MERCER CAPITAL
Business Valuation & Financial Advisory Services

IN THIS ISSUE

Value Matters™

Issue No. 2, 2013

The Management Interview

Why It's an Important Piece of the Valuation Process and What You Should Expect

One critical part of the valuation process is the management interview or, as it is sometimes called, the due diligence visit. The management interview provides the business appraiser with an opportunity to integrate many sources of information about a business into a logical and consistent whole. The interview also helps to complete an overall understanding of how a particular business operates. The process of preparing for and conducting a management interview requires the appraiser to develop a command of the facts and circumstances of this particular valuation case.

The Objectives of the Management Interview

The specific objectives of the management interview include:

1. Reviewing details of documents previously provided by management in order to ensure that all necessary financial and operational disclosure has been obtained and is reasonably understood.
2. Forming an impression of the local economy based upon observation (to help challenge or verify economic statistics or management's overview of the economic situation).
3. Identifying those factors or trends that can reasonably be expected to influence the future performance of the business.
4. Formulating an overall opinion of management's ability to achieve anticipated operating results.

The management interview, if properly conducted, will enable the appraiser gain a more complete perspective of a business than is possible from reviewing documents alone.

Ultimately appraisers have the task of understanding the risk profile of the business as a whole and the facets that compose it and of assessing the opportunity profile of business. Risk and growth assessment are both over arching (the forest) as well as the core (the trees) of the appraiser's valuation development and reporting processes.

Appraisers are often asked why they need to pose certain questions or to collect certain data (sometimes owners and managers chafe at questions in the why and what-if categories). In fact, a good management interview likely involves a few tense moments. Einstein may have said it best when he commented, "not everything that can be counted counts, and not everything that counts can be counted."

Face-to-Face vs. Phone Interview

Most valuation firms make it policy that first-time engagements with a client company require an on-site interview. Subsequent valuations of the same business enterprise need not require a visit unless there has been a material change in the key personnel, facilities, financial performance, an extended time since the prior visit, or some other factor that, in the determination of the appraiser and/or the client, suggests something more than a teleconference and exchange of information. Special circumstances limiting the need and/or relevance of on-site visitation might include the valuation of investment vehicle entities, such as family limited partnerships or other entities that hold and manage assets that can be thoroughly studied from afar.

There are additional factors that influence the nature of the due diligence process. These may include the client's need to address questions about the engagement, the client's concern for engagement timing and expense, the nature of the valuation opinion, and the involvement and needs of other advisors, particularly fiduciaries.

The Preparation You Should Expect From Your Appraiser

Good interviewing, whether on-site or by other means, starts with thorough preparation. Assuming information collection is largely complete; the materials should be reviewed and organized in a fashion that facilitates productive inquiry by the appraiser and responsiveness from the interviewee. Historical financial information should be recast in a manner that allows for the examination of trend over time (say, five years) and that promotes the ability of client and appraiser to highlight potential financial adjustments. Also, the appraiser should have reviewed documents related to the business's history, ownership, and current organizational structure. Economic data for the city, county, and region should be obtained from independent sources, as well as from the business, when available and reviewed. Also, the subject company's marketing and web-based materials can provide a useful context for assessing the success of the report in presenting the company as it exists in the eyes of those who own and operate it. Industry vocabulary and news items can also prove helpful in assessing the company's position within its industry and among its competitors.

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Most valuation practitioners use some form of questionnaire or checklist that is structured in such a fashion as to promote coverage of the subject matter that could be reasonably expected to influence the valuation. A well-crafted valuation report will provide the reader with a thorough narrative description of the subject business enterprise and the ownership interests therein.

Who Should Be Interviewed?

Identifying who should be interviewed and where interviews should be conducted is important to gaining appropriate perspective about the subject company. The nature, size, and complexity of the business enterprise generally guide the appraiser's design of the interview process. Small businesses with concentrated operations usually do not require the appraiser to meet with more than a few select individuals or at more than a single location. Large diverse businesses with complicated operations and highly delineated senior job responsibilities may require the appraiser to meet with numerous individuals and at differing locations.

The valuation of most small, closely held businesses generally involves the interviewing of a senior, big-picture executive (president, CEO, COO) and a financial officer. In many cases additional interviews or follow-up might be conducted with an external accountant or legal advisor.

Agenda of a Typical Management Interview

The following bullet points provide an outline of a typical management interview. For perspective, assume the subject company is a manufacturing business with $50 million in annual revenue and a single facility harboring both production and administrative departments. The budgeted time is approximately five hours, effectively a day-long interview session when coupled with the travel burden normal to most due diligence.

- **The appraiser will request a suitably private and comfortable space** in which to spread out and assemble all participating parties.
- **A tour of the facility** with the appropriate management personnel to understand the physical and human resources required to conduct operations will be on the agenda. Tours can be quite brief or very involved. A good tour provides the best opportunity for the appraiser to understand capacity, safety, functional flow, technology, critical stages and other attributes of the physical side of the business. The degree of physical asset intensity provides a preview of balance sheet composition and financing needs of the business. It often makes sense to follow the path of the product as it evolves from supplied inputs to finished product (dock to dock). Facility tours provide important perspective for understanding the financial representation of assets on the balance sheet and the operational results and margins captured by the income statement.

