<u>Why You Need an Accurate Current Business Valuation Now</u>:

Why You Want One Now; What It Is or Should Be; and

How to Use It to Best Enhance the Performance and Valuation of Your Company

by

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A good, comprehensive, and *accurate current business valuation* is both objective and subjective. While it typically accentuates the *positives*, it should also identify the *negatives* that could reduce a company's value.[1] Although there are many *quantitative* aspects to it, in which standard valuation formulas are applied to estimate the value of assets based on numerical data inputs,[2] there should also be *qualitative*[3] and *creative*[4] aspects to it too. It is or should be a product of -- and if performed correctly, completely, and well requires in its determination -- both science and art.

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[1] For example, if a company has a good management team it should command a higher value, while a lack of marketability or liquidity reduces value.

Some examples of negative factors that could harm a company's value follow. An architectural firm with a famous architect, for example, could be subject to the so-called "key-person risk", and lose value if it were sold to a third party without the famous architect "coming along" as part of the deal. Understanding if your company could soon potentially be "leapfrogged" on a technology basis or whether your business could become obsolete within a short period of time is key. Likewise, it is important to understand if your business could become less important because of changing *consumer preferences*.

As someone who has represented a number of well-known popular apparel brands as both an intellectual property ("IP") and mergers and acquisitions ("M&A") lawyer, it is this author's general view and experience that most highly popular and profitable apparel brands are typically only "hot" for about 5 years or less before *consumer preferences* change and price reductions are necessary.

[2] *Quantitative valuation* relies on measurable data or numerical information to produce an estimate of the value of your assets.

[3] Q*ualitative valuation* relies on a non-monetary estimate of valuation. It involves asking and reviewing answers to questions such as whether the business being valued is in a sector that has "*headwinds*" or "*tailwinds*". Is it a business that requires a significant amount of future investment for it to continue to operate "as is" or to grow? What is the strategic impact of the company's IP? What is the amount of *brand loyalty* held by the company's consumers?

Quantitative and qualitative valuation both address the question of company valuation from different non-mutually exclusive points of view and may both come in useful depending on the audience and reason for the valuation.

[4] By "*creative*", this article means the ability to see overlooked value that others have not noticed (sometimes known as "*thinking outside-the-box*"), which with the benefit of hindsight, like a good invention or new innovative product, may seem somewhat obvious. <u>Once this *creative valuation* thinking is conveyed to and fully appreciated by others, a much higher valuation typically results</u> than that previously measured based on *quantitative valuation methods* alone.

"*Why science and art?*", you ask. "*Isn't business valuation an absolute*?" The answer to that question is a clear and resounding "*No!*", and this article hopes to succinctly explain to you why, and how that fact and your clear and deeper understanding of it presents significant opportunities for you.

I. <u>Why You Want an *Accurate Current Business Valuation Now*</u>.

An *accurate current valuation* of your privately-held business now (a "Current Business Valuation") provides you and your company with a snapshot of today and a roadmap for tomorrow. Among other things, it provides you with a measure of your privately-held company's *general* monetary worth now, illustrating what appears to be working in its favor and what is working against it. In a variety of ways, an accurate current business valuation allows you to better understand your company's present status and to make better informed decisions with respect to it moving forward.

If your company is privately-held you need an accurate current business valuation. Why? Because unlike publicly-held companies, the equity interests in privately-held firms such as yours, and in other privately-held corporations, partnerships, and limited liability companies are sold privately, and often irregularly. Consequently, previous sale transactions often provide limited evidence of the current value of a private company, since its business value changes over time. Its share price or equity value is associated with considerable uncertainty due to limited market exposure and high transaction costs.

