

Demystifying **Distributorship** **Valuation**

**Translating and Understanding Your
Valuation in an Evolving Market**

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Strategic Valuation Needs

Mergers, Acquisitions &
Recapitalizations

Growth
Opportunities

Ownership & Family
Succession Planning

Tax Compliance Valuation Needs

Estates

Gifting

Trust Transactions

Controversy Resolution Valuation Needs

Shareholder / Brewery
Disputes (Fair Value)

Corporate &
Shareholder Divorce

Buy-Sell Planning &
Trigger Events

Financial Reporting Valuation Needs

Purchase Price
Allocation

Rights Valuation &
Impairment Testing

Benefit Plans

The Business Transfer Matrix

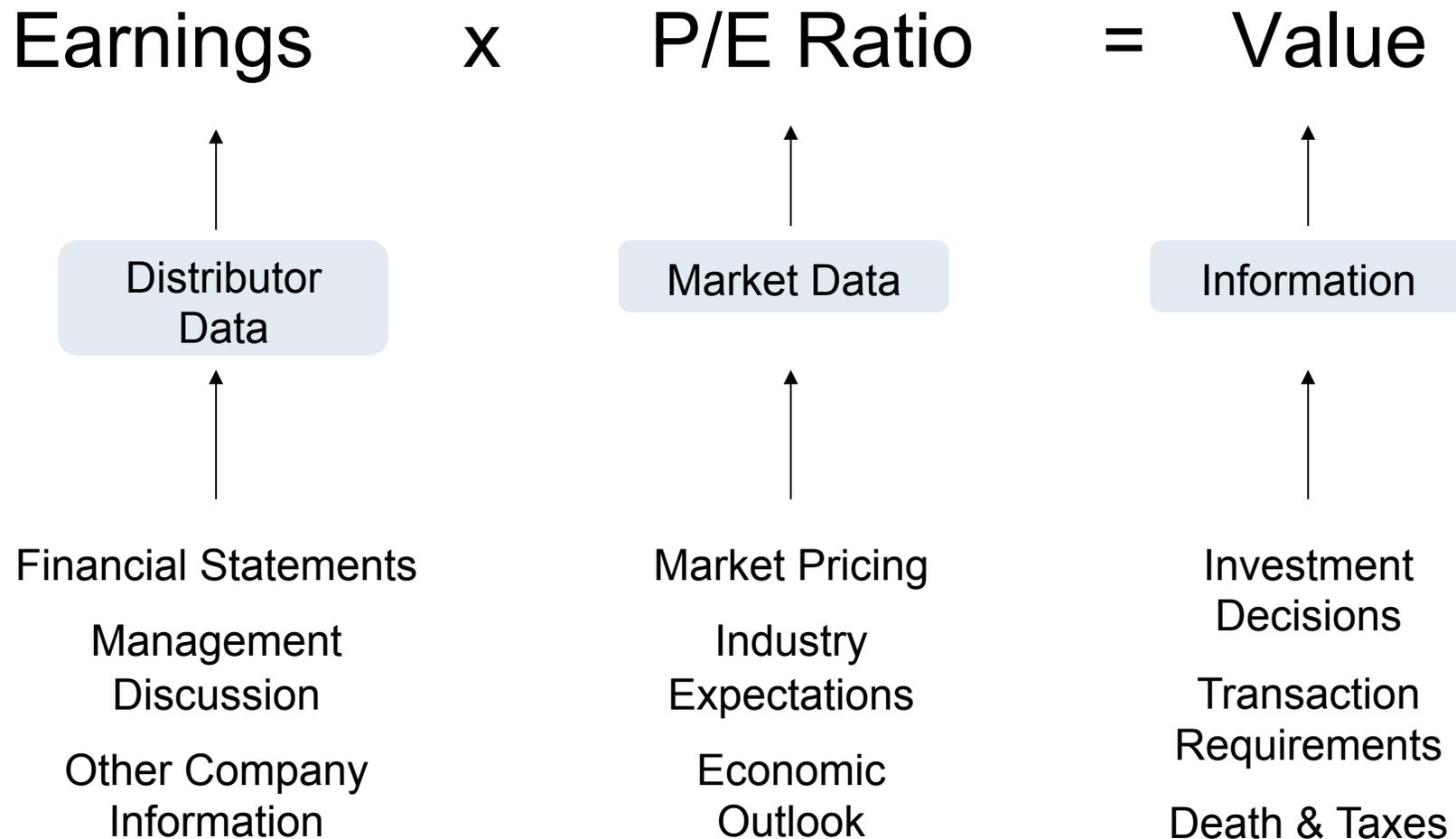
	PARTIAL SALE/TRANSFER	TOTAL SALE/TRANSFER
VOLUNTARY TRANSFER	Outside Investor(s) “Inside” Sales to Management “Inside” Sale to ESOP Combination/Cash Out Going Public Gifting Programs Buy-Sell Agreements	Sale of Business Stock-for-Stock Exch. w/Public Co. Stock/Cash Sale to Public Co. Installment Sale to Relatives/ Insiders ESOP/Management Buyout Buy-Sell Agreements Liquidation
INVOLUNTARY TRANSFER	Divorce Forced Restructuring Shareholder Disputes Buy-Sell Agreements	Divorce Bankruptcy / Forced Restructuring Shareholder Disputes Buy-Sell Agreements Liquidation Death