- **The interview will start by focusing on "the big picture."** Senior management will be interviewed to gain a proper understanding of key industry and economic drivers for the business. The supply and demand features of the product, the influence of regulation, commodity pricing, labor availability, evolution of the industry and its adjacent sectors, and many other areas of investigation can be important to gaining a base of understanding for the company's real-time and long-term challenges and opportunities.

- **Key internal and external elements of the business will then be addressed.** Appropriate members of management will be interviewed to gain an understanding and description of key internal and external elements of the business. At this stage of the management interview process, the appraiser has a big-picture grasp of the economic and industry attributes of the business as well as grounding in the brick and mortar and mechanical intensity of the business. Now it's time to delve deeper into the functional and descriptive specifics of the company, which are used to complete the appraiser's understanding and promote proper narrative documentation of the business in the valuation report. Descriptions and lists of the products, key suppliers, key customers, personnel, management organization, trend analysis, competition, and other relevant data should be reasonably disclosed and assessed for its relevance to the valuation.

- **Clarifying information is obtained or requested.** Initial information requests rarely provide all the data required to complete a valuation analysis. Optimally, the appraiser is accumulating information items during the interview and is able to exit the process with materials in hand. If the information is not readily available, it is obtained shortly following the interview. The nature of follow-up information is often more specific to the adjustments and documentation for the appraisal.

- **The interview is ended and the timing of the next stage of the engagement is communicated.** In most medium to larger valuation practices, there is usually some follow-up for details. Often, a senior analyst or executive may have conducted the interview. Accordingly, follow-up may come from a supporting valuation analyst who is assisting in the compilation of work documentation and appraisal modeling.

Experience has taught us that the overriding goal for interviewing and face-to-face meetings is to get the big picture in the words of and from the perspective of company managers and owners that know more about their industry and their operation than the appraiser ever will.

Mercer Capital News

Jay D. Wilson, Jr. Receives ASA Designation

Jay D. Wilson, Jr., vice president, has earned the right to use the Accredited Senior Appraiser (ASA) designation in the business valuation discipline from the American Society of Appraisers.

Earning the designation requires a minimum of five years or 2,000 hours of business appraisal experience, completion of written examinations, peer review of a business valuation report, and other qualifying criteria demanded by the Society's International Board of Examiners.

Jay, a senior member of Mercer Capital's Financial Institutions Group, also holds the Chartered Financial Analyst (CFA) designation from the CFA Institute and the Certified Business Appraiser (CBA) designation from the Institute of Business Appraisers.

New Kindle Book Released

Buy-Sell Agreements for Baby Boomer Business Owners

This new Kindle book shares essential information from the print book, *Buy-Sell Agreements for Closely Held and Family Business Owners*, but is shorter and focused on the concerns of baby boomers.

It focuses on valuation and improving the valuation mechanisms of new and existing buy-sell agreements and addresses the fact that most of us boomers can't afford (time or money) for our agreements not to work. It also encourages baby boomer business owners to work with their team of professional advisers to make sure that their agreements will work when triggered.

Available at Amazon for only $2.99 for a short time.

Concluding Thoughts

The management interview is an important part of the valuation process. Users of valuation reports should inquire into the level of due diligence used by an appraiser to ensure that confidence in the results is warranted. Some appraisers do not visit the business in the normal course of preparing appraisals. In many cases, these appraisers provide fee quotes that are considerably less expensive than other appraisers who follow due diligence procedures similar to those outlined in this article. In the case of valuations, however, as in many other areas of life, cheaper is not always better. Caveat emptor.

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Article adapted from *A Reviewer's Handbook to Business Valuation: Practical Guidance to the Use and Abuse of a Business Appraisal* by Timothy R. Lee and L. Paul Hood (John Wiley & Sons, 2011)

2014 Fiscal Year Estate Tax Proposals: About Fairness Indeed

Miles C. Padgett & Donald D. Kozusko
WealthManagement.com

A Look at the Estate Tax Provisions in the President's FY 2014 Budget Proposal

Eileen Reichenberg Sherr
The Journal of Accountancy

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Each industry sector is led by senior professionals who monitor industry trends and have years of experience in assisting clients with their valuation and transaction advisory needs.

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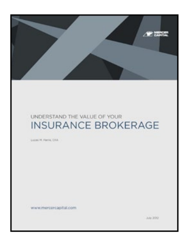

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Mercer Capital

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Mercer Capital is a national business valuation and financial advisory firm founded in 1982. We offer a broad range of valuation services, including corporate valuation, gift, estate, and income tax valuation, buy-sell agreement valuation, financial reporting valuation, ESOP and ERISA valuation services, and litigation and expert testimony consulting. In addition, Mercer Capital assists with transaction-related needs, including M&A advisory, fairness opinions, and strategic alternatives assessment.

We have provided thousands of valuation opinions for corporations of all sizes in a variety of industries. Our valuation opinions are well-reasoned and thoroughly documented, providing critical support for any potential engagement. Our work has been reviewed and accepted by the major agencies of the federal government charged with regulating business transactions, as well as the largest accounting and law firms in the nation on behalf of their clients.

Contact a Mercer Capital professional to discuss your needs in confidence.

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