A Current Business Valuation is useful for: (i) determining *in general* the price a buyer or seller is or may be willing to pay or receive in the sale of a business;[5] (ii) fund-raising through bank loans or venture capital;

<u>Sale of an HVAC Company</u>**. For example, this author represented a regional HVAC company (the "Company") as its outside M&A lawyer in its sale. The HVAC industry in general has relatively low profit margins, and most of the Company's services and sales generated profit margins in the industry's general range. The Company's business mentor, however, noticed that the Company had an over 40% profit margin in installing "clean rooms", which was a relatively small niche portion of its overall service and sale offerings. For various reasons the Company believed (wrongly) that the "clean rooms" portion of its business was not scalable. The Company's family owners privately believed the Company's sale value to be about $15 million, and a number of investment bankers which the Company interviewed all generally believed that at best it could be sold in the low-$20 million range. The Company's business mentor, however, by creatively thinking outside-the-box, realized that the Company's high-margin "clean room" product and service offering <u>was scalable</u>. Consequently, the business mentor strongly encouraged the investment banker ultimately selected by the Company to focus on the Company's special, somewhat overlooked, high-margin "clean room" segment of its business in marketing the business for sale in a buyer auction. In the auction, buyer bids for the Company came in from potential strategic buyers at $19 million, $22 million, $24 million, and $44 million. The $44 million bidder, a multi-billion-dollar national HVAC company, understood with clarity (after conversations with the Company's business mentor and investment banker) what the business mentor had realized -- how the high-margin "clean room" portion of the Company's business was scalable -- and accordingly realized how, if the bidder could successfully win the buyers' auction and acquire the Company, the bidder could greatly geographically expand and better commercially exploit the target company's high margin "clean room" expertise to grow the bidder's own business (i.e., a synergy of 2+2=7). That $44 million bidder, of course, became the Company's selected exclusive buyer. **This transaction illustrates how, as in so many cases, <u>creative outside-the-box thinking</u> (which remained hidden in traditional quantitative analysis and to those with closed minds) <u>more than doubled the earlier expected value of the Company target</u>.

[5] A business valuation can help you set a minimum value for the sale of your business, so you do not sell it at a lower than appropriate value. That said, <u>business value is really an *expected price* your business would sell for, and a business valuation is no substitute for an actual offer</u>. Once your company is actually in the M&A sale market, what

(iii) gift and estate taxation matters;[6] (iv) litigation and other types of dispute resolution, where quantification of damages is important; (v) estimating the value of partners' ownership interests for buy-sell agreements; (vi) allocating a purchase price among business assets; (vii) intellectual property ("IP") tax planning and compliance;[7] and (vii) many other business and legal purposes.

A Current Business Valuation is also a *useful base* to work from to: (i) look for potential existing hidden business value (or in other words what, if anything, makes your company *special*);[8] (ii) develop new business value through the identification, creation, protection, and commercialization of unique business methods and IP;[9] and/or (iii) potentially alter current business practices, methods, tactics and/or strategy to provide your business with a greater competitive advantage.

II. **What An Accurate Current Business Valuation Is or Should Be**.

A. The Quantitative Approach.

In general, a "*business valuation*" is a process and set of procedures used to estimate the *current* economic value of an owner's interest in a business. As noted earlier, among other potential uses, it is used to determine *in general* the price a buyer or seller is or may be willing to pay or receive in the sale of a business.

Before the value of a business can be properly measured, the reason for the business valuation (formally known as the "*business valuation standard*") and the circumstances surrounding the business valuation (formally known as the "*premise of value*") must be specified.

Standards of value include: (i) fair market value; (ii) investment value; and (iii) intrinsic value.[10]

Premises of value include: (i) going concern; (ii) assemblage of assets; (iii) orderly disposition; (iv) liquidation; (v) in use; and (vi) in exchange.[11]

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a buyer offers to pay may be in the range of that valuation or not, depending what the market is and the particular *fit* for a given potential buyer.

[6] A business valuation can help you gift an appropriate amount of assets to both minimize taxes and make and maximize transfers at times when valuations are comparatively low.

[7] The U.S. tax code has several provisions that require IP and intangible asset valuation for tax planning and compliance.

[8] See note 4 above.

[9] Unlike what is usually the case with physical property, IP can be shared and commercially exploited among many others, whether they are competitors or are involved in other types of business. The licensing of business methods, patents, and other forms of IP can be used to add new revenue streams to, and increase the business valuation of, a company.

[10] A detailed description of each of these *standards of value* is beyond the scope of this article.

[11] A detailed description of each of these *premises of value* is beyond the scope of this article.

Business value results can differ considerably depending on the choice of both the standard of value and the premise of value.

Three brief illustrations may help to somewhat illuminate the foregoing.

