

The Playbook for Today's Economy

Understanding the Key Drivers of Business Value

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Discussion Outline



- » What is Business Value?
- » Why is Business Value important?
- » Key equation to consider
- » Factors that Influence Value
 - Controllable factors (internal)
 - Uncontrollable factors (external)
- » Playbook for today's economy

What is Business Value?



- » Cash flow - the value of a business today is the present value of all of the expected future benefits (cash flow) from that business discounted to the present at an appropriate discount rate – or at the required return of investors for that business

$$\text{Value} = V_0 = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \dots + \frac{CF_n}{(1+r)^n}$$

- » Overall risk of the business
- » Combination of cash flow and risk impacts how much the business is worth

Why is the value of the business important?



- » Managers and employees can all positively impact the value of the business
- » Communication is key
 - Discuss what ownership in the business means
 - Examples
 - Legal items need to be considered
- » The more employees understand, the more they will contribute

Why is the value of the business important?



- » Developing an understanding of value is instrumental in creating an “ownership culture”
- » Understanding value is different than knowing conclusion
- » Key is understanding what drives value
 - Factors pushing it up or knocking it down
 - Does not need to be a “technical” understanding
 - Not only “ESOP-specific” issues

Key equation to consider

» Value (V) = Profit (P) times a Multiple (M)

or

$$V = P \times M$$



Profit in Value Equation

» Profit (P) = Total Revenue (TR) minus Total Cost (TC)

or

$$P = TR - TC$$

» Management and Employees need to understand how to:

- Increase revenue
- Decrease cost

Multiple in Value Equation

» Multiple = a function of underlying factors related to risk and growth

or

$$M = f(\text{risk, growth})$$

» Management and Employees need to understand how to:

- Grow the business
- Minimize risk

Keys to Value Equation



» Value = a function of

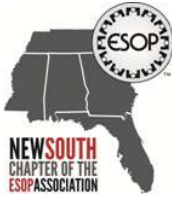
- Revenue
 - Cost
 - Risk
 - Growth
- = Profit
- = Multiple

What factors influence value?



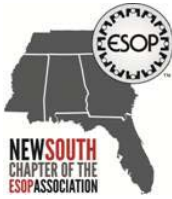
- » Controllable influences
 - Internal to the business
- » Uncontrollable influences
 - External to the business (economic environment)

Controllable Influences



- » Expenses
- » Management Team
- » Employee Morale
- » Business Development
- » Financial Statements

Controllable Influences - Expenses



- » Business expenses (travel, personnel, other)
- » Vendor contracts
- » Inventory control
- » Others?



Controllable Influences – Management Team



- » Tenure
- » Succession planning
- » Compensation structures
- » Board of Directors
- » Others?



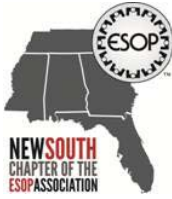
Controllable Influences – Employee Morale



- » Compensation (salary, benefits, other)
- » Communication
- » Turnover
- » Goals, mission statement
- » Others?



Controllable Influences – Business Development



- » Customer relationships (potential and existing)
- » Customer referral program
- » Customer feedback is important
- » Others?



Controllable Influences – Financial Statements



- » Are financial statements clean? (easy to understand)
- » Financial ratios as compared to industry
- » Others?



