VALUESCOPE
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Two Credible Financial Experts, Why Such Different Values or Damages?

Collin County Bar Association

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Greg Scheig has more than 30 years of consulting and valuation experience. He provides litigation support, valuation and financial consulting services to companies in a broad range of sectors (with expertise in Energy Sector).

Greg previously worked with two national valuation firms where he led their Dallas practices. Prior to that he was a Senior Manager with Deloitte Consulting's strategy practice.

Principal

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Education

- ❑ University of Texas at Austin, M.B.A, Finance and Accounting
- ❑ University of Texas at Austin, B.S., Petroleum Engineering

Professional Affiliations

- ❑ Chartered Financial Analyst (CFA) Institute
- ❑ American Institute of Certified Public Accountants
- ❑ Texas Society of Certified Public Accountants

Valuation Practice Areas

Financial Reporting

- Purchase price allocations
- Goodwill impairment
- Intellectual property
- Derivative securities
- Valuation of embedded securities

Litigation Support

- Bankruptcy matters
- Economic damages
- Valuation disputes
- Lost profits
- Tax litigation
- Marital dissolution

Transaction Advisory

- Sell-side & buy-side analysis
- Financial due diligence
- Capital formation
- Merger synergy analysis
- Fairness & solvency opinions

Tax Reporting

- Estate & gift tax appraisals & discounts
- IRC 409A & IRC 83(b) ESOP valuations
- C to S conversions
- Goodwill & Non-competes

Management Consulting

- Econometrics, statistical analyses & forecasting
- Executive compensation analysis
- Succession planning
- Operations optimization

Global Transfer Pricing

- Advance pricing agreements
- Functional & economic analyses
- Cost sharing arrangements
- Compliance & documentation

Table of Contents

Legal Matters and Preferred Outcomes

Example	High Value Preferred	Low Value Preferred
Transaction	Seller	Buyer
Employee Compensation	Employer - fewer units	Employee - more units
Gift Tax Matter	IRS – fewer units gifted given limits	Taxpayer – more units gifted
Economic Damages	Plaintiff	Defendant
Bankruptcy	Debtor / Trustee	Creditors

Fictional Company – “ServiceCo”

Characteristics:

- A Service Company (not capital intensive)
- Professional services
- Fast growing
- Recently turned profitable
- 5 founders
- 100 staff
- Optimistic Outlook

