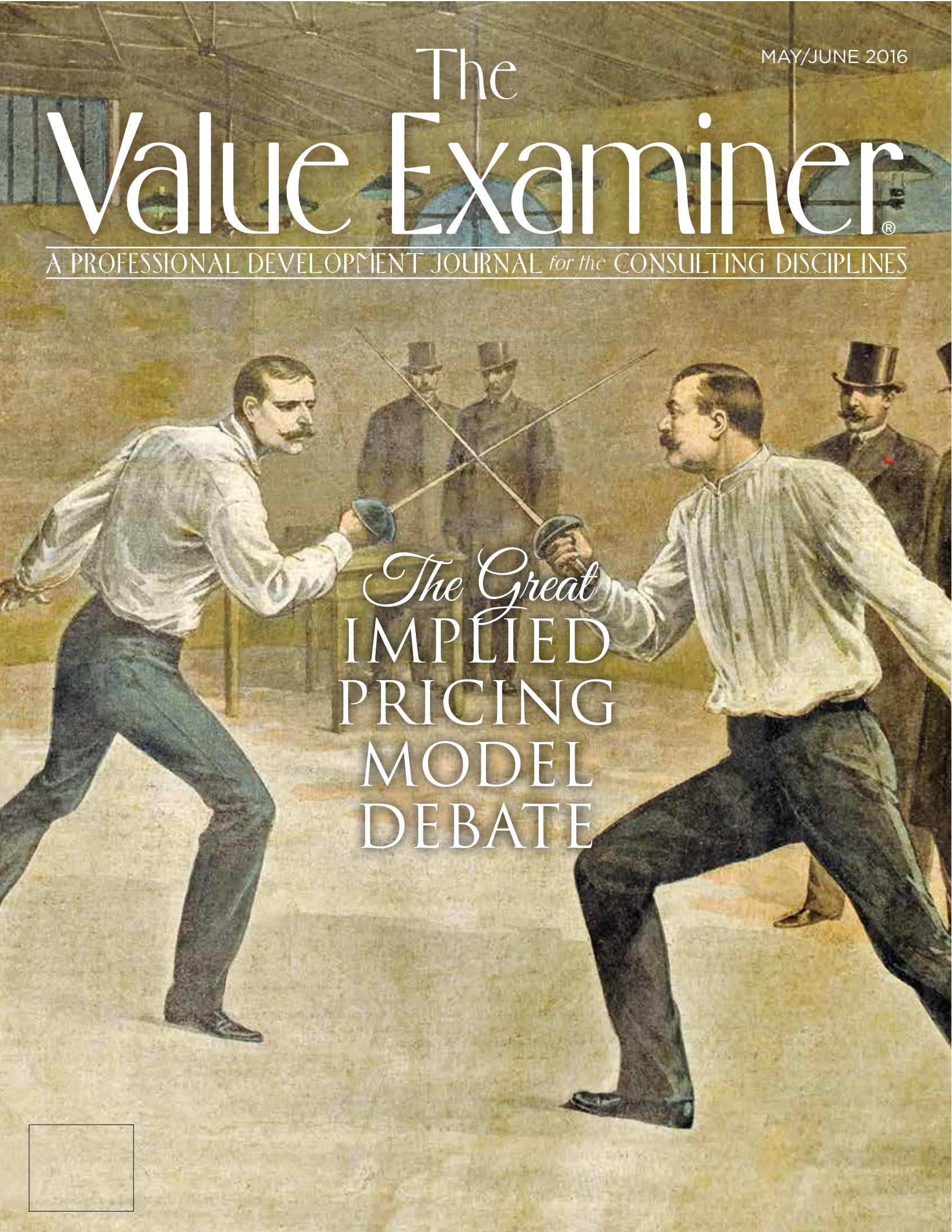
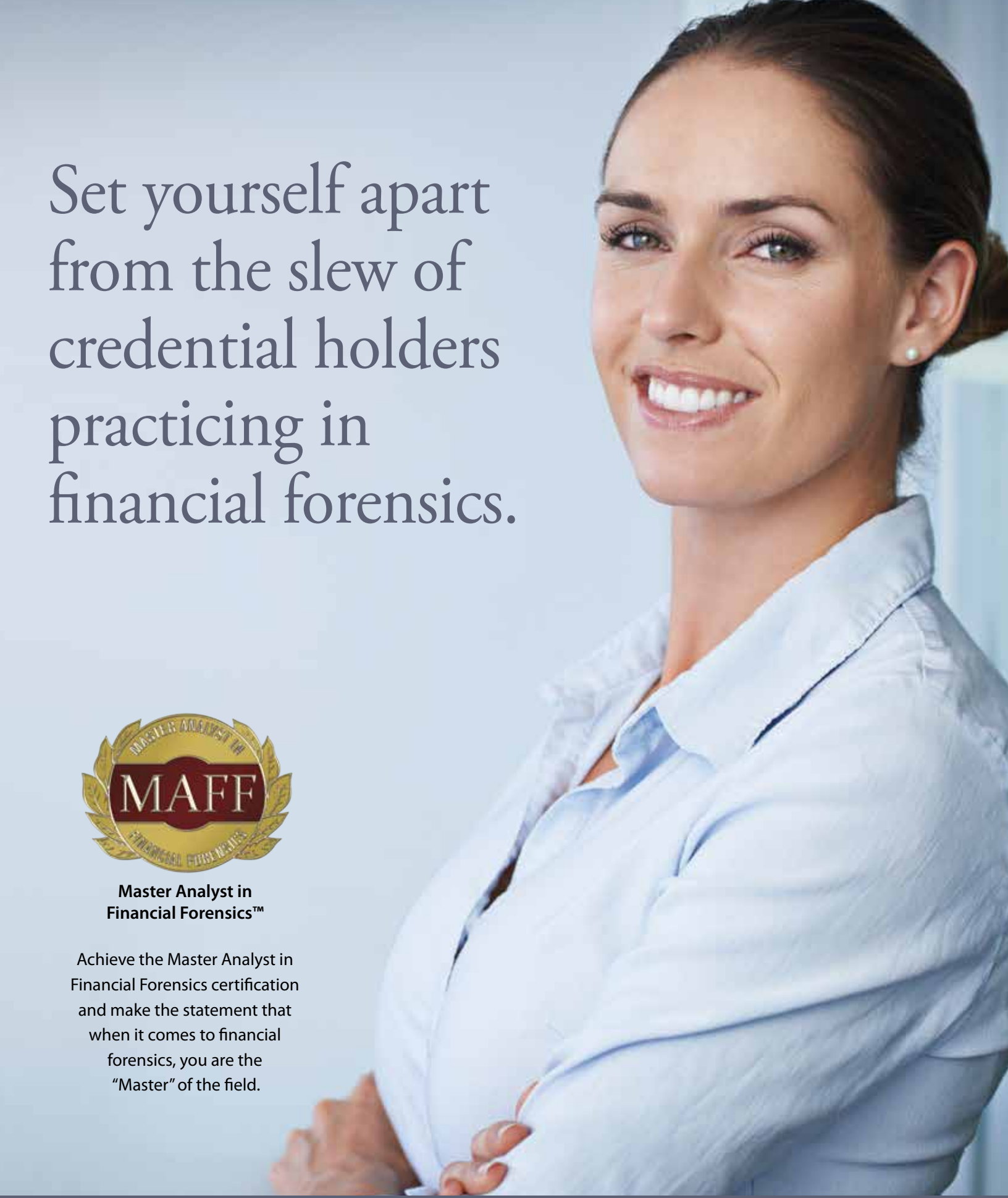
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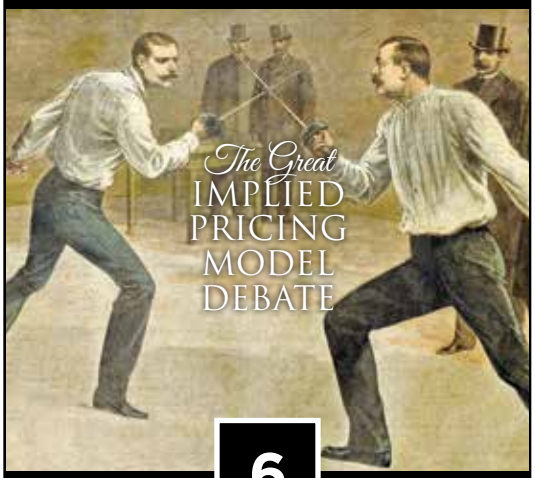
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On The Cover



