JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 1 - JULY 2013

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that the *Duff & Phelps recommended equity risk premium is to be added to either the spot rate for the risk-free rate or the normalized risk-free rate.*

In preparing a build-up model for the cost of equity, two key components are the equity risk premium (ERP) and the risk-free rate. Duff & Phelps currently recommends using a normalized risk-free rate of 4.0% when the spot rate is below 4.0% and the actual spot rate when the risk-free rate is 4.0% or higher. As such, analysts must be careful when choosing to use the Duff & Phelps recommended ERPs and risk-free rates. Sometimes the recommended ERP is on top of a spot risk-free rate and sometimes it is on top of a normalized risk-free rate, currently at 4.0%.

As of February 28, 2013, Duff & Phelps recommends that the ERP should be 5.0% on top of a normalized risk-free rate of 4.0%.

Duff & Phelps Risk Premium Report 2013, Duff & Phelps, LLC, pages 128-130.

Note that the spot rate was 2.7% on February 28, 2013 and 3.3% on July 16, 2013. The range during this period was a low of 2.4% to a high of 3.4%.

Federal Reserve Statistical Release, Risk-free rate, 20-year Treasury Bond Yield, 7/18/13.

For additional information you can purchase VPS's *Financial Valuation and Litigation Expert* journal, FVLE Issue 43, June/July 2013 (available at www.valuationproducts.com).

UPCOMING WEBINAR (AUGUST 15, 2013)

How to Detect and Attack a 'Rigged' Valuation
Preparing the Case Against an Unethical Valuation

Jim Hitchner, CPA/ABV/CFF, ASA
Harold Martin, CPA/ABV/CFF, ASA, CFE

Have you ever read a business valuation report where you knew the valuation was rigged to obtain a higher or lower value? Did the biased assumptions and inputs make you want to scream? Learn the tricks of the trade on how some valuation analysts can manipulate the process in order to please their client and/or win at all costs. Learn how to detect and attack biases. We will focus on the income approach including choice of methods, projections/forecasts, normalization adjustments, historical weightings, taxes, discount rates, growth rates and reconciling values.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 2 - AUGUST 2013

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...the difference between a calculated value and an opinion of value?

Under the AICPA's *SSVS No. 1*, CPAs are free to provide calculations any way they see fit as long as they comply with *SSVS No. 1*. Furthermore, there is no prohibition in *SSVS No. 1* concerning the use of an opinion of value nor is there an explicit endorsement. It's up to each analyst to decide whether he or she can have an opinion of value in a calculation engagement. However, that doesn't make it right or practical.

Some CPAs are providing calculations, calculated values and calculation reports as their only and final value in a litigation setting. Some are also offering calculated values as their opinion of value. Remember, in a litigation setting an expert opinion must be with "reasonable certainty." While there is no prohibition against this, from a practial perspective, why would you want to? If you are admitting that a calculation engagement does not include all of the procedures required for a valuation engagement and had a valuation engagement been performed, the results may have been different, how can this be with reasonable certainty? Saying that your opinion of the calculated value of XYZ Company is $4,000,000 is like saying that my opinion (with reasonable certainty) of the calculated value (without reasonable certainty) of XYZ Company is $4,000,000.

One possible exception to this is if you prepare a calculated value where you did enough work to have obtained reasonable certainty. However, again, why would you want to do this? If you did enough work to obtain reasonable certainty you are probably very close to having a valuation engagement. In that regard, call it a valuation engagement with a conclusion of value vs. a calculated value.

For more on this topic, download a free copy of the article, "'Linked Out' A Response to a Business Valuation Standards Discussion," from VPS's *Financial Valuation and Litigation Expert* journal, Issue 40, December 2012/January 2013.

UPCOMING WEBINARS

AUGUST 15, 2013

How to Detect and Attack a 'Rigged' Valuation
Preparing the Case Against an Unethical Valuation

Jim Hitchner, CPA/ABV/CFF, ASA
Harold Martin, CPA/ABV/CFF, ASA, CFE

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AUGUST 27, 2013

How to Reconcile Your Value and Support Your Conclusions

Chris Hamilton, CPA, CFE, CVA
Mark Kucik, CPA, CVA, CFF, CM&AA

The analyst has completed all the analysis required by the standards and utilized several methods to value the business. Now it is time to come to a conclusion and present the basis for the opinion of value. What should the analyst consider? What are the criteria for selecting the primary method? Should multiple methods be weighted? This session will address those questions and more related to the theory that all methods should, theoretically, lead to the same conclusion. This session will assist the practitioner in reconciling that theory with the reality of actual engagements.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 3 - SEPTEMBER 2013

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that the use of exit multiples in the terminal year calculation in a DCF can result in unsustainable and unsupportable long-term growth rates?

Let's use an example to illustrate how the improper use of exit multiples in the terminal year can inflate values with embedded high long-term growth rates.

Improper use of exit multiples in the terminal year - Check the Implied Long-Term (LT) Growth Rate

Assumptions

- Five-year interim period
- Discount rate (DR) is 20%
- EBITDA in year five of $1,000,000
- Exit multiple is EBITDA multiple X $1,000,000
- Net cash flow (NCF) in the terminal year (5th year here) of $500,000

Example using an exit multiple of 5 X EBITDA

- LT Growth = [DR(Exit Value) - NCF]/(NCF + Exit Value)
- LT Growth = [.20($5,000) - $500]/($500 + $5,000)
- LT Growth = $500/$5,500
- LT Growth = .091 = 9.1%

Other examples and results

- Exit multiple of **3** LT Growth rate = **2.9%**
- Exit multiple of **4** LT Growth rate = **6.7%**
- Exit multiple of **5** LT Growth rate = **9.1%**
- Exit multiple of **6** LT Growth rate = **10.8%**
- Exit multiple of **7** LT Growth rate = **12.0%**
- Exit multiple of **8** LT Growth rate = **12.9%**

In this example, you can see that the long-term growth rates outpace the nominal GDP growth rate at a multiple of EBITDA that approaches four. Obviously, these results are particular to the discount rate, the exit multiple and the cash flows. For example, just by lowering the discount rate the embedded long-term growth rates are also lowered. See below at a discount rate of 15%. All other assumptions are the same.

- Exit multiple of **3** LT Growth rate = **-1.4%**
- Exit multiple of **4** LT Growth rate = **2.2%**
- Exit multiple of **5** LT Growth rate = **4.5%**
- Exit multiple of **6** LT Growth rate = **6.2%**
- Exit multiple of **7** LT Growth rate = **7.3%**
- Exit multiple of **8** LT Growth rate = **8.2%**

For additional information, see the archived webinar "Common and Uncommon Business Valuation Mistakes - How to Detect and Avoid These Mistakes," led by Jim Hitchner and Jim Alerding, and originally broadcast on June 19, 2013 or see the article "Business Valuation Mistakes: How to Avoid Them - Income and Cash Flow and DCF Terminal-Year Exit Multiples," from the *Financial Valuation and Litigation Expert* journal, (*FVLE* Issue 44, August/September 2013). Both items are available for purchase at www.valuationproducts.com.

UPCOMING WEBINAR - OCTOBER 17, 2013

Dos and Don'ts in the Valuation of Small Businesses and Professional Practices

Including Divorce Valuation Issues

Stacey Udell, CPA/ABV/CFF, ASA, CVA
Lari Masten, MSA, CPA/ABV/CFF, CVA, ABAR
Mark Hanson, CPA/ABV, CVA

Valuing small businesses and professional practices (less than $3 million in value) is often more difficult than valuing larger businesses and professional practices. You will learn the solutions to key issues that are unique to small businesses and professional practices including: enterprise/practice and personal/professional goodwill, key person, noncompete agreements, normalization including compensation, pass-through entities, information challenges, BV standards and valuation approaches and methodologies.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 4 - NOVEMBER 2013

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that withdrawal and termination language in an engagement letter is a key area that is not always addressed by valuation and forensic analysts?

Stacey Udell, CPA/ABV/CFF, ASA, CVA, Member, Gold Gerstein Group LLC, Moorestown, NJ, recently wrote a very helpful article in the latest issue of VPS's *Financial Valuation and Litigation Expert* journal. In the article titled "Engagement Letters: How Do Yours Measure Up?" Stacey covers the important issue of how to successfully withdraw from an engagement. Some sample language follows:

- We reserve the right to discontinue services if balances are not paid when due.
- If there is substitution of attorneys, we reserve the right to withdraw from the engagement.
- Firm, LLP reserves the right to withdraw our services due to:
    - Failure by the Client or counsel to allow a reasonable amount of time for the agreed-upon assignment to be completed.
    - Client's failure to meet the financial obligations delineated in this Agreement.
    - Disagreement of opinion between the Client or counsel and Firm.
    - Disagreement between the Client or counsel and Firm over the conduct of the Client's case.

Some additional suggestions are as follows:

- If for any reason the transaction is terminated prior to its consummation and Firm is requested to terminate work, then Firm's fee shall not be less than Firm's total time and costs at our normal rates, plus out-of-pocket expenses.
- If we do not hear to the contrary within a 30-day period of time, it is understood that our invoice is accepted as presented. We reserve the right to discontinue services as well as retract all analyses and reports, if billings are not paid when due.

For additional information on engagement letters and additional sample wording, see Stacey Udell's full article "Engagement Letters: How Do Yours Measure Up? " from the *Financial Valuation and Litigation Expert* journal, *FVLE* Issue 45, October/November 2013 (available at www.valuationproducts.com).

UPCOMING WEBINAR - NOVEMBER 21, 2013

How to Review Your Own Valuation Analysis and Report

Is It Reliable, Understandable, Complete and Persuasive?

Mark Kucik, CPA, CVA, CM&AA
Chris Hamilton, CPA, CFE, CVA

This session will provide you with an organized process to properly review your own reports to determine if they are reliable, understandable, complete and persuasive. The presentation will include tools to help you review reports quickly and efficiently. Also included are BV compliance issues, fitting the service type and report to the client needs, length of the report and sample language.

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DO YOU KNOW?

ISSUE 5 - DECEMBER 2013

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that you may be in compliance with NACVA standards but out of compliance with the AICPA's SSVS No. 1?

First, both the NACVA' standards and the AICPA's SSVS No. 1 are well done. Both organizations did a great job putting these standards together. However, while the NACVA standards are very closely aligned to SSVS No. 1, they are not the same. The biggest difference is in the length and amount of detail.

The NACVA standards are 21 pages long with seven pages of actual standards. The other 14 pages include the title page, the table of contents and an appendix for the *International Glossary of Business Valuation Terms*. SSVS No. 1 is 76 pages long with 30 pages of actual standards. The other 46 pages include the title page, copyright, contents of statement, foreword, and appendices for illustrative list of assumptions and limiting conditions for a business valuation, the *International Glossary of Business Valuation Terms*, glossary of additional terms, Interpretation No. 1-01, scope of applicable services of SSVS No. 1, and a list of those involved in the standards.

This is not a contest about length. As we said, both set of standards are very well done. However, if you are a CPA and a member of NACVA and/or the IBA you must abide by both sets of standards. While the NACVA standards cover what SSVS No. 1 covers, it does so at a higher, less-detailed level. In fact, the NACVA standards start off by stating in their introduction, "These principles-based Standards have been developed to provide guidance to members and other valuation professionals performing valuation services." SSVS No. 1 has many more specific requirements that are to be considered and/or abided by. Let's take a few examples.

Under Section **F. Approaches and Methods**, the NACVA standards state "Valuation methods are commonly categorized into the asset-based, market, income, or a combination of these approaches. Professional judgment is used to select the approaches and the methods that best indicate the value. Rules of thumb are acceptable as reasonableness checks, but should not be used as stand-alone method."

In SSVS No. 1, the **Valuation Approaches and Methods** section includes nine paragraphs that go into detail on the factors to consider in the application of the various methods. An example for the capitalization of benefits method (Paragraph 31 a), follows:

"*Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:

- ***Normalization*** adjustments
- Nonrecurring revenue and expense items
- Taxes
- **Capital structure** and financing costs
- Appropriate capital investments
- Noncash items
- Qualitative judgments for risk used to compute discount and **capitalization rates**
- Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)"

Under Section **I. Documentation**, the NACVA standards state "Quantity, type, and content of documentation are matters of the member's professional judgment. Members should retain documentation for a sufficient time period to comply with legal, regulatory, and professional requirements."

In SSVS No. 1, the **Documentation** section (Paragraphs 44 and 45) states the following:

"44. Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs 25-30)
- Assumptions and limiting conditions (paragraph 18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph 19)
- Basis for using any ***valuation assumption*** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph 43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph 39)
- Other documentation considered relevant to the engagement by the valuation analyst

45. The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention."

There are other examples but we think you get the point; you must comply with both sets of standards if you are a CPA and a member of NACVA and/or the IBA.

