



# Business Valuation for Family Law Legal Professionals

Collin County Bar Association- Family Law Section  
Continuing Legal Education

April 27, 2023



# Presentation Topics

- Introduction
- Potential Needs for Valuation Services
- Summary of the Valuation Process
- Standards of Value
- Premise of Value
- Business Valuation Methods
- Personal Goodwill
- Divorce Case Study

# Greg Scheig, CPA/ABV/CFF, CFA, CMA

Managing Director

**Greg Scheig** is a Managing Director in the Business Valuation practice of the Valuation Advisory group.

Over his 30-year consulting career, Mr. Scheig has performed hundreds of valuations involving common stock shares, partnership units, and financial derivatives. As an expert witness, Mr. Scheig has provided deposition and courtroom testimony in matters relating to tax valuations, bankruptcy, economic damages, and utility regulatory matters in a variety of legal settings.

Mr. Scheig previously worked with Vantage Point Advisors, Inc. as a Managing Director working on valuations, expert testimony, and financial advisory services with a focus on energy related companies. Mr. Scheig was employed at several other valuation firms that include ValueScope, Inc., Kroll Associates, Inc., and CBIZ Valuation Group, where he led their Dallas practices. Preceding his valuation-focused roles, he was a Senior Manager with both Deloitte Consulting and FINANCO, Inc. in Austin.

## Professional Memberships

American Institute of Certified Public Accountants (AICPA) | Texas Society of Certified Public Accountants  
CFA Institute | CFA Society of Dallas/Fort Worth | Appraisal Issues Task Force (AITF) | American Society of Appraisers | International Institute of Minerals Appraisers | Society of Petroleum Engineers (SPE)

## Practice Areas

Oil & Gas Valuation | Trust & Estate | Bankruptcy | Complex Business Litigation | High-Stakes Marital Dissolution

## Industry Focus

Energy & Power | Business & Industrial Services | Technology, Media, & Telecommunications



### Education

M.B.A, Finance  
University of Texas at Austin  
B.A., Petroleum Engineering  
University of Texas at Austin

### Designations

Chartered Financial Analyst (CFA)  
Certified Public Accountant (CPA)  
Accredited in Business Valuation (ABV)  
Certified in Financial Forensics (CFF)  
Chartered Global Management Accountant (CGMA)  
Certified Mineral Appraiser (CMA)

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# David Pryde, CFA ASA

Senior Vice President, Valuation Advisory

**David Pryde** is a Senior Vice President in the Valuation Advisory group. He has performed hundreds of valuations and other consulting engagements for corporate transactions, trust and estate tax compliance, and financial reporting purposes.

In addition to valuation advisory matters, Mr. Pryde has extensive commercial litigation consulting experience with disputes involving business valuations, transactions, marital dissolutions, corporate bankruptcy, and the quantification of lost profits, diminution in value, and other economic damages. These matters have occurred in a variety of legal forums, including federal and state courts, the United States Tax Court, the Delaware Court of Chancery, and International Chamber of Commerce (ICC) and JAMS arbitrations.

Prior to joining Stout, Mr. Pryde was a Senior Vice President in AlixPartners, LLP's global litigation and arbitration advisory practice, where he consulted on large and complex commercial disputes and SEC investigations. David was also a Senior Vice President at Vantage Point Advisors and a Manager at ValueScope, where he specialized in valuation engagements for companies primarily in the middle market.

## Professional Memberships

CFA Institute | CFA Society of Dallas-Fort Worth | American Society of Appraisers | Tarrant County Bar Association

## Practice Areas

Complex Business Litigation | Valuation Disputes | High-Stakes Marital Dissolution | Transaction Disputes | Trust & Estate



## Education

B.B.A., Finance, Magna Cum Laude  
University of North Texas

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## ABOUT STOUT

# Who We Are

Stout is a global investment bank and advisory firm. Our clients and their advisors rely on our premier expertise, deep industry knowledge, and unparalleled responsiveness on complex matters.