6

Does The Implied Private Company Pricing Line Make Sense? (Part II)

By Richard R. Conn, CMA, MBA, CPA, ABV, ERP

In the January/February 2016 issue of *The Value Examiner*, the author was invited to publish his thoughts on the Implied Private Company Pricing Line (IPCPL). Subsequently, Rod Burkert, Peter Butler, and Bob Dohmeyer, along with Ivor Gorshunov provided a counter argument to the author's article. In this article, Richard Conn, who remains unconvinced about the viability of the IPCPL construct, presents a sur-rebuttal to some of the arguments offered in the earlier article. The summation of this issue will be featured in the July/August edition of *The Value Examiner*.

In This Issue...

15 **IPCPL AND MARGIN REVERSION: IMPLICATIONS FOR THE VALUATION OF SMALL PRIVATELY HELD COMPANIES**

By Igor Gorshunov, MBA, CFA

The Implied Private Company Pricing Line (IPCPL) Model is a consistent market-implied approach to measure the cost of capital for private companies. Its key element is the cost of capital for the smallest private companies, derived from Pratt's Stats information on the acquisition prices and the companies' financials. This article originally appeared in the *Business Valuation Review*, Volume 34, Number 2, 2015, American Society of Appraisers. It is reprinted in *The Value Examiner* with the permission of the American Society of Appraisers. ALL RIGHTS RESERVED.

20 **CASE STUDY (PART II): APPLYING AND ASSESSING THE CAPITALIZATION RATE**

By Pasquale Rafanelli, CPA, ABV, CVA, CBA, ASA, CFE , MAFF

In the March/April issue of *The Value Examiner*, the author discussed what a capitalization rate is and how an expert can arrive at the capitalization rate, including the four methods, one can use in arriving at the discount rate. He also discussed, in detail, the first two methods the Build-Up 1 and Build-Up 2 Methods. He concludes this series by discussing the Capital Asset Pricing Model (CAPM).

24 **GENERALISTS BEWARE—FRANCHISED AUTOMOTIVE DEALERSHIPS ARE A DIFFERENT BREED**

By Travis Flenniken, CFA, CVA; and Matt Stelzman, CVA, MAFF, ASA

Any appraiser who has discussed value with an auto dealer has heard the term "blue sky." The term is thrown around in the dealership industry as frequently as debits and credits in an accounting firm, but what does it really mean and how is it useful? This article presents some ideas on why the Blue Sky Method can be useful.

Departments



ACADEMIC REVIEW

CONTEMPORARY RESEARCH IN VALUATION AND FORENSIC ACCOUNTING

By Peter L. Lohrey, PhD, CVA, CDBV

Summaries of contemporary research in valuation and forensic accounting selected from numerous academic research outlets that illustrate the core of this novel research while increasing awareness among the community of the subject matter.



LITIGATION CONSULTING

COURT CORNER

By Peter Agrapides

Summaries and analysis of the most important cases that involve valuation and expert testimony issues, in both federal and state courts.



PRACTICE MANAGEMENT

PRACTICING SOLO

By Rod P. Burkert, CPA, ABV, CVA

The author interviews sole practitioner Sheryl Brake, CPA, CGMA, CVA, CEPA, from Mead, Colorado.

42 **HOW TO MAKE WRITING PART OF YOUR PRACTICE**
By Nancy McCarthy, Senior Editor, The Value Examiner

45 **ANNOUNCEMENT**
The Value Examiner is looking for nominees for the editorial board.