Uncontrollable Influences

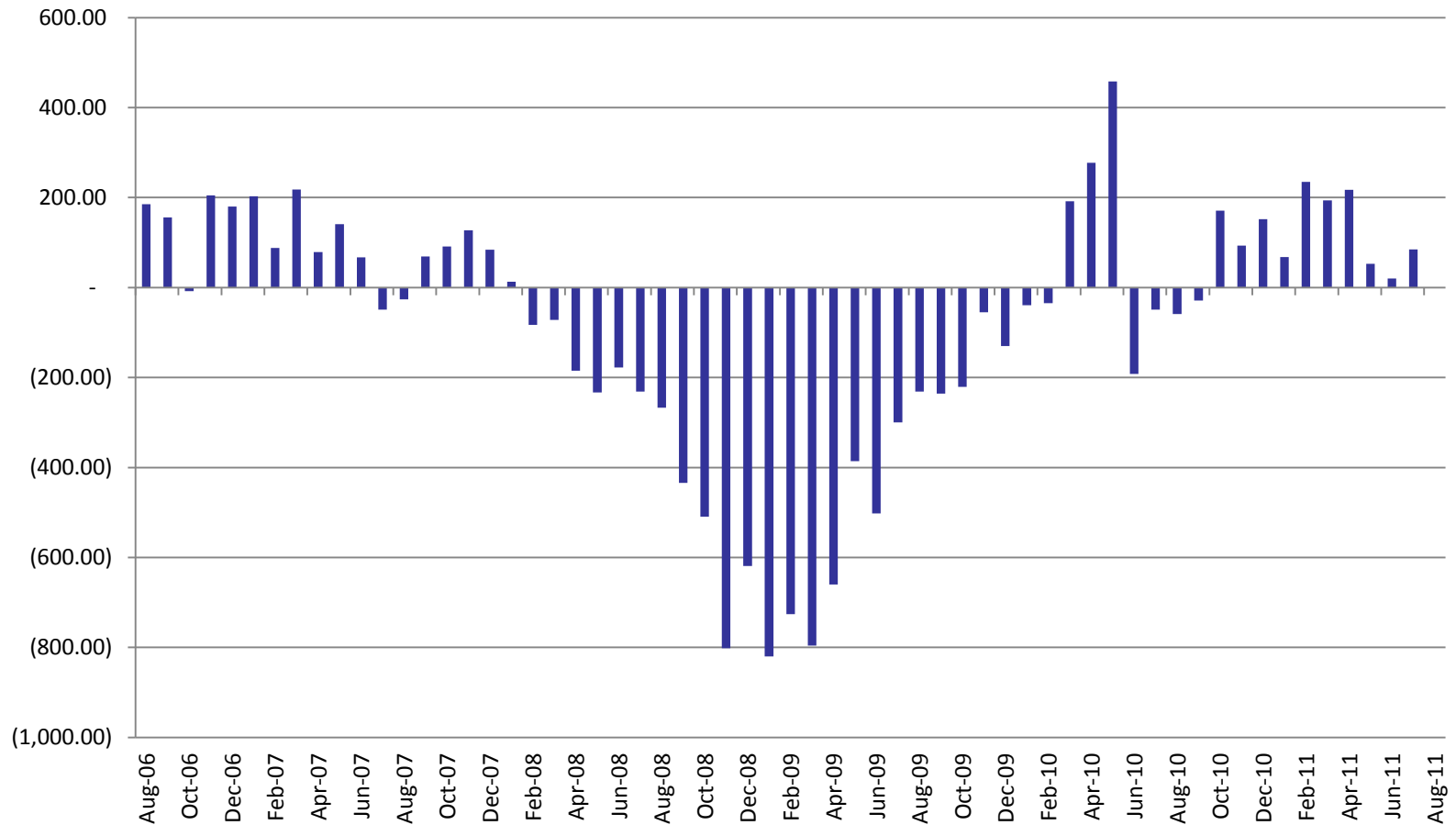


- » Economy
- » Financial Markets
- » Government
- » Environment