For additional information on BV standards including how to comply with multiple sets of standards, register for our December 9th webinar.

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1 As of June 1, 2011, NACVA and the IBA unified their respective standards.

LAST TWO WEBINARS OF 2013:

DECEMBER 9, 2013

BV Standards Q&A:
Real World Solutions to Perplexing Issues

Jim Hitchner, CPA/ABV/CFF, ASA
Carla Glass, CFA, FASA
Robert Grossman, CPA/ABV, CVA, ASA, MST, CBA

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DECEMBER 12, 2013

Fundamentals of Personal Injury and Wrongful Death Economic Damage Calculations
Includes Sample Reports, Document Requests and Questionnaires

Jim Koerber, CPA/ABV/CFF, CVA, CFE
Brian Schmittling, CPA/ABV/CFF, CVA, CFE
Rob King, CPA/ABV, CVA, CFE

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 6 - JANUARY 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...the best way to use Pratt's Stats?

Pratt's Stats is very well known for researching and presenting transactions concerning private businesses. As a matter of fact, Pratt's Stats only includes transactions where the target is a private business. However, the buyers are either private or public businesses.

The Pratt's Stats database is offered by Business Valuation Resources, LLC (BVResources) www.bvresources.com and www.bvmarketdata.com. One of the best features of the Pratt's Stats database is the flexibility of the screening process. That flexibility has allowed us to take a much closer look at the transactions of private businesses by public companies.

Public company acquisitions of private companies are the best transactions in the database because they contain, or can lead the valuation analyst to, more detailed information. While there are many more transactions where the buyer is a private business, much of the important details of the transaction, the buyer, and/or the seller is not available. This has led many analysts to dismiss the method or to use it only as a corroborating/secondary method instead of a primary method. For additional analyses of these issues see "Transaction Databases: Useful or Not?" *Financial Valuation and Litigation Expert* journal, *FVLE* Issue 21, October/November 2009.

Now, back to the "best" way to use Pratt's Stats. According to the Pratt's Stats FAQ, "As of November 2012, approximately 32% of all transactions in the Pratt's Stats® database were sourced from the SEC (as opposed to being collected from business brokers.) These transactions provide extensive, verifiable information well-suited for litigation work." Pratt's Stats also includes public company buyers from Canada which we believe is included in the 32 percent figure. Some interesting facts are as follows (www.bvmarketdata.com accessed 11/26/13):

Public SEC reporting companies where the seller is a U.S. business - the total period December 1993 to October 2013

Out of the 20,543 total transactions (as of November 26, 2013), 4,953 (24 percent) include a public company buyer where the source of the data is the U.S. SEC and the seller is a U.S. business

- 3,283 transactions (66 percent) are stock deals
- The median MVIC is $16.5 million
- The median net sales is $11.8 million
- The median EBITDA is $575 thousand
- The median net income is $152 thousand
- The median net profit margin is 2 percent
- The median multiple of MVIC/net sales is 1.3
- The median multiple of MVIC/EBITDA is 9.5

Conclusion

So, what does all this data mean? It means that Pratt's Stats is a good tool to search for and evaluate public company purchases of private businesses. They also tell you which SEC documents they used to obtain the information with a link to those documents. The valuation analyst can then review these SEC filings and either check the Pratt's Stats multiples and other business parameters or calculate them on their own. These SEC filings often contain a lot of information about the acquired business that is not available when a private business buys another private business. One warning is that there are a material number of foreign businesses acquired. The data presented here screened those foreign businesses out. Another warning is that a material number of transactions are of businesses that are losing money or are at least reporting that they are losing money.

We still believe each transaction should be reviewed. Is it then that the use of Pratt's Stats in the GCTM can be used as a primary method versus a corroborating/secondary method or outright dismissal.

For additional information on the use of Pratt's Stats see the front page article, "Pratt's Stats: The Public Side," *Financial Valuation and Litigation Expert* journal, *FVLE* Issue 38, August/September 2012.

UPCOMING WEBINAR - JANUARY 8, 2014

NEW YEAR BV UPDATE:
The NEW Concepts, Data, Models and Methods from 2013 That You Need to Know and Understand

Join Jim Hitchner and Harold Martin for this great program to start the new year.

Are you way behind in your reading from 2013? Is your new year's resolution to wade through that stack of publications on your desk? This webinar will help you keep that resolution and clear that clutter. We will only present what we believe to be some of the most important pieces of BV information from 2013. This will include only **NEW** concepts, data, models and methods in such areas as cost of capital, discounts for lack of marketability, excess compensation, S corps, BV standards, and BV mistakes in Tax Court.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 7 - FEBRUARY 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that a recent Tax Court decision emphasized the use of a "certified" appraiser?

"While we do not disagree with the estate's assertion that the decedent's interest in PHC may be difficult to value, we believe that this further supports the importance of hiring a qualified appraiser. In order to be able to invoke 'reasonable cause' in a case of this difficulty and magnitude, the estate needed to have the decedent's interest in PHC appraised by a certified appraiser. It did not. Instead, the estate relied on the valuation by [Initial Valuator] but did not show that he was really qualified to value the decedent's interest in the company."

This is from the United States Tax Court, T.C. Memo 2014-26, *Estate of Helen P. Richmond, deceased, Amanda Zerbey, Executrix, Petitioner v. Commissioner of Internal Revenue, Respondent*, filed February 11, 2014. This dispute over value concerned a 23.44% interest in a personal holding company that held mostly publicly traded stocks. It is important to note that the estate used a value from an unsigned draft report.

This decision further states: "Given that the Commissioner has met his burden to show that the accuracy-related penalty applies, the burden shifted to the estate to show why it should be excused from the penalty. The estate failed to make such a showing. As a result, we find that the estate has not demonstrated that it acted with reasonable cause and in good faith in reporting the value of the decedent's interest in PHC on the state tax return. As a result, the Commissioner's imposition of an accuracy-related penalty under section 662(a), (b)(5), and (g) will be sustained."

This case is rich in issues including the calculation of built-in capital gain tax and discounts for lack of control and lack of marketability. The values also vary as follows:

Estate tax return	$3.1 million
Taxpayer's expert	$5.0 million
Court's decision	$6.5 million
IRS's expert	$7.3 million
IRS audit	$9.2 million

UPCOMING WEBINAR - March 4, 2014

Engagement Letters in Valuation and Forensic Services

Our Biggest Protection

Donald J. DeGrazia, CPA/ABV/CFF
Stacey D. Udell, CPA/ABV/CFF, CVA

Well-drafted and well-communicated engagement letters not only align CPA, analysts and client expectations from the start, but also substantially reduce the risk of disputes and claims arising later. We will discuss specific examples of engagement letter wording that work and others that may – or may not – cause problems later.

More Information

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 8 - JULY 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that Duff & Phelp's new *Valuation Handbook* contains data and data changes that may impact how you calculate the cost of equity capital?

The new Duff & Phelps *2014 Valuation Handbook - Guide to Cost of Capital (Valuation Handbook)* authored by Roger Grabowski, Jim Harrington and Carla Nunes, is a great new resource for calculating the cost of capital.[1] You probably already know that the *Valuation Handbook* now combines the old Morningstar/Ibbotson "SBBI"-type data (now called CRSP Deciles Size Premia Study data) with the traditional Duff & Phelps *Risk Premium Report* data (which was previously a stand-alone publication). What you might not know is that there are some interesting and useful data and data changes that have not been part of the prior Ibbotson books or the *Risk Premium Report*.

New Data and Changes to Existing Data

Unconditional Equity Risk Premiums (ERP)[2]

- "Historical" ERP minus WWII interest rate bias[3]
- "Supply-side" ERP minus WWII interest rate bias

Conditional ERP[4]

- 5.0% conditional ERP matched with a normalized risk-free rate of 4.0% as of December 31, 2013. This implies a base U.S. cost of equity capital of 9.0% (5.0% + 4.0%)

Corroborating Evidence (Conditional ERP)[5]

- Dr. Aswath Damodaran's adjusted (by D&P) implied ERP against a risk-free spot rate[6]
- Dr. Aswath Damodaran's adjusted (by D&P) implied ERP against a normalized risk-free rate of 4.0%
- Default spread model (DSM) ERP[7]

Size Premiums (RPs)[8]

- Ordinary least squares (OLS) betas and RPs
- Annual betas and RPs
- Sum betas and RPs
- In-depth data and comparisons of the characteristics of CRSP category 10z companies, and the characteristics of D&P portfolio 25 companies

Industry Risk Premiums (RPi)[9]

- Now requires at least 10 companies vs. 5 companies (as in old Ibbotson)
- 36 months of contiguous return data vs. 36 months within 60 months (as in old Ibbotson)
- Gives full information beta
- Based on three different estimates of ERP:
  - Historical ERP (as in old Ibbotson)
  - Supply-side ERP (new)
  - D&P recommended ERP (new)

Look for our in-depth review of this important new resource in our next issue of *Financial Valuation and Litigation Expert* journal.

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[1] Visit www.duffandphelps.com/CostofCapital for more information.
[2] An unconditional ERP is based on long-term historical data, not adjusted for current market conditions through the business cycle.
[3] World War II interest rate bias is due to government-imposed stability in the U.S. government bond interest rates from 1942 to 1951. This caused high average realized return premiums that some perceive as overstating the overall ERP from 1926 to 2013.
[4] The conditional ERP is D&P's recommended ERP as of a certain period based in part on current economic conditions. To learn more, download a free copy of "Duff & Phelps Decreases U.S. Equity Risk Premium Recommendation to 5.0%" at www.duffandphelps.com/CostofCapital
[5] D&P uses Dr. Damodaran's implied ERP model and the default spread model as corroborating evidence for their recommended ERP. D&P does not report the underlying data. For further information on these models see Shannon P. Pratt and Roger J. Grabowski, *Cost of Capital: Applications and Models*, 5th ed. (Hoboken, NJ: John Wiley & Sons, 2014), chapter 8, appendix 8A, "Deriving ERP Estimates."
[6] Dr. Damodaran solves for the discount rate that equates the current S&P 500 index level with his estimates of future cash distributions (dividends and stock buybacks). As published in the *Valuation Handbook*, D&P then converts this to an arithmetic average compared to the 20-year U.S. government bond rate as of the beginning of 2014. (Dr. Damodaran uses geometric averages and a 10-year bond rate.) For additional detail on Dr. Damodaran's ERP calculations and historical and updated ERPs (not converted by D&P), visit Dr. Damodaran's website http://pages.stern.nyu.edu/~adamodar/
[7] The DSM assumes that the ERP is constant and deviations can be measured by changes in the long-term average of the difference between Baa and Aaa bonds.
[8] Size premiums are based on the difference between actual returns and the estimated return using the capital asset pricing model (CAPM). This is frequently referred to as the return "in excess" of CAPM. The *Valuation Handbook* calculates the expected return based on three types of beta.
[9] Industry Risk Premia were previously published in Table 3-5, "Industry Premia Estimates" in the *Morningstar/Ibbotson SBBI Valuation Yearbook*. In the new *2014 Valuation Handbook*, these premia are still called "industry risk premia," but the nomenclature used within equations for this term is changed from "*IRP*" to "*RPi*." The formula for calculating an industry risk premium is $RPi = (FIB \times RPm) - RPm$ where *RPi* is the risk premium for the industry (i.e., industry risk premium), *FIB* is the full-information beta for the industry, and *RPm* is the risk premium for the market (ERP).

Financial Valuation and Litigation Expert Journal

Financial Valuation and Litigation Expert is a bi-monthly journal presenting views and tools from the leading experts in financial valuation, forensics/fraud, and litigation services. Articles in this full-color publication range from basic to advanced levels, but the emphasis is always on giving readers tools and practical knowledge to help them in their practice.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 9 - AUGUST 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...whether a calculated value can also be an opinion of value?

The bottom line is that there is no prohibition in *SSVS No. 1* on the use of an opinion of a calculated value or a conclusion of value. However, there is no explicit endorsement either. It is silent on this issue. That means it is up to the valuation analyst to decide whether they can provide an opinion of value in a calculation engagement. Calculations were intended to provide wide flexibility, and valuation analysts can provide calculations any way they see fit, as long as they comply with *SSVS No. 1*.

Litigation Engagements

Now, on to the tricky part: a litigation environment where you intend to offer your opinion of value. In litigation settings, an opinion is usually given with "reasonable certainty." So, can a calculation and calculated value be provided with reasonable certainty? Given the language in paragraph 21b in *SSVS No. 1* you would think that the answer is no.