### Valuation Advisory

- Family Law Matters
- Marital Estate/Personal Goodwill
- Corporate Tax Planning & Compliance
- ESOP's
- Financial Reporting
- Valuation Disputes
- Trust & Estate

### Disputes, Compliance, & Investigations

- Contract Compliance
- Expert Testimony & Consulting
- Investigations
- Regulatory Compliance & Financial Crimes

### Transaction Advisory

- Accounting & Reporting Advisory
- Financial Due Diligence
- IT Due Diligence
- IP Advisory & Transactions
- M&A Support Services
- Tax Services
- Transaction Opinions

### Investment Banking

- M&A Advisory
- Capital Markets
- Special Situations & Distressed M&A
- Strategic Alternative Assessments

### Specialty Services

- Automotive Component Defect & Recall Consulting
- Digital & Data Analytics
- Legal Management Consulting
- Transformative Change Consulting

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# Potential Needs for Valuation Services

- Mergers, acquisitions, and divestitures
- Succession and business planning
- Tax planning
- Litigation issues
- Shareholder/partner buyouts

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# Summary of the Typical Valuation Process

The ultimate selection of methodologies employed will be dependent upon a number of factors, including, but not limited to, each legal entity's historical financial performance, the nature of management's forward expectations, the materiality of fixed assets on the balance sheet, and the availability of comparable public companies and market transactions.



## Key Data Needs (per Legal Entity)

- Historical financial statements
- Business plans, budgets, or long-term forecasts
- Detail on intercompany P&L and balance sheet accounts
- Tax basis information for the following assets:
  - Fixed assets
  - Goodwill and intangible assets (if any)
- Net operating loss carryforwards / tax credits
- Transfer pricing studies
- Revenue and earnings by foreign country
- Detail on non-operating assets and liabilities
- List of affiliated companies and investments

## Common Valuation Focus Areas

- Supportable Cash Flow Projections
- Rate of Return
- Consistency of Cash Flows and Rate of Return
- Pre-Existing Transfer Pricing Analyses / Assumptions
- Geographic Footprint
- Fixed Assets
- Appropriate Statutory Tax Rate
- Ownership Structure
- Intercompany Accounts (Operating vs. Financing)

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# Standards of Value

- Fair Market Value
  - Tax standard, well defined
  - Hypothetical buyer and seller
  - Knowledgeable buyer and seller with no undue influence to buy or sell
  - Valuation discounts for lack of control and marketability typically apply to minority interests
  - Strategic premiums typically ignored
  
- Fair Value
  - Often used in litigation, definition varies by state, not well defined
  - Valuation discounts may or may not apply
  
- Investment or Strategic Value
  - Value to a specific buyer
  - Includes the impact of synergies and strategic premiums
  - Often relevant in a merger or acquisition

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# Business Enterprise Value

## *Book Value Basis*

### ABC Company

Assets		Liabilities and Equity	
<b>Current Assets</b>		<b>Current Liabilities</b>	
Cash	\$ 50	Accounts Payable	\$ 150
Accounts Receivable	250	Accrued Expenses	250
Inventory	200		<u>400</u>
	<u>500</u>	<b>Long-Term Liabilities</b>	
<b>Net Property and Equipment</b>	600	Interest-Bearing Debt	450
<b>Intangible Assets</b>	<span style="border: 1px solid black; padding: 2px;">???</span>	<b>Shareholders' Equity</b>	<span style="border: 1px solid red; padding: 2px;">250</span>
<b>Total Assets</b>	<u><u>\$ 1,100</u></u>	<b>Total Liabilities and Equity</b>	<u><u>\$ 1,100</u></u>