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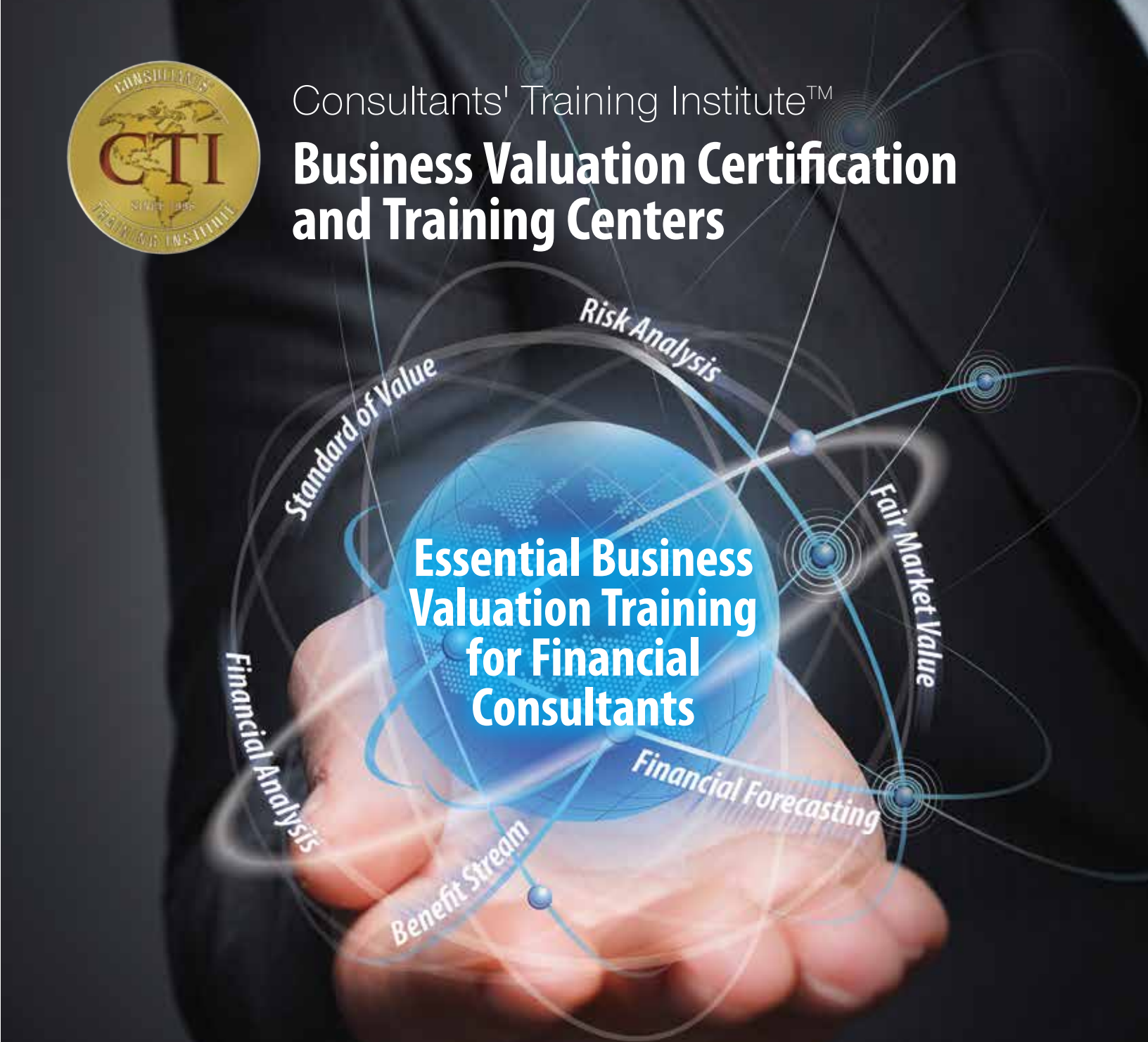
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VALUATION

Does The Implied Private Company Pricing Line Make Sense? (Part II)

By Richard R. Conn, CMA, MBA, CPA, ABV, ERP

In the January/February 2016 issue of *The Value Examiner*, I was privileged to be invited to publish Part I of the topic: "Does The Implied Private Company Pricing Line (IPCPL) Make Sense?" This is a subject that has been on my mind for some years now. In response to that original 'Does it Make Sense' article in the same issue, Messrs. Burkert, Butler, and Dohmeyer (whom I shall subsequently respectively refer to as BB&D for convenience), and Mr. Gorshunov produced two separate responses with the intent of dispelling my concerns and providing additional support for the IPCPL construct. I have carefully considered their responses—but remain even less convinced about the viability of the IPCPL than I was previously. This article will present a sur-rebuttal to some of the arguments BB&D and Gorshunov offered in the Jan/Feb. issue. A subsequent Part III will be published in the next *The Value Examiner* to provide what I believe is the third main weakness of the IPCPL and give an overall summation of my findings.

In their replies, both BB&D and Gorshunov have offered a defense for the concept that "very small privately held companies have higher total risk, lower debt capacity, and are less liquid than much larger private companies".[1] And, [Conn] "concentrates on the issue of the dependency between the size of the company and its cost of capital".[2]

Well, that is very interesting—but that was not at all the nature of my complaint against the IPCPL. I took no position whatever on the relationship between the size of Enterprise Value (EV) and the cost of capital. The IPCPL postulates that smaller firms have higher risk-rates. I offered no comments either in support of or against this concept.[3]

My complaint against the IPCPL was very specific and is quoted verbatim right in the middle of the BB&D rebuttal: "It just does not make sense that one could expect revenues to be a reliable predictor or determinant of the cost of equity." In order to have any faith in the usefulness of the IPCPL, one must believe that there is a dependable and reoccurring correlation between a firm's revenues and the firm's risk-rate. After all, that is the way the model works—the user inputs the target firm's current revenues and a specific rate (which BB&D apparently now classify as a WACC) is the output.