> *Calculation engagement*--A valuation analyst performs a calculation engagement when (1) **the valuation analyst and the client agree on the valuation approaches and methods** the valuation analyst will use and **the extent of procedures** the valuation analyst will perform in the process of calculating the value of a subject interest (**these procedures will be more limited than those of a valuation engagement**) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. **A calculation engagement does not include all of the procedures required for a valuation engagement** (paragraph 46). [Emphases added]

Let's take this in two parts. One is not a big deal; the other is.

1) Agreement with the Client

This is not a big deal unless you allow it to be a big deal. Most clients are unfamiliar with all the approaches, methods, procedures, assumptions, applications, data choices, etc. that make up a valuation analysis, whether a valuation engagement or a calculation engagement. Let's be serious. The client doesn't ask for a calculation engagement; most don't even know what it is or that it even exists. What the client wants is a less expensive process to estimate a value. They simply want a cheaper valuation analysis. What this means is that although the client has to agree to the extent of the work performed, it is the valuation analyst who really decides what is to be done. The proverbial buck stops with you.

2) More Limited Procedures That Do Not Include All the Procedures Required in a Valuation Engagement and Had a Valuation Been Performed, the Results Might Have Been Different

This is a big deal, particularly in a litigation setting. How does this sound? "My opinion of the calculated value of XYZ Company is $4,000,000." Sounds fine on the surface, right? Let's parse this some. What you are really saying is, "My opinion (with reasonable certainty) of the calculated value (without reasonable certainty) of XYZ Company is $4,000,000." This sounds odd, as it should. So, while a calculation engagement is not prohibited by *SSVS No. 1*, from a practical respective, why would you want to put yourself in this untenable position?

There are some possible exceptions to this statement, which are discussed in the front page article "Calculations and Opinions: Bringing Clarity to a Cloudy Issue, "*Financial Valuation and Litigation Expert* journal, FVLE Issue 50, August/September 2014. This article also discusses the use of an opinion in a non-litigation setting and presents a comparison chart of the types of services and the types of value allowed within the four valuation standard-setting groups in the U.S.

UPCOMING WEBINAR - SEPTEMBER 9, 2014

Business Valuation Calculations and Calculation Reports:
Litigation and Non-Litigation

Including Two Updated (September 2014) Sample Calculation Reports

Presenters: Jim Hitchner, CPA/ABV/CFF, ASA and Jim Alerding, CPA/ABV, ASA

Hitchner and Alerding spent over six years on the AICPA BV Standards Writing Task Force responsible for *SSVS No. 1*, and know these standards inside out. This includes calculation services. They are two of the foremost experts on business valuation standards. They will tackle the tough issues, including calculations in a litigation environment, and take the time to answer your questions in a straightforward manner.

One of the main highlights of this session will be the presentation and discussion of two sample calculation reports (one short and one long) that are in complete compliance with the valuation standards of the AICPA, IBA and NACVA. We will also cover compliance issues for ASA and USPAP calculations. You will learn just about everything you ever wanted to know about calculations and calculation reports.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 10 - SEPTEMBER 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...that there are at least 20 ways to calculate the cost of equity capital?

You know about the Build-Up Model and the Modified Capital Asset Pricing Model. So, that's two methods, correct? Well, within each of these widely recognized models there are many data choices that lead to at least 20 estimates for the cost of equity capital (COEC). Also, we are talking about 20 COEC estimates using the new Duff & Phelps *2014 Valuation Handbook - Guide to Cost of Capital*.

You probably already know that the *Valuation Handbook* now combines the old Morningstar "Ibbotson"-type data (now called CRSP data) with the traditional Duff & Phelps *Risk Premium Report*. However, there have been many changes, revisions, and additions that get you to at least 20 COEC estimates. We say "at least" because there are more than 20 ways. However, we are trying to think "inside the box" and avoid what we believe to be outliers and, well, crazy results.

The *Valuation Handbook* contains a great deal of data, explanations, formulas, examples, and suggested applications. That's why we believe there are at least 20 ways to calculate the COEC. Here are a few things you need to decide on before you use this information.

1. What equity risk premium (ERP) are you going to use (*ex post*, *ex ante*, CRSP, D&P, historical, supply-side, WW II bias, adjusted, unadjusted, conditional, unconditional, Damodaran, DSM)?
2. What size premium are you going to use (CRSP deciles 10, 10a, 10b, 10w, 10x, 10y, 10z, D&P separate, D&P combined; based on OLS beta, annual beta or sum beta)?
3. What beta are you going to use (OLS, sum, annual, monthly, historical, predicted, FIB)?
4. What industry risk premium are you going to use (based on historical ERP, supply-side ERP or D&P recommended ERP)?
5. What risk-free rate are you going to use (spot rate or normalized rate)?

So, after you figure all this out, do you calculate all 20 COEC estimates and, if so, do you average them, weight them, dismiss some, emphasize some, etc.? If you want to know about the 20 ways to estimate the COEC and you want the answer to how to use and reconcile the data, sign up for Jim Hitchner's and Don Wisehart's October 8, 2014 webinar.

UPCOMING WEBINAR - OCTOBER 8, 2014

20 Ways to Calculate the Cost of Equity Capital:

A Case Study

How to Apply the New Data and Methods from the 2014 Duff & Phelps Valuation Handbook

Presenters: Jim Hitchner, CPA/ABV/CFF, ASA and Don Wisehart, CPA/ABV/CFF, ASA, CVA, MST

The main highlight of this session will be a new case study that shows 20 ways to calculate the cost of equity capital using the new Duff & Phelps *2014 Valuation Handbook*. You will learn how to determine, support, and present on the cost of equity capital. This session also evaluates the tools, resources, and methods available to determine the cost of equity capital and how to reconcile the results into a supportable conclusion.

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 11 - NOVEMBER 2014

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud and litigation services profession.

Do You Know...

...enough about tangible asset appraisals to prepare a credible business valuation?

No, you do not need to have a strong background in tangible asset appraisals to render credible business valuation opinions. However, a good underlying knowledge of this area will be helpful in many situations. The following example will help illustrate this.

The aggregate of the tangible asset values are higher than the business value (income and market approaches)

First, you cannot reconcile the values here without knowledge of certain important terms, including premises of value, used in the tangible asset appraisal discipline (see terms and definitions below). For example, the tangible asset values are probably valued under the premise of value, *Fair Market Value in Continued Use*, assuming that the business earnings support the tangible asset values.

However, in this case the tangible assets are not earning their fair rate of return. For a variety of reasons, the company cannot earn a fair return on its tangible assets. This is often referred to as economic obsolescence. The American Society of Appraisers (ASA) defines economic obsolescence as follows:

"*Economic obsolescence* (sometimes called "external obsolescence") is the loss in value or usefulness of a property caused by factors external to the property, such as increased cost of raw material, labor, or utilities (without an offsetting increase in product price); reduced demand for the product, increased competition, environmental or other regulations; inflation or high interest rates, or similar factors."*[1]*

In this example, the value of the company is not the higher value of the tangible assets. It is the lower business value derived by applying the income and market approaches to value.

Net Tangible Asset Value (Assumed Earnings)
\- Economic Obsolescence
= Business Valuation (Income and Market Approaches)

However, there is a twist to this. On a control basis, if the orderly liquidation value is higher than the business valuation, then orderly liquidation value is the correct value of the company, not the business value after economic obsolescence. This is just one example of the importance of having a reasonable knowledge of tangible asset appraisals.

Premises of Value

Premises of value, such as going concern value and orderly liquidation value, are important in business valuation. They are also important in the tangible asset appraisal world, which has additional terms and definitions.

The ASA premises of value for the Machinery and Technical Specialties discipline are:*[2]*

Fair Market Value. The estimated amount, expressed in terms of money, that may reasonably be expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date.

Fair Market Value - Removal. The estimated amount, expressed in terms of money, that may be reasonably expected for a property, in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, as of a specific date, considering the cost of removal of the property to another location.

Fair Market Value In Continued Use. The estimated amount, expressed in terms of money, that may be reasonably expected for a property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, including installation, as of a specific date and assuming that the business earnings support the value reported. This amount includes all normal direct and indirect costs, such as installation and other assemblage costs to make the property fully operational.

Fair Market Value-Installed. The estimated amount, expressed in terms of money, that may be reasonably expected for an installed property in an exchange between a willing buyer and a willing seller, with equity to both, neither under any compulsion to buy or sell, and both fully aware of all relevant facts, including installation, as of a specific date. This amount includes all normal direct and indirect costs, such as installation and other assemblage costs, necessary to make the property fully operational.

Orderly Liquidation Value. The estimated gross amount, expressed in terms of money, that could be typically realized from a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis, as of a specific date.

Forced Liquidation Value. The estimated gross amount, expressed in terms of money, that could be typically realized from a properly advertised and conducted public auction, with the seller being compelled to sell with a sense of immediacy on an as-is, where-is basis, as of a specific date.

[1] American Society of Appraisers, *Valuing Machinery and Equipment: The Fundamentals of Appraising Machinery and Technical Assets*, 2nd ed. (2005), p. 70.
[2] Ibid., pp. 3-4.

If you want to know more about tangible asset appraisals and the effect on business valuation, sign up for VPS's December 9, 2014 webinar, presented by Ray Moran, ASA, MRICS, Edwin Litolff, MAI, CCIM and Steven Harski, ASA, CFE. www.valuationproducts.com

UPCOMING WEBINAR - DECEMBER 9, 2014

Tangible Asset Valuations within Business Valuations: Golf Courses to Steel Mills
What Business Valuers Need to Know

Presenters:
Raymond Moran, ASA, MRICS, Edwin Litolff, MAI, CCIM and Steven Harski, ASA, CFE

Ray Moran and Steven Harski have spent extensive time managing multidiscipline cross-border engagements and sorting tangible asset issues for valuation, litigation and forensic assignments. Edwin Litolff has significant experience in litigation support and separating real property from business value interests. They will share their experiences relating to fair value and fair market value determinations in business combinations, litigation and forensic services, and regulatory issues encountered in the Americas, Europe and Asia/Pacific.

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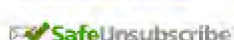

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DO YOU KNOW?

ISSUE 12 - FEBRUARY 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...what long-term growth rate to use in the capitalized earnings/cash flow method of the income approach?

Well, your peers responded to a similar question in a recent VPS webinar poll as follows:

What do you normally see in terms of a long-term growth rate (pick one)?
a. 3% or less - 37%
b. 3% to 5% - 53%
c. 3% to 6% - 10%
d. 7% or higher - 0%
e. Not applicable - 1%
(Note: the percentages do not add to 100% due to rounding.)

As you can see, 100 percent of the participants said the long-term growth rate was 6 percent or less, with 90 percent saying it was 5 percent or less. This poll appears to confirm that valuation analysts are looking at nominal GDP growth (real and inflation) as a benchmark (see below). Obviously, long-term growth rates can be less. Numerous analysts use inflation rates if they believe that the company they are valuing will only be able to grow at that rate. Also, remember that the assumption of 0 percent growth, or less-than-inflationary growth, usually means that the company is losing value each year.

Long-term growth rates are an area where mistakes can be made in both the capitalized cash flow method and the terminal year of a discounted cash flow model. One quick check is a review of two sources of economic long-term growth for the U.S. economy. Since 1926, the starting point for CRSP/old Ibbotson risk premium data, the nominal GDP growth rate in the U.S. economy has been around 6 percent.(1) The *Livingston Survey* forecasts inflation and real GDP growth in the U.S. every six months. In December 2014, the nominal growth rate predicted for the next 10 years was around 5 percent.(2)

(1) Lawrence H. Officer and Samuel H. Williamson, "Annualized Growth Rate of Various Historical Economic Series," www.measuringworth.com, 2014. Growth rates as of 2013.
(2) Consensus Median Average, Livingston Survey, Federal Reserve Bank of Philadelphia, Dec. 2014, p. 4.

If you want to know more about avoiding mistakes in growth rates and other issues in the capitalized earnings/cash flow method, sign up for VPS's February 26, 2015 webinar, presented by Jim Hitchner, CPA/ABV/CFF, ASA. www.valuationproducts.com

UPCOMING WEBINAR - FEBRUARY 26, 2015

Detecting and Avoiding
Business Valuation Mistakes
The Capitalization of Earnings/Cash Flow Method

*****Includes a detailed checklist to help you identify and avoid mistakes*****

Presenter: Jim Hitchner, CPA/ABV/CFF, ASA

Some business valuation mistakes are obvious. It is the mistakes that are less common and harder to detect that can torpedo an engagement. Join Jim Hitchner for this eye-opening session focusing on mistakes that can be hidden in the frequently used capitalization of earnings/cash flow ("CCF") method of the income approach.

