



Schenck^{SC}

CPAs AND SO MUCH MORE.

Business Valuation & Litigation Support Trends

Volume 5 • Issue 1 • January 2010

Are Rules of Thumb Useful?

Many industry-specific formulas or simple calculations have arisen over the years for valuing companies. Where do they come from? Originating in industry studies or surveys, the minds of business brokers, transaction databases, cocktail conversations, publications and other even less reliable sources, these so-called rules of thumb are often used -- and abused -- in value determination.

For example, suppose an organization compiles statistics on 100 insurance agencies. The organization then averages all the selling prices and calculates that the average agency sold for 100% of one year's gross revenue. This creates a rule of thumb for valuing insurance agencies. The problem is that one agency may have sold for twice one year's gross while another may have sold for half of one year's gross. Thus, rule-

Continued on page 2...

Anatomy of a Business Valuation: What to look for when reading a valuation report

You're in the beginning stages of selling your company. You hired a valuator to get an idea of what the business is worth. He or she delivers the report. Now what?

The value appears to be in the ballpark, but what do the report's details mean? Whatever your reason for a valuation, a basic understanding of the report's content is crucial.

Points of Interest

In today's fast-paced business environment, it's not uncommon for executives to quickly scan a valuation report, searching for the final figure. But you can learn much more from a report if you know what to look for throughout. Here are four key areas within the document to focus on:

1. **Procedures.** A valuator will usually visit the site as well as perform a detailed financial analysis. Any information the valuator uses should have been available, or at least foreseeable, at the valuation's "as of" date.
2. **Methodology.** With various valuation approaches available, valutors generally choose one based on a company's unique characteristics. The valuation report should discuss all of the

valuator's approaches, including why some methodologies may be more appropriate than others.

3. **Discounts.** Once the valuator applies a methodology, he or she determines whether to apply valuation discounts (or premiums) to the preliminary value. Common discounts include the minority interest and lack of marketability. If the valuator applies discounts, he or she should detail why each was chosen, based on empirical evidence and the company's unique characteristics.
4. **Conclusion.** The value conclusion should make economic sense, considering both a hypothetical buyer and a hypothetical seller.

In addition to these four areas, also look for the definition of the entity being valued. This definition should include the valuation's purpose, the company's name, the number of shares, the entity type and the "as of" date.

Dig Into the Details

If you've ever received a business valuation report and wondered, "What's the difference between a discount rate and a capitalization rate?" you're not alone. The right resources can help you decipher the report's details. Please give us a call if you need help evaluating a valuation report.

Business Valuation & Litigation Support Trends is published four times a year and is available to clients and friends of Schenck at no charge. For name and address corrections, or to receive the newsletter electronically, please call Dawn Krueger at 920-996-1465, or email dawn.krueger@schencksc.com.

All dates for events are subject to change; please call or visit us online for confirmation.

schencksc.com | 800-236-2246

Business Valuation & Litigation Support Trends

January 2010 • Page 2



Are Rules of Thumb Useful?

Continued from page 1...

of-thumb formulas may be accurate for businesses whose performances are about average, but other businesses will vary. To apply a rule of thumb to a business that varies significantly from the average is not appropriate.

A Rule Is a Rule?

Assume that the rule of thumb is: Value = 100% of annual revenue. In a simplified example, this rule would provide the same value for two agencies even if their net incomes are substantially different. Consider some other factors that might affect value:

- Agency A has 125 clients, while Agency B has 75.
- One of Agency B's clients accounts for 25% of the agency's fees.
- Agency A has a long-term, noncancelable lease for its offices.

Some considerations unique to the insurance business would be:

- the size and mix of commission income from life, health and business products,
- whether business is concentrated with a particular insurance carrier, and

- the relationship of sellers to significant customers.

Each industry has its own unique considerations. Rules of thumb are not always based on a sound foundation. They are generalities and must be considered as such in their use and application. While they can help you determine a general value range, don't rely on them as an authoritative means of valuing a company. You can use rules of thumb to corroborate value determinations derived by more traditional methods if you combine them with a thorough understanding of the business and its financial history, sound business judgment and common sense. Please call us with any questions you may have about rules of thumb or other valuation matters.

Your Business Valuation Team

Fox Cities 800-236-2246

Mark A. Hanson, CPA, CVA, ABV
Steven F. Predayna, CPA, CVA
Robert A. De Bruin, CPA, CVA

Fond du Lac 800-236-2245

Ronald E. Brien, CPA, CVA

Green Bay 800-676-0829

Kenneth J. Lardinois, CPA, CVA
Daniel J. Young, CPA, CVA
LeRoy W. Matuszak, CPA, CFP®, CVA
Chris Hendricks, CPA, CVA

Manitowoc 800-550-0558

Stephen P. Shellman, CPA, CVA

Milwaukee 888-556-5580

Karin M. Gale, CPA, CM&AA

Sheboygan 800-236-2248

Todd A. Mueller, CPA, ABV, CBA
Donna J. Schultz, CFP®, AVA

An Important Message

While every effort has been made to provide valuable, useful information in this publication, Schenck and any related suppliers or associated companies accept no responsibility or any form of liability from reliance upon or use of its contents. Any suggestions should be considered carefully within your own particular circumstances, as they are intended as general information only.

Schenck provides a full range of services including accounting, tax, payroll, information technology, business consulting, retirement planning, investment and human resource solutions for today's business, government and personal challenges. To learn more about our full line of solutions and how we can help, visit us online at schencksc.com, or call 800-236-2246.

Appleton • Fond du Lac • Green Bay • Manitowoc • Milwaukee • Oshkosh • Sheboygan • Stevens Point