What is Valuation?

The “GRAPES” of Value

- » **G** It is a **growth** world
- » **R** It is a world of **risk and reward**
- » **A** It is an **alternative investment** world
- » **P** It is a **present value** world
- » **E** It is an **expectational** world
- » **S** It is a **sane, rational and reasonable** world

Intro to Valuation



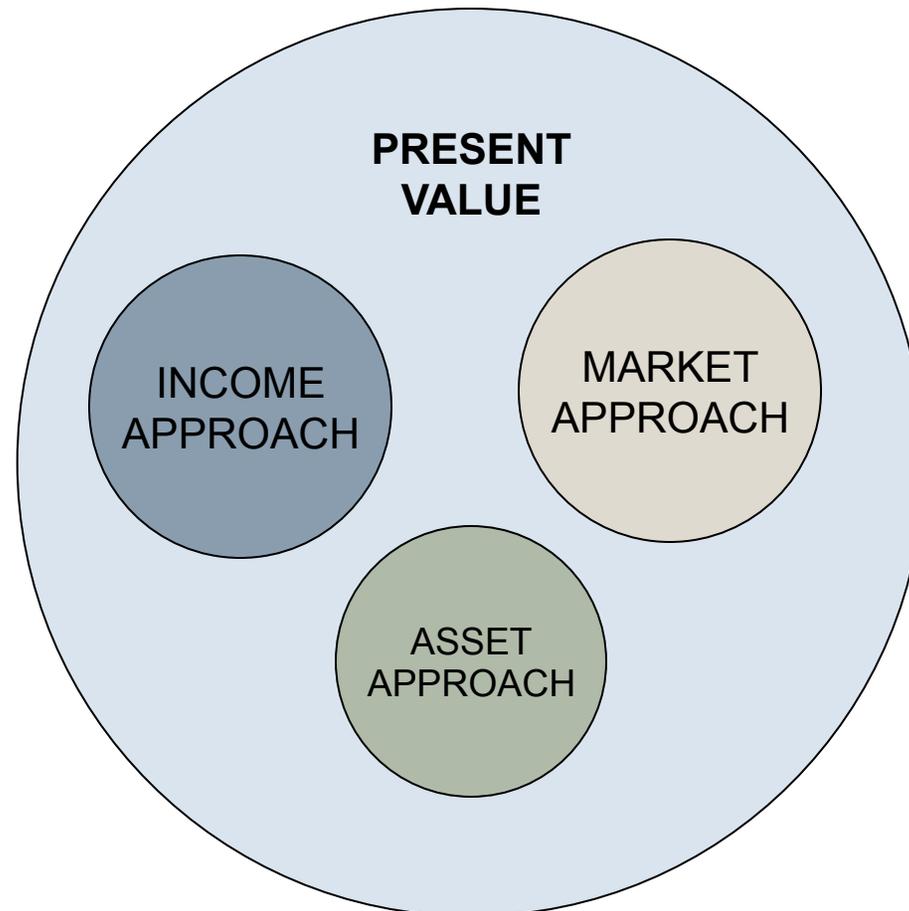
The Rules of the Game

- » **Valuation is governed by standards, which set the rules that practitioners must follow.**
 - Uniform Standards of Professional Appraisal Practice (USPAP)
 - IRS Revenue Ruling 59-60 et al
 - American Society of Appraisers (ASA)
 - American Institute of Certified Public Accountants (AICPA)
 - Institute of Business Appraisers (IBA)