1. *Scenario One*. Assume your company has been doing well, and that its revenues and profits have been increasing each year. You decide you want to sell it, but are prepared to take your time to select the right buyer, with the best offer, who you assume will continue to operate the business after its sale.

Here, the typical *standard of value* for your company that would usually be selected by a valuation analyst to most accurately measure its value is the so-called "*fair market value*".[12] Your *premise of value* would be "*going concern*", since you are selling your entire ownership interest in your company,[13] and the *premise of value* refers to the *underlying assumption of how the asset at issue will be exploited in the future*. In short, your goal in *Scenario One* was to sell your entire equity interest in your company to the highest paying most suitable buyer who after the sale is completed would continue to operate the business.

2. *Scenario Two*. Assume you own a business that has developed an innovative product of great interest to a large multi-national publicly-held company. This public company wants to purchase your company at a high price because it believes it can greatly increase the sales of your company's innovative product by selling it internationally.

Here, in *Scenario Two*, the buyer is applying the so-called "*investment value*" standard of value[14] in measuring your company's business value. Buyers applying this business valuation standard are often willing to pay a much higher amount for a business because they believe they can obtain certain unique and valuable advantages from the business purchase (i.e., a synergy of 2+2=7).

3. *Scenario Three*. Assume your company owes a very large outstanding bill to a creditor, and that that creditor is growing very impatient. You and your company do not have enough money to pay the creditor, so you intend to sell your company's assets as quickly as possible to pay-off your company's outstanding debt.

Here, your *premise of value* is the so-called "*forced liquidation*",[15] since the circumstances under which you intend to sell your company's assets are those in which you will generally not have adequate time to seek a suitable buyer given that you are required to act very quickly under duress.

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[12] "*Fair market value*" is the value of a company determined between a willing buyer and a willing seller, each with full knowledge of all relevant facts and neither of which is compelled to conclude a transaction. The fair market value standard is the most common valuation standard.

[13] A "*going concern*" is where it is assumed the business will continue forever in its current form.

[14] The "*investment standard of value*" is the value that a company has to a particular investor. The effect of synergy is included in valuation under this standard.

[15] A "*forced liquidation*" or "*forced selling*" usually entails the involuntary sale of assets or securities to create liquidity in the event of an uncontrollable or unforeseen situation.

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The above three (3) scenarios seek to show you that there are various *standards of value* and *premises of value* to choose from in determining a *quantitative business valuation* of your company. Business valuation depends on assumptions. Consequently, it is important for you to understand that the relevant facts and related value standard choices that valuation analysts elect to apply (although they will all tell you there are professional standards dictating their decisions) can considerably alter the business valuation results for your company. Again, business valuation is not an absolute.

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The Typical Business Valuation Report.

The typical business valuation report (the "Report") begins with a summary of the purpose and scope of the business appraisal, and its effective date and intended audience.

1. The Economic Conditions Description. After the summary, the Report usually proceeds to describe the national, regional, and local economic conditions as of the valuation date, and the general conditions of the industry in which the subject business operates.

2. The Financial Statement Analysis. Thereafter, the Report typically provides the financial statement analysis. This analysis usually involves ratio analysis (e.g., liquidity, profitability, turnover, etc.), common size analysis, trend analysis, and industry comparative analysis. This information allows for a comparison by the valuation analyst of the subject company to other businesses in the same or similar industries, and to determine trends affecting the company and/or the industry over time. Growth or decline in revenues or expenses and other trends can be ascertained by reviewing and comparing the company's financial statements over different time periods. Comparing the subject company to its industry helps with risk assessment and ultimately the discount rate and selection of market multiples. The primary measure used to show the liquidity of the company is *cash flow*, which shows the company's cash in and outflow.

3. The Normalization of the Financial Statements. The Report will typically normalize financial statements. The primary goal of normalization is to identify the ability of a company to generate income for the company's owners. One measure of income is the amount of cash flow that the owners can remove from the business without negatively affecting its operations. The most common normalization adjustments fall into the following four (4) categories: (i) comparability adjustments; (ii) non-operating adjustments; (iii) non-recurring adjustments, and (iv) discretionary adjustments.[16]

4. The Income, Asset, and Market Approaches. Three (3) different approaches are commonly used in business valuation: the income, asset-based, and market approach.[17] Within each approach there are various techniques to determine the value of a company by using the definition of value appropriate for the specific appraisal assignment. The *income approach* essentially determines value by calculating the net present value of the benefit stream generated by the business (i.e., its discounted cash flow). *Asset-based approaches* generally determine value by adding the sum of the parts of the business (i.e.,

[16] A detailed description of each of these adjustments is beyond the scope of this article.

