

Contents at a Glance

<i>Introduction</i>	1
<i>Part I: What Business Valuation Means</i>	7
Chapter 1: The Value of Understanding Business Valuation	9
Chapter 2: What Triggers a Business Valuation?.....	19
Chapter 3: Understanding the Tangibles and Intangibles of Business Valuation....	35
Chapter 4: Approaches and Methods — Basic Theories of the Valuation Process	45
Chapter 5: The Challenge of Valuation in a Knowledge Economy.....	61
<i>Part II: Getting Familiar with Valuation Tools, Principles, and Resources</i>	73
Chapter 6: Getting Familiar with a Typical Valuation Report.....	75
Chapter 7: Meeting the Supporting Players in the Valuation Process.....	87
Chapter 8: Understanding Financial Statements	111
Chapter 9: Using Rule-of-Thumb Valuations for Mom-and-Pop Businesses.....	131
<i>Part III: If You're Selling a Business . . .</i>	153
Chapter 10: Making Sure You're Ready to Sell.....	155
Chapter 11: Deciding What to Do about the Family Company.....	167
Chapter 12: Due Diligence on the Sell Side	181
Chapter 13: Case Study: Valuation on the Sell Side.....	189
<i>Part IV: If You're Buying a Business . . .</i>	203
Chapter 14: How Do You Know Whether You're Ready to Buy?	205
Chapter 15: Moving from Valuation to Negotiation.....	215
Chapter 16: Due Diligence on the Buy Side	225
Chapter 17: Forensic Accounting and the Due Diligence Process.....	239
Chapter 18: Case Study: Valuation on the Buy Side	251

<i>Part V: Don't Try This at Home! Turning Things Over to the Valuation Experts</i>	261
Chapter 19: Divorce.....	263
Chapter 20: Estate Planning and Gifting	275
Chapter 21: Attracting Outside Investors to Your Startup.....	287
<i>Part VI: The Part of Tens</i>	297
Chapter 22: Ten Reasons to Consider a Prenup	299
Chapter 23: Ten Questions to Answer Before Considering a Partnership Agreement	307
Chapter 24: Ten Things to Consider Before Transforming Your Company Into an ESOP	313
<i>Glossary</i>	319
<i>Index</i>	327

<http://www.pbookshop.com>

Table of Contents

.....

<i>Introduction</i>	1
About This Book	1
Conventions Used in This Book	2
What You're Not to Read	3
Foolish Assumptions	3
How This Book Is Organized	4
Part I: What Business Valuation Means	4
Part II: Getting Familiar with Valuation Tools, Principles, and Resources	4
Part III: If You're Selling a Business . . .	4
Part IV: If You're Buying a Business . . .	5
Part V: Don't Try This at Home! Turning Things Over to the Valuation Experts	5
Part VI: The Part of Tens	5
Icons Used in This Book	6
Where to Go from Here	6

Part I: What Business Valuation Means

Chapter 1: The Value of Understanding Business Valuation

Basic Tenets and the Importance of Valuation for Businesspeople	10
Value differs from price	10
Planning drives value	10
No two valuations are exactly alike	11
Valuation isn't a one-time deal	12
The Basic Building Blocks for Calculating Value	12
Discount and capitalization rates: The numbers that really matter	13
Doing your homework: Due diligence	13
How rule of thumb enters into business valuation	14
Getting Expert Help	15
The Move toward Intangible Asset Valuation	16
Family Businesses: Important Valuation Targets	16

Chapter 2: What Triggers a Business Valuation?

