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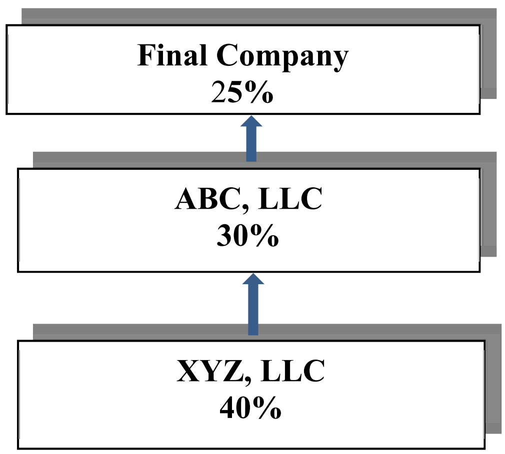
Valuing Multi-Tier "Minority" Ownerships

When a situation is encountered in which a "stack" of entities own a non-controlling "minority" interest in a series of companies, care must be taken so that the effective value of the initial underlying company or asset is not diluted to an inappropriate amount. This structure is often referred to as a multi-level entity or multi-level interest. This type of structure is sometimes encountered as part of an asset protection plan. An example of such a structure of companies is shown below:



While this type of configuration can be much more complex, it should be treated is the same manner discussed below.

There is a difference in value between owning an asset directly and owning an interest in a company that owns that asset or interest in that asset. For example, if a typical seller asking $100,000 for an investment were given a choice between $100,000 cash or stock for a 25% interest in some company that held $400,000 in cash, most would choose the direct receipt of the $100,000 in cash. If the choice were between $100,000 in cash and $100,000 "worth" of minority interests in limited partnerships, the choice would be very clear – an investor would typically demand much more than $100,000 "worth" of minority interests in limited partnerships.

According to Shannon Pratt, "One issue that occasionally arises in valuing entity interests is the extent to which closely held securities, which are already illiquid securities, are further discounted if held inside an entity. My research indicates that additional discounting typically is warranted but that such discounts are usually incremental in nature. Incremental discounts can be similar in magnitude to typical marketability discounts when the features of the entity interest further restrict or otherwise provide much lesser marketability than the closely held securities held by the entity."[1]

It would be inappropriate to apply both a discount for lack of control and a discount for lack of marketability to the non-controlling interest at each level (except for assets not owned by the underlying entity) in this multi-tier "stack." Instead, typically a discount for lack of control and lack of marketability is applied at the lowest level and then a

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[1] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. 288-289.

pro rata amount is taken for each succeeding level with a multi-tier discount applied once at the "final" level of value being appraised.

In order to make it easier to understand, the following "example" has been created. The discounts shown have been "pulled from the air" in this example, i.e. no explanation is provided for them.

The applicable level of discount needed to compensate for the difference between owning an interest in another entity instead of holding the underlying assets directly should be similar in size to that of an illiquidity discount. Illiquidity discounts typically range from 8% to 12% with an average of 10%.

XYZ, LLC owns real property appraised at $1 million dollars with no other assets or liabilities. A discount for lack of control of 15% and a discount for lack of marketabilty of 25% have been determined to be applicable at this level of the analysis. No other assets or liabilities are held by ABC, LLC and Final Company other than the interest in the underlying entity. Thus, a 10% Multi-Tier Discount is applied at the Final Company level. Accordingly, the value of a 25% interest in the "Final Company" would be determined as follows:

XYZ, LLC		
XYZ, LLC - 100% Control Value	$1,000,000	
Less: Discount for Lack of Control	$150,000	15.0%
Non-Controlling Interest Value	$850,000	
Less: Discount for Lack of Marketability	$212,500	25.0%
Non-Controlling, Non-Marketable Interest Value	$637,500	
Times Interest Being Valued	40.00%	
VALUE CONCLUSION - 40% Non-Controlling, Non-Marketable Interest	$255,000	
ABC, LLC		
Times: Interest Being Valued	30.00%	
VALUE CONCLUSION - 30% Non-Controlling, Non-Marketable Interest	$58,650	
Final Company		
Less: 10% Multi-Tier Discount	$5,865	10.0%
Non-Controlling, Non-Marketable, Multi-Tier Interest Value	$52,785	
Times: Interest Being Valued	25.0%	
VALUE CONCLUSION - 25% Non-Controlling, Non-Marketable Interest	$13,196	
Total Combined Discount		42.6%

If other assets and/or liabilities are introduced at the other levels, discounts for lack of control and lack of marketability may very well apply to those assets, but not to the interest in the underlying real property that has flowed through multiple entities other than the multi-tier discount as shown.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**

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