What BB&D and Gorshunov are really saying is that smaller EV firms have higher costs of capital, ***and*** implicitly, they also mean that there is direct correlation between firm EV size and revenues—the smaller the EV the lower the revenues and vice versa.[4]

1 Burkert, et al., 2016. Rebuttal: The IPCPL Does Make Sense. The Value Examiner. Jan/Feb 2016: 14-16.

2 Gorshunov, I. 2016. Letter to the Editor. The Value Examiner. Jan/Feb 2016: 17.

3 However, for an excellent investigation on the subject, see the soon to be published "Do Valuation Multiples Reflect a Size Effect?" in the Journal of Business Valuation and Economic Loss Analysis by Cornell & Gokhale.

4 For ease of exposition, I will continue to use the term EV (Enterprise Value) of the firm to mean the sum of both the market value of the equity capital and debt invested in the firm (but excluding excess non-operating assets). And, when there is no debt, EV = market value equity capital (albeit, it may be the Private Market we are speaking of). This will avoid the ambiguity of only using the term Market Capital or MVIC.

On the former point, I do not care to offer an opinion and on the latter, I categorically disagree—there is no direct correlation between firm EV and revenues. Nor have I found any empirical evidence that would support this alleged correlation between revenues and EV (apart from the generalization that a $100 million revenue firm will usually be expected to have a larger EV than one with only ten million dollars in revenues).

TABLE 1

	Annual Revenues (000's)	Average Annual Net Free Cash Flows (000's)	Historic Annual Cash Standard Deviation (000's)	Cash Standard Dev. As a percent of Net Free Cash
Firm A	4,000	500	50	10 percent
Firm B	10,000	250	50	20 percent

I do not believe we can rely upon small firm entrepreneurs to be as inept as the IPCPL Model requires. If we were to ask 100 entrepreneurs if they would prefer to own either Firm A or Firm B (see Table 1) and Firm A had four million dollars in annual revenues with $500k in average annual net free cash flows with a historically observed $50k annual standard deviation; or Firm B having ten million dollars in annual revenues with $250k in average annual net free cash flows with a historically observed $50k in annual standard deviation, I suspect the majority would opt for Firm A. The Firm A expected cash returns are twice as large ($500k vs. $250k) and the risk is lower (as proportionally a $50k standard deviation is only ten percent of the expected $500k cash return vs. twenty percent of the $250k return). Therefore, in a world of rational investors, it ***must be*** the case that the EV of Firm A is greater than Firm B. Even without specifically knowing the absolute risk-rates between the two, we can rest assured that the firm with the higher expected cash returns and lower perceived risk is going to be more highly desired by potential investors and, ergo, have a higher EV.[5] The fact that one firm has four million dollars in revenues vs. ten million dollars of the other, is mostly irrelevant. However, the IPCPL is dependent upon Firm B having the larger EV simply because it has greater revenues.

Of course, this anecdotal hypothesis is only economic navel gazing on my part—I am speculating upon how rational, risk-averse entrepreneurs would be expected to act. I am supposing that expected revenues are comparatively unimportant to investors, whereas expected net free cash flows are of a primary all-consuming importance. If BB&D are unwilling to accept my speculation on the subject, they should be willing to accept the empirical findings from their own datasets. The following four panels of Figure 1 employ data directly from the IPCPL and are arranged to show that there is, at best, only weak correlation between revenues and EV.

5 For example, temporarily ignoring the logical assumption that Firm B would have to have the higher risk-rate, even if we assume, for simplicity, that the Capitalization Rate is the same ten percent for both firms, then Firm A would have an EV of $5 million ($500k/ten percent) and Firm B's EV would only be $2.5 million ($250k/ten percent).