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DO YOU KNOW?

ISSUE 13 - MARCH 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...that your website may provide fertile fodder for cross-examination?

"Expert Witnesses often have someone from their marketing department design their website or hire someone to design it for them, without taking the time to review what they have written. Keep in mind that you are ultimately responsible for what is written and posted on your website. Do not let the marketing person 'fluff-up' your credentials, as your website is often the first place opposing counsel will go to dig up dirt on you." This quote is from "Expert Witness, The 5 Biggest Mistakes Expert Witnesses Make On Their Websites," Alex Babitsky, 2007, SEAK, Inc., an organization that provides training, seminars, publications, and professional directories for expert witnesses. www.seak.com

Many websites use similar language in describing the firm or the professionals within the firm. Many of the websites say that their firms and services are "unique," "superior," and the "best." They hire the "best" and the "brightest," have "uncommon" professionalism, are market "leaders," are "widely" recognized, hold "distinguished" certifications, possess "unparalleled" expertise, and offer "exemplary" services. They are "recognized leaders," possess "extraordinary independence and judgment," have "distinguished" staff, are a "leading" firm, offering "world-class" services. They are "nationally recognized," offer "premier" services, and hold themselves to the "highest standard of excellence."

If you go to some well-known dictionaries and look up the definitions of many of the above-highlighted terms you will realize that there is material here for a tough line of cross-examining questions. Let's take an example. Ms. Attorney is trying to create a credibility problem for Mr. Valdude, the valuation analyst working with opposing counsel.

Attorney: Mr. Valdude, do you believe that your services are without equal and that you are the only person in the U.S. who provides such quality services?
Valdude: I believe I am one of the best.
Attorney: I didn't ask you that. I asked you if you are number one, without an equal, in the entire U.S.
Valdude: No, I do not believe that. As I just said, I do believe I am one of the best.
Attorney: Here is a copy of the *Merriam Webster Dictionary*. Do you recognize this dictionary as one of the most well known?
Valdude: Yes.
Attorney: Please read the definition of "unique."
Valdude: "the only one; being without a like or equal"
Attorney: Given that definition of "unique," and your prior testimony, do you believe that you and your services are "unique"?
Valdude: No.
Attorney: Please read the following description of you, your firm and its services that I downloaded from your website. [Attorney hands Valdude a copy.]
Valdude: "John Valdude and Valdude and Associates, LLC are nationally recognized for their unique expertise in business valuation and forensic services."
Attorney: Mr. Valdude, do you agree with that statement?
Valdude: I guess not. However, I didn't write that. Someone in my firm wrote it.
Attorney: Did you know that sentence was on your website?
Valdude: Yes. [Sheepishly looking down.]
Attorney: Do you believe that you and your firm are nationally recognized?
Valdude: Yes.
Attorney: What authoritative group or organization determined that you and your firm are nationally recognized?
Valdude: No one. I determined that. It's just well known.
Attorney: How many people have you polled to gather that data?
Valdude: I didn't poll anyone. It's just well known.
Attorney: Are you telling this court that the reason that you and your firm are nationally recognized is because you say it is?
Valdude: Yes.
Attorney: You have no concrete proof, do you?
Valdude: No.
Attorney: Please read the following description of you and your firm concerning independence that I copied from your website. [Attorney hands Valdude a copy.]
Valdude: "John Valdude and Valdude and Associates, LLC possess extraordinary independence."
Attorney: Mr. Valdude, do you agree with that statement?
Valdude: Yes, absolutely. [Valdude proudly sits straight with a slight sneer, thinking the attorney has now made a mistake].
Attorney: Please read the definition of "extraordinary" from the *Merriam Webster Dictionary*.
Valdude: "going beyond what is usual, regular, or customary; exceptional to a very marked extent"
Attorney: Do you possess extraordinary independence versus just ordinary independence?
Valdude: Yes, if you put it that way, yes.
Attorney: So you are more independent than all your peers, correct?
Valdude: I don't know what you mean. [Valdude is confused].
Attorney: If you are extraordinary, that means that everyone else is just plain ordinary, correct?
Valdude: Yes, I guess so.
Attorney: I don't want you to guess. Are you more extraordinary than your ordinary peers?
Valdude: Yes.
Attorney: By what metric or benchmark do you know you possess extraordinary independence?
Valdude: I just know it. I am very careful to be very independent and unbiased.
Attorney: That's not what I asked you. By what metric or benchmark do you know you possess extraordinary independence?
Valdude: It's just something I know.
Attorney: With no real concrete evidence or support, correct?
Valdude: I guess not. The only evidence is I know how I conduct my analyses.
Attorney: So you have self-designated yourself as being extraordinary?
Valdude: Yes.
Attorney: Here is a full copy of the pages on your website. Please read this carefully and tell me if there are any other untruths or unsupportable statements? [Note: There are.]

We won't belabor the point here. We can use several more of the descriptors already presented and go through a similar cross-examination. We think you get the point, sharply.

[Note: Much of this material was taken from "Websites: Uninteresting, Unsupportable and Unsafe?" *Financial Valuation and Litigation Expert*, FVLE Issue 26, August/September 2010, Valuation Products and Services, LLC.]

If you want to know more about the dos and don'ts of expert witness testimony, including additional sample cross-examination questions and answers, sign up for VPS's March 24, 2015 webinar, presented by Jim Alerding, CPA/ABV, ASA and Ed Dupke, CPA/ABV/CFF/CGMA, ASA. www.valuationproducts.com

UPCOMING WEBINAR - MARCH 24, 2015

Providing Expert Testimony: What to Watch For and What to Watch Out For

****Includes A Deposition Preparation Checklist and Sample Cross-Examination Questions and Answers****

Presenters: Jim Alerding, CPA/ABV, ASA and Ed Dupke, CPA/ABV/CFF/CGMA, ASA

Alerding and Dupke have testified over 500 times and have a wealth of experience to share.

- When and how to approach testimony in various types of trials
- The dos and don'ts concerning trial testimony
- The differences between trial testimony and deposition testimony
- Potential trick questions from opposing counsel
- Preparing for a deposition
- Preparing for trial
- Soft spots in testimony
- How attorneys use BV standards to reinforce or destroy an expert's credibility
- Review of the work of another expert - USPAP Standard No. 3 - What conclusions can you offer?

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JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

DO YOU KNOW?

ISSUE 14 - MAY 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...that two new IRS Job Aids on S Corp valuations and reasonable compensation are now available?

For free copies of these two new IRS Job Aids visit our website at:
http://www.valuationproducts.com/featuredarticles.html

- "The IRS Valuation of Non-Controlling Interests in Business Entities Electing to be Treated as S Corporations for Federal Tax Purposes: A Job Aid for IRS Valuation Analysts," dated October 29, 2014 and released April 30, 2015
- "Reasonable Compensation Job Aid for IRS Valuation Professionals," dated October 29, 2014 and released April 30, 2015

If you want to know more about the IRS Job Aid on reasonable compensation, sign up for VPS's May 7, 2015 webinar, presented by Michael Gregory, ASA, CVA, who was the original IRS issue champion on both IRS Job Aids: http://www.valuationproducts.com/webinar.html

UPCOMING WEBINAR

May 7, 2015, 1-3 pm EDT

New IRS Job Aid on How the IRS Determines Reasonable Compensation
Presented by the Original IRS Issue Champion

Presenter: Michael A. Gregory, ASA, CVA

Former IRS Territory Manager Michael Gregory will speak on this topic for the first time ever, explaining the major elements of this document, how the IRS handles the issue of reasonable compensation, and the impact on business valuation analysts. Don't miss this important session by the original IRS issue champion of the initiative.

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Jim Hitchner's
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DO YOU KNOW?

ISSUE 15 - JUNE 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

June 10, 2015 VPS Webinar Presented by Jim Hitchner

Detecting and Avoiding Business Valuation Mistakes
The Guideline Company Transactions Method
Small- to Medium-Size Businesses

Do You Know...

...that you only have Four Choices on the Reliability of a Value based on Transaction Databases?

The choices, ranked by level of reliability, are simple but powerful:

1. Accept the method as a primary method
2. Accept the method as a corroborating method
3. Accept the method as a non-corroborating method
4. Dismiss the method as unsupportable and unreliable

Accept the Method as a Primary Method

Most analysts will make this choice when they know enough about the buyer, the seller, and the terms of the transaction to calculate supportable valuation multiples (e.g., invested capital/EBITDA). This usually occurs when either the buyer or the seller is a public company and the transaction is material enough to require detailed disclosure of the types of information needed to develop supportable multiples.

Pratt's Stats contains 5,307 public buyers of U.S. businesses, which is 25% of the transactions involving U.S. businesses. Of the 5,307 transactions, 5,192 report IC/Net Sales multiples and 2,821 report IC/EBITDA multiples. In the DoneDeals database the buyer, the seller, or both must be a public company. Neither BIZCOMPS nor the IBA database includes public companies.

While Pratt's Stats and DoneDeals report various multiples, we find that, where practical, researching the relevant SEC documents helps to support using the guideline company transaction method (GCTM) as a primary method.

Accept the Method as a Corroborating Method

This choice is sometimes made when the buyer and the seller are private businesses and there is very little known about the buyers, the sellers, or the terms of the transactions. In this situation, usually the income approach -- either the capitalization of cash flow (CCF) method or the discounted cash flow (DCF) method -- is the primary value and the analyst only uses the GCTM to corroborate that value. Usually analysts use the GCTM as a corroborating method when the value is close to the value obtained by the primary method typically based on the income approach. Some analysts will use numerical weights, which can sometimes be difficult to support.

Accept the Method as a Non-corroborating Method

You are probably surprised at this choice for the level of reliability. That's because you almost never see this choice made. Most analysts will dismiss the GCTM when the value is different -- usually materially different -- from the primary method typically based on the income approach. However, the data constraints are present whether the analyst uses the GCTM as a corroborating or non-corroborating method. While a non-corroborating level of reliance may sound silly, an analyst who dismisses the GCTM only because the value is so different from the primary method value needs to explain why, in other engagements, he or she used it as a corroborating method simply because the value was close to the primary method value.

Dismiss the Method as Unsupportable and Unreliable

This choice is made due to the data constraints and the difficulty in supporting values based on very little information. However, the business valuation standards of the four U.S. valuation bodies require their members to at least consider the use of guideline company transactions, so an outright dismissal, without the research, is not recommended.

For additional information on transaction databases, attend the VPS webinar on June 10th.

UPCOMING WEBINAR

June 10, 2015, 1-3 pm EDT

Detecting and Avoiding Business Valuation Mistakes
The Guideline Company Transactions Method
Small- to Medium-Size Businesses

Includes Three Case Study Examples
Includes 13-Point Checklist

Presenter: Jim Hitchner, CPA/ABV/CFF, ASA

Business valuation mistakes can be deadly, regardless of the purpose of the valuation. Some are seen on a frequent basis but others are harder to detect. That is the purpose of this webinar - to assist in the detection and avoidance of mistakes. This presentation is focused on the guideline company transactions method (GCTM) of the market approach and its application to small- to medium-size businesses.

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DO YOU KNOW?

ISSUE 16 - June 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...that the New IRS S Corp Job Aid Stands Firm on the Issue of Tax Adjusting S Corps?