 - National Association of Certified Valuation Analysts (NACVA)
 - Canadian Institute of Chartered Business Valuators (CICBV)
 - CFA Institute (CFA)

Valuation Experts & Industry Experts

Valuation Content?

Approaches to Value



Approaches to Value

Asset / Cost
Approach

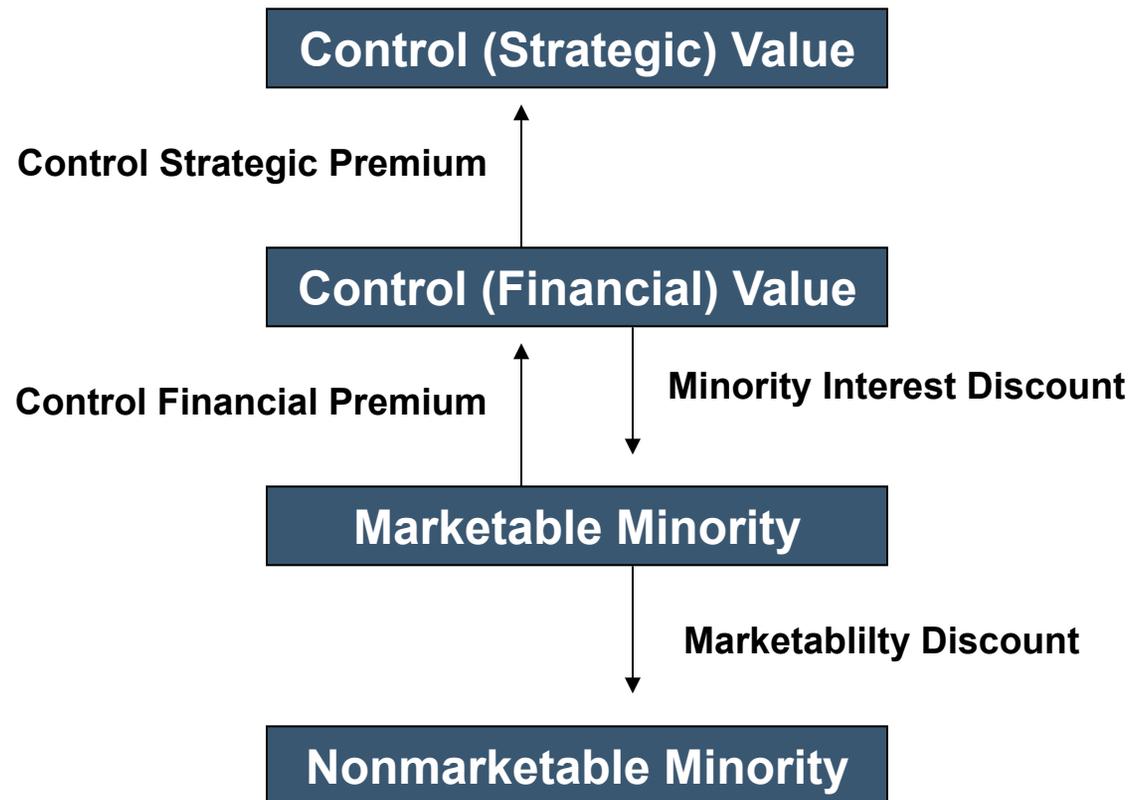
Income
Approach

Market
Approach

**Each Approach
Must Be
Considered
in Every Valuation**

Equity Value vs. Enterprise Value

Levels of Value



Fair Market Value vs. The Real World

Valuation Processes

Engagement Processes

Engagement
Letter

Information
Request

Performance of
Due Diligence

Valuation Procedures

Analytical
Methodologies

Writing of
the Report

“Develop and
Communicate
”