[17] A detailed description of each of these approaches is beyond the scope of this article.

net asset value). The *market approaches* generally determine value by comparing the subject company to other companies in the same industry which are the same size and/or within the same general region. A number of valuation methods use various methods of each of the foregoing three (3) different approaches.[18] The valuation analyst must use his or her discretion in deciding which of these approaches to use, since each has its advantages and drawbacks. Most academic treatises and court opinions encourage valuation analysts to use more than one technique, and to compare them with each other to reach a value conclusion. Again, as should be very clear by now, business valuation is not an absolute.

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B. The Qualitative Approach.

While the *quantitative approach* to valuation relies on numerical and measurable data in order to calculate the value of the property, the *qualitative approach* is focused on the analysis of *the characteristics and uses of the property*, such as the legal strength of a patent.

The *qualitative approach*, also referred to as *qualitative evaluation*, does not rely on analytic data, but is performed through the analysis of different indicators to determine the importance of, for example, the company's IP rights or business methods. The indicators cover all aspects that can impact the value of the *property asset*, including without limitation legal aspects, the technological level of company innovations (if any), and market details.

For example, it attempts to address matters such as those called out by the following questions:

1. How would you compare the company's innovations, if any, to the current state of the art?

2. What is the geographic coverage of the "reference market"?[19]

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[18] Private equity firms typically use the "First Chicago" method, which basically combines the income approach with the market approach.

[19] The geographic coverage of the "reference market" can be a very important aspect of business valuation, which the below transaction story illustrates.

Sale of a Small Software Company*. This author represented a relatively small U.S. software company (the "Company") as its outside M&A lawyer in its sale. The Company sold software licenses to end user licensee customers for its four (4) related software products, each of which the Company owned and had years earlier developed. The Company had annual revenue of about $10-to-$12 million dollars, and its majority shareholder, who was in his 60s, decided it was time to sell the company he founded over 20 years earlier. The Company had a very small staff but had the largest market share of the four (4) major competitors in its product space. It marketed its software products nationally, including to several prominent universities (where professors and students in relevant academic departments used the software) and to name-recognizable large publicly-held companies in relevant industries (where researchers and other employees used the software). The Company had no meaningful international sales, in part due to its small staff and in part due to its lack of effort. Seizing upon this fact, the Company's chosen investment banker was able to obtain nearly 50 indication of interest letters from prospective buyers to purchase the Company, with the value proposition for most being rapid international expansion of product sales (i.e., expansion of geographic coverage of the reference market), and the fact that the market space for the specific product itself was expanding. While price offers varied, the Company was ultimately sold for over $200 million dollars.* ***This transaction illustrates how the final sales price for a company being sold can be a truly significant multiple of its annual sales revenue when (i) a creative and thoughtful qualitative valuation unmasks significant hidden value that most***

3. If the property is IP, at what level is it in its life-cycle (for example patents generally have a term of 20 years from the date of filing) and what is its strategic impact on the business?

In general, the *qualitative approach* is primarily subjective, but that does not diminish its importance.

Sale of an Event Planning Company. *For example, this author acted as outside M&A sale lawyer for a U.S. company (the "Company") whose business was essentially being an international event planner, organizing and managing biotechnology conferences several times a year in various locations throughout the world. The Company's annual revenues were modest (under $6 million), and while it owned (i) proprietary software it earlier developed at a cost of about $1 million that assisted it with keeping track of the names and addresses of its attendees and related event planning matters, (ii) dozens of website domain names, and (iii) 10-15 U.S. and foreign trademarks, the value of its IP did not appear at first glance to be significant. A* quantitative business valuation *would not likely have generated an especially high business valuation. A* qualitative business valuation *by the company's investment banker, however, revealed that the company's customer database (a trade secret) had a special synergistic value to certain buyers. Thereafter, in a buyer's auction, the investment banker focused on that point of special value, and a publisher of treatises on biotechnology won the buyer's auction with an offered purchase price of approximately $50 million, and ultimately purchased the target company for that price.* ***This transaction is a prime example of how quantitative business valuation alone does not necessarily identify full business value, and how a creative qualitative valuation can unmask significant value that most others (including often the company itself) miss.***

III. How to Use an Accurate Current Business Valuation Now to Best Enhance the Performance and Valuation of Your Company: Opportunities For You.