# Business Enterprise Value

## Market Value Basis

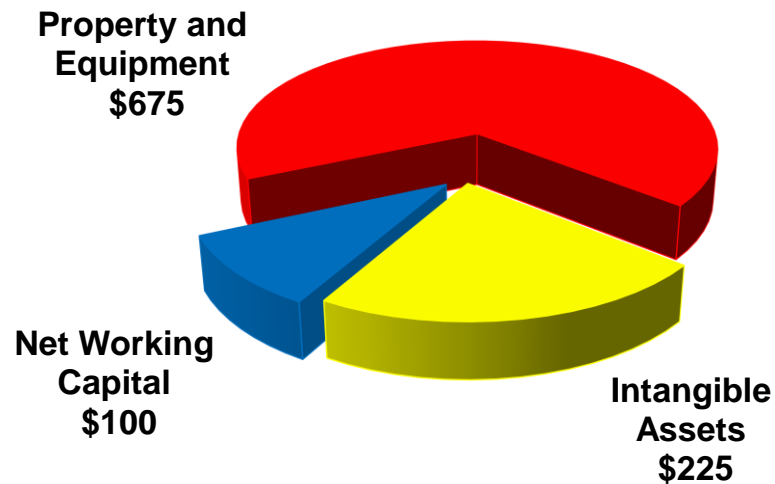
### ABC Company

Assets		Liabilities and Equity	
<b>Current Assets</b>		<b>Current Liabilities</b>	
Cash	\$ 50	Accounts Payable	\$ 150
Accounts Receivable	250	Accrued Expenses	250
Inventory	200		<u>400</u>
	500	<b>Long-Term Liabilities</b>	
		Interest-Bearing Debt	450
<b>Net Property and Equipment</b>	<b>675</b>	<b>Shareholders' Equity</b>	<b>550</b>
<b>Intangible Assets</b>	<b>225</b>		
<b>Total Assets</b>	<b><u>\$ 1,400</u></b>	<b>Total Liabilities and Equity</b>	<b><u>\$ 1,400</u></b>

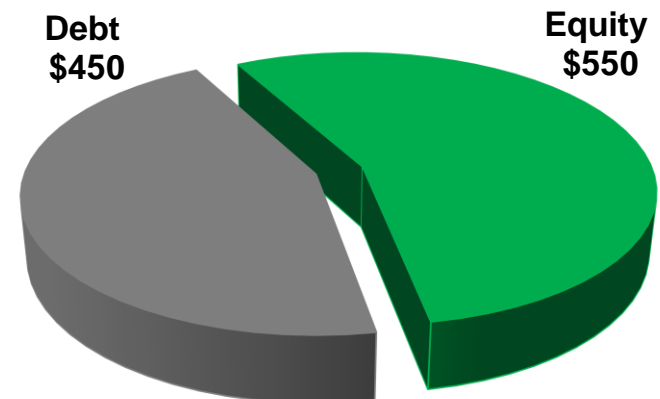
# Business Enterprise Value

## *Market Value Basis*

**Asset Value = Business Enterprise Value  
or Total Capital**



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# Income Approach

- Methods:
  - Capitalized Cash Flow (CCF)
  - Discounted Cash Flow (DCF)
- Different methods to arrive at present value of future income (or net cash flows)
- Fundamental concept: Value at a specific time is the present worth of future benefits

# Capitalized Cash Flow Analysis

		<u>Normalized Projection</u>
Debt-Free Net Income		\$ 75
Adjustments:		
Add: Depreciation		15
Less: Capital Expenditures		(20)
Less: Increases in Net Working Capital		(20)
Distributable Cash Flow	(a)	<u>50</u>
Capitalization Rate:		
Discount Rate (WACC)	(b)	15%
Less: Long-Term Growth Rate	(c)	-5%
Capitalization Rate	(d)	<u>10%</u>
Business Enterprise Value	(a) / (d)	<u><u>\$ 500</u></u>

# What is Distributable Cash Flow?

= Available Cash Flow

- Adjust for Non-Arm's Length Transactions
  - Owners' Compensation
  - Real Estate Leases
  - Transactions with Related Entities
  - Loans from Owners
- Adjust for Nonrecurring Events