Uncontrollable Influences - Economy



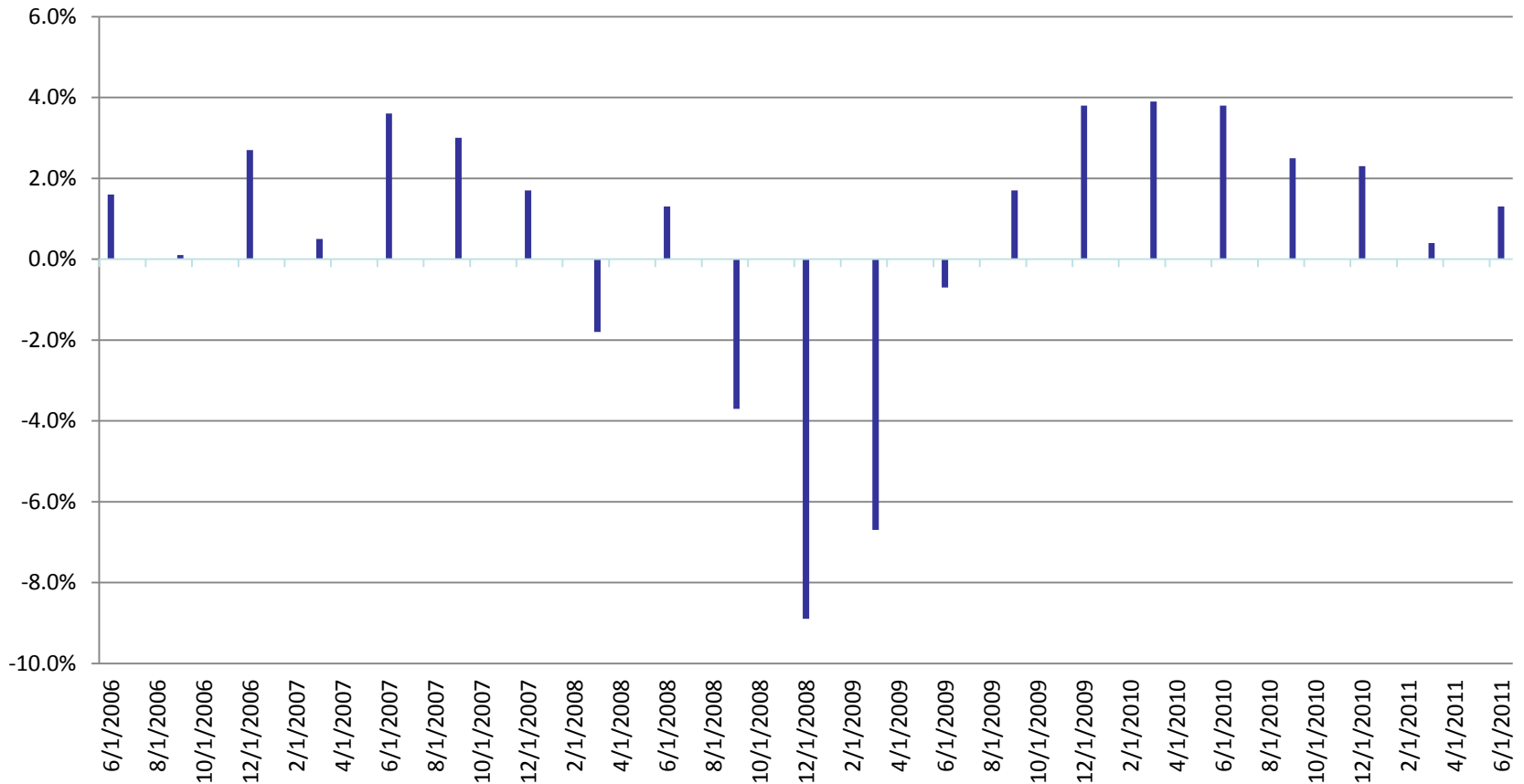
Change in Non-Farm Payrolls for past 5 years (in thousands)



