**TechHub, LLC[[1]](#footnote-1)  
Representative Valuation Case[[2]](#footnote-2)**

TechHub is an outsource provider of IT services for small to mid-sized firms operating out of Logan, Utah. The firm provides network, hardware, software, development and cloud storage solutions based on a monthly subscription fee to its clients across the nation. Founded in 2008 by a former IT manager from Amazon and spouse, a local intellectual property attorney, the firm had substantial growth in its first five years of operation, but has had disappointing result since.

The market for outsourced IT support and complementing products is expanding at nearly twice the rate of the macro economy and would appear to be poised to experience robust growth for the foreseeable future as globalization, technological intensity, and expectations of “careers” transform legacy functions and resource allocation.

The founders hired a former Adobe director-level executive in 2017 to be the firm’s CEO and offered the individual a 20%, non-voting, non-participating equity stake based on a 10-year vesting schedule. In addition to sharing the initial 1,000,000 common equity shares equally following a capital investment of $600,000, the founders jointly own $400,000 of preferred shares with a dividend rate of 15%, which shares are convertible to a 20% common equity stake in the firm at any time in the future.

The two founders each take annual salaries of $250,000 plus the preferred dividend and their portions of a generous distribution – in 2019 the distributions amounted to $2,500,000.

In addition to having $1,450,000 in accounts payable against $1,640,000 in Current Assets, the firm has long-term debt in the form of bank loans totaling $2,000,000 at 10% as of the end of 2018 with the expectation of increasing overall debt load in 2019 to $2,500,000. The firm’s stakeholders have financed most hardware and fixed asset acquisition through leases and the aforementioned debt financing. The firm is structured as an LLC with the stakeholders accounting for the firm’s EBT through their personal state and federal income tax reporting. The founders admit to processing approximately $135,000 or personal expenses through the firm’s accounts and receive generous annual distributions.

The firm’s 2019 P&L, the last year for which balanced financials are available, show revenues from hardware sales, software sales, IT subscriptions, cloud computing (storage), enterprise solutions (development), and consulting of $8,812,890 against an operating income of $1,696,316 and Net Income of $1,070,274. The firm’s operating margins, as expected, appear high for a hardware firm, but somewhat low for a SAS firm owing to the combined income statement structure in use. This is due in part to the salaries the founders pay themselves, but also a function of the annual rent expense – which appears up to 20% higher than local market rents for the size and type of space the firm occupies. The building the firm occupies is owned by the founders in a separate entity.

The firm’s depreciation runs at approximately 12% of annual revenues and is reflective of long-term assets of approximately $8,460,000, including approximately $4,000,000 in servers and $3,000,000 in patented technology. It has Net Working Capital of approximately $350,000.

Over the years the firm has used an international network of contract developers, programmers, and systems analysts to provide many of the back ground functions for their clients, but now see this may have resulted in stagnant revenues and limited client satisfaction. Accordingly, the firm has begun to use domestic contract workers more intensively than in the past. Moving forward, and under the insistence of the new CEO, the firm has committed to using domestic contract workers for these system critical functions.

TechHub’s domestic employee base is well paid and the firm enjoys limited turnover. As most of the firm’s clients are on long-term subscription contracts (one year plus) averaging approximately $3,500 per year, management is confident in the persistency of its client base, recent concerns notwithstanding.

The firm’s owners have informally valued the company each year using a simple method suggested by their accountant as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Estimated Equity Value** | | | | | |
| **Year** | **Value** | **Year** | **Value** | **Year** | **Value** |
| 2008 | 2,250,000 | 2012 | 16,625,000 | 2016 | 15,000,000 |
| 2009 | 4,500,000 | 2013 | 20,600,000 | 2017 | 17,000,000 |
| 2010 | 9,000,000 | 2014 | 19,500,000 | 2018 | 18,000,000 |
| 2011 | 14,500,000 | 2015 | 17,300,000 |  |  |

The space in which Tech Hub operates is filled with numerous small operators, like Tech Hub themselves, and appears ripe for “roll up” opportunities. The firm’s growth, though impressive, is less than might be expected given the cash flows available for reinvestment and the firm’s operating incomes are high enough for Tech Hub to be attractive to outside investors. As such, the CEO has been approached by Opportunity Capital, a regional venture capital firm, with a $30,000,000 equity offer with the express intention of using the capital infusion to identify other firms in the same space prepared for acquisition (“roll up”). As expected the offer is dependent on an independent valuation of the firm’s operations, cash flows and valuation. Additionally, Opportunity Capital insists 1) the CEO’s ownership vesting schedule be moved forward prior to the capital infusion, 2) the CEO’s equity stake be converted to voting, fully participating equity shares, 3) the founders and CEO be tied to a 10-year non-compete arrangement with salaries to be set by the newly formed board of directors, 4) any future distributions taken be formally approved by the board, and 5) the founders preferred shares be immediately converted to common equity.



1. This Valuation Case is representative of actual firms for which live valuation estimations have been performed by the author and/or Associates. The names, locations, and quantitative details have been altered to protect the subject firms’ privacy. [↑](#footnote-ref-1)
2. Developed by Richard Haskell, PhD (rhaskell@westminstercollege.edu), Gore School of Business, Westminster College, SLC, U T, (2019). [↑](#footnote-ref-2)