## What is Capitalization Rate?

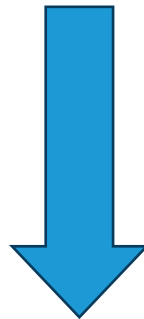
*Capitalization Rate = Rate of Return – Growth Rate*

In this example,

Rate of Return = 15% and the Growth Rate = 5%

Capitalization Rate (“Cap Rate”) = 15% - 5% = 10%

$$\frac{\$50}{10\%} = \$500 \quad \& \quad \$50 * 10x = \$500$$



$$\frac{\$50}{10\%} = \$50 * 10x$$

# Discounted Cash Flow Method

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Residual</u>
Distributable Cash Flow	\$ 50	\$ 55	\$ 61	\$ 64
Present Value (15% WACC)	\$ 47	\$ 45	\$ 43	
Total PV of Cash Flows (Years 1-3)	134			
Residual Cash Flow Value	448			
Business Enterprise Value	<u>\$ 582</u>			
		Capitalization Rate		<u>10%</u>
		Residual Value		635
		PV of Residual		<u>448</u>

## Reviewing a Valuation Report – Income Approach Considerations

- Are the projected growth rates and margins reasonable relative to historical results and relative to the industry?
- Has long-term growth been assessed properly?
- Are the discount or capitalization rates adequately supported both theoretically and by market data?
- Is the assumption regarding future officers' compensation consistent with employment agreements in place?
- How sensitive is the analysis to changes in certain assumptions?
  - Sales growth
  - Margins
  - Cost of capital
  - Long-term growth rate
- Are the methods out of favor with the specific court?

# Guideline Public Company Analysis

	<u>Enterprise Value / EBITDA</u>
Public Company Multiples	
High	9.0x
Average	6.0x
Median	5.5x
Low	3.5x
Selected Multiple	5.0x
Subject Company EBITDA	<u>\$ 100</u>
Business Enterprise Value	<u><u>\$ 500</u></u>

## Reviewing a Valuation Report – Market Approach Issues

- Are criteria used to select peer group publicly traded or merged and acquired companies clearly explained?
- Is the population from which companies or transactions are drawn clearly explained?
- Does the report explain why certain pricing multiples are relied upon over others?
  - Enterprise Value/EBITDA
  - Price/Earnings
  - Price/Forward Earnings



# Asset Approach

## *When to Utilize*

- The subject company is a holding company
- A liquidation of the company's assets is contemplated
- The subject company is asset intensive
- The subject company is not expected to generate positive earnings or cash flow

# Asset Approach

<b>Assets</b>	<b>Book Value</b>	<b>FMV Realizable Percentage</b>	<b>Fair Market Value</b>
Total Current Assets	\$ 500	90%	\$ 450
Net Property and Equipment	600	150%	900
Intangible Assets	0	???	???
Total Assets	\$ 1,100		\$ 1,350 (a)
<b>Liabilities and Equity</b>			
Total Current Liabilities	\$ 400	100%	\$ 400 (b)
Long-Term Liabilities	450	100%	450 (c)
Shareholders' Equity	250		500 (a - (b + c))
Total Liabilities and Equity	\$ 1,100		\$ 1,350

# Rules of Thumb

- Rules of thumb that you might hear:
  - Companies are worth 5x EBITDA
  - Companies are worth 1x sales
  - Companies are worth book value on the balance sheet
- These simplistic rules of thumb imply that all private companies have the same risk and growth prospects
- Rules of thumb might be OK in some situations and some market environments, but very inaccurate in others
- Static rules of thumb are dangerous, as valuation is always relative to the specific company and the specific date
- Most useful as a “sanity check”

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# Personal Goodwill

- Highly important for divorce matters
- Under Texas law, the value of personal goodwill in a business is excluded from the marital estate
- Example: Joe Smith, CPA
  - “Joe Smith CPA, LLC” = significant personal goodwill for Joe Smith
  - Deloitte = minimal personal goodwill
- Multiple methods of measuring
  - “Multiattribute Utility Model” (MUM)
  - Needs to be reasonable and supportable

# Multiattribute Utility Model Example – Dental Practice (Location #1)

- MUM for active participation and significant reliance on owner:
  - Owner is the only doctor at this location
  - Owner is responsible for majority of client/patient interaction
  - Owner handles all training and scheduling of staff, billing and insurance procedures, patient bookings software, etc.