A Closer Look

» Cost / Asset Methods

- Net Asset Value (tangible)
- Excess Earnings Method (tangible & intangible)
- Why is an asset-based method important?
 - » Enterprise value equals tangible value PLUS intangible value

Key Factors

- » Value of hard assets?
- » Tax considerations?
- » Off-balance sheet costs or assets?
- » Direct vs. indirect
 - Distributor rights value (enterprise value *less* tangible asset value)

Income Approach Methodologies

Direct
Capitalization

DCF
Analysis

The Income Approach

- » Value = Profit x Multiple
- » Equity value vs. Enterprise value
- » Which profit measure is used?
- » What is the relevant multiple?

Key Factors

- » Mark expenses to normalized or pro forma levels
 - Non-recurring or unusual events
 - Differentiating return on labor from return on capital
 - » a.k.a. compensation adjustments and other benefits
 - Strategic vs. financial adjustments/considerations

Intro to Valuation

Framework of Value for Public and Private Companies

$$V_{mm} = \frac{CF_{mm}}{R_{mm} - G_{mm}}$$

Markets value
public
companies ...

$$V_{private} = \frac{CF_{private, normalized}}{R_{private} - G_{private}}$$

... we value
private
companies

Intro to Valuation

Value = Multiplier x Performance Measure



Value	Multiplier	Performance Measure
Equity Value	Equity Return	Earnings
Asset Value	WACC	Debt-Free Net Income
Equity Value	Equity Return	Net Cash Flow to Equity
Asset Value	WACC-based	Gross Cash Flow to Invested Capital (EBITDA)

Levels of Value Meets Basic Valuation Equation

	Conceptual Math	Relationship	Value Implications
Strategic Control Value	$\frac{CF_{e(c,s)}}{R_s - [G_{mm} + G_s]}$	$CF_{e(c,s)} \geq CF_{e(c,f)}$ $G_s \geq 0$ $R_s \leq R_f$	$V_{e(c,s)} \geq V_{e(c,f)}$
Financial Control Value	$\frac{CF_{e(c,f)}}{R_f - [G_{mm} + G_f]}$	$CF_{e(c,f)} \geq CF_{e(mm)}$ $G_f \geq 0$ $R_f = R_{mm} (+/- \text{ a little})$	$V_{e(c,f)} \geq V_{mm}$
Marketable Minority Value	$\frac{CF_{e(mm)}}{R_{mm} - G_{mm}}$	$G_v = R_{mm}$	V_{mm}
Nonmarketable Minority Value	$\frac{CF_{sh}}{R_{hp} - G_v}$	$CF_{sh} \leq CF_{e(mm)}$ $G_v \leq G_{mm}$ $R_{hp} \geq R_{mm}$	$V_{sh} \leq V_{mm}$

What Is a Multiplier?

- » Required rate of return
 - Equity
 - Assets (WACC)
- » Growth rate
- » $1 \div (\text{Rate of Return} - \text{Growth Rate})$

Growth Rate

- » Different measures of cash flow grow at different rates (EBITDA, EBIT, Net Income)
- » There is no single “growth rate”
- » A growth rate in one method may not apply in another method

Market Approach Methodologies

Subject
Transaction

Market
Transaction

Public Company
Method

Market Approach Methodologies

- » The weight of history on today's valuation
 - Past or recent brand/territory acquisitions
 - Past or recent stock transactions
 - Your actions compared to the “market”
 - Expectations and evolving realities
 - » Financial crisis – new world in financing
 - » Consolidation – same house / multi-house