In the article listed below, Jim Hitchner, editor-in-chief of *Financial Valuation and Litigation Expert*, presents his views on this new document and also provides some counter-arguments to the IRS position on tax adjusting S corps. As you can see from the following quotes, the IRS continues to take a very strong position:

> With respect to the attribute of pass-through taxation, absent a compelling showing that unrelated parties dealing at arms-length would reduce the projected cash flows by a hypothetical entity level tax, no entity level tax should be applied in determining the cash flows of an electing S Corporation. In the same vein, the personal income taxes paid by the holder of an interest in an electing S Corporation are not relevant in determining the fair market value of that interest. (p. 5)
>
> The suggestion by some commentators that a Valuation Analyst must apply, as a matter of conventional practice, a valuation paradigm based on taxable corporations (C Corporations) to entities that do not pay tax ignores a major factual component, that the entity being valued has chosen its form, including its pass-through tax status, for business reasons. If a valuation is to be persuasive, it must be based on the actual attributes of the interest being valued. Accordingly, pass-through entities should be, where at all possible, compared to other pass-through entities in the valuation process. (p. 7)
>
> With respect to the question of pass-through taxation, no entity level tax should be applied in the valuation analysis of a non-controlling interest in an electing S Corporation, absent a compelling demonstration that independent third parties dealing at arms-length would do so as part of a purchase price negotiation. In a similar manner, the personal income taxes of a potential interest buyer or interest seller are not relevant in determining the fair market value of an interest in an electing S Corporation. The application of investor level characteristics such as personal tax rates results in an investment value to an assumed candidate buyer rather than a fair market value based on the informed, competing interests of the hypothetical willing and financially able parties contemplated by the fair market value standard. (p. 20)

Financial Valuation and Litigation Expert Journal

***FVLE* Issue 55, June/July 2015 Articles**

- **THE NEW IRS S CORP JOB AID - What You Need to Know**
- **AICPA Presents New Fair Value Measurement Credentials**
- **Directly Valuing Private Minority Interests Using the Income Approach**
- **Standards of Value, Personal Goodwill, and Double Dipping**
- ***Ferolito v. AriZona Beverages*: The Application of DLOM in New York Fair Value Cases**
- **Non-Controlling Interests and Capital Structures**
- **Business Appraisal within the Cannabis Industry**
- **Cost of Capital Corner**

http://valuationproducts.com/fvle.html

UPCOMING WEBINAR

July 8, 2015, 1-3 pm EDT

The Guideline Public Companies Method
Amazing Lessons from the Tax Court

Presenter: Lance Hall, ASA

Earlier this year, Lance Hall was asked to teach a class on the use of the guideline public companies method (GPCM). After 30 years of valuing companies for a living, this was the last topic he normally would have chosen. However, in preparing for the class, he was simply amazed by how much he did not know. As a result of his preparation, he has accumulated a comprehensive and authoritative compilation of statutes, IRS promulgations, and tax court decisions on the selection and use of the GPCM. This presentation is for all business valuation experts from beginning to advanced. This webinar will increase the accuracy and defensibility of your expert reports.

Your entire office can attend and earn CPE for just $239.
Our simple pricing plan means you get access to the live webinar for the whole office as well as an archived copy with transcript and handouts for later viewing.

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Jim Hitchner's
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DO YOU KNOW?

ISSUE 17 - JULY 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...what is really in your Industry Growth Rate?

Valuation analysts often use industry information for expected growth rates. However, make sure you know whether the growth rate is a nominal or real growth rate. The real growth rate is the growth rate excluding inflation; the nominal growth rate has both the inflation and the real growth rate included.

Analysts will often go to an industry publication -- for example, *The Widget Industry Review*. The publication says that revenues of the widget industry are expected to grow by 5% a year. That would be a nominal growth rate, since revenue growth rates include inflation and unit (real) growth. However, assume the publication says shipments of widgets are expected to grow at 3% per year. That's the growth in the number of widgets, which is a real growth rate with no embedded inflation.

An industry analysis may predict, "We expect our industry to grow for the next five years by 4% a year." To avoid a misunderstanding and possible mistake, call the publisher and ask, "Is that a real or nominal growth rate?" The answer may be, "I'm not sure; let me check." It is important to know which it is. Analysts may quote an industry growth rate and then use it as a nominal rate. Later, in a litigation setting, they find out it's a real rate and they didn't add inflation on top of that real growth rate. This mistake could change the value significantly. This is a frequent mistake. The bottom line is, never trust a published growth rate unless you know what it encompasses.

For more information on the use of the industry growth rate, see Business Valuation Mistakes: How to Avoid Them, Part Three, Capitalized Cash Flow Method" (article includes pertinent information on growth rates), *Financial Valuation and Litigation Expert*, Issue 48, April/May 2014.

UPCOMING WEBINAR

August 25, 2015, 1-3 pm EDT

Small Business Divorce Valuations
Including Case Studies and Examples

Presenters: Jim Alerding, CPA/ABV, ASA, and Jim Ewart, CPA/ABV/CFF, CVA

Experienced valuation and litigation professionals Alerding and Ewart will lead you through the maze of valuing small businesses for divorce purposes. Using examples and case studies, they will cover the practical aspects of completing the divorce engagement, including personal goodwill.

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DO YOU KNOW?

ISSUE 18 - SEPTEMBER 2015

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...Why You Use a 20-Year Treasury Bond as the Risk-free Rate in a Build-up Model or the Modified Capital Asset Pricing Model?

Under fair market value, an investment in a private business is typically considered a long-term investment. A particular investor may have a shorter investment horizon, but that would be more of an investment value. This is why most valuation analysts use a longer-term, 20-year Treasury bond as the risk-free rate. A 20-year Treasury is the longest-term bond that goes back to 1926, the starting point for the new Duff & Phelps CRSP data and prior Ibbotson risk premium data. Furthermore a 20-year Treasury bond is used by Duff & Phelps when determining the equity risk premium and size premiums for the Risk Premium Report data that goes back to 1963. The use of a 20-year Treasury bond is consistent with Duff & Phelps calculations. [Note: The Duff & Phelps annual publications, *Valuation Handbook - Guide to Cost of Capital* and *Valuation Handbook - Industry Cost of Capital*, contain everything (and more) that used to be published in the discontinued Morningstar publications.]

This is one of the many questions to be addressed in the upcoming webinar "**Hardball with Hitchner, Pratt, and Fishman"** on September 22nd. For more information, see below.

UPCOMING WEBINAR

September 22, 2015, 1-3 pm EDT

Hardball with Hitchner, Pratt, and Fishman

They Tackle the Tough Issues and Present a Consensus View

Three of the most experienced valuation analysts in the nation are taking on the tough questions about how to incorporate new valuation concepts, how to use new sources, and how to make the best choice when looking at similar data.

Join Jim Hitchner, Shannon Pratt, and Jay Fishman for the **Hardball with Hitchner Webinar** to get straightforward answers to your questions on cost of capital, discounts for lack of marketability, S corps, transaction databases, and reports.

Your entire office can attend and earn CPE for just $239.
Our simple pricing plan means use get access to the live webinar
for the whole office as well as an archived copy for later viewing.

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DO YOU KNOW?

ISSUE 19 - NOVEMBER 2015

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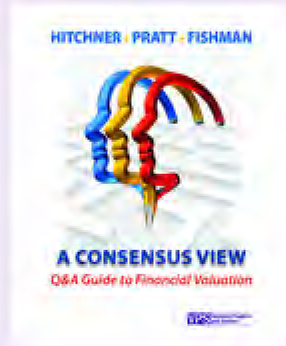

Coming December 2015

New VPS Guide

Hitchner Pratt Fishman
A Consensus View
Q&A Guide to Financial Valuation

https://www.valuationproducts.com/HPFQA/

Includes Over 150 Questions and Answers
(Q&A below is excerpted from the Q&A Guide)

Do You Know...

... the Proper Way to Reconcile Values?

Here is the bottom line. If value conclusions from two or three different methods are very far apart, something is wrong. Depending on the facts and circumstances, averaging the results of values that are far apart will only ensure error and that the value conclusion is wrong. One or more of the methods have resulted in an unreliable value, making the value conclusion incorrect. This is often due to lack of data and/or the incorrect application of the method. Some analysts will apply a lower weight to a method where there is less reliability, usually due to data constraints. While we understand the logic, there can be unsupportable presentations and/or abuses. See the chart below for an example. The application of weights increased the value from $10 million to $13.6 million, a 36% difference.

CCF = Capitalized Cash Flows
GPCM = Guideline Public Company Method
GCTM = Guideline Company Transactions Method

Reconciling Values and How It Can Distort the Value

Method	Value ($Million)	Weight	Wgt. Value
CCF	10	60%	6.0
GPCM	18	20%	3.6
GCTM	20	20%	4.0
Value			13.6

With a range of $10 to $20 million, all the value conclusions and methodology need to be revisited. It is unlikely that all valuation methods will converge on the exact same value, but the range should be more reasonable and the reason for weighting the approaches should be logical and supportable.

What's the real value? It's likely $10 million, assuming good data and reasonable assumptions in the CCF method.

A Consensus View Q&A Guide to Financial Valuation

In this new guide, HITCHNER, PRATT, and FISHMAN answer the most important valuation questions they've been asked over the years.

- The 2016 Q&A Guide includes:
  - Chapter 1 Income Approach
  - Chapter 2 Cost of Capital/Rates of Return
  - Chapter 3 Discounts and Premiums
  - Chapter 4 Business Valuation Standards and Ethics
- An annual guide presented by three of the BV industry's thought leaders
- Each year, new chapters will be added and existing chapters will be updated

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DO YOU KNOW?

ISSUE 20 - DECEMBER 2015

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Do You Know...

... Whether the Build-Up Model and the Modified Capital Asset Pricing Model Are Still Valid and Supportable?

There have been recent criticisms about the use of the Build-Up Model (BUM) and the Modified Capital Asset Pricing Model (MCAPM). Certain analysts question the use and supportability of these two methods of calculating the cost of equity capital. Furthermore, these criticisms go so far as to question whether the models should be used at all.

First and foremost, what's the alternative to these models? Is it survey data, the use of transaction market multiple data, or something else? Well, we believe that these two methods are still valid and are still an important part of a valuation analysis. As further support for this position, see excerpts below:

Shannon P. Pratt and Roger J. Grabowski, *Cost of Capital Applications and Examples*, 5th edition, Wiley, 2014

- The two commonly used models to estimate the cost of capital for discounting or capitalizing expected net cash flows for a closely held business are the build-up method and the modified version of the capital asset pricing model (CAPM). (p. 693)
- As the magnitude of the effects of the differences between the private and public capital markets have on the cost of capital is further researched and the databases and surveys of closely held companies are expanded and improved, the estimation of a cost of capital directly from the private markets will become more reliable and defendable. For now, however, the build-up method and the expanded CAPM still remain the best tools available for estimation of a cost of capital for a closely held business. (p. 709)

James R. Hitchner, editor and co-author, *Financial Valuation Applications and Models*, 3rd edition, Wiley, 2011

- Several methods are available to calculate the cost of capital or discount/cap rate for a specific investment. Some of the more common methods include:
  - Build-up method (BUM)
  - Capital asset pricing model (CAPM) method
  - Modified capital asset pricing model (MCAPM) method
  - Weighted average cost of capital (WACC) method
  - Price/earnings method (p. 183)
- The build-up method (BUM) is often used by analysts who work with small and medium-size businesses. In a build-up method, the discount rate is calculated by adding together the analyst's assessment of the systematic and unsystematic risks associated with a particular subject company or ownership interest. The most widely used methodology for deriving a rate under this approach uses four or five basic elements to derive an indication of a discount rate with at least one element being based on empirical evidence compiled by Ibbotson or Duff & Phelps. (p. 194) [Now the Duff & Phelps *Valuation Handbook - Guide to Cost of Capital*]
- Valuation analysts typically rely on two alternative models to calculate the discount rate: the Modified Capital Asset Pricing Model (MCAPM) and its simplified relation, the Build-Up Model (BUM). (p. 246)

Jay E. Fishman, Shannon P. Pratt, James R. Hitchner, et al., *PPC's Guide to Business Valuations*, 25th edition, Thomson Reuters, 2016

- Within the income approach, two common procedures have evolved to estimate the all-important equity discount rate: the Capital Asset Pricing Model (CAPM) and the Build-Up Method. (p. 5-44)
- The CAPM was developed at the University of Chicago in the 1960s. Although it has been subject to considerable criticism and there have been many attempts to develop alternative models, the CAPM is still the most widely used in the field of finance today.(p. 5-44)
- The remainder of this discussion is based on the modified CAPM (MCAPM) method that has been adopted by the business valuation profession. (p. 5-45)
- As previously noted, there are two primary techniques for determining a company's discount rate, the build-up method and the CAPM method, which is based on guideline public company data. (p. 5-57)
- When guideline public companies cannot be found, the build-up method that is discussed in this section is typically used. (p. 5-57)

Shannon P. Pratt with Alina V. Niculita, *Valuing a Business, The Analysis and Appraisal of Closely Held Companies*, 5th edition, McGraw Hill, 2008

- The CAPM is a conceptual cornerstone of modern capital market theory. Its relevance to business valuations is that businesses and business interests are a subset of the investment opportunities available in the total capital market; thus, the determination of the prices of businesses theoretically should be subject to the same economic forces and relationships that determine the prices of other investment assets. (p. 185)
- We have previously defined the discount rate or the cost of capital generally as the sum of a risk-free rate and a risk premium. The build-up model divides the risk premium into its three main subcomponents and estimates the cost of capital as the sum of the following:
  1. A risk-free rate
  2. A risk premium, including one or all of the following subcomponents:
     - An equity risk premium
     - A size premium
     - A company-specific risk premium (p. 200)

Gary R. Trugman, *Understanding Business Valuation, A Practical Guide to Valuing Small to Medium Sized Businesses*, 4th edition, American Institute of Certified Public Accountants, Inc., 2012

- Many valuation analysts, especially those who work with smaller closely held companies, use the build up method for developing a discount rate. (p. 472)
- CAPM has been modified to be used as a method of determining a discount rate, commonly used in the appraisal of larger companies (p. 473)

Z. Christopher Mercer and Travis W. Harms, *Business Valuation, An Integrated Theory*, 2nd edition, Wiley, 2008

- Appraisers use a variety of related techniques to derive appropriate discount rates. In this chapter, we consider the appropriate discount rate in the context of the Integrated Theory using one such technique, the Adjusted Capital Asset Pricing Model (or ACAPM). (p. 153)

Coming December 2015

New VPS Guide

Hitchner Pratt Fishman A Consensus View Q&A Guide to Financial Valuation

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- The 2016 Q&A Guide includes over 150 questions and answers:
  - Chapter 1 Income Approach
  - Chapter 2 Cost of Capital/Rates of Return
  - Chapter 3 Discounts and Premiums
  - Chapter 4 Business Valuation Standards and Ethics
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DO YOU KNOW?

ISSUE 21 - DECEMBER 2015

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Do You Know...

... if the supply-side equity risk premium will always be less than the historical equity risk premium?

In theory, eventually the supply-side ERP and the historical ERP should converge. The Morningstar/Ibbotson *2013 Valuation Yearbook* (p. 68) addressed this as follows:

> A common belief in the industry is that the supply-side model always creates an equity risk premium lower than the historical model, but this is not the case. If investors foresee a future decline in earnings, price would drop in anticipation with no current change in earnings. The P/3E [price to three year average earnings] would need to drop below the 1926 P/3E level of 10.65 in order for the supply-side equity risk premium to be greater than the historical model. Looking back at the 87-year history, we can see this occurred 16 times.
>
> This unsustainable P/E growth, which began in the 1980s, is expected to return to historic levels in the future. Therefore, the historical and supply-side equity risk premiums are expected to converge over time.

... how Duff & Phelps calculates the supply-side equity risk premium?

Duff & Phelps calculates the supply-side ERP almost identically to the methodology used in the former Morningstar/Ibbotson SBBI Valuation Yearbook. The original Ibbotson and Chen study relied upon a single year's price-to-earnings (P/E) ratio when evaluating the long-term growth in the P/E ratio, which is subtracted out when calculating the supply-side ERP.[1,2]

> Ibbotson and Chen report on a study in which they estimated forward-looking long-term sustainable equity returns and expected ERPs since 1926. They first analyzed realized equity returns by decomposing returns into factors including inflation, earnings, dividends, price-to-earnings ratios, dividend payout ratios, book values, returns on equity, and GDP per capita (The fundamental building blocks of equity being 'supplied' by companies).
>
> They forecasted the ERP through supply-side models built from historical data by removing the price-to-earnings ratio inflation (a top-down approach for estimating the market's re-pricing due to the underlying economic changes in aggregate). Those authors determined that the long-term ERP that could have been expected, given the underlying economics, was less than the realized premium.[3]

In the former Morningstar/Ibbotson *SBBI Valuation Yearbook* and in the new *Valuation Handbook - Guide to Cost of Capital*, a three-year average P/E ratio is used in the calculation of the supply-side ERP:

> We used a normalized three-year average price-to-earnings ratio in the most recent period...that is, we examined the compound annual growth in price-to-earnings ratios from 1926 to the current year [2014] where the current year's price-to-earnings ratio is calculated using a three-year average of earnings. Using the three-year average allows the adjustment to smooth out the volatility of extraordinary events and allows earnings to better reflect a normalized trend...we used the three-year average based on the prior-year's earnings, the current year's earnings estimated at year end and the forecast earnings in the following year.[4]

Like the "historical" ERP, the supply-side ERP changes over time, and so does the difference in the historical ERP and the supply-side ERP. The differential in ERPs implied by the original Ibbotson and Chen study was 1.25%. In the last five years, the differential has ranged from a low of 0.5% to a high of 0.8%.[5]

1. Roger G. Ibbotson and Peng Chen, "Long-Run Stock Market Returns: Participating in the Real Economy," *Financial Analysts Journal*, January/February 2003, pp. 88-98.
2. While the study goes back to 1926, the majority of the P/E effect has been in the last 25 years or so.
3. Duff & Phelps *2015 Valuation Handbook - Guide to Cost of Capital*, p. 3-26 (footnote omitted).
4. Ibid., pp. 3-26 to 3-27.
5. Data for 2015 and 2014 from Duff & Phelps *2015 Valuation Handbook - Guide to Cost of Capital* and *2014 Valuation Handbook - Guide to Cost of Capital*, Appendix 3. Data from 2011 to 2013 from Morningstar/Ibbotson *Valuation Yearbooks*, back page.

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DO YOU KNOW?

ISSUE 22 - JANUARY 2016
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Do You Know...

...Whether Your Peers Are Tax Affecting S Corps?

As you know, we present monthly webinars on a variety of business valuation topics. During these webinars we take polls of the participants. One frequent poll question is the percentage of the participants who tax affect S corps (operating companies) as a starting point in a valuation. Some of those responses follow:

- September 22, 2015 82%
- January 29, 2014 71%
- October 15, 2013 89%
- August 15, 2013 81%
- June 19, 2013 67%
- February 13, 2013 76%

We know that the IRS has won several tax court cases dealing with the issue of tax affecting pass-through entities (*Gross, Wall, Heck, Adams, Dallas, Giustina,* and *Gallagher*). We agree that this is a formidable fact. However, in addition to the polling results above, four well-known valuation books accept the position that S corps can or should be tax adjusted as a starting point (see the excerpts below).

Furthermore, all the U.S. valuation bodies (AICPA, ASA, IBA, and NACVA) teach tax adjusting as a starting point. Also, in our experience in litigation matters, both sides usually tax adjust as a starting point, which is then accepted by the court. There are many litigation and/or court cases (albeit outside the tax court) where tax adjusting is accepted. Generally, the valuation profession and many courts disagree that S corps should not be tax adjusted as a starting point.

For example, there was a recent New York case, *Ferolito v. AriZona Beverages USA LLC*. Both sides tax affected the earnings of the S corp, one at 38 percent and one at 43.5 percent. The court selected 43.5 percent. As such, tax affecting this S corp was agreed upon by experts from both sides and the court. Tax affecting was not an issue in this case, only the amount of taxes.

Selected Excerpts

Fishman, Pratt, Griffith, and Hitchner, *PPC's Guide to Business Valuations*, 25th edition, 2015, Thomson Reuters

In the past, since the capitalization rates determined in accordance with either the build-up method or the CAPM method (discussed in sections 505 and 506) usually relate to after tax earnings, most valuation practitioners subtracted (and continue to subtract) taxes from the entity level earnings of these pass-through entities as a starting point before dividing those earnings by the related cap rate. (p. 5-35)

The techniques discussed so far attempt to measure the benefits of a pass-through entity (primarily a savings due to the avoidance of the taxes on dividends and capital gains) as compared to a C corporation either by adjusting the cash flow/earnings for taxes or by adjusting the discount rate. (pp. 5-38, 5-39)

James R. Hitchner, editor and coauthor, *Financial Valuation Applications and Models*, 3rd edition, 2011, Wiley

Four models [Chris D. Treharne, ASA, MCBA; Daniel Van Vleet, ASA, CBA; Z. Christopher Mercer, ASA, CFA; and Roger J. Grabowski, ASA] for the valuation of noncontrolling interests in pass-through entities have been presented. Each of these theories has foundation in the logical issues that a noncontrolling buyer and seller would consider upon a transaction of their interest.

Each of the four theories considers the following issues:

- Amount and timing of distributions
- Retained net income
- Holding period and exit strategy
- *Tax rates - personal, corporate, and capital gains* [emphasis added]
- Further effect of minority or marketability discounts
- Possible ability to participate in step-up-of-basis transaction (p. 624)

There is now wide agreement that it is the avoidance of tax on dividends and capital gains, rather than solely an avoidance of tax on corporate income, that forms the main advantage of pass-through entities, with different views remaining about how best to measure that advantage. (p. 573)

Shannon P. Pratt and Alina V. Niculita, *Valuing a Business The Analysis and Appraisal of Closely Held Companies*, 5th edition, 2008, McGraw Hill

It is important to recognize that both C corps and S corps pay taxes on corporate income. Whether that tax is actually paid by the corporation or the individual is absolutely irrelevant. What is relevant is the difference between the value of a company valued as a C corporation, valued using publicly traded C corporation data (because it is by reference to publicly traded C corporations that we value the S corporation), and an S corporation. It is for this reason that most S corporation models begin by valuing the company 'as if' a C corporation, using the rates of return derived from publicly traded C corporations, and then go on to recognize the benefits of the Subchapter S election. From the investor's perspective, there are two primary benefits: (1) the avoidance of dividend tax on the receipt of distributions, and (2) the ability to build up their basis in their stock. (pp. 618-619)

Gary R. Trugman, *Understanding Business Valuation A Practical Guide to Valuing Small to Medium Sized Businesses*, 4th edition, 2012, American institute of Certified Public Accountants

It is not uncommon for an appraiser to tax affect the earnings of S corporations by applying marginal C corporation tax rates to their earnings. This is consistent with the approach employed in our reports. (p. 667)

The reality of the situation is that personal taxes will be paid whether distributions are made to the [S corp] shareholders or not. It seems reasonable to consider these taxes in a similar fashion as corporate taxes. Either way, the government is going to get paid. (p. 673)

The model that I like the most, probably because to me it is the most simplistic, is Treharne's model. It was also the model that was referenced in Delaware Open MRI. The judge in that case did a fabulous job of explaining what he did. In fact, a footnote in the opinion cites a presentation that Treharne gave at an American Society of Appraisers' (ASA) conference as his source. (p. 687)

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DO YOU KNOW?

ISSUE 23 - FEBRUARY 2016

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Do You Know...

...how to account for excess depreciation and amortization in the terminal year of a discounted cash flow model?

First, you do not ignore it, as some analysts do. Second, the question here is not whether you should calculate the excess depreciation and amortization. The answer to that question is an unequivocal "yes." There is real additional value to the benefits of the tax shield attributable to higher, but temporary, levels of tax depreciation and amortization.

The terminal year of a DCF model must reflect the normalized level of cash flows into perpetuity. The key word here is "normalized." If the company has long-lived assets such as buildings and/or goodwill that are being depreciated or amortized over a long period of time for tax purposes, including such depreciation or amortization in the terminal-year assumption will distort the cash flows. The long-term tax benefit of such level of depreciation and/or amortization should be reflected in the analysis but may be captured separately from the terminal-year calculations. Some analysts improperly match capital expenditures to the depreciation/amortization, including the temporary increase in depreciation/amortization from the long-term assets. To reiterate, the assumption for capital expenditures should drive the depreciation/amortization assumptions, not the other way around. An analyst matching capital expenditures to depreciation/amortization, including this excess amount, would obtain an unreasonable and unsupportable value. The normalized depreciation calculation should be driven by the normalized capital expenditures.

Now, what do you do with this depreciation/amortization tax benefit overhang? You value it separately. You calculate the tax benefit of the annual excess amount and present value the benefit over the life of the excess amount at the terminal year. This amount is then present valued to period zero. (Or in one step, just use present value periods and factors representing the years in which such excess tax savings occur to calculate the value of the tax benefits at the valuation date.) The value of the tax benefit from the additional depreciation/amortization above the normalized level is then added to the value obtained from the DCF using normalized cash flows. For additional information, see "Amortization Should be Excluded from Terminal Value Calculations," Gilbert E. Matthews, *Financial Valuation and Litigation Expert*, Issue 47, February/March 2014, www.valuationproducts.com/pastFVLE.html.

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DO YOU KNOW?

ISSUE 24 - MARCH 2016

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...what the hidden assumptions are when weighting and reconciling two values?

Part 1) WEIGHTING AND RECONCILING TWO VALUES
You have two indications of value, one from the capitalized cash flow (CCF) method of $5.0 million and one from the guideline company transaction method (GCTM) of $3.8 million. Let's ignore discounts for the time being and assume both values are on the same level of value. If you average the two indications of value, the conclusion is $4.4 million, with a 50 percent weight to each value. Now, let's assume the analyst decides not to use numerical weights but uses the acceptable method of qualitative weights. For example, the analyst may say he or she believes the CCF method has better support than the GCTM and chooses $4.8 million without any numerical weights.