Uncontrollable Influences - Economy



Quarterly GDP Growth % over past 5 years



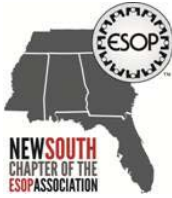
Uncontrollable Influences - Economy



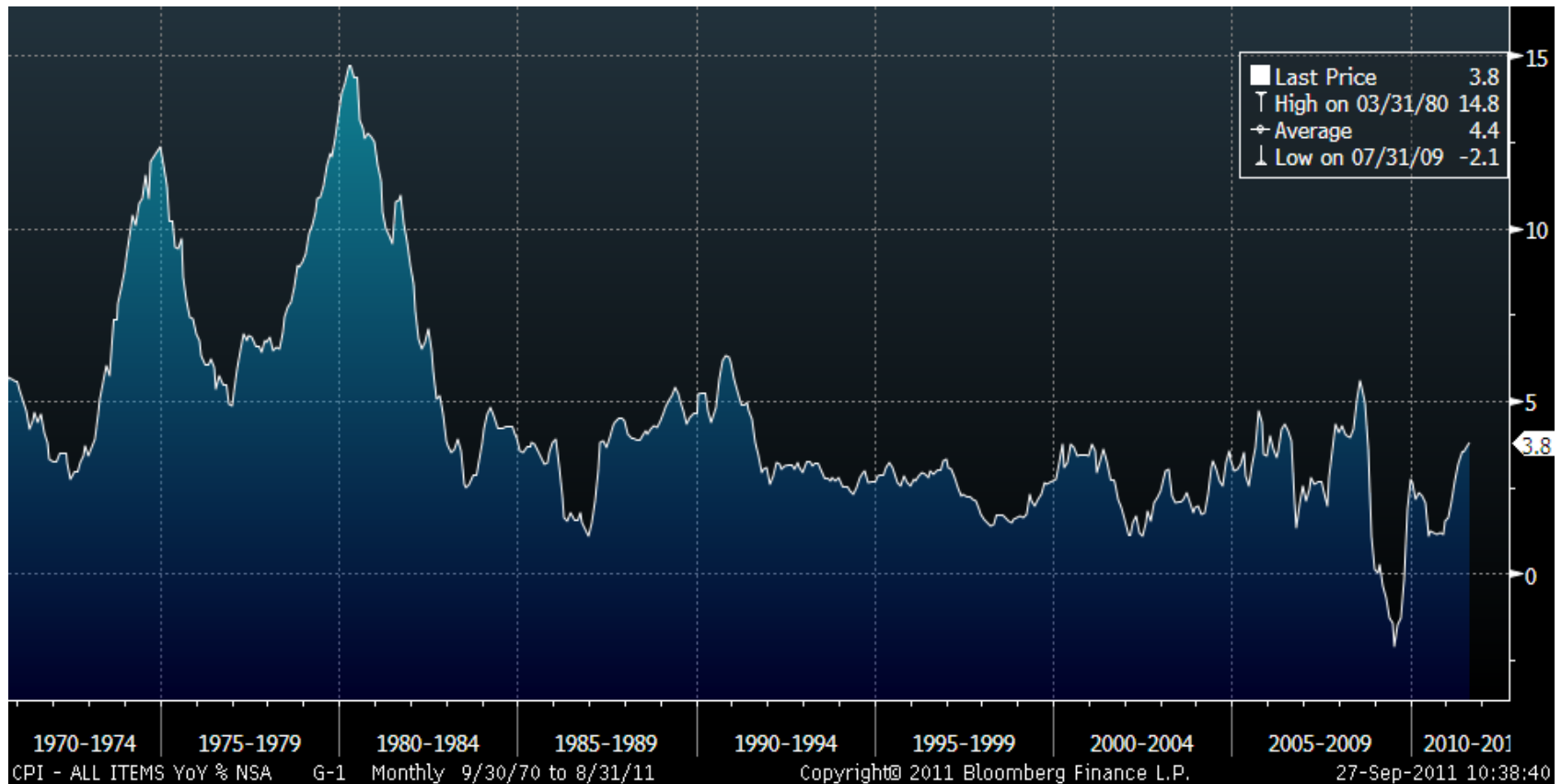
