

Trucking Valuation Methodology

Business valuation is supported by two basic economic principles:

- **Principle of substitution** – A buyer would not pay more for an asset than it would cost to acquire or create some other asset that would provide equal or greater economic utility to the owner.
- **Principle of future benefits** – A buyer would not pay more for an asset than the present value of the future benefits the asset is expected to deliver to the owner after adjusting the time value of money and the risk of realizing those future benefits when expected.

Definition of Value: The two most frequently used are:

Fair market value is defined according to sections 20.2031-1(b) and 25.2512-1 of the Treasury Regulations as:

The amount at which property would change hands between a willing seller and a willing buyer when neither is acting under any compulsion and when both have reasonable knowledge of the relevant facts.

Investment value is the *specific value* of a company to a *particular investor* for individual investment reasons. Strategic or investment valuations used in M&A transactions typically include synergistic benefits.

Methods: Three fundamental approaches to estimating the value of a company:

- a. Income approach
- b. Market approach
- c. Asset approach

Income approach – valuation based on discounted future benefits of earnings, cash flows, dividends or other benefit streams. Theoretically, the most correct method for a going-concern operating company. It is not frequently used for smaller trucking companies given the difficulties of projecting future earnings and establishing an appropriate cost of capital or discount rate. The two primary methods are:

- Discounted economic income method (DCF) - the value of a business is defined as the present value of the financial benefits of ownership into perpetuity. The fair market value is based on the future benefits to be derived from ownership of the business or its securities. Future earnings or dividends can be used, but most frequently debt free cash flow is used. The debt

free cash flow (frequently simplified as EBITDA) projects the funds (before interest expense and principal co-payment) available for all holders of equity and long-term creditors.

- Capitalized economic income method

Market approach – valuation based on the application of market multiples or capitalization factors to measurement of earnings, cash flow and other financial factors. The primary methods used with this approach include the following:

- Guideline public company or comparable company or capital markets method – an appropriate multiple of earnings, cash flow, book value, dividends paid, revenues or invested capital is selected from representative companies traded in the market place and then applied to the specific company being valued. (EBITDA and EDIT are frequently used in larger profitable trucking transactions.)
- Merger and acquisition method
- Rule of thumb method

The Market approach (frequently referred to as “Comps” or “Multiples”) is useful when the following are considered:

- It acts as a vital “sanity check”
- It attempts to use actual public valuations and transaction details to infer value for a “similar” company
- It is most appropriately used in conjunction with other methods and where sufficient financial information is available for the company being valued
- It generally applied to going concerns (i.e. truckload carriers with normalized operating ratios below 93% or 94%)
- It is frequently used because of the apparent ease of comparison, but generally incorrectly applied because of comparability inconsistencies
- Multiples of 3.0 - 4.5 times EBITDA are frequently used for privately owned middle market asset based carriers with 3.0 – 3.5 times common during weaker economic conditions and 3.5 – 4.25 times common during periods of strong earnings and buyer interest.

Asset approach – valuation based on a measure of the market values of the company’s assets. Theory is that the current value of the assets minus current value of the liabilities equals the current value of the equity (economic principle of substitution). The two primary methods used to develop an Asset Valuation are:

- Asset accumulation method
- Excess earnings method (Revenue Ruling 68-609)

The Asset approach is appropriate in following circumstances:

- Liquidation
- Companies with substantial tangible assets
- High quality balance sheet
- Early phase of business where book values are a proxy for fair market values
- Future viability of company is doubtful
- Industries with financial and regulatory ease-of-entry

Asset valuation is used extensively in the trucking industry for several reasons:

- Most carriers are small with few proprietary customer relationships
- There are limited financial and regulatory barriers to entry particularly in the full truckload segment
- Many carriers do not have self-sustaining operating ratios, (i.e. a 94% or better for most truckload carriers) thus the future viability of the company is doubtful

Application specific to truckload carriers:

- Net asset value – the company’s tangible and *intangible* assets along with liabilities are adjusted to fair market values. The liabilities are deducted from the asset value to determine the value of the company’s equity. The primary tangible asset adjustment is the conversion of rolling stock net book value to orderly liquidation value. The total intangible value is generally determined by establishing a combined value for the company’s drivers and its “book of business”. Driver values are commonly determined by multiplying \$1,500 - \$5,000 per retained driver. The value assigned to the company’s “book of business” is commonly calculated as 3% - 6% of the trailing twelve months of non-broker revenue at or above market rates.
- This method is frequently used to value smaller carriers (i.e. generally less than \$20 million in annual revenue) and less profitable larger trucking companies (generally meaning carriers with an operating ratio above 95% or 96%).

Other factors: Two other factors frequently can affect the valuation of a business:

1. Controlling versus minority interest (published multiples for publicly traded companies generally do not reflect values for controlling interest).
2. Discount for lack of marketability – the application of market value ratios derived from publicly held companies provides an indication of the price at which the securities of a privately held trucking company would trade if they were equally marketable. The stock of a closely held trucking company cannot be bought or sold through securities brokers. This fact requires an adjustment to reflect the negative element of value associated with the lack of liquidity. The discount associated with the lack of marketability frequently ranges between 25 and 50 percent but can be even higher.