FIGURE 1: PANEL A

232 All Cash Transactions

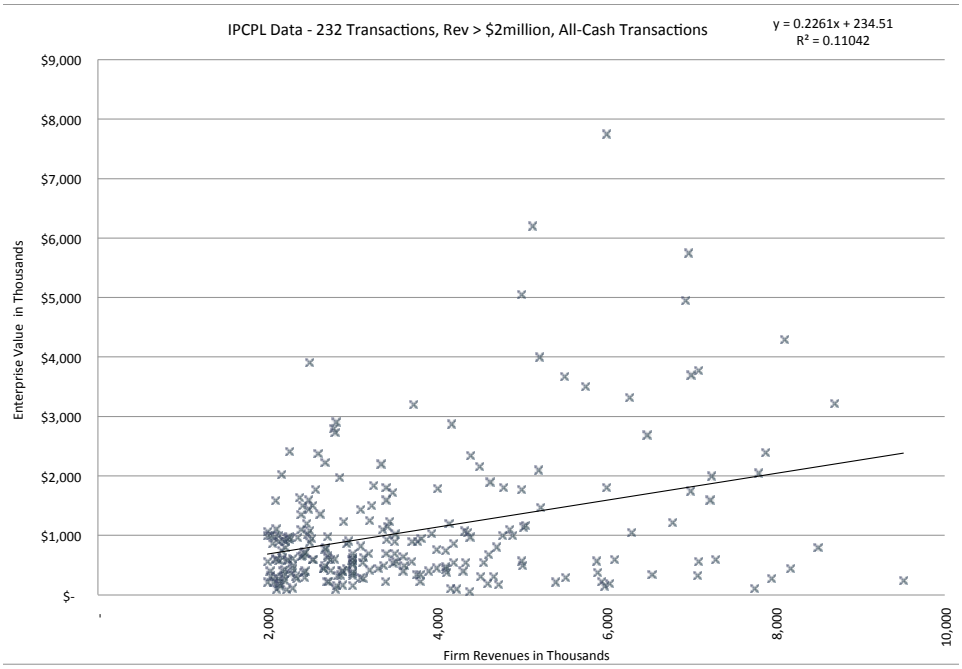


FIGURE 1: PANEL B

752 Transactions—including Panel A data as well as 520 seller-financed deals.

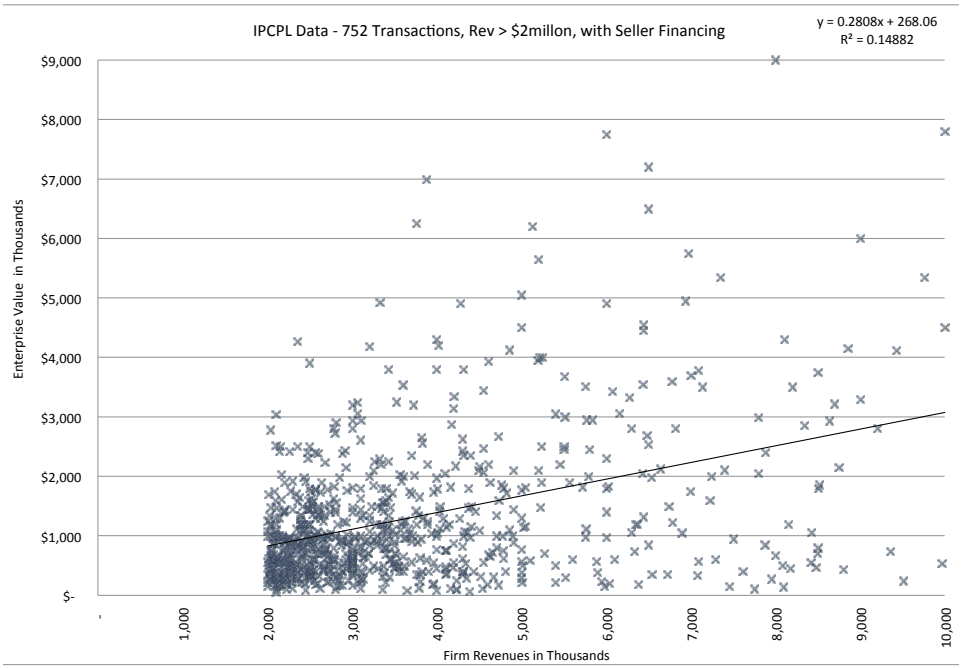


FIGURE 1: PANEL C

706 Transactions—MVIC Adjusted by BB&D to compensate for seller-financing and difference between firm profit/loss reporting date vs. transaction date.

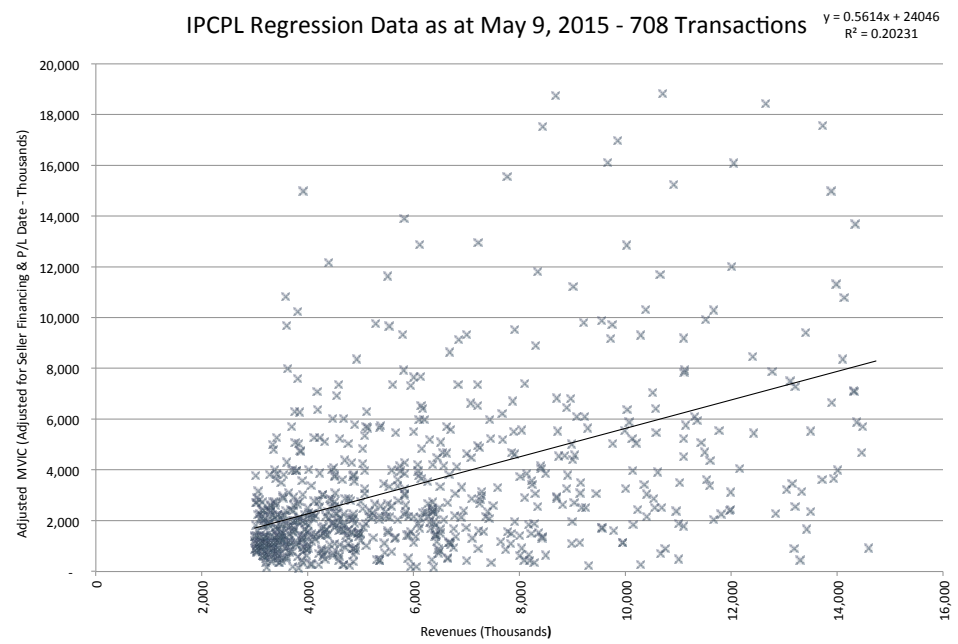


FIGURE 1: PANEL D

708 Transactions—"k" risk-rate = operating incomes (adjusted for owner's compensation) divided by MVIC (adjusted for seller-financing and P/L date lag) plus "g" of 3.63 percent (being 1.25 percent real growth and 2.38 percent average inflation as employed by IPCPL at the time).

