

# **CONSULTING WITH MANAGEMENT TO CREATE SHARE VALUE – A NEW SOURCE OF BUSINESS FOR APPRAISERS**

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## **Notes for Presentation**

These notes do not stand on their own, but are only an introduction to the attached cases, Joiner Inc. (Case 1) & Super Label (Case 2).

### *GREETINGS FROM THE FRIGID NORTH!!*

As I planned this presentation in mid-January, Toronto, where we live, is virtually shut down. All the banks and most offices are closed after nearly 40 inches of snow in the first two weeks in the year. This morning, the radio announced the temperature was now in double digits, 20 degrees below zero.

In such an environment, everyone has to run a little faster to stay warm. One area where our firm, CVS, does this is the subject of my talk.

## **The Appraisal Business**

As, Business Appraisers, we value companies for many purposes; however, except for ESOPs, assignments for the same client do not recur frequent. Our repeat business seems to happen about every four to five years, but can go on for a long time; the first Valuation in my files is dated October 1959. Since then, in two cases, we have served three generations of a family.

Even with some repeat business, as a CPA, sometimes envy my fellow accountants whose clients need attention and pay fees at least once a year. CVS has found such a service which, as an added benefit, gives higher than usual fees.

How much do you get for the average valuation?

- \$5,000?
- \$10,000?
- more?
- less?

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We increased our average from about \$10,600 in 1994 and 1995 to just under \$17,000 since 1996. We did this partly by having a reasonable number of computer software and other technology projects where we can get a premium and partly by the service I'm going to talk about today.

Would you like a retainer of \$18,000 or more a year? Plus a Valuation assignment?

There is a way you can get this, which our firm happily manages to do at least once or twice a year.

The secret is advising the owners and managers of a firm in preparing appropriate, tough, but realistic Business Plans, whose objective is to increase Shareholder Value even by dealing with "sacred cows". This activity can create, one of those rare, "win-win situations"; regular business for you and greater wealth for your client's shareholders.

### **Improving the Multiple**

The Net Income Value of a business is obtained by applying a Multiple to its Sustainable Net Income. Thus far, in this presentation, we have talked about what the Business Appraiser can do to assist management in recognizing which activities increase and which reduce the Economic Value Generated of a business. The various steps discussed above will decrease or eliminate those activities that reduce Economic Value Generated. This should not only increase the Sustainable Net Income but also diminish risks.

Now, I briefly want to turn to "What the Business Appraiser Can Do To Improve the Multiple". Let's look at some of the factors that determine the Multiple:

Interest Rates	Applicable Risks
Growth Rate	Growth Rate
Investor Enthusiasm	Investor Enthusiasm

For some of these, there is little that can be done; for others, such as Investor Enthusiasm, the Business Appraiser, working with management, can do a substantial amount. After all, Warren Buffett, who certainly understands Shareholder Value stated:

"Risk comes from not knowing what you are doing".

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### CASE STUDIES

Rather than discussing these factors individually, I have put together two cases based on actual transactions to show how CVS was able to help the management of two businesses increase the value of their companies by very large amounts.

The first, Joiner, is a software company; it demonstrates the impact of "unique" niche product. The case was written to teach the "Valuation of Software and Software Companies" in 1997, when the business was sold. However, it also shows what we were able to do to help management. The increase in value was fifteen times in three years.

The second, Super Label, is a printing company, it illustrates the benefits of industry consolidation. The case was prepared for this presentation and represents "work in progress", with a transaction pending. The increase in value, so far, allowing for shareholder advances, is seven times in a little more than four years.

### An Example

*1991 TO 1994*

What would you say this software company was worth?

	<b>\$'000</b>			
<b>Year to May 31</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994</b>
<b>Revenue</b>				
Products	230	554	1,264	1,312
Services	<u>1,919</u>	<u>1,837</u>	<u>1,532</u>	<u>1,577</u>
	2,149	2,381	2,796	2,889
<b>Expenses</b>				
Operating	1,871	2,210	2,249	2,203
R&D	<u>93</u>	<u>221</u>	<u>293</u>	<u>464</u>
	1,964	2,431	2,542	2,667
Pre-tax Profit (Loss)	185	(50)	254	222
Income Tax	<u>(43)</u>	-	<u>(47)</u>	<u>(56)</u>
Net Income	<u>142</u>	<u>(50)</u>	<u>207</u>	<u>166</u>

A 2/3 partner was bought out on a Valuation of:

- a) \$1,500,000
- b) \$1,650,000
- c) 1,800,000
- d) \$1,950,000

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### *1995 TO 1997*

The next three years were very different; profits went down sharply in 1995 and 1996, with a loss before R&D in the latter year. Then, there was a turn-around and they turned up sharply as shown in the table below. Because of the carry-forwards, no taxes were payable during the period and that line has been omitted.

How much had the value of the business increased by May 1997?

			<b>\$'000</b>
<b>Year to May 31</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
<b>Revenue</b>			
Products	2,264	1,590	4,110
Services	<u>742</u>	<u>627</u>	<u>846</u>
	3,006	2,217	4,956
<b>Expenses</b>			
Operating	2,356	2,360	3,459
R&D	<u>876</u>	<u>639</u>	<u>1,017</u>
	3,232	2,999	4,475
Pre-tax Profit (Loss)	(226)	(782)	481
Income Tax			
Net Income			

It was sold in June 1997 for:

- a) \$5,000,000
- b) \$10,000,000
- c) \$20,000,000
- d) \$30,000,000

Our first case study will tell you who bought it, why, and how this increase in value was achieved.

### **Conclusion**

In concentrating on Shareholder Value, many large corporations know what they are doing. Even though our clients are not in that league, we can offer them a similar service, selling it as "a matter of the business continuing to thrive". A Business Appraiser is the ideal professional to assist management in developing and implementing the necessary systems to measure the status of Shareholder Value.

In the long run, no enterprise can survive unless it earns returns greater than, or equal to, its cost of capital. To achieve this means not only satisfying the needs of its stakeholders, but also generating an attractive return to those who supply its capital.