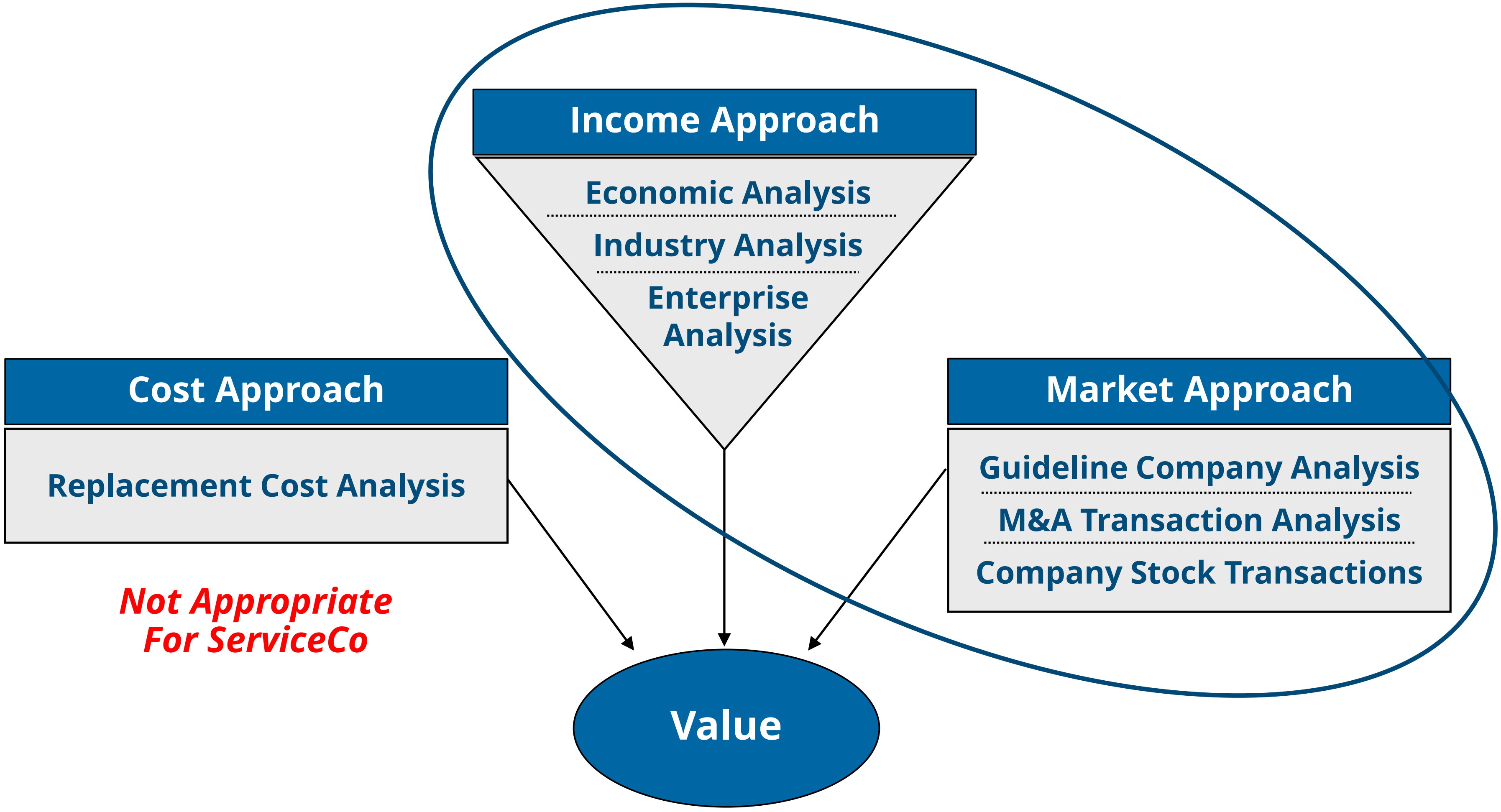
- Attorneys on both sides of “some issue” retained experts

Quick Disclaimer

- All Numbers Were Made Up
- Fictional Experts – Neither one is me
- No specific cases / clients referenced
- Given their independence, neither expert <u>always</u> takes the high or low route to a concluded value
- Both fictional experts make some relevant points

Valuation Methodology 101

There are 3 "approaches" to determine value of any business, common stock, partnership unit or asset



Fictional Appraisers & Their Respective Conclusions

Harry Highval, ASA	**Larry Lowball, CPA/ABV**
• Degree in Finance • ASA Courses / Accredited Senior Appraiser Designation	• MPA Accounting • Passed CPA exam • Training for Accredited in Business Valuation
• Concluded Value for Equity of ServiceCo was **$130 Million**	• Concluded Value for Equity of ServiceCo was **$70 Million**

Two independent experts with good credentials…
How could their conclusions be so disparate?

Which expert is not independent?
Which one is lying for his client?
Which expert is obviously not competent?

Basis of Value Determination

- **Level of value?**
  - Enterprise Value
  - Equity Value
  - Net Asset Value (NAV)
  - Market Value of Invested Capital (MVIC)

- **Standard of value?**
  - Fair Market Value - *Willing buyer, willing seller, neither under compulsion to buy or sell, both with reasonable knowledge of the facts*
  - Fair Value (GAAP) - *The amount at which an asset could be bought or sold in a current transaction between willing parties, other than in a forced sale*

In this example, the Fair Market Value of the Common Equity, on a Controlling Interest Basis, was determined by both appraisers.

Table of Contents

ServiceCo Historical Income Statements

- 4-Year Sales growth from $7.4M to $26.1M
- All earnings reinvested to support growth
- Turned profitable in 2019