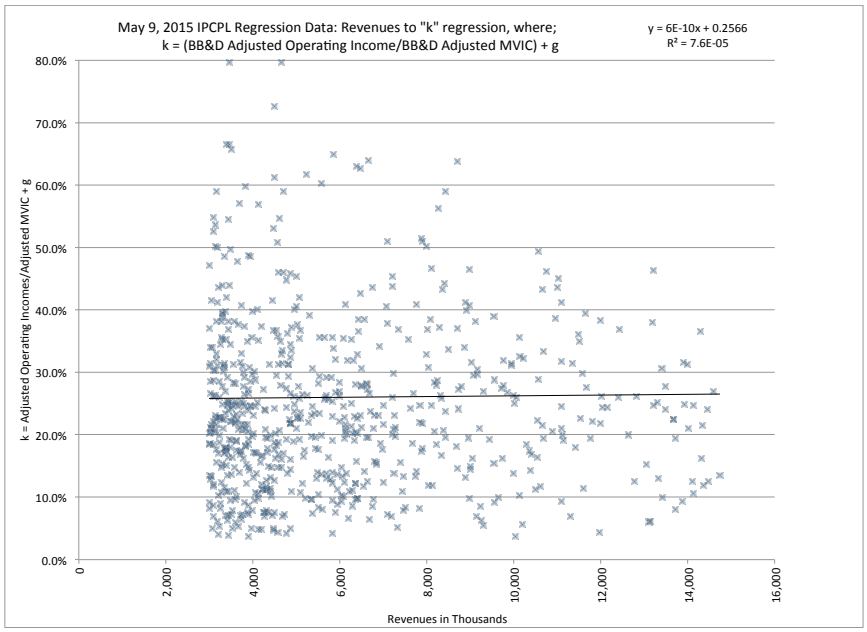


Figure 1, Panels A and B are derived from the dataset that Dohmeyer and Butler published shortly after the appearance of their first paper. It is exactly the same data I used previously to show that there is no correlation between revenues and cost of capital. It is again being used here to demonstrate that there is only a very poor correlation between the explanatory variable revenues (x-axis) and firm EV (y-axis). Of course, if there was a strong correlation between the two, as BB&D and Gorshunov have inferred, one would expect to see a high degree of concentration or clustering of the data points in a positively sloped line (or, perhaps, concave-to-the-origin curve) rising up from left to right. This would confirm, at least for this dataset, that EV's tended to rise in some discernable proportion as small firm revenues increased. Instead, the visual impression here is just random chaos.

Panel A shows there are the 232 firms with revenues exceeding two million dollars sold in all-cash transactions ($1.075 million mean and $698k median sales price). A linear regression has been undertaken which resulted in an R-Squared of only 0.1104 (so, the variation in firm revenues has only managed to explain eleven percent of the change in EV). In other words, the degree of correlation between revenues and EV is quite low. Further, the resulting 'line of best-fit' was found to be: y = $234.51k + 0.2261x where the x coefficient was found to be statistically significant and the y-intercept of $234.51k was not

(P=0.1736).[6] The standard error of the regression is $1.054 million. Applying the Empirical Rule, we know that ninety-five percent of the population observations can be expected to occur between +/- 2 standard deviations from the sample mean ($1.075 million). Therefore, in order to gain a high-level understanding of how useful revenues (ranging between two million dollars and ten million dollars) are as a predictor of EV, we note that this data indicates EV would be expected to range between $1.075 million +/- (2 x $1.054 million) ninety-five percent of the time, or: negative $1,033 (effectively zero) to $3.183 million. Such a large range confirms what the low R-Squared has already highlighted—revenues are a poor predictor of EV.[7]

Panel B are the 752 firms (still with revenues exceeding two million dollars, as required by the IPCPL) that includes the subset of 232 Panel A transactions plus an additional 520 transactions that involved some degree of seller-financing.[8] The data average sales price is $1.305 million and the median is $0.945. Here again, there is no strong visual indication of a central clustering around the expected positively-sloped line or curve. The results appear quite random. A linear regression yielded an R-Squared of 0.1488 (so less than fifteen percent of the changes in firm EV has been explained by the changes in firm revenues). The derived regression line is: y = $268k + 0.281x and, owing to the larger sample size, both the x-coefficient and y-intercept are statistically significant in this case.[9] The standard error of this regression is $1.149 million. The Empirical Rule indicates that ninety-five percent of the time, the population observations would be expected to range between $1.305 +/- (2 x $1.149 million) = effectively zero to $3.603 million. These findings are consistent with the smaller sample and the conclusions would be the same—revenues are not a reliable predictor of EV.

Panel C employs the data IPCPL used to determine the May 9, 2015 Data Point 1 (I have not adjusted the data in any way, other than to exclude the 145 transactions that reported negative adjusted operating profits; this was done so that Panel C would correspond with the positive operating profits required by Panel D). Here the line of best-fit reports an R-Squared of 0.2023 (over twenty percent) and one might conclude that this represents mild positive linear correlation between revenues and EV (which BB&D have classified as Market Value of Invested Capital [MVIC] here).[10] However, if the hope is that this mild increase in revenues-to-EV correlation will also be indicative of an improved revenue-to-risk-rate correlation (which is central to the IPCPL theory), then Panel D shows that this is not the case.

Panel D employs the same 706 transactions as Panel C, but now the regression is run between revenues and risk-rate "k" (where k = [BB&D Adjusted Operating Income]/[BB&D Adjusted MVIC] + g). The R-Squared is virtually zero (at 0.00008) as is the slope of the regression line. There is no correlation here between revenues and risk-rate "k".[11]

BB&D have told us that there is a strong inverse relationship between firm EV and its risk-rate (the smaller the firm, the higher the rate) and also, implicitly, that there is a high degree of direct correlation between a firm's revenues and its EV (the greater the revenues, the larger the EV). However, their own data does not support this correlation—there is only a weak relationship between revenues and EV. And, more importantly, there is virtually no observable correlation between revenues and risk-rates.

6 "P" stands for 'Probability Value'; the lower the "P" stat the better, and lower than 0.05 indicates statistical significance at the ninety-five percent confidence level. The F-Stat of the regression was 28.55 and the standard error of the intercept was $171.8k and 0.0423 for the x coefficient.

7 A more precise appreciation of the breadth of the confidence interval can be had by noting that the y-intercept confidence interval (CI) ranged from -$104k to $573k and the x coefficient CI ranged from 0.143 to 0.309. Therefore, at say the four million dollars in revenues level, EV would be expected to range between (-$104 + 0.143 x $4,000) to ($573 + 0.309 x $4,000) or, $0.468 million to $1,813 million. Proportionally such a wide range in CI relative to the four million dollars in revenues again confirms that revenues are not a reliable predictor of EV.

8 To be fair to BB&D, the dataset has been broken up into these two groups so that the reader can explicitly see the all-cash transactions separately from the larger grouping. Since there is no way of knowing how much transaction prices may have been distorted by the presence of seller-financing, the EV's of this larger dataset needs to be viewed with a higher degree of skepticism.

9 The regression F-Stat is 131.13 and the y-intercept standard error is $99.8k and the x coefficient standard error is 0.024. The ninety-five percent CI for the y-intercept ranged between $72k to $464k and 0.23 to 0.33 for the x coefficient.