Exploring Reasons for Wanting a Business	20
It's time for a new career	20
You're fulfilling a dream	21
You're taking advantage of a strategic opportunity	22
You're buying a business to pass on to your heirs	23



Shaking the Money Tree: How Lenders Make Thorough Valuation a Necessity.....	24
Borrowing to buy a business: What lenders want to see	25
Preparing for mergers and other big-money deals.....	26
Seeking new or continued funding for an existing business	27
Attracting public or private investors	27
What If You Want — or Need — to Sell a Business?	28
Doing some smart estate planning	28
Reaching retirement	29
Letting the kids take over	29
Facing threats from market forces	30
Separating from a co-founder or partner.....	30
Dealing with divorce.....	32
Exit Plans: Writing the Ending.....	32
Who benefits from an exit plan?	33
When should an exit valuation be done?.....	33

Chapter 3: Understanding the Tangibles and Intangibles of Business Valuation 35

Examining Your Reasons for Valuing This Business.....	36
Introducing Standards of Value	37
The mother of all standards: Fair market value.....	38
Perceptions of investment value	38
The fundamentals of intrinsic value.....	39
Going over going-concern value	39
Liquidation value	40
Adjusting or Normalizing a Financial Statement	41
Other Considerations: Science Meets Art	42
Adding business and economic news	42
Folding in tangible assets	43
Drawing valuation conclusions with intangible assets	43

Chapter 4: Approaches and Methods — Basic Theories of the Valuation Process 45

A Step-by-Step Overview of the Valuation Process.....	47
Risky Business: Gauging Circumstances for the Best Results	49
Understanding the different approaches.....	50
Calculating risk and its relationship to present value	55
Using discount and capitalization rates and income valuation methods	56

Chapter 5: The Challenge of Valuation in a Knowledge Economy . . . 61

Moving from a Hard-Asset to an Intangible-Asset Economy.....	61
Reviewing types of assets	62
Recognizing the increasing value of intellectual property.....	63
Determining the Value of a Company Based on Ideas	64
The importance of real, documented income.....	64
What strategic buyers and lenders want to see	66

Reaching Intangible Value	67
Taking a stab at brand valuation	67
Recognizing customers as valuation drivers	69
Preserving Your Knowledge Business for the Future	70
Shaky times: When the founder's brain leaves the building	70
What owners need to do: Planning ahead	71

Part II: Getting Familiar with Valuation Tools, Principles, and Resources..... 73

Chapter 6: Getting Familiar with a Typical Valuation Report 75

What a Valuation Report Is Supposed to Do.....	76
Outlining a Typical Valuation Report	76
Cover	77
Valuation summary.....	77
Valuation assignment	80
Economic outlook.....	81
Industry outlook.....	82
Business overview	83
Conclusion of value	85
Appendixes	86

Chapter 7: Meeting the Supporting Players in the Valuation Process 87

Getting Help in Valuing Your Business	87
Recognizing situations that call for valuation experts.....	89
Finding the experts you need.....	90
Seeking the qualities your experts should have	91
Appraising What Appraisers Do	92
How appraisers are trained and certified.....	93
What appraisers cost	95
How to examine a business appraiser's work process	96
What to ask a prospective business appraiser	97
Taking Account of Accountants.....	98
How accountants are trained	99
How accountants are certified	100
What accountants cost	101
How to examine an accountant's work process	102
What to ask a prospective accountant	102
Hiring Advocacy: Attorneys	103
How attorneys are trained and certified.....	104
What attorneys cost	105
How to examine an attorney's work process	105
What to ask a prospective attorney	105
Brokers: One-Stop Valuation and Sale Services.....	106
How business brokers are trained and certified.....	107
What business brokers cost	108

How to examine a broker's work process	108
What to ask a prospective business broker	108
Chapter 8: Understanding Financial Statements	111
Gathering the Financial Data You Need.....	112
Looking into Support Data	112
External data	112
Internal data	113
Taking a Look at Financial Statements	114
The balance sheet.....	114
The income statement.....	118
Statement of retained earnings.....	122
Cash-flow statement	123
Ratios and formulas for valuation	126
Chapter 9: Using Rule-of-Thumb Valuations for Mom-and-Pop Businesses	131
What Rules of Thumb Do in Business Valuation	132
2008 Rules of Thumb from the Business Reference Guide.....	133
Full-service restaurants.....	133
Bars.....	135
Gift shops.....	137
Medical practices.....	138
Auto repair shops.....	140
Day-care centers for children.....	142
Dry cleaning.....	144
Coin laundries	146
Bookstores.....	149
Bed-and-breakfasts	149
Part III: If You're Selling a Business	153
Chapter 10: Making Sure You're Ready to Sell	155
Understanding Why Timing Is Important.....	156
Examining the Motivations behind a Potential Business Sale	156
Anticipating the owner's retirement	158
The kids are taking over!.....	158
Weighing the possibility of a merger or acquisition from a friendly suitor	159
Changing market conditions are threatening a company's future	159
Bringing Valuation into the Picture before You Bring In the Buyers....	159
Providing a reality check	160
Transparency: Preparing for a sale	161
Heading off problems to increase value	162

