
- Determine horizon value (terminal year value)
- Discount future cash flows & horizon value to present time

Market Approach – Guideline Company Method

Select Comparable (“Guideline”) Companies

- Develop appropriate “comparable” criteria
 - Industry characteristics
 - Size of companies
 - Trading activity of the stock
 - Availability of information
 - Financial trends: profitability, growth, etc...
 - Financial analysis: ratio comparisons

Market Approach – Guideline Company Method

- Adjust for differences between guideline companies and subject company
- Develop Valuation Multiples
 - Price to Earnings (P/E)
 - Price to Revenues (P/R)
 - Price to Book Value (P/BV)
 - Price to Assets (P/A)

Market Approach – Transaction Method

Review past transactions in subject company's stock

Review sources of acquired company transaction data. Transactions ARE provided by business brokers, CPA's, investment bankers, etc...

Market Approach – Transaction Method

Transactions are normally of 100% control purchases and some may represent “strategic” buyers

Multiples of EBIT, EBITDA and Revenues are typically available

Transaction terms (financing, contingent payouts, etc..) need to be well understood if transaction multiples are to be used as a valuation method. Otherwise they may be useful as a sanity check.

Asset-Based Approach

- Assets and liabilities are restated to market values. May require machinery & equipment and/or real estate appraisals.
- Market Value of net assets will represent 100% of the Company's equity value
- Typically not a suitable method for valuing going concern operating companies (method does not provide values for goodwill and other intangible assets)

Other Considerations

- Understand Company's strategy for handling the repurchase liability
- Non-Operating Assets (added to value)
- Use of Preferred or Super Common Stock
- The ESOP Tax Shield Benefit
- ESOP "put option" and the lack of marketability discount
- Valuing ESOP S Corporations

ESOP “Musts”

- Valuation must be timely
- Trustee must understand the valuation and the valuation process
- Valuation report must fully and adequately reflect all relevant factors
- Valuation must be performed by an independent, experienced business appraiser



QUESTIONS?

Chuck Coyne, ASA

Chuck is an Accredited Senior Appraiser of the American Society of Appraisers, and a Managing Director of Empire Valuation Consultants, LLC. He has over 20 years of experience in the valuation of closely-held business interests. He has prepared valuations for estate and gift tax, employee stock ownership plans (ESOPs), family business succession, bankruptcy and reorganizations, fairness opinions, family limited partnerships (FLP) and limited liability companies (LLC), marital dissolution, shareholder and partnership disputes, allocation of purchase price among acquired assets, goodwill impairment testing, and mergers, acquisitions, and divestitures.

Contact: Chuck Coyne, Tel. (860) 233-6552, 61 South Main Street, Suite 201, West Hartford, CT 06107. Email:

CCoyne@empireval.com

About Empire Valuation Consultants

From our founding in 1988, Empire Valuation Consultants has grown into one of the nation's leading and most respected independent valuation consulting firms. This reputation is a result of our experience, the quality of our people, and the Empire commitment to delivering timely and reliable results. Empire is a national leader in ESOP valuations. We understand the complex regulatory, tax and financial considerations for structuring and valuing equity ownership interests. This understanding is crucial both when establishing an ESOP, and in its annual administration. Empire has also advised many fiduciary trustees in the sale or refinancing of ESOP owned companies. We provide our services throughout the Country from our offices located in Manhattan, N.Y., Rochester, N.Y., San Francisco, CA, and our New England Regional Office in West Hartford, CT.

Visit our website at: www.empireval.com

EMPIRE
VALUATION CONSULTANTS