10 The F-Stat of the regression is 178.5. The Standard Error of the y-Intercept, at 282.8k is not statistically significant (P = 0.93) whereas the x coefficient, with a 0.042 standard error is (P = 0). For a firm with $4,000 in revenues, the ninety-five percent MVIC confidence interval would range between: $1,711k to $2,825k. Proportionately this wide range in the confidence interval indicates revenues are not a useful predictor of MVIC.

11 As will be discussed in Part III, the regression results were completely insensitive to the selection of the growth rate "g". The R-Squared stat remained at virtually zero regardless of which growth rate was employed between zero to ten percent.



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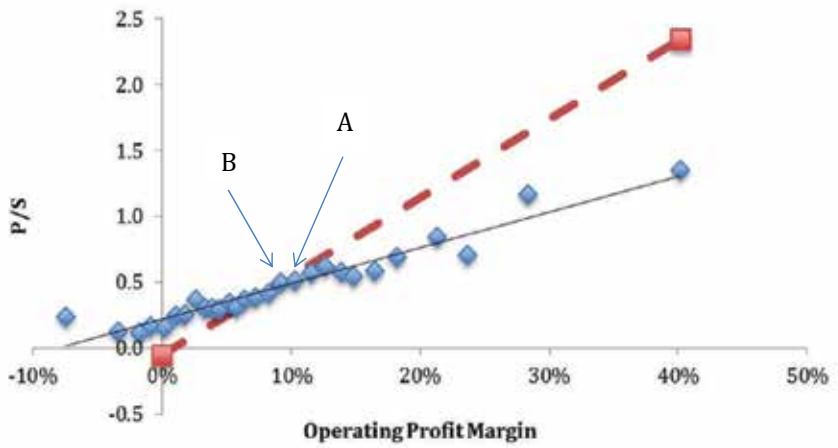
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THE GORSHUNOV CHART

Both BB&D and Gorshunov have produced exactly the same graph in their replies against my original article. So both, obviously, believe there is something really important about this representation that supports their case in favor of the IPCPL—but I am unclear as to what this would be. The graph is simple—twenty-eight data points where an OLS (ordinary least squares) best-fit line (the black one) has been regressed through the blue data points showing an upward trend or slope between increasing profit margins and the P/S (Price-to-Sales) Ratio. This kind of regression between a ratio over a ratio turns out to be a special case and 'unit-less' as we shall see.

The independent or explanatory variable (x-axis) is operating profit margin (OPM): the ratio of operating income over revenues (sales). The dependent variable (y-axis) is the P/S statistic: the purchase price over revenues (sales) ratio. For the reader's convenience, I have 'borrowed' Gorshunov's graph and, with the exception of two individual data points, have faithfully reproduced it as Figure 2.

FIGURE 2



Blue Data Points: twenty-eight Median Observations. Gorshunov extracted this from 840 Pratt's Stats transactions

Black Regression Line: Line-of-Best-Fit determined from Gorshunov's regression of the twenty-eight points

Red Reversion Line: Line Gorshunov' hypothesizes would represent mean reversion[12]

Let us be clear upon what this graph and the regression line does and does not tell us. It definitely does tell us that, as the OPM percentage increases, so too can the P/S ratio be expected to increase. Just by visual inspection of the tight clustering of the blue data points around the regression line, we would expect a very high R-Squared—there is very little unexplained variation in the blue dots. Ergo, there is high positive correlation between profit margin percentages and price-to-sales ratios. So, really all this is telling us is that investors are willing to pay higher ***relative*** prices for firms where they get to keep proportionately more of the expected cash generated.[13] But, this tells us nothing about the absolute measures of these firms—these are relative proportions. This fact will be made clear in an example below.

12 It is unclear to me how Mr. Gorshunov can speculate on the ultimate mean reversion of data that is entirely static. After all, the 840 Pratt's Stats transactions are only observed once at the time of sale and never again. However, the issue of margin mean reversion is irrelevant to the viability of IPCPL theory in general and has no bearing on his regression findings of the black line which uses actual Pratt's Stats data.

13 However, these ratios ignore the impact of non-operating expenses and taxes. Rational investors would certainly take these post operating margin effects into account before committing to a price.

The BB&D reply informs us that the equation for this regressed line is: y = 0.21 + 2.73x, where x is the OPM percent. So, let's take the example where we are comparing a Firm D with one million dollars in revenues and a twenty percent OPM to Firm E that has one million dollars in revenues and a thirty percent OPM:

> FIRM D: y = 0.21 + 2.73(20 percent) = 0.756 P/S ratio, therefore, when S = $1 million, EV = $756k
> FIRM E: y = 0.21 + 2.73(30 percent) = 1.029 P/S ratio, therefore, when S = $1 million, EV = $1,029k

Firm E is worth more, in absolute dollars ($273k = $1,029k - $756k) because the investor gets a larger expected absolute return ($300k in annual operating profits vs. only $200k for "D"). But, let's also look at the implied earnings-to-price capitalization rates:

> FIRM D Cap Rate: = E/P = ($1,000k x 20 percent)/$756k = **26.4 percent**
> FIRM E Cap Rate: = E/P = ($1,000k x 30 percent)/$1,029k = **29.1 percent**

Here, the firm with the larger EV also has the ***higher*** capitalization rate. **This is in direct contradiction to what the IPCPL expounds.** The IPCPL would have us believe that larger EV firms have ***lower*** risk-rates. In this case, the reason why the regression results are turning out this way is because of the 2.73 slope of the line.[14] Investors know that the higher the expected OPM percent becomes, the less likely they can count on that continued higher return. Although this may be an oversimplification, it is usually much less risky to count upon a business that has a steady and continuous history of producing, say, a ten percent OPM to continue doing so than to believe a firm that has just produced a single instance of a ninety percent OPM will reliably continue to do so.[15] The mistake in interpreting Gorshunov's chart would be to believe that moving from left-to-right on the horizontal axis (to higher OPM percent's) somehow implied the subject firms were increasing in revenues. No such inference can be made—and this fact can be easily demonstrated.

