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# WHAT'S IT WORTH
# VALUATION CONCEPTS AND MAKING IT WORK FOR YOU

Presentation to IMEC, May 11, 2021

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## AGENDA

- Introductions
- Foundations of Valuation Theory
- Applying the Theory Today
  - Premises of Value: Premises and Rules
- How Can the Same Business Have Many Values?
  - Process of Valuation
- COVID, PPP and the New Principle of Resiliency
- Lessons for Corporate Decision Making

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## MEET TODAY'S PRESENTER

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## MEET SIKICH

**1,000+** TOTAL PERSONNEL

**90+** PARTNERS

**NATIONWIDE PRESENCE** WITH CLIENTS SERVED **IN 50 STATES**

**35+** YEARS **SERVICING CLIENTS** AS A FIRM

**1** **POSITIVE** AND **COLLABORATIVE** CULTURE

**AUDIT, ACCOUNTING & TAX**
- Assurance & Accounting Services
- Employee Benefits Plan & Retirement Plan Audits
- Tax Compliance & Planning
- International Tax

**TECHNOLOGY**
- ERP & CRM Software and Consulting
- IT Services
- Cloud & Hosting Services
- IT Security Services
- Technology Consulting & Projects
- Security & Compliance
- Cybersecurity

**ADVISORY**
- Forensic & Valuation Services
- General Business Consulting
- Human Capital Management & Payroll Consulting
- Insurance Services
- Investment Banking
- Marketing & Design
- Private Equity
- Public Relations
- Retirement Services
- Risk Advisory
- Succession Planning
- Supply Chain
- Transaction Advisory
- Wealth Management

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## MANUFACTURING& DISTRIBUTION EXPERTISE

- **1800+** M&D Clients
- Industry team of **100+ professionals**
- Quarterly industry pulse surveys & reports
- Quarterly industry newsletters

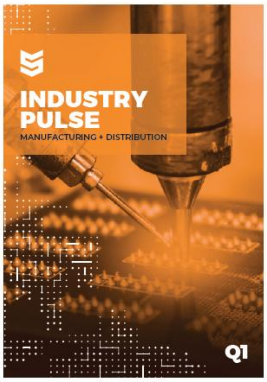
IMEC

IMA Illinois Manufacturers' Association

VIA Valley Industrial Association

fei financial executives international chicago chapter

ACG Association for Corporate Growth

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# FOUNDATIONS OF VALUATION THEORY

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## BRIEF HISTORY OF VALUATION THEORY

- Roots in the insurance industry (claim settlement for fire insurance – 1900)
- Constitutional amendment creating income taxation: Internal Revenue Service to inform fair market value
- Societal development of fair market value in:
  - Utility rate making
  - Litigation and damages
  - Eminent domain
  - Property tax
- Dr. James C. Bonbright developed theory in context in Valuation of Property, Vols.1 and 3, 1937
- Different values of the same business depending upon the purpose of the appraisal
  - There are both tangible and intangible assets comprising a business
  - Different assets require different rates of return: became IRS ARM 34
  - Assets can be value "in exchange", "in use", in orderly liquidation or in forced liquidation

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## PREMISES OF VALUE: PRINCIPLES AND RULES

- Valuation theory is a belief system derived from economic and financial principles
- In capitalism, it believes that value lies at the intersection of:
  - **Income Approach:** the present value of future returns
  - **Market Approach:** current trading multiples
  - **Cost or Asset Approach:** the cost to reproduce the business or asset
- **Fair Market Value:** price at which property trades between willing buyer and seller, neither under compulsion with reasonable sharing of information; assumes value in exchange using market inputs for leverage and rates of return
- **Investment Value:** value to a particular investor; generally higher than fair market value and best represented by the Income Approach
- Price and value are only the same by coincidence
  - Cash is king; liquidation always comes at a discount to value
- Based on cashflow
  - Cash available for distribution to owners after investments made in growth
- Normalized for non-recurring events, owner compensation for labor, market leverage and taxation
- Principles tempered by rules depending on purpose
  - Uniform Standards for banking, IRS for taxation, case law for litigation, law for property tax

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# APPLICATION TODAY

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## APPLYING THE THREE APPROACHES TODAY

- Up until 2000, it was believed that the three approaches should intersect – that's where value is
  - USPAP (Uniform Standards of Professional Appraisal Practice), for banking, was finally read and it is clear that this interpretation changed
- While approaches continue to be "weighted", it is not best practice
- Reliance on an approach should depend on the quality of the underlying data and the purpose of the appraisal
- Appraisal theory is **notoriously inaccurate regarding intangible valuation** and these assets represent the majority of value in today's businesses
- Rather than an intersection, the hierarchy of value should look like:
  - Highest: Income Approach
    - Middle: Market Approach
      - Lowest: Cost or Asset approach

Please don't ask what the multiple of EBITDA is…

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## PROCESS OF VALUATION

- **Principle:** While the past is of interest, **the heart of valuation is predicting the future**
  - What is the future return profile?
  - What is the risk of attaining that sequence of returns both near-term and long-term?
- This profile is measured in the Income Approach and is baked into the Market Approach
- Process includes:

**Management interviews** → **Extensive research into third-party databases:** benchmarking by industry, economic data, rates of return → **Financial analysis** → **Comparison:** good, better, best in class → **Application of the three approaches and selection of the one that best suits the situation** → **Tailoring of the conclusion to any rules associated with the purpose of the valuation**

- Reporting is most rule driven: format determined by purpose
- Certified or uncertified consulting

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# COVID, PPP AND RESILIENCY

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## ADJUSTING TO THE TIMES

**A pandemic is the ultimate non-recurring event**

- It has generated unusual interference of the government into economic affairs
  - How long does the government pump trillions into the economy? How long do interest rates remain so low?
- Things have changed; many trends have been hastened by the pandemic; relics and winners
- PPP money is a new and very big reality; this, low interest rates and the age of owners is **causing incredible selling**
  - Will this money be invested in expansion or distributed to owners?
- PPP is, by definition, a non-operating asset

- General thought is 2020 should not be considered in the appraisal process ; an aberration
- 2021 to a lesser extent
- Real principle
  - How resilient is the company?
  - How did it fare in the pandemic?
  - Old-world or New-world?
- In industries that need recovery, discounted cash flow method is the best to account for ramp up
- For the first time in a long time, appraisers must consider whether company is resilient as a going concern in the new economy or a potential fire sale

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# LESSONS FOR CORPORATE DECISION MAKING

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## LESSONS FOR CORPORATE DECISION MAKING

- It's about:
  - The Income Approach
  - The company and less about the "market"
  - Return, risk and holding period
- A decision that increases value will:
  - ✓ Increase return
  - ✓ Reduce risk
  - ✓ Shorten holding period

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# QUESTIONS?

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# THANK YOU!

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