Even though the analyst says he or she did not use numerical weights, there is an implicit-- maybe even an explicit-- weight that is easily calculated. With only two indications of value, you can easily back into weights using the simple algebraic formula:

VC = PWM1(M1 Value) + (PWM2)(M2 Value)

Where:
VC = Valuation Conclusion,
PWM1 = Percentage Weight for Method 1
PWM2 = Percentage Weight for Method 2 and
PWM2 = (1 - PMW1)
M1 = Method 1
M2 = Method 2

Using our example:

4.8 = (PWM1)(5.0) + (1-PWM1)(3.8)
4.8 = 5.0PWM1 + 3.8 - 3.8PWM1
4.8 = 1.2PWM1 + 3.8
1.0 = 1.2PWM1
PWM1 = .8333
PWM1 = 83% rounded
PWM2 = 100% - 83% = 17%

The derived weights are 83 percent to the CCF method and 17 percent to the GCTM. As you can see, a small difference in the concluded value ($4.4 million to $4.8 million) results in a weighting change of 50 percent/50 percent to 83 percent/17 percent. Also, a qualitative weighting method was just changed to a quantitative method by simple algebra and indicates very little weight to one of the methods. There is nothing wrong with qualitative weighting. It's done all the time. However, with only two value indications, which is not uncommon in smaller businesses, qualitative weights can be turned into quantitative weights.

Our next *Do You Know* No. 25 will present hidden assumptions when there are more than two indications of value.

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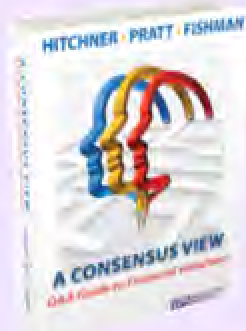

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DO YOU KNOW?

ISSUE 25 - MAY 2016

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Do You Know...

...what the hidden assumptions are when weighting and reconciling more than two values?

Part 2) AVERAGING OR WEIGHTING MORE THAN TWO VALUES

Let's take the example from the prior *Do You Know* No. 24, which presented two indications of value, and add a third indication of value, say $2 million by the net asset method. Our values are as follows:

CCF Method	$5.0 million
GCTM	$3.8 million
Net Asset Method	$2.0 million

The mean average is $3.6 million [(5.0 + 3.8 + 2.0)/3]. Does this sound reasonable? Let's break this apart some. The CCF value of $5.0 million is 39 percent higher than the average of $3.6 million, 32 percent higher than the GCTM value of $3.8 million, and 150 percent higher than the NAV value of $2.0 million. Let's assume that the analyst believes that the CCF method is the best method and that the GCTM is better than the NAV method. The pecking order is CCF method, GCTM, and the NAV method. Great, now what do we do? Here are the choices:

- Use a mean average of $3.6 million
- Use a median average of $3.8 million
- Use numerical weights
- Throw one or more value indications out
- Use qualitative weighting
- Forget about it and go fishing

Using a straight mean average means each method has equal weight, 33.3 percent each. How can a $2 million value have equal weight to a $5.0 million value? The median is not much better here, as it may appear that the analyst is putting all the weight on the GCTM value. This is not the case, but it does appear so.

If we use numerical weights, where do they come from? Well, they come from professional judgment. That's fine, but let's continue our example. The analyst applies weights as follows, again with the assumption that the CCF method is the best method and the GCTM is better than the NAV method.

CCF Method	$5.0 million	70%
GCTM	$3.8 million	20%
NAV Method	$2.0 million	10%

This results in a value of $4.5 million. Is this a better value conclusion than an averaging technique? Probably yes. However, there could be criticism about the credibility of relying on a method with only a 10 percent weight. The CCF value has a weight seven times as great as the NAV value.

Many analysts would probably throw the NAV value of $2.0 million out (with support), as it is so much less than the other two values. Let's assume we do that. Here is another look at numerical weights:

CCF Method	$5.0 million	80%
GCTM	$3.8 million	20%

The value conclusion is now $4.8 million, probably closer to the actual value. However, even here the CCF value weight is four times the GCTM weight, not as bad as seven times the NAV weight in the previous example, but still a factor to consider.

Qualitative weights can also be used when you have the three indications of value presented previously. Again, let's assume that the analyst believes that the CCF method is the best method and that the GCTM is better than the NAV method. The analyst may just say this and select, say $4.8 million. The analyst may also throw out the NAV value and use qualitative weights, but then you are back to the issue presented in *Do You Know* No. 24, "Weighting of Two Values."

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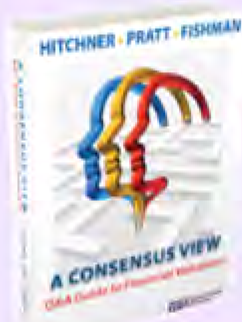

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DO YOU KNOW?

ISSUE 26 - JUNE 2016

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Do You Know...

...the difference between liquidity and marketability?

In recent years the valuation profession has generally come to a consensus that lack of marketability and lack of liquidity are different concepts. The distinction is fairly important. We define *liquidity* as "actively traded public equivalent," further defined as "instant sale with cash received within three days." This should be the standard used in business valuation. Any change from this definition would necessitate the application of a discount for lack of liquidity and/or a discount for lack of marketability.

The *IRS DLOM Job Aid* recognizes marketability as an indication of the "fact of 'Salability,' while liquidity indicates how fast that sale can occur at the current price" and with minimal cost. The *IRS DLOM Job Aid* provides the following additional guidance:

- If it's liquid, it's marketable
- If it's nonmarketable, it's illiquid
- Being illiquid does not necessarily mean nonmarketable - it may still be sellable but not quickly or without loss of value

Having defined liquidity (or lack thereof), we propose a new term, *marketable illiquid*, which results in expanded terms:

- Liquid
- Marketable illiquid
- Nonmarketable

We exclude the term *liquid marketable*, because anything liquid has to be marketable, and the term *nonmarketable illiquid*, because anything nonmarketable has to be illiquid. Below are general examples of the application of the terms to commonly identified assets:

Asset	Term
Actively Traded Public Stock	*Liquid*
A Large Block of Public Stock (Blockage)	*Marketable Illiquid*
Thinly Traded Public Stock	*Marketable Illiquid*
Restricted Stock in a Public Company	*Marketable Illiquid*
Control Interest in a Public Company	*Marketable Illiquid*
Control Interest in a Private Company	*Marketable Illiquid*
Minority Interest in a Private Company	*Nonmarketable*
Real Estate	*Marketable Illiquid*
Machinery and Equipment	*Marketable Illiquid*

Nonmarketable does not mean that the asset cannot be sold. It means that there is no ready and/or available market for that asset and that it would be difficult to sell the asset.

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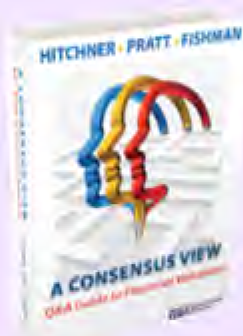

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DO YOU KNOW?

ISSUE 27 - SEPTEMBER 2016

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...what data should go into a discount rate?

In a July 2016 Delaware Court of Chancery opinion[1], the judge constructed his own discount rate and his own discounted cash flow (DCF) method and attached those detailed calculations to the opinion. This case offers rare insight into the thought process that goes into selecting opposing data choices and applications. This incredibly detailed opinion gets into the following areas of the discount rate:

- Used the spot rate for the risk-free rate
- Used the CRSP supply-side equity risk premium
- Used the CRSP 10w subdecile size premium
- Rejected the use of Barra betas, which many valuation analysts use
- Rejected a raw beta, which many valuation analysts use
- Used forward-looking beta based on beta smoothing, raw beta weighted by two-thirds and the market beta of one (mean reversion) weighted by one-third
- Used the Hamada formula to unlever and relever the beta
- Used the Company's existing capital structure to calculate the WACC

This case also discusses the DCF method in great detail as well as the guideline public company method.

The different values were as follows:

Expert 1	**$17.90 Per Share**
Expert 2	**$ 7.95 Per Share**
Merger Price	**$ 8.50 Per Share**
Court's Opinion	**$10.21 Per Share**

The Court stated its opinion about the wide difference in value:

> Unfortunately, the existence of drastic differences between experts' valuations is not an uncommon issue. See *In re Appraisal of Dell Inc.*,2016 WL 3186538, at *45 (Del. Ch. May 31, 2016) (expressing concern over the problem of significant valuation differences between experts and citing study showing that respondents' experts produced valuations on average 22% below deal price, and petitioners' experts produced valuations on average 186% above deal price) ("Two highly distinguished scholars of valuation science, applying similar valuation principles, thus generated opinions that differed by 126%, or approximately $28 billion. This is a recurring problem.").[2]

This July case and another Delaware Court of Chancery case decided in August will be discussed in detail by Jim Hitchner at our webinar on September 22, 2016.

[1] *In re Appraisal of DFC Global Corp.*, C.A. No. 10107-CB, decided July 8, 2016.
[2] *In re Appraisal of DFC Global Corp.*, C.A. No. 10107-CB, decided July 8, 2016, Memorandum Opinion, p. 16.

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Webinar Date:
Thursday, September 22, 2016, 1-3 pm EST

Hitchner will use two new (August and July 2016) blockbuster Delaware court case decisions as a backdrop to an intense discussion of very detailed Court opinions of valuation components, data, methods, models, and applications. The Courts discussed each expert's positions on a wide variety of topics and then decided what to do. There is an exceptional amount of detail. BV analysts MUST know about these two cases. Hitchner will express his personal opinions of the often countering positions of five experts and tell you whether he agrees with the Courts' decisions.

Your entire office can attend and earn CPE for just $239.
Our simple pricing plan means your get access to the live webinar for the whole office as well as an archived copy and handouts for later viewing.

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Jim Hitchner's
Valuation Products and Services

DO YOU KNOW?

ISSUE 28 - FEBRUARY 2017

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...the most important issue in the guideline company transactions method?

The level of reliance is the most important issue. The choices for the level of reliance are simple but powerful:

1. Accept the method as a **primary method**
2. Accept the method as a **corroborating method**
3. Accept the method as a **non-corroborating method**
4. Dismiss the method as **unsupportable and unreliable**

Now, let's evaluate these choices.

1. Accept the Method as a Primary Method
The GCTM can be used as a primary method when we know enough information about the transactions. This usually occurs when the buyer and/or the seller is a public company. Depending on the materiality of the transaction, there is often a great deal of data disclosed about the transaction. For example, the ever-popular Pratt's Stats database, which includes over 26,000 private company sellers, has over 5,300 transactions of public buyers of private companies. Also, Public Stats includes over 3,800 public company buyers of public company sellers. If sufficient and reliable data can be presented, then the GCTM can be used as a primary method.

2. Accept the Method as a Corroborating Method
Most of the time, particularly when valuing small- to medium-size companies, the data relied upon is a private buyer of a private seller. In those transactions, we really know little about the buyer and the seller. For example, we often do not know the following about the company sold:

- Historical performance
- Expected performance (margins, growth, and risk)
- What assets were bought?
- What liabilities were assumed?
- Does the transaction price include expected synergies?

These are important factors to consider in a valuation. As such, many valuation analysts will only use this method (under the above constraints) as a corroborating method to the results of the income approach.

3. Accept the Method as a Non-Corroborating Method
The thought of using the GCTM as a non-corroborating method sounds silly at first. However, this is a serious situation. If you can use the GCTM as a corroborating method, why not also use it as a non-corroborating method? Shouldn't this go both ways? Why is it that when the GCTM value is close to the income approach value it corroborates that method, but when the GCTM value is not close to the income approach value it is simply thrown out? On the face of it, this does not seem fair.

4. Dismiss the Method as Unsupportable and Unreliable
As previously mentioned, when the transaction data are from a private buyer of a private seller, very little is really known about the transaction. There is a long list of important data missing. This makes the value obtained by this method difficult to support. As such, many analysts will dismiss this method after they complete their research.

It is up to each analyst to determine the level of reliance on this method. No matter how much work you put into this method, the level of reliance is the most important issue to consider.

For more information on the guideline company transactions method, join us for the first of Jim Hitchner's new StraightTalk webinar series,
Best Practices: Business Valuation Methods

Jim Hitchner's StraightTalk webinar series,
Best Practices in Applying Business Valuation Methods,
can take your valuation practice to the next level.

We will present six webinars: guideline company transactions, capitalized cash flow, discounted cash flow, cost of capital, guideline public company, and the asset methods. The first presentation is focused on the Guideline Company Transactions Method (GCTM) of the market approach.