The Gorshunov chart appears in Figure 2. It is a faithful reproduction but for two data points—which I have indicated as Point A and Point B. I eliminated his original two points which were ***exactly*** at the same coordinates as my replacements (if these were vectors from the origin in R2, they would have precisely the same length and direction as the original vectors I replaced) and substituted two actual firm sales I had found with the same ratios. The first transaction, Point A, is for a typical small private firm that had four million dollars in revenues and $400k in operating profits (and, hence, the observed ten percent OPM). That firm sold for about $2.0 million—explaining the 0.5 P/S ratio ($2 million/$4 million). Point B, which is virtually adjacent to Point A and just a little to the left, represented a transaction that I found in the public market for a firm with $4,369,050,000 in revenues and $410,671,000 in operating profits (and, hence, a 9.4 percent OPM). The EV of the purchase price was $2.1627 billion—explaining the 0.495 P/S ratio ($2,162,700,000/$4,369,050,000).

This is what was meant when I said this regression is 'unit-less'—the absolute level of revenue becomes irrelevant (indeed, undetectable) as a result of the fact that revenues appear in the denominator of both the explanatory and dependent variables of the Gorshunov chart.

Now, had Mr. Groshunov run his regression with my revised dataset—he would have obtained precisely the same results as he had previously observed (as I said, the coordinates of my Points A and B are exactly the same as the two original data points I eliminated). So, what does Mr. Groshunov's chart tell us about the correlation between revenues and the cost of capital when it is entirely plausible that virtually co-located data points can have revenues that are billions of dollars apart? Absolutely nothing, is the correct answer.

In the original paper, "IPCPL and Margin Reversion: Implications for the Valuation of Small Private

14 Indeed, it can easily be shown that, assuming the Operating Earnings/Price ratio is a reasonable proxy for the E/P ratio, as the IPCPL does, and this is representative of a capitalization rate, the E/P ratio in the formula: y = 0.21 + 2.73x is a linearly increasing function of the operating margin percent. At any given level of revenue, Mr. Gorshunov's regression can be used to show that an increase in EV will also lead to an increase in the capitalization rate.

15 Mr. Gorshunov himself points out this fact in explaining the true nature of mean reversion—the returns of under-performing firms tend to improve over time (or they fail) and over-performing firms tend to descend.

Held Companies"[16], Mr. Groshunov finds it remarkable that his more extensive sample parameters (he uses 1997 through 2014 Pratt's Stats data) conforms to the more narrowly defined IPCPL findings of Feb. 15, 2015. As he states: "This is a strong indication that the original IPCPL Point 1 is an accurate estimation."[17] This may indeed be an indication of a high degree of P/S-to-OPM percent central tendency over time. Or, it just may be pure coincidence. While Mr. Groshunov's original sample selection consists of 840 ratios, his actual regression is only based upon twenty-eight individual median data points. In essence, the 840 points are used to determine the twenty-eight median points, and then, 812 of the sample observations are discarded before the regression is run.[18] A regression performed on twenty-eight single data points will not be as statistically robust as one based upon an 840 point sample.

Regardless of the strength of association between the OPM percent and the P/S ratio, we know for certain that these findings give us no indication of the correlation between absolute revenues and cost of capital. This is because the absolute measure of revenues is factored out of the sample data prior to the execution of the regression—as was demonstrated by my substitution of a transaction incorporating billions of dollars in revenues.

SUMMARY AND CONCLUSIONS

BB&D and Gorshunov have argued that there is a systematic inverse relationship been firm size and risk-rate—the smaller the firm (i.e., EV) the higher the risk. While this ***may be*** the case, they have provided no evidence to show that small firm revenues are systematically related to risk-rates. This was one of my two primary complaints against the IPCPL in Part I. If you are going to rely upon the IPCPL to generate accurate risk-rate estimates, you must implicitly believe that revenues are a dependable yardstick for risk because revenues are the key explanatory variable the IPCPL uses to generate risk-rate outputs.

However, the IPCPL data itself quite conclusively shows that small firm revenues are only mildly related to EV size, at best, and completely uncorrelated to the empirical risk-rates reported in the transactions upon which the IPCPL is based. The Groshunov regression shows that investors are willing to pay higher relative prices for firms with higher operating profit margin percentages—but the word ***relative*** is the key point here. There is nothing in the Groshunov analysis addressing the concern that absolute revenues can be used to predict reliable risk-rates. In fact, the Groshunov regression line shows that, at any given revenue amount, higher EV's lead to higher risk-rates (contrary to IPCPL theory).

In their Jan/Feb rebuttal, BB&D make some remarkable claims in defense of the IPCPL that, to my mind, provide a much stronger argument against the viability of the IPCPL than in support of it. These observations will be presented in the forthcoming Part III, as will my presentation of what I believe to be the third of the three main IPCPL weaknesses. VE



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16 Gorshunov, I. 2015. IPCPL and Margin Reversion: Implications for the Valuation of Small Privately Held Companies. Business Valuation Review. Summer 2015, Vol. 34, No. 2, pp. 70–73.
17 Ibid.
18 Moreover, we are not told what standards are applied in order to define the boundaries of the twenty-eight different OPM percent groupings.

VALUATION

IPCPL and Margin Reversion: Implications for the Valuation of Small Privately Held Companies

By Igor Gorshunov, MBA, CFA

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BV Review

The Implied Private Company Pricing Line (IPCPL) Model is a consistent market-implied approach to measure the cost of capital for private companies. Its key element is the cost of capital for the smallest private companies, derived from Pratt's Stats information on the acquisition prices and the companies' financials. When these companies were aggregated, they collectively appeared to be in a steady state, which allowed the authors of the IPCPL Model to estimate the cost of capital from the Gordon formula. The purpose of this paper is to analyze the pricing of individual small privately held companies to check whether it is consistent with the two concepts: the IPCPL cost of capital and the finiteness of the competitive advantage period, which, other things being equal, should, over time, lead to the profit margin convