

# INTERSTS IN CLOSELY HELD CORPORATIONS

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As with any type of case, the lawyer does not have to be an expert in the subject of business valuations to do as effective job representing his/her client. However, the lawyer does need to have a general working knowledge of the major valuation approaches that are commonly used by business valuation experts. The particular approach and method used by the expert will depend on the facts and circumstances of the business being valued. Listed below are the three most commonly used approaches:

## Valuation Approaches:

1. The Asset Based Approach----- The asset based approach is a general way of determining a value of a business using one or more methods based directly upon the value of the assets of the business less liabilities. There are a number of different methods that can be used to value a business under the asset based approach. Often times, the terms “book value” and “cost value” are used interchangeably. The lawyer should be aware that there is a significant difference between these valuation methods. Book value is simply the difference between the cost of acquiring a capital asset and the amount of depreciation taken on it. Because depreciation is an arbitrary number, which does not necessarily reflect the true economic life or value of an asset, book value is probably the least reliable method to use when determining the value of a business. Cost value in its most simplistic term means valuing an asset at the cost of replacement. The problem with the asset based approach is that the value of a business is often times not due to the value of the underlying assets themselves, but is dependent upon the value of the earnings stream that is expected to be derived from the business assets. As such, this approach is generally more appropriate for valuing businesses that are relatively new or whose earning have been unstable.
2. The Market Approach-----Under this method the business is valued based upon similar transactions that have occurred. Often times the expert will find publicly traded companies or closely held companies which are comparable to the business that is being valued. The expert will examine multiples from the prices and financial data of these companies and apply these multiples to the financial data of the business being appraised.
3. The Income Approach-----The value of the business is determined based on future income. The future earnings of the business is converted to a present value by either capitalizing the current earnings using an appropriate capitalization rate, or by

discounting the future earnings using an appropriate discount rate. It is important for the lawyer to understand the impact of the discount or capitalization rate on value. The discount or capitalization rate will be expressed as a percentage. As the rate goes up, the value of the business goes down. A small difference in the capitalization rate or the discount rate used by the expert can have a significant impact on value.

There are many approaches used by experts to value closely held businesses. It should be noted, that in most situations, a hybrid of one or more of the above referenced approaches will be used to establish the valuation of the business.