	For the Year Ended:									
	31-Dec-15		31-Dec-16		31-Dec-17		31-Dec-18		31-Dec-19	
	Actual	**%**	**Actual**	**%**	**Actual**	**%**	**Actual**	**%**	**Actual**	**%**
Revenue	$7,445,982	*100.0%*	$10,099,635	*100.0%*	$13,970,701	*100.0%*	$19,042,564	*100.0%*	$26,101,071	*100.0%*
Cost of sales (COS)	50,000	*0.7%*	62,000	*0.6%*	83,557	*0.6%*	283,463	*1.5%*	353,308	*1.4%*
Gross Profit	7,395,982	*99.3%*	10,037,635	*99.4%*	13,887,144	*99.4%*	18,759,100	*98.5%*	25,747,762	*98.6%*
Selling, general & administrative (SG&A)	6,710,614	*90.1%*	9,743,238	*96.5%*	14,121,546	*101.1%*	18,759,419	*98.5%*	22,924,735	*87.8%*
Earnings before interest, taxes, depreciation & amortization **(EBITDA)**	685,368	*9.2%*	294,397	*2.9%*	(234,403)	*-1.7%*	(318)	*0.0%*	2,823,028	*10.8%*
Depreciation expense	155,921	*2.1%*	6,766	*0.1%*	-	*0.0%*	241,827	*1.3%*	241,827	*0.9%*
Earnings before interest & taxes **(EBIT)**	529,447	*7.1%*	287,631	*2.8%*	(234,403)	*-1.7%*	(242,146)	*-1.3%*	2,581,200	*9.9%*
Other income, net	(339)	*0.0%*	515	*0.0%*	15,066	*0.1%*	6,325	*0.0%*	(223,369)	*-0.9%*
Pretax Income (EBT)	529,108	*7.1%*	288,146	*2.9%*	(219,337)	*-1.6%*	(235,821)	*-1.2%*	2,357,831	*9.0%*

ServiceCo Historical Balance Sheets

- No long-term debt
- $2M+ working capital
- Not distressed

	As of:									
	31-Dec-15		31-Dec-16		31-Dec-17		31-Dec-18		31-Dec-19	
	Actual	**%**	**Actual**	**%**	**Actual**	**%**	**Actual**	**%**	**Actual**	**%**
Current Assets										
Cash & cash equivalents	$547,068	*61.5%*	$674,759	*53.8%*	$681,405	*53.8%*	$1,425,352	*63.9%*	$2,451,543	*61.6%*
Accounts receivable, net	288,976	*32.5%*	390,871	*31.2%*	483,008	*31.2%*	635,563	*28.5%*	1,357,353	*34.1%*
Prepaid expenses	28,232	*3.2%*	98,128	*7.8%*	355,795	*7.8%*	-	*0.0%*	43,768	*1.1%*
Total Current Assets	864,275	*97.1%*	1,163,758	*92.8%*	1,520,208	*92.8%*	2,099,793	*94.2%*	3,852,664	*96.7%*
Fixed assets, net	3,521	*0.4%*	68,256	*5.4%*	68,256	*5.4%*	-	*0.0%*	-	*0.0%*
Other assets	21,920	*2.5%*	21,920	*1.7%*	21,920	*1.7%*	129,691	*5.8%*	129,691	*3.3%*
Total Assets	$889,717	*100.0%*	$1,253,934	*100.0%*	$1,610,384	*100.0%*	$2,229,483	*100.0%*	$3,982,355	*100.0%*
Current Liabilities										
Accounts payable	$41,159	*4.6%*	$368,675	*29.4%*	$39,766	*29.4%*	$19,803	*0.9%*	$120,637	*3.0%*
Accrued expenses	-	*0.0%*	-	*0.0%*	624,236	*0.0%*	1,521,923	*68.3%*	1,427,921	*35.9%*
Other current liabilities	86,750	*9.8%*	49,568	*4.0%*	419,390	*4.0%*	174,840	*7.8%*	-	*0.0%*
Total Current Liabilities	127,909	*14.4%*	418,243	*33.4%*	1,083,392	*33.4%*	1,716,566	*77.0%*	1,548,558	*38.9%*
Long-term debt, net of current	-	*0.0%*	-	*0.0%*	-	*0.0%*	-	*0.0%*	-	*0.0%*
Total Liabilities	652,909	*73.4%*	1,108,243	*88.4%*	1,858,392	*88.4%*	2,851,566	*127.9%*	2,683,558	*67.4%*
Total Equity	236,808	*26.6%*	145,691	*11.6%*	(248,007)	*11.6%*	(622,082)	*-27.9%*	1,298,797	*32.6%*
Total Liabilities & Equity	$889,717	*100.0%*	$1,253,934	*100.0%*	$1,610,384	*100.0%*	$2,229,483	*100.0%*	$3,982,355	*100.0%*

ServiceCo Financial Analysis Takeaways

- ServiceCo has grown significantly year-over-year
  - Compound annual growth rate (CAGR) of 36.8%

- EBITDA has been inconsistent, however in 2019 the Company boasted its highest EBITDA margin in the last 5 years

- The Company has no liquidity issues currently, with $2.3M in working capital (8.8% of revenue)

- With no debt on the balance sheet, there are also no solvency issues

Overall, the Company's significant growth in revenue and profitability and no immediate concerns on the balance sheet point towards a positive outlook.