» Oil prices (per barrel) over past 5 years



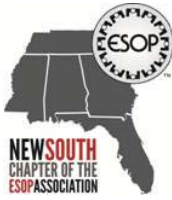
Uncontrollable Influences - Economy



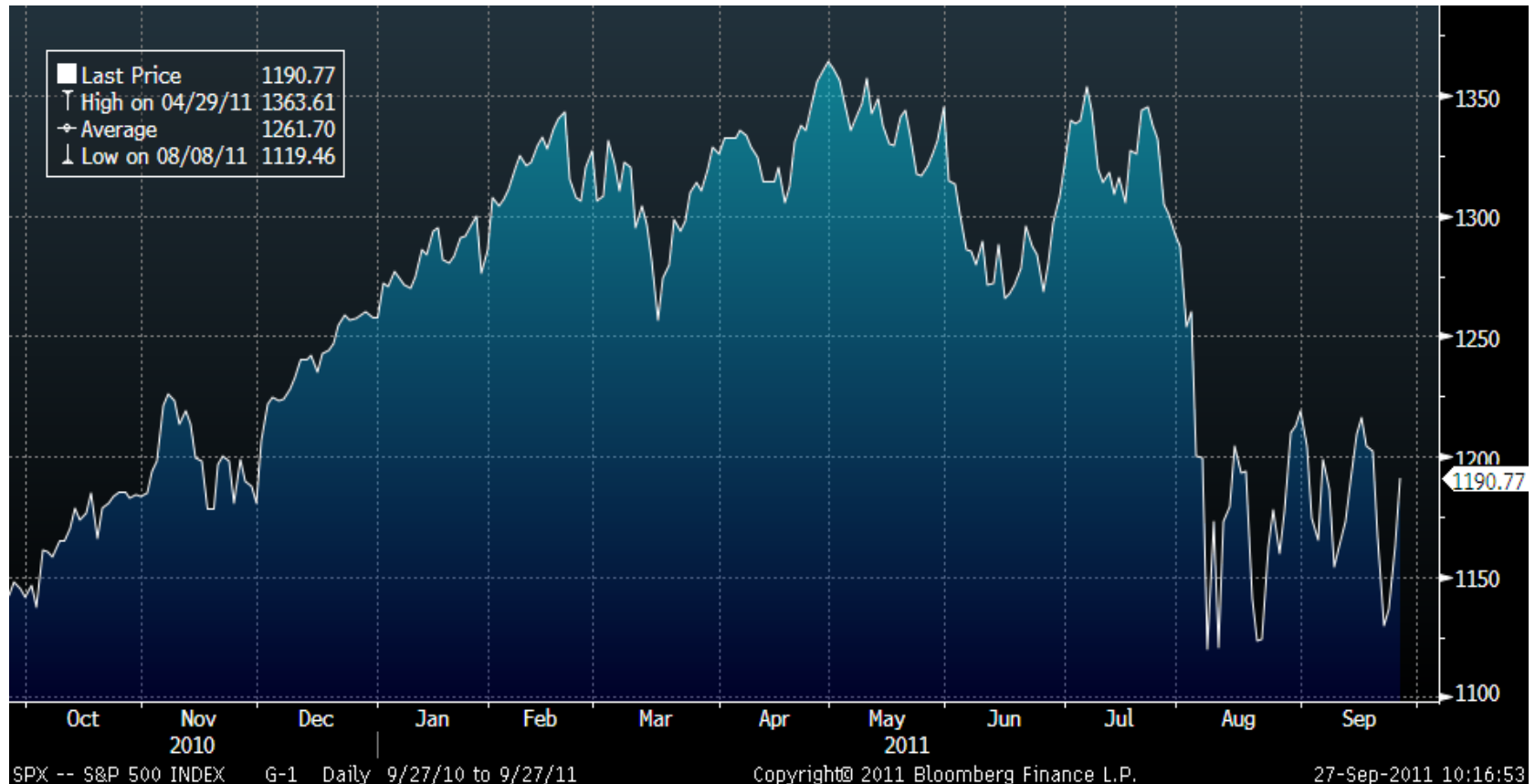
» Inflation data, CPI from 1970 to present