Market Transactions

- » Relies on publicly available and citable transaction data
 - Very little “public” data available
 - Inconvenient lack of citable transaction source material (expert data realm and professional data realm)

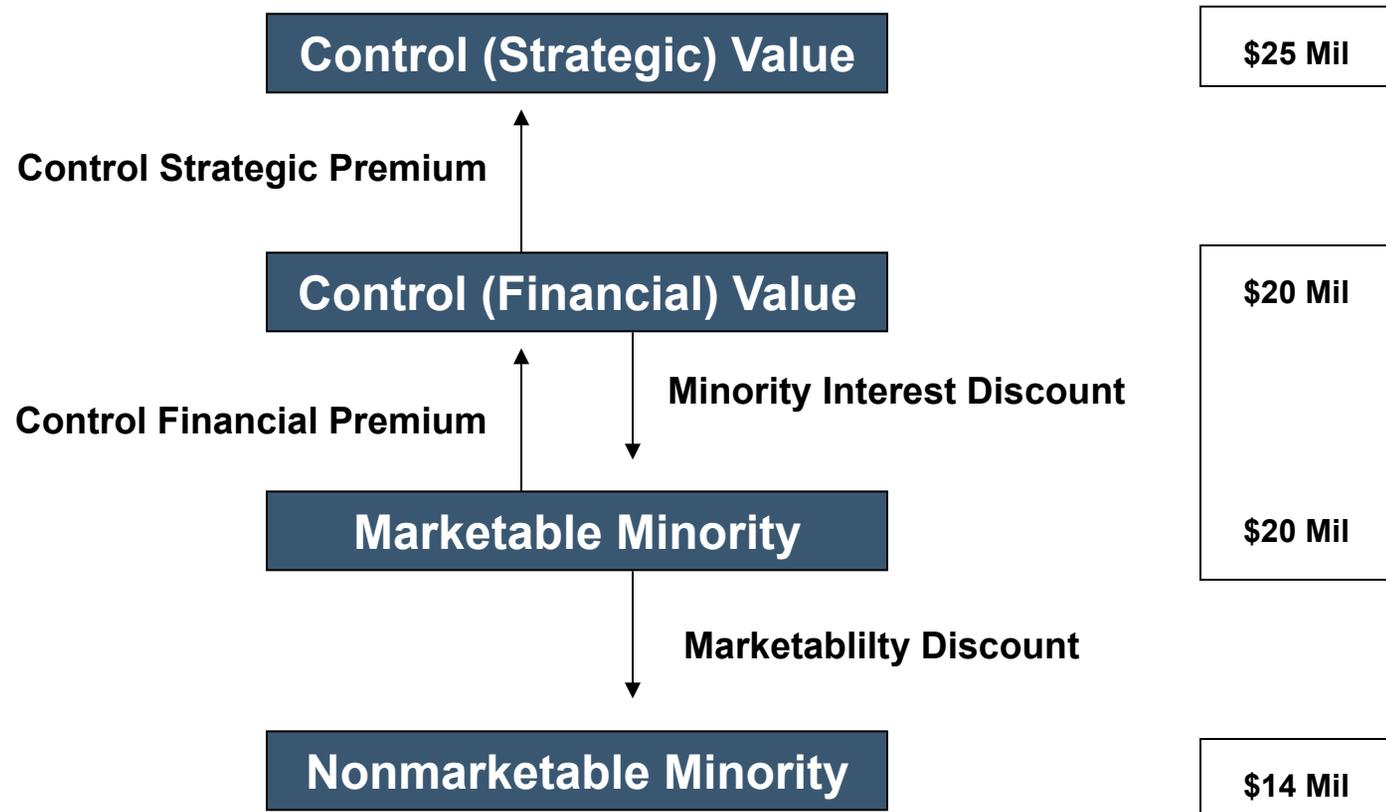
Market Approach

- » Rules of thumb (the good and the bad)
 - Evolution over time
 - » Per-case measures
 - » Gross-profit measures
 - » Enterprise and cash flow measures
 - Reconciling to the rest of the financial universe

Reconciling the Value Conclusion

- » Averaging of methodologies
- » Adjustments
 - Discounts and premiums
 - Non-operating assets
 - Contingent assets & liabilities

Levels of Value



Tests of Reason

- » Relative value analysis
- » Reconciliation of current value with past value
- » Reconciliation with broad market financial measures
- » Reconciliation with transaction activity (internal and external)
- » Reconciliation to rules of thumb?