Determining the Kind of Transaction You Want	165
Outright sale	166
Employee stock ownership plan (ESOP)	166
Ownership transfer to key family members	166
Chapter 11: Deciding What to Do about the Family Company	167
Planning for the Worst Possible Scenario	168
Examining the State of the Family Business.....	169
Specific characteristics of family companies.....	169
How families hurt the value of their businesses.....	170
Why “equal” in a family business isn’t always fair	174
Getting Your Family Down to Business	175
Following a phased-in approach.....	176
Addressing the fairness question head-on.....	178
Setting up the best plan for the generations.....	178
Chapter 12: Due Diligence on the Sell Side	181
Looking at Why a Seller Has to Do Due Diligence	181
Understanding the Three Stages of Due Diligence.....	183
Tricks of the Trade: Collecting and Exchanging Information	184
Gathering your own company data.....	184
Protecting your company with a confidentiality agreement.....	187
Chapter 13: Case Study: Valuation on the Sell Side.	189
Heading Off Common Valuation Disasters	190
Writing down your wishes.....	190
Making sure that your records are adequate.....	191
Taking time to plan.....	192
Considering confidentiality	192
Setting Up Your Prevaluation Plan.....	192
Finding the problems	193
Analyzing the prevaluation.....	195
Performing the Valuation	196
Taking valuation from fantasy to reality.....	196
Checking the structure of the deal	200
Looking at an example of a deal in progress.....	201
 Part IV: If You’re Buying a Business	 203
Chapter 14: How Do You Know Whether You’re Ready to Buy? . . .	205
Knowing What Typically Drives a Business Purchase.....	205
Getting Ready to Buy	206
Tackling challenges unique to buyers.....	207
Looking at whether the business is right for you.....	208
Evaluating a failing business	209
Understanding how the mating process (typically) works	211
Restarting the Value Process.....	213

Chapter 15: Moving from Valuation to Negotiation	215
Knowing What Valuation Does for the Dealmaking Process.....	216
Identifying potential pitfalls and opportunities	216
Timing the purchase well	216
Minimizing emotional shocks.....	217
Getting Ready to Meet the Seller	217
Recognizing window dressing.....	218
Remembering motives	218
Knowing what sellers want.....	219
Let's Make a Deal: Negotiating.....	219
Deciding whether to handle negotiations yourself	219
Getting ready to negotiate.....	220
Understanding what you should do in negotiation	222
Working with someone who's negotiating for you.....	223
Chapter 16: Due Diligence on the Buy Side.	225
Seeing What Due Diligence Means in Practice.....	225
Looking at the Unofficial First Stages of Due Diligence	226
Researching the company	227
Consulting your family and the pros.....	228
The Informational Game Plan: Cracking the Books (and the Internet).....	229
Gathering the Company's Data.....	231
Knowing which questions to ask about the target company.....	232
Checking with the company's departments	233
Collecting Outside Data about Your Industry and the Economy	235
Chapter 17: Forensic Accounting and the Due Diligence Process.	239
Understanding Forensic Accountants	239
Characterizing a qualified forensic accountant	240
Recognizing situations that link forensic accounting and valuation.....	243
Comparing Basic and Forensic Accounting	246
Recognizing Business Situations That Trigger Forensic Accounting ...	247
Doing a Forensic Accounting Test.....	248
Looking at Forensic Accounting Case Studies	249
Chapter 18: Case Study: Valuation on the Buy Side.	251
Being Frank: Selecting an Industry	251
Doing Research in Advance.....	252
Contacting the Target	253
Negotiating the quick-and-dirty valuation stage.....	253
Knowing when to talk . . . and when to hang up	254
Moving on to Company Number Two	254