If this article is doing its job and achieving its intended purpose, it should be *crystal clear* to you by now that business valuation is not an absolute. The fact that business valuation is not an absolute means you can influence it and change it, and that fact presents *opportunities for you*.

Get a business valuation of your company *now.* Use it to learn and better understand:

1. Its present *general* estimated business value.

2. Where it stands in its general industry, and how it compares to its peers on various levels (and as important, *why* it is performing better or worse than they are).

3. How, going forward, you can make your company more competitive and profitable, so you can receive a higher business valuation in the future, as well as create more wealth for you.

Use your company's business valuation to help timely identify for you competitive "issues" and "challenges". Once identified, these "warning signals" may encourage you to consider altering certain aspects of your business and take appropriate action.

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others (including often the company itself) misses, and (ii) a buyer understands the unmasked significant hidden value of the target company, recognizes the untapped value (and prospective profits) for itself, and uses the investment value method of business valuation to offer a "win-win" purchase price.

To increase your company's value you should consider identifying, creating, protecting, and commercially exploiting more unique business methods and/or IP assets.[20] IP, as you may already be aware, has several

[20] Query: What percentage of company holdings today are *tangible property (such as machinery and real estate),* and what percentage are *intangible property (such as IP)*? The correct answer a few decades ago would have been about 75% tangible property, 25% intangible property. Today, intangible property -- mainly IP – represents about 70% of companies' holdings, which is in part why you should consider IP assets to be so important.

How IBM Once Used It's IP to Add to Its Profits and Business Value. During the 1990s, through an internal IP initiative IBM increased its annual patent-licensing royalties a whopping 3,300% -- from $30 million in 1990 to nearly $1 billion in 2000, only 10 years later. That money was largely free-cash flow, a recurring net revenue stream that at the time represented 1/9th of IBM's annual pre-tax profits and went straight to IBM's bottom line.

You too can take action to create product and/or service differentiation for your company, giving it a potential competitive advantage over its competitors. This strategy, if successful, should increase your business valuation and wealth.

You may be interested to learn about several types of somewhat unique *trademarks* you could federally register to *brand* your company's updated product/and or service line, if appropriate (which again, if successful, will give your company more valuable IP and consequently a higher business value). Most people are unaware of these forms of trademarks, especially since a few of them are comparatively new. These marks are:

1. An "*olfactory mark*". To gain federal trademark protection this mark must be *ornamental* (i.e., a distinctive scent for a product that otherwise is not supposed to have a scent) and not *functional* (i.e., a scent for a product that is supposed to have a scent, such as perfume). Examples include a sewing thread infused with a floral scent, the aroma of cinnamon for furniture, and the smell of fresh-cut grass for tennis balls.

2. A "*touch mark*". This very new type of mark is one in which the product packaging has a *tactile attribute*, in which your fingers will sense and feel something unrelated to the product. An example is a velvet textured covering on the surface of a bottle of wine. Given that it is very new, many countries outside the United States currently do not recognize the *touch mark*, although it is beginning to be recognized in Europe.

3. A "*motion mark*". This mark is a visual mark that imparts a sense of motion. For example, the Sony TriStar horse comes galloping towards you for a few brief seconds when you play a Sony TriStar Blu-Ray disc or DVD. Motion marks also are currently used with many consumer software products (sometimes with sound).

4. *A "sound mark"*. This mark is a *sound* that has been registered with the USPTO. Examples include the Pillsbury Doughboy giggle, AOL's "You've Got Mail", the NBC chimes, the MGM roaring lion, and the Angry Birds jingle. The latter was given away as a free ringtone, which when user's phones went off was great product marketing. If a company has a product or service where having a particular sound helps make a connection between that product or service and the company's consumer, the company can secure federal trademark registration for the sound.