Attribute	Importance	Goodwill Allocation - Existence				Score (Multiplicative)
		Company		Owner(s)		
Competition for Products / Services	3		1			3
Customer/Patient Interaction	3				4	12
In-bound referrals made to:	3				4	12
Repeat Revenues	3			3		9
Reputation	3				4	12
Specialization, Licenses/Expertise	3				4	12
Systems and Organization	3				4	12
Age & Health of Owner(s)	2			3		6
Business Name	2		0			0
Location Demographics	2		1			2
Management Depth	2				4	8
Owner(s) Presence:	2				3	6
Retirement Year of Owner(s)	2				4	8
Source of New Business	2			3		6
Marketing & Branding	1			2		2
<b>Sum</b>	<b>36</b>					<b>110</b>
Possible Points per Attribute	x 4					
<b>Total Possible Score</b>	<b>144</b>					
Score						110
Total Possible Score						144
<b>Personal Goodwill Allocation (rounded)</b>						<b>75%</b>

# Multiattribute Utility Model Example – Dental Practice (Location #2)

- MUM for less active participation and moderate reliance on owner
  - Multiple other doctors that treat patients and handle operations
  - Owner visits 1-2x per week, but is still responsible for all operations (staffing, training, billing, etc.)

Attribute	Importance	Goodwill Allocation - Existence				Score (Multiplicative)
		Company		Owner(s)		
Competition for Products / Services	3			2		6
Customer/Patient Interaction	3					3
In-bound referrals made to:	3		1			3
Repeat Revenues	3		1			3
Reputation	3			2		6
Systems and Organization	3				3	9
Specialization, Licenses/Expertise	3			2		6
Business Name	2	0				0
Location Demographics (1)	2	0				0
Management Depth	2				3	6
Source of New Business	2		1			2
Age & Health of Owner(s)	1			2		2
Marketing & Branding	1		1			1
Owner(s) Presence:	1		1			1
Retirement Year of Owner(s)	1			2		2
<b>Sum</b>	<b>33</b>					<b>50</b>
Possible Points per Attribute	x 4					
<b>Total Possible Score</b>	<b>132</b>					
Score						50
Total Possible Score						132
<b>Personal Goodwill Allocation (rounded)</b>						<b>40%</b>

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# Allergy Clinic Valuation for Divorce

## *2021 Valuation Date*

### Husband's Expert (the doctor)

- \$1.71 Million Aggregate Equity Value to the Community

### Wife's Expert

- \$3.81 Million Aggregate Equity Value to the Community

So how did they get such apparently disparate answers?

# Allergy Clinic Valuation for Divorce

## *2021 Valuation Date*

### Husband's Expert (the doctor)

- \$1.71 Million Aggregate Equity Value to the Community
- Personal Goodwill 77.3%
- Discount rate = 19%
  - Size Premium 5%
  - Company Specific Risk 3%
- First forecast year sales = \$5.3 Million
- First forecast year EBITDA = \$24 thousand (0.4%)

# Allergy Clinic Valuation for Divorce

## *2021 Valuation Date*

### Wife's Expert

- \$3.81 Million Aggregate Equity Value to the Community
- Personal Goodwill 35%
- Discount rate = 11%
  - Size Premium 5.2%
  - Company Specific Risk 0%
- First forecast year sales = \$5.8 Million
- First forecast year EBITDA = \$200 thousand (4%)

# Allergy Clinic Valuation for Divorce

## *2021 Valuation Date*

So who was right?

- Case settled



**Questions?**