Uncontrollable Influences – Financial Markets



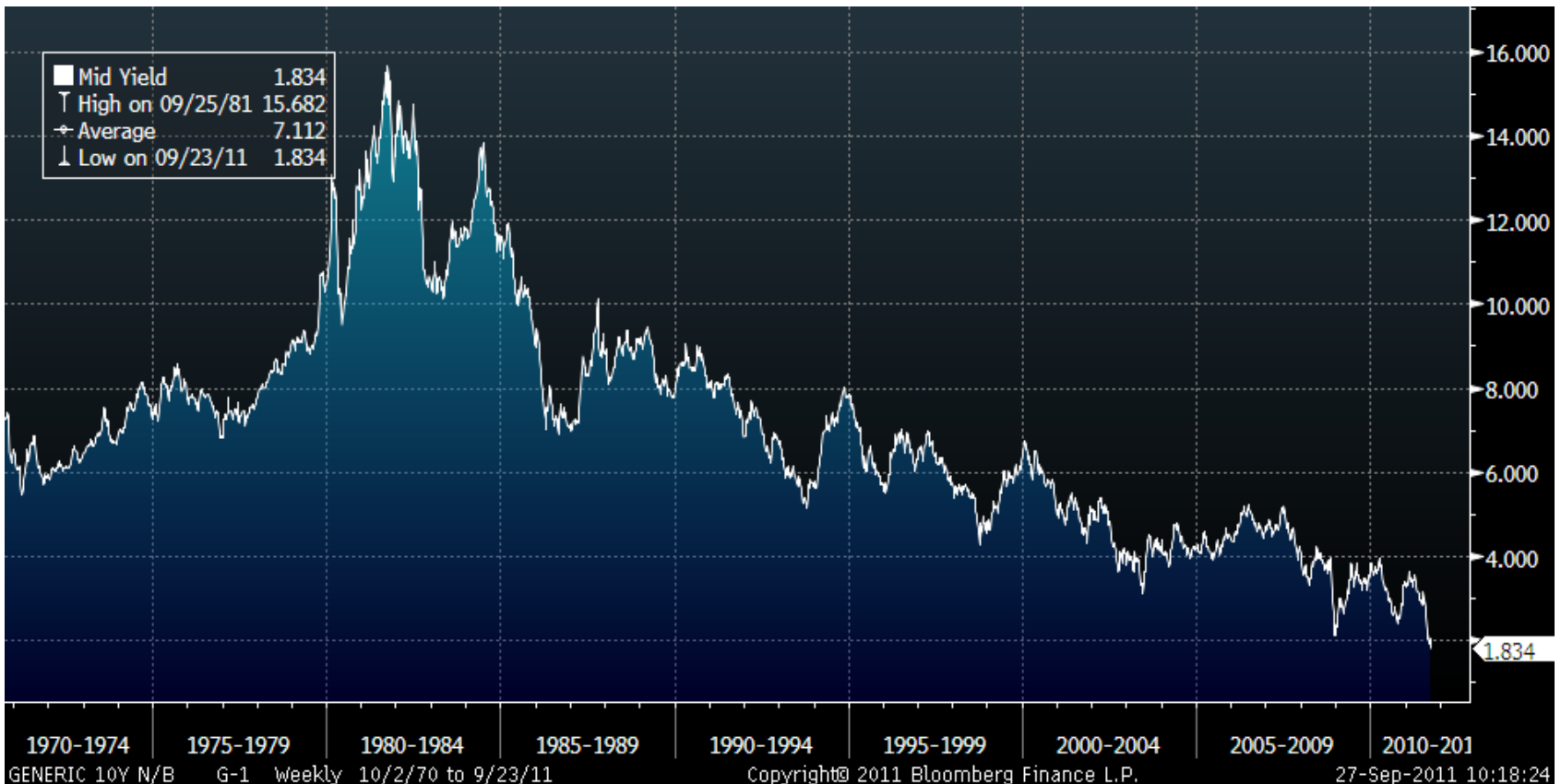
» S&P 500 over the past 12 months



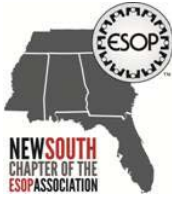
Uncontrollable Influences – Financial Markets



» 10 year treasury note yield since 1970



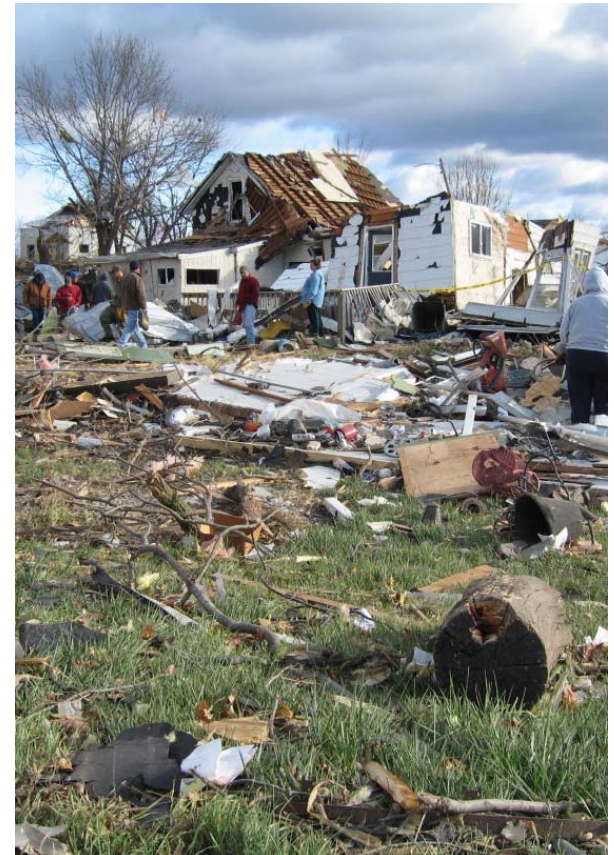
Uncontrollable Influences – Government



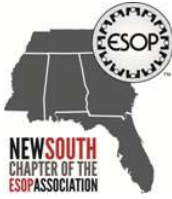
- » Policy / Leadership
- » Taxes
- » National debt



Uncontrollable Influences – Environment

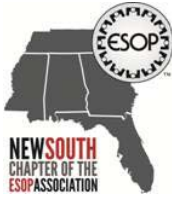


Uncontrollable Influences - Summary



- » Economy in a slow growth period; Job creation difficult
- » Oil Prices have fallen from recent levels; Inflation is moving higher
- » Government continues bipartisan struggles; National debt still not resolved
- » Natural disasters continue

Playbook for Today's Economy



- » Each business is impacted differently by economy
- » An employee base that can adapt to changing conditions will help to drive value
- » A positive culture can overcome many obstacles
- » Given controllable and uncontrollable influences, what would you change?

Questions?

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