The lesson intended here is that any company with a bit of *vision* and creativity can create product and/or service distinctiveness, use IP to protect it, and in the case of trademarks create *strong consumer brand identification*, thereby increasing product and/or service value, leading to a higher business valuation. In other words, *you can use your accurate current business valuation to help enable you, on your own or with the help of others, to be a visionary to make your company financially stronger, more brand identifiable, and more profitable, and of course make yourself wealthier.*

Creation of a Company Program to Internally Develop and Build a Patent Portfolio. *This author, although a partner at a large national Los Angeles-based law firm at the time, acted for several weeks as an on-loan temporary General Counsel for a client that was a publicly-traded technology company located outside of Boston. In addition to* unique business attributes.[21] Generally, for example, IP can offer high margins due to low variable costs in licensing. For brands, for example, the *trademark* allows its owner to leverage existing brand equity within the company, through brand extensions, or with business partners in the case of franchising where the trademark's goodwill is licensed to franchisees. Sufficiently broad *patents* can be powerful elements of competitive advantage. *Copyrights* can often provide additional advantages known as derivatives. A core media asset, for example, such as the Harry Potter novels can, by virtue of the initial copyright, generate substantial downstream revenues through exclusivity rights associated with films, apparel, video games, board games and merchandizing. And *trade secrets* can be licensed for significant financial returns.[22]

Overall, licensing IP can be very lucrative and increasingly is adding to the revenues, profits, and business valuations of the companies that engage in it.

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upgrading the company's form documents and handling other legal matters, to help enhance the value of the company this author created a company program to internally develop and build a company patent portfolio (the "Program"), enabling it to eventually license some its patents to third parties to create for itself a new revenue stream, and enabling it to eventually cross-license its patents with those of its competitors to avoid expensive patent infringement litigation. Prior to creation of the Program, valuable innovations, developed at not inconsiderable expense by the company's electrical engineers, that were not used by the company in its products (and there were many) simply fell through the cracks. All the potential money that could have been earned, and other value that could have been utilized, was simply wasted and lost forever. ***This story illustrates how change in a company's business methods can turn exiting "straw" , viewed as waste, into potential gold.***

[21] For example, unlike traditional tangible property, an unlimited number of people can "consume" IP without its depletion.

[22] Many trade secrets would probably seem very mundane if revealed to the public. Examples of famous trade secrets include the recipe for the *Krispy Kreme* doughnut, the formula for *WD-40* (developed to prevent corrosion and purportedly used by 80% of Americans), the recipe for *Twinkies*, the *New York Times Bestseller List* definition of a "best seller" (which is not merely based on the number of books sold), and the formula for *Listerine* (the over-the-counter mouthwash).

The Trade Secret Formula of Listerine. Dr. J. J. Lawrence, the inventor of Listerine, licensed his trade secret formula in 1881 to local pharmacist J. W. Lambert. Lambert subsequently started Lambert Pharmacal Company. In 1955, following a merger, the company was renamed Warner-Lambert Pharmaceutical Company. Royalty payments of over $22 million for over 70 years were made to the inventor's family based on the trade secret license, even though the trade secret formula was revealed during that time. In 1959 Warner-Lambert sued to attempt to stop payments given the formula was no longer secret. At the time it was paying about $1.5 million per year in royalties, which was based on the amount of Listerine manufactured or sold. The federal court ruled the contract did not provide that payments could be stopped if the trade secret was discovered by others, especially since the rights to the formula were acquired when the formula was still secret, and the licensing company derived competitive advantage from it. See Warner-Lambert Pharmaceutical Company, Inc. v. John J. Reynolds, Inc., 178 F. Supp. 655 (S.D.N.Y 1959). Warner-Lambert was purchased by Pfizer in 2000, and Johnson and Johnson acquired Pfizer's consumer healthcare division in late December 2006. *Presumably, since trade secrets may last in perpetuity, the trade secret royalty payments continue to be paid*.

IV. **Conclusion**

In sum, you need a good, comprehensive, and accurate current business valuation now, to provide you with a snapshot of your privately-held company's *general* monetary worth today, and to identify for you how your business compares to its peer group. Only by seeing and understanding the "good, the bad, and the ugly" with respect to your company's current status and standing in its industry can you take positive steps to make your company more competitive and to grow its business value and your wealth.