Seeing How Failing to Consult an Advisor Can Cost You 255
 Knowing when to involve advisors..... 255
 Encountering problems..... 256
 Seeing what could've been done..... 258
 Checking Benchmarking Data 258
 Understanding Deal Structure 259

Part V: Don't Try This at Home! Turning Things Over to the Valuation Experts 261

Chapter 19: Divorce263

Doing Estate Planning Regardless of Marital Status 263
 Planning Prenuptial and Postnuptial Agreements 264
 Breaking down a prenuptial agreement 265
 Creating a postnuptial agreement 267
 Seeking the Correct Professionals..... 267
 Looking at What Happens to a Family Business in Divorce..... 268
 State laws on splitting property..... 270
 The marital balance of power 271
 Determining the Business Value in a Divorce..... 272
 Keeping Valuation Dates in Mind 273

Chapter 20: Estate Planning and Gifting.....275

Succession Planning: A Critical Part of Business Planning 276
 Considering Family Matters 276
 Anticipating problems..... 276
 Considering blended and nontraditional families 277
 Creating contingency plans for relatives who renege..... 278
 Creating a Succession Plan..... 279
 Creating an Estate Plan 280
 Finding the Experts You Need for Estate Planning 281
 Fitting Buy/Sell Agreements into Estate Planning and Valuation 282
 Taking Gifting into Consideration 283
 Gifting strategies 283
 Gifting techniques..... 284

Chapter 21: Attracting Outside Investors to Your Startup.....287

Exploring Your Startup Resources..... 288
 Seeing How Valuation Professionals Work with Startups 290
 Creating the Starting Point: The Business Plan 291
 Working with Investors..... 292
 Angel investors..... 293
 Venture capitalists..... 294
 IPO investors 295

Part VI: The Part of Tens	297
Chapter 22: Ten Reasons to Consider a Prenup	299
It Gets You to Talk Honestly about Money at the Start of a Marriage.....	300
Your Life's Work Shouldn't Go down the Drain.....	300
If Both Spouses Have Sacrificed to Build the Business,	
They Need to Share	301
The Working Spouse Shouldn't Lose the Business Entirely	302
Kids from Earlier Marriages Need Protection.....	302
Kids from Your Next Marriage Need Protection, Too.....	304
Planning for Worst-Case Scenarios Is a Good Habit.....	304
Your Business and Personal Finances Really Are Connected	305
Family Legacies Need Protection	305
When a Marriage Ends, a Prenup (Or Postnup)	
Can Save You Both Money.....	306
Chapter 23: Ten Questions to Answer Before Considering a Partnership Agreement	307
Who Will Be in the Partnership?.....	308
How Much Capital Does Each Partner Have to Kick In at the Start?.....	308
How Will Decisions Be Made?	309
Do You Have a Plan for Resolving Disputes?	309
How Will the Firm Admit New Partners?	310
How and When Will Profits — or Losses — Be Shared?.....	310
What Happens If a Partner Leaves or Dies?	311
How Will the Partnership Be Sold or Dissolved?.....	311
How Will Legal Disputes inside and outside	
the Partnership Be Handled?.....	312
Will Noncompete Issues Be Covered?.....	312
Chapter 24: Ten Things to Consider Before Transforming Your Company Into an ESOP	313
Research How ESOPs Are Created	314
Understand Why ESOPs Are Attractive in Certain Situations.....	314
Know How the Tax Advantages Work.....	315
Examine How Valuation Comes In.....	316
Get a Handle on Your Launch Steps.....	316
Prepare for Preparation Costs	317
Get Ready to Train Next-Generation Leadership	317
Plan Ongoing Training for Employees	318
Estimate ESOP Costs after Launch	318
Realize That ESOPs Can Fail.....	318
Glossary	319
Index	327