Common Issues in Valuation Reports

- » Failure to satisfy IRS RR 59-60 requirements
- » Lack of compliance with USPAP Standards 9 & 10 (analytical development and report documentation)
- » Lack of appraisal credentials and promulgation of professional BV standards
- » Conflicts of interest and potential advocacy
- » Insufficient financial disclosure and historical review
- » Lack of support for and/or documentation for projections
- » Lack of support and/or failure to apply and document financial adjustments
- » Failure to consider all valuation approaches (asset / income / market)
- » Potential inappropriate use of proprietary data or data that is not publicly available and subject to review and scrutiny

Common Issues in Valuation Reports

- » Failure to define the standard and level of value used
- » Confusion of strategic and fair market value concepts and adjustments
- » Data and method adjustments that do not follow published, accepted or replicable procedures
- » Math errors
- » Confusion of enterprise and equity values
- » Improper or insufficient support of valuation discounts and premiums
- » Use of generic growth rate assumptions
- » Use of generic capital structure assumptions
- » Insufficient historical and operational overviews and descriptions
- » Improper use of public company data and improper comparisons

Common Issues in Valuation Reports

- » Conclusions that fail to reflect common sense, informed judgment and reasonable
- » The compounding of multiple, seemingly small assumptions and treatments that culminate in flawed conclusions
- » Failure to consider relevant events and circumstances known or reasonably knowable at the valuation date
- » Inappropriate consideration of events and circumstances that could not have been reasonably known or knowable at the valuation date (possibility and probability profiles)
- » Lack of support and documentation of discount rates and costs of capital used in direct capitalization and DCF methods

Common Issues in Valuation Reports

- » Lack of peer analysis or comparisons
- » Lack of price and unit volume analysis
- » Lack of trend analysis and financial ratio analysis
- » Disconnects and logic flaws from one valuation method to another or within a financial projection
- » Lack of economic and territory overviews and analyses
- » Lack of macro economic overview
- » Lack of industry overview
- » Failure to bifurcate operating and non-operating value

What Is a Buy-Sell Agreement?

Buy-sell agreements are agreements by and between the shareholders (or equity partners of whatever legal description) of a privately owned business and, perhaps, the business itself that establish the mechanism for the purchase of stock following the death (or other adverse changes) of one of the owners. In the case of corporate joint ventures, they also **establish the value for break-ups or for circumstances calling for one corporate venture partner to buy out the other partner.**

Buy-Sell Agreements

Require agreement **at a point in time**

Relate to transactions that will or may occur
at future points in time

Define the conditions that
“trigger” the buy-sell provisions

Determine the **price(s)** at which the
specified future transactions will occur

Potential “Trigger Events”

- » **Q** Quits
- » **F** is Fired
- » **R** Retires
- » **D** Disabled
- » **D** Death
- » **D** Divorce
- » **B** Bankruptcy
- » Others?



Three Questions to Ask Yourself

1

Do you have a buy-sell agreement?

If so, what type of agreement is it?

2

Do you know what your buy-sell agreement says?

There are six defining elements that must be in every process agreement if you want the valuation process and, therefore, the agreement, to work

3

How is your buy-sell agreement funded?

How life insurance proceeds are treated can make a big difference in the valuation of the company

The Six Defining Elements of Process Buy-Sell Agreements

Standard of Value	Qualifications of Appraisers
Level of Value	Appraisal Standards
The “As Of” Date	Funding Mechanism

Questions?

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