In obtaining a good, comprehensive, and accurate current business valuation now, you should determine your *business standard* (the reason you are seeking a business valuation) and your *premise of value* (the circumstances pursuant to which you are seeking a business valuation). This information will allow a seasoned and competent valuation analyst to make a better discretionary selection for you of the appropriate *business valuation standard* to use, and the appropriate *premise of value* to use, in *quantitatively* determining the current *economic value* of your interest in your business.

That said, a good, comprehensive, and accurate current business valuation should not stop there. It should also -- if performed correctly, completely, and well -- be the product of a *qualitative and creative analysis* as well. If your business valuation report does not contain more than only *a standard quantitative analysis*, you need to seek out additional assistance from others, such as a seasoned business mentor or investment banker, who can provide for you this additional level of assistance and value (i.e., a *qualitative and creative business value analysis*). Intangible assets, such as IP assets, while more subjective and accordingly more difficult to capture in terms of appropriate business value,[23] tend to be today's drivers of value.[24] They provide unique competitive advantages that one company may have over its peer competition, and in doing so provide for a higher business valuation.

Sometimes the intangible asset or value already exists in a company, hidden to all but a select few with *creative eyes and open minds*. An unturned dull stone, not shiny to others, may be worth millions and millions of dollars in creating a business valuation that allows the company to be sold for multiples of its estimated quantitative valuation.[25] Other times you need to consider for yourself and take advice from others, such as an experienced *business mentor* or *investment banker*, as to how best to increase your company's business valuation. Good methods to do this involve, without limitation, identifying, creating,

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[23] "Conventional accounting methods haven't necessarily evolved to measure the value of intangibles as effectively as they do tangible capital. *** [T]hey have different characteristics than tangible assets." See C. Skroupa, "*How Intangible Assets are Affecting Company Value in the Stock Market*", Forbes, November 1, 2017.

[24] The effect of intangible assets on company value in the stock market is very important and is increasing the total market value of companies. While years ago tangible assets were the primary drivers of company value, that is no longer the case. While once filling only 20% of corporate balance sheets, today intangibles fill 80% of corporate balance sheets. See C. Skroupa, "*How Intangible Assets are Affecting Company Value in the Stock Market*", Forbes, November 1, 2017.

The share of total U.S. GDP attributable to IP-intensive industries was 38.2% in 2014 and has been increasing every year for many years. See "*Intellectual Property and the U.S. Economy: 2016 Update*", at ii, Economics and Statistics Administration and U.S. Patent and Trademark Office.

[25] See "Sale of an HVAC Company" in note 3 above. See also "Sale of a Small Software Company" in note 16 above.

protecting (i.e., registering with appropriate government agencies where appropriate), and commercially exploiting unique business methods and/or IP assets.[26]

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You, and only you, can take the steps necessary to obtain a good, comprehensive, and accurate current business valuation of your company now, to make better informed decisions to:

(i) strengthen your business to become more competitive, profitable, and to enjoy a higher future business valuation; and/or

(ii) optimize your business so it becomes more competitive, profitable, and enjoys a "full" and higher valuation for a future sale (and greater future liquid wealth for you).

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The views in this article express the personal views of the author and do not represent the views of any other person or entity and do not constitute legal advice. This article only touches on some of the many complexities of business valuations.

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Scott J. Lochner was raised in Pennsylvania and received his *J.D. degree* from the *New York University School of Law*, where he was an Articles Editor on the Journal of International Law and Politics. Scott received his *B.A. degree* with *high honors*, *Phi Beta Kappa*, from *Lehigh University*, and spent his junior year abroad at the *London School of Economics*. He is admitted to practice law in *California, New York,* Massachusetts,** and *the District of Columbia*.* Scott's background includes over 20 years of practicing both business and transactional IP in Los Angeles as a Partner and Special Counsel at two large prominent national law firms, each headquartered in Los Angeles. In addition, he also at times has served clients as temporary in-house general counsel for several public and private companies. In his law firms Scott advised clients ranging from family-owned businesses to multi-national corporations headquartered in the United States, Asia, and Europe in a broad variety of industries. In addition to general business counseling, Scott has specialized in: (i) domestic and international merger and acquisition transactions, having represented primarily privately-held middle-market companies (and/or their owners) as sellers, and privately-held or publicly-held companies as buyers, in over 150 transactions, generally ranging in transaction dollar value from $10 million to over $1 billion, and (ii) transactional IP matters, predominantly with respect to identifying, protecting, and commercializing IP for both high tech and consumer product and service companies. The IP legal projects have generally consisted of assigning, licensing, and otherwise monetizing patents, copyrights (including software), trademarks, service marks, domain names, and trade secrets, as well as the sale and distribution of consumer products and services, and the building, extending (into other product/service categories), and expanding (both nationally and internationally) of consumer brands. Scott also is a successful inventor who through his company, Lochner Technologies, LLC, has successfully monetized his U.S. patents through agreements with nearly 30 large technology companies, including Apple, IBM, HP, Dell, Sony, LG, and Blackberry Limited, among others. From 2008 to