Table of Contents

Guideline Public Companies

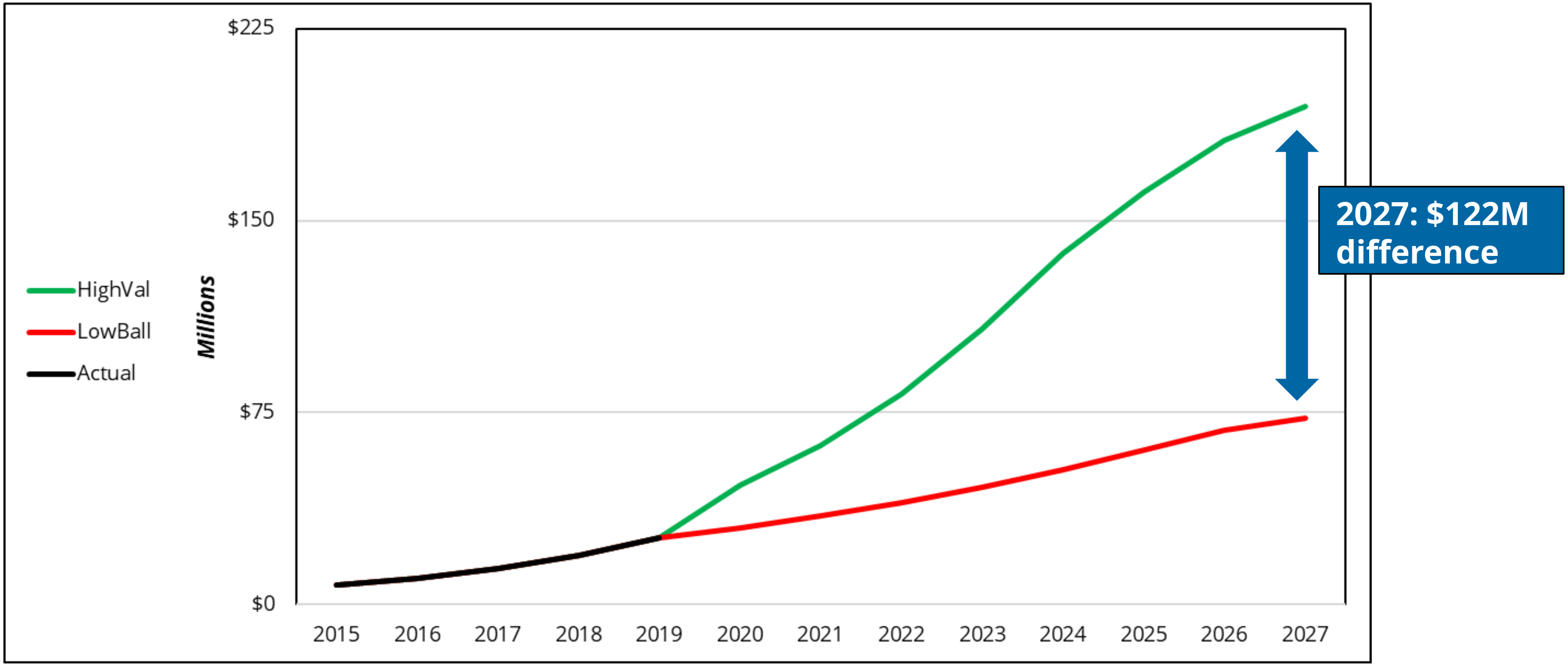
- Public companies (obviously much larger than ServiceCo)
- No "perfect" comparables
- Exposed to similar market conditions and risks
- Both experts considered the ***same*** group for discount rates and market multiples

Company Name	Ticker Symbol	Description
CBIZ, Inc.	CBZ	Accounting
CRA International, Inc.	CRAI	Economic / Financial Consulting
Exponent, Inc.	EXPO	Scientific Consulting
FTI Consulting, Inc.	FCN	Economic/Bankruptcy Consulting
Resources Connection, Inc.	RECN	Accounting, Finance, Risk Consulting

Table of Contents

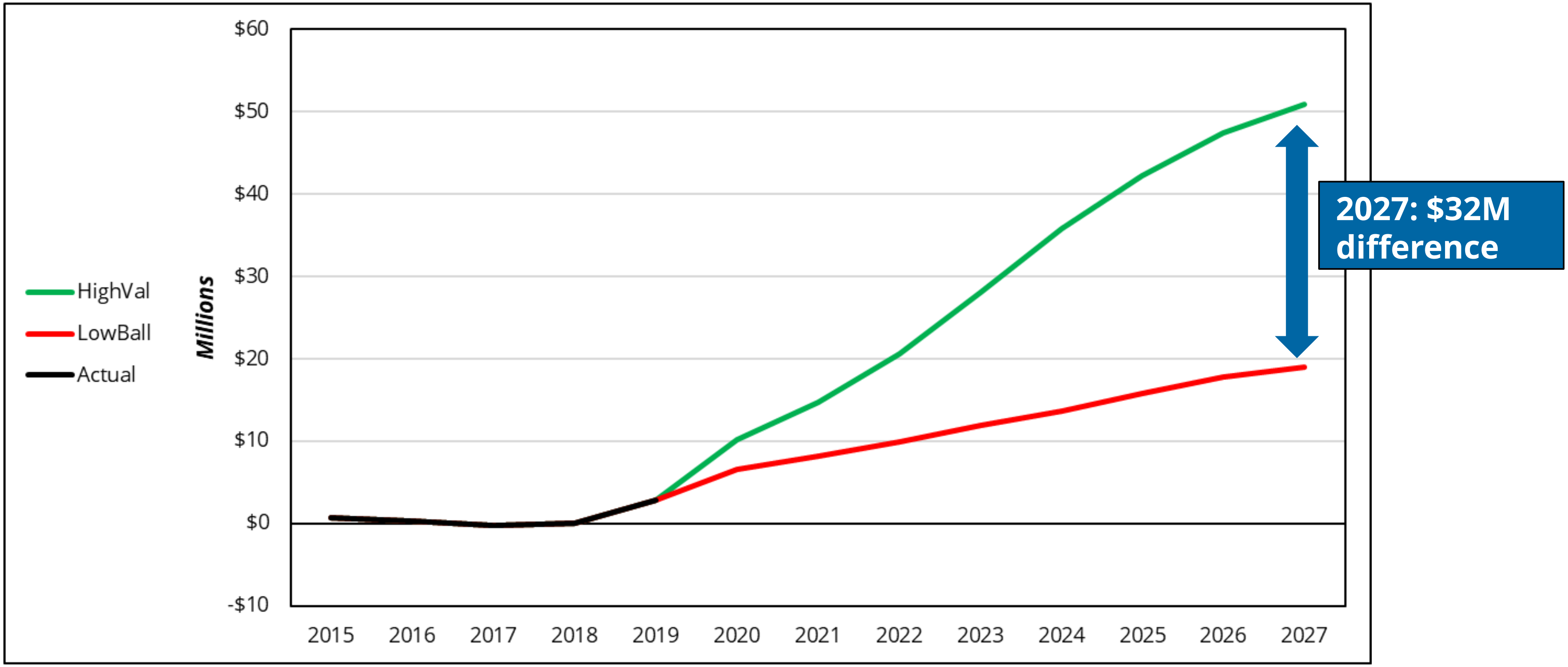
Sales Forecast Differences

- Company presented their forecast to both experts
  - High growth in sales (30%+ for next 5 years)
- Highval utilized this forecast
  - "ServiceCo knows their markets/business better than an outsider"
- Lowball disregarded, "normalized" to a 15% growth rate over the next 6 years



EBITDA Forecast Differences

- ServiceCo forecast EBITDA margins rising to 25+%
- Highval again utilized ServiceCo forecast
- Lowball performed his own forecast based on “education, experience, and training” and industry resources
- Resulted in similar EBITDA margins but the gap in revenue led to a wide gap in projected EBITDA



Discount Rates

- Cost of Equity
  - Capital Asset Pricing Model (CAPM)
  - In addition to market risk, a premium for size and company-specific risk may be appropriate

- Cost of Debt
  - Market (i.e. Moody's Baa Rate)

- WACC - Weighted Average Cost of Capital
  - Capital structure weightings based on market data

- Both used CAPM, but handled "risk" differently in their calculations:

Henry Highval, ASA	Larry Lowball, CPA/ABV
• Cost of Equity = 22.6%	• Cost of Equity = 17.6%
• WACC = 19.1%	• WACC = 15.0%
• Higher discount rates to reflect potentially optimistic forecast	• Less risk assumed because his own forecast was more achievable

Expert Report Differences

Henry Highval, ASA

- Company forecast
  - Higher Sales
- Risk-Adjusted WACC (higher)
  - Affects present value calculations, and
  - Affects exit value (estimated value into perpetuity)
- 8 years forecast cash flows with exit value
- **Concluded value = $127M**

Larry Lowball, CPA/ABV

- Developed his own forecast
  - Not “inflated”
- Risk-Adjusted WACC (lower)
  - Affects present value calculations, and
  - Affects exit value (estimated value into perpetuity)
- 8 years forecast cash flows with exit value
- **Concluded value = $84M**

Table of Contents

Guideline Company Method

- Brief Primer
  - Based on price multiples of comparable public companies
  - The multiples are then applied to subject company financial metrics

- Multiples reflect known conditions on a specific date
  - Equity market risks
  - Interest rates
  - Industry risks
  - Company-specific risks
  - Efficient markets – consider all information in support of trades

Highval and Lowball used the same set of public companies, how were their conclusions so disparate?

Expert Report Differences

Henry Highval, ASA	Larry Lowball, CPA/ABV

• Considered both trailing ***and*** forecast (2020) metrics (sales and EBITDA)
  • ServiceCo just turned profitable in 2019, and
  • Last six months' profit margins were much higher
  • Future value conclusions discounted one year at WACC
• Reflected adjusted EBITDA
• **Concluded value = $140M**
	• Considered ***only*** trailing metrics (sales and EBITDA)
	  • Consistent with reported multiples
	  • Keep valuation approaches separate (no income in market)
	  • Reflects facts, not inflated assumptions
	• Reflected reported (not adjusted) EBITDA
	• **Concluded value = $71M**

Table of Contents

M&A Transaction Method

- Brief Primer
  - Based on multiples from M&A transactions of controlling interests
  - The multiple(s) are then applied to subject company financial metrics

- Reflect known conditions on the time of the transaction

- Multiples within an industry will vary based on the stage of the company (i.e. expected growth), company-specific risk… etc.

Highval and Lowball used the same set of transactions, how were their conclusions so disparate?

Expert Report Differences

Henry Highval, ASA	Larry Lowball, CPA/ABV
• Considered a group of transactions reported in several databases • Also considered an additional private equity transaction for a very similar company (15x ***forward*** EBITDA) • Highval opted to use the multiple from this transaction as the basis of value • **Concluded value = $128M**	• Considered same group of transactions • Did not consider the additional transaction since he could not verify accuracy of the data • Applied the "industry practice" of applying average EV/S and EV/EBITDA multiples to trailing reported values • **Concluded value = $64M**

Table of Contents

Respective Conclusions

Henry Highval, ASA

Valuation Method	Value
Income Approach	
Discounted Cash Flow Method	$127,300,000
Market Approach	
Guideline Public Company Method	$140,200,000
Merger and Acquisition Method	$127,500,000
Equity Value	**$130,000,000**

Larry Lowball, CPA/ABV

Valuation Method	Value
Income Approach	
Discounted Cash Flow Method	$83,800,000
Market Approach	
Guideline Public Company Method	$71,447,083
Merger and Acquisition Method	$64,400,000
Equity Value	**$70,000,000**

So which one is right? It depends…

Table of Contents

Epilogue

- Unknown to either appraiser, ***AFTER*** the valuation date, an offer has been made for the company for $150M
- "Obviously," both experts missed the mark on FMV?

- But, does this offer equal fair market value?
  - It is an offer, not a closed transaction
  - Subject to buyer's due diligence
- Fair market value is a ***hypothetical*** buyer, this is a ***specific*** buyer
- Synergistic value in the offer since:
  - European acquirer wants a US presence
  - ServiceCo has valuable locations, good client list
  - Buyer plans to open additional US sales locations, utilizing existing and future capacity in DFW
  - Buyer would be expected to have cost savings (i.e., higher future earnings) given economies of scale

- **Questions?**

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