The Guideline Company Transactions Method

*** Includes New Detailed Case Study ***
*** Includes Report Language ***

Webinar Date:
Tuesday, March 8, 2017

A fantastic training opportunity as your entire office can attend and receive CPE for just $239 -- and receive an archived copy and handouts for later viewing.

To review full program outline, learning objectives, and to purchase,
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Jim Hitchner's
Valuation Products and Services

DO YOU KNOW?

ISSUE 29 - APRIL 2017
A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

...if there are cost of capital benchmarks?

Most valuation analysts either use the build-up method (BUM) and/or the modified capital asset pricing model (MCAPM) to develop their cost of equity capital. While there is some disagreement on the inputs to these models, they are still widely used and accepted. However, in certain litigation venues it can be difficult to explain the intricacies of these models and data inputs so that the trier of fact can fully understand what was done. That's where some benchmarking can come in handy. Let's take an example (illustration only) of the use of the BUM and the MCAPM. Then let's compare the results to some benchmark data that I have been reviewing over the past few years.

The basic formula for MCAPM is expressed as follows.
(Note: E(Ri) is often referred to as ke):

$$E(R_i) = R_f + \beta(RP_m) + RP_s \pm RP_c$$

Where:

E(Ri)	=	Expected rate of return on security i
Rf	=	Rate of return available on a risk-free security as of the valuation date
β	=	Beta
RPm	=	Equity risk premium (ERP) for the market as a whole
RPs	=	Risk premium for smaller size
RPc	=	Risk premium attributable to other company risk factors

The basic formula for the traditional build-up model is:

$$E(R_i) = R_f + RP_m + RP_s \pm RP_i \pm RP_c$$

Where:

E(Ri)	=	Expected rate of return on security i
Rf	=	Rate of return available on a risk-free security as of the valuation date
RPm	=	Equity risk premium (ERP) for the market as a whole
RPs	=	Risk premium for smaller size
RPi	=	Industry risk premium
RPc	=	Risk premium attributable to other company risk factors

Let's assume we are valuing a smaller company that is reasonably profitable as of December 31, 2016. For purposes of this illustration only, we will present the calculations based, in part, on the Duff & Phelps *2016 Valuation Handbook-Guide to Cost of Capital*, appendix 3, supply-side ERP and CRSP data, from 1926 to 2015.

MCAPM

ke = 2.8 + 1.2(6.0) + 5.6 + 3.0
ke = 18.6%
Say 19%

BUM

ke = 2.8 + 6.0 + 5.6 + 2.0 + 3.0
ke = 19.4%
Say 19%

In this illustration, the cost of equity capital is 19%. Now let's look at some benchmark data to see how the 19% compares. Exhibit 1 is in the form of a build-up model that shows increasing risks and the associated increase in the required rate of return. Our subject company fits in as shown below.

• Large-cap stock ($77 billion average)	11%
• Micro-cap stock ($199 million average)	18%
• **Subject Company**	**19%**
• Small-cap stock ($102 million average)	20%
• D&P category 25 ($148 million average)	24%

Exhibit 1

Cost of Capital
Benchmark Data

As of December 31, 2016

U.S. 30-day Treasury bill [1]	**0.43%**
U.S. five-year Treasury note [2]	**1.93%**
U.S. 20-year Treasury bond [3]	**2.79%**
Prime rate [4]	**3.75%**
Aaa corporate bond [5]	**3.98%**
30-year conventional mortgage [6]	**4.32%**
Baa corporate bond [7]	**4.73%**
Large-cap stock ($77 billion average) [8]	**11.05%**
Micro-cap stock ($199 million average) [8]	**17.93%**
Small-cap stock ($102 million average) [8]	**20.26%**
Subdecile category 10b ($2 million - $109 million) [8]	**23.26%**
D&P size category 25 ($148 million average) [9]	**24.13%**
Subdecile category 10z ($]2 million - $65 million) [8]	**25.69%**
VC Bridge/IPO [10]	**20%-35%**
VC second stage/expansion [10]	**30%-50%**
VC first stage/early development [10]	**40%-60%**

Notes:
[1] https://fred.stlouisfed.org/series/TB4WK
[2] https://fred.stlouisfed.org/series/DGS5
[3] https://fred.stlouisfed.org/series/DGS20
[4] https://fred.stlouisfed.org/series/WPRIME
[5] https://fred.stlouisfed.org/series/WAAA
[6] https://fred.stlouisfed.org/series/MORTGAGE30US
[7] https://fred.stlouisfed.org/series/WBAA
[8] Duff & Phelps *2016 Valuation Handbook-Guide to Cost of Capital*, pp. 7-9, 7-11, appendix 3, all data from 1926 to 2015, large cap is decile 1, micro-cap is deciles 9 and 10, small cap is decile 10.
[9] Duff and Phelps *2016 Valuation Handbook*, Exhibit A-1, all data from 1963 to 2015.
[10] *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, Accounting & Valuation Guide, 2013, American Institute of Certified Public Accountants, p. 148.

For additional information on the use of this benchmark exhibit and other important cost of capital issues, you must attend our upcoming April 29, 2017 webinar, with Jim Hitchner as presenter,
Best Practices: The Cost of Capital

Jim Hitchner's StraightTalk webinar series:

Best Practices: Business Valuation Methods

The Cost of Capital

*** Includes New Detailed Case Study ***
*** Includes Report Language ***

The highlight of this session will be a new case study that shows the various ways to calculated the cost of equity using the new Duff & Phelps *2016 Valuation Handbook*. You will learn how to determine, support, and present on the cost of equity capital. Hitchner will also go through a detailed discussion on the weighted average cost of capital.

Webinar Date:
Wednesday, April 26, 2017, 1-3 pm EDT

A fantastic training opportunity, as your entire office can attend and receive CPE for just $239 -- and receive an archived copy and handouts for later viewing.

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Jim Hitchner's
Valuation Products and Services

DO YOU KNOW?

ISSUE 30 - JUNE 2017

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

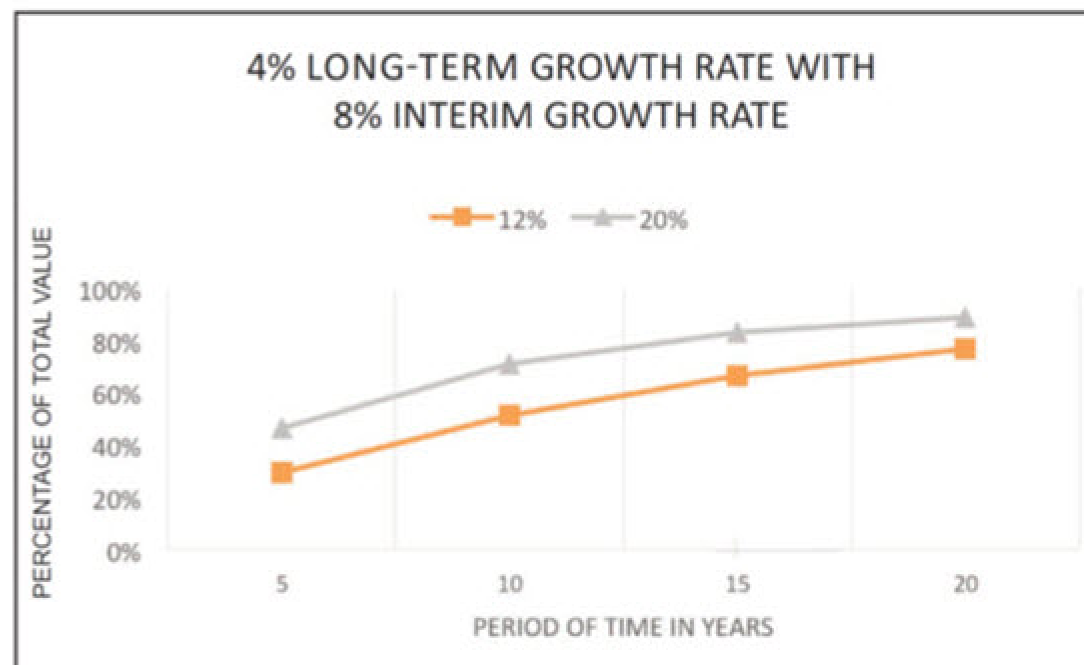
...if the terminal year of a DCF is based on a perpetuity model?

The quick and easy answer is "yes." However, the long and complex answer is "not really." In the income approach, the business valuation profession usually values the going concern of a business into perpetuity, which an attorney once said is a "very long time." However, given the power of discounting and compounding, it really is not a "very long time." It's a rather short time.

Present-value factors mitigate the length of time where perpetuity values actually matter. In corporate finance, larger discount rates compound at different levels than smaller discount rates. The decline in present-value factors is not linear but asymptotic. Therefore, the calculation of present-value factors using higher discount rates rapidly results in a point in the cash flow analysis where the present-value factor is very small. As a result, the present value of the cash flows is pretty much front-loaded based on the early years of the projections in a discounted cash flow (DCF) method.

We illustrate this concept by looking at discount rates of 12 percent and 20 percent. Let's assume a five-year interim growth of 8 percent per year, followed by a long-term constant growth rate (into perpetuity) of 4 percent. For simplicity, we will use end-of-year cash flows, with the first year at $100. The charts' data present the percentage of the total value attributable to the four time periods of 5, 10, 15, and 20 years at each discount rate.

	Years			
	5	10	15	20
Discount Rate				
12%	29%	51%	66%	77%
20%	46%	71%	83%	89%



What is also interesting is that we ran the models with very high interim growth rates and negative interim growth rates, and the results were similar. The bottom line here is that a large part of the value in a DCF model is captured in about 15 to 20 years. At both lower and higher discount rates, the majority of the value is captured in 10 years.

This concept and many important "best practices" will be covered in detail in our upcoming 6/28/17 webinar, with Jim Hitchner as presenter:

Best Practices: The Discounted Cash Flow Method

Jim Hitchner's StraightTalk webinar series:

Best Practices: Business Valuation Methods

The Discounted Cash Flow Method

*** Includes New Detailed Case Study ***
*** Includes Report Language ***

The discounted cash flow method is a bedrock valuation technique. This session will cover the issues every analyst needs to consider to master this common but complex method.

Webinar Date:
Wednesday, June 28, 2017, 1-3 pm EDT

A fantastic training opportunity, as your entire office can attend and receive CPE for just $239 -- and receive an archived copy and handouts for later viewing.

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Jim Hitchner's
Valuation Products and Services

DO YOU KNOW?

ISSUE 31 - OCTOBER 2017

A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.

Do You Know...

... whether your business valuation colleagues are tax affecting S corps as a starting point in a valuation?

Valuation Products and Services (VPS) presents monthly webinars in financial valuation and forensic services. As part of each webinar, we have the audience answer poll questions. Given the importance of S corp valuations, we have frequent questions about S corps. Most poll questions ask something like, "When valuing an S corp operating company, do you generally tax affect as a starting point in the income approach?" See the results below (N/A = not applicable):

Date	Webinar	Yes	No	N/A
1/31/17	Annual New Year BV Update	70%	27%	3%
2/3/16	Annual New Year BV Update	79%	16%	4%
9/22/15	Hardball with Hitchner	83%	15%	2%
1/29/14	Annual New Year BV Update	71%	19%	10%
10/15/13	Dos and Don'ts in Small Businesses	81%	11%	8%
8/15/13	How to Detect and Attack a Rigged Valuation	81%	18%	1%
6/19/13	Common and Uncommon BV Mistakes	67%	26%	7%
2/13/13	Small Business Solutions in BV	76%	18%	6%
9/12/12	Hitchner Q&A Panel	77%	17%	6%
8/1/12	Valuation of Small Businesses	63%	22%	15%
Overall Mean Average Yes		**75%**		
Overall Median Average Yes		**77%**		

As you can see, over three quarters of the responses do indeed tax affect earnings as a starting point in the valuation of an S corp. For more information on how to value S corps -- with brand-new polls -- attend our 10/26/17 webinar,

Best Practices in Business Valuations - S Corps

See below.

Jim Hitchner's StraightTalk webinar series:

Best Practices in Business Valuation

S CORPS

*** Includes New Detailed Case Study ***
*** Includes Report Language ***

Welcome to our new
"Best Practices in Business Valuation Series"

Our six-part "Best Practices: Business Valuation Methods" was so successful we decided to tackle other important areas in BV, starting here with the valuation of S corps.

Webinar Date:
Thursday, October 26, 2017, 1-3 pm EDT

A fantastic training opportunity, as your entire office can attend and receive CPE for just $239 -- and receive an archived copy and handouts for later viewing.

To review the full program outline, learning objectives, and to purchase,
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