[26] A more detailed discussion of this topic is beyond the scope of this article.

2012 Scott served on the Corporations Committee of the Business Law Section of the State Bar of California (and on the Subcommittee on Mergers and Acquisitions), and since 2017 he has been a member and has served as a senior officer of the Executive Committee of the Los Angeles County Bar Association Business Law Section.

*Inactive member.

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Scott has been a frequent author and speaker. Selected published articles by him that you may find to be of interest include:

1. S. Lochner, *Intentional Pro-Active Preparatory Steps for Success: Preparing for the Eventual Sale of Your Business* (publication pending), June 2018.

2. S. Lochner, *Building, Protecting and Expanding a Brand*, Law360, June 22, 2011.

3. S. Lochner, *Create Your Ideal Custom Letter of Intent: Why You, the Prospective Seller of a Privately-Held Business, Want and Need Your Own Customized Letter of Intent ("LOI")*, Macro Strategic Design, Inc., September 24, 2014 (http://www.macrostrategicdesign.com/videos--articles/create-your-ideal-custom-letter-of-intent).

4. S. Lochner, *Build an Experienced, High-Quality M&A Team and Prepare Early: How to Best Improve One's M&A Transaction Outcome (aka "The Early Bird Catches the Worm")*, Macro Strategic Design, Inc., August 19, 2014 (http://www.macrostrategicdesign.com/videos--articles/build-an-experienced-high-quality-m&a-team-and-prepare-early).

5. S. Lochner, *Sell-Side and Buy-Side Transaction Tips for Today's M&A Deals: Leading Lawyers on Understanding Recent Legal Developments, Handling Cross-Border M&A Deals, and Navigating the Current Economic Climate*, at 77-89, Advising Clients in Mergers and Acquisitions (Inside the Minds®), Thomson Reuters/Aspatore, May 2011.

6. S. Lochner, *EARN-OUTS: A Useful Tool in M&A Transactions for Bridging Gaps in Perceptions of Business Value*, VC Expert's Encyclopedia of Private Equity and Venture Capital, January 2009 (https://www.vcexperts.com/buzz_articles/636).

7. S. Lochner, *International Joint Ventures: Get the Global Edge*, TheM&AAdvisor.com, August 13, 2010.

8. S. Lochner, *International Joint Ventures: An Overview*, Manatt, Phelps & Phillips, LLP, August 10, 2010 (http://www.manatt.com/news.aspx?id=12054).

9. S. Lochner, *A Legal Primer on Software Shrink-Wrap, Click-Wrap or Click-To Accept and Browse-Wrap License Agreements*, Intellectual Property Today, December 2003.

10. S. Lochner, *Risk-Minimization Strategies in Licensing Intellectual Property from Entities That Are, or Might Become, Financially Troubled,* Intellectual Property and Technology Law Journal, June 2002.

11. S. Lochner, *Hart-Scott-Rodino Act as Applied to Technology, Patent and Trademark Licenses*, Manatt, Phelps & Phillips, LLP, March 9, 2006.

<u>Selected speaking engagements by Scott have included</u>:

Mergers and Acquisitions Basics, Presentation to the California State Bar Annual Meeting.

Acquisition Agreements: Critical Issues You Need to Know, Nat'l Constitutional Center Conferences.

Drafting Copyright and Trademark Licenses: The Dos and Don'ts, Nat'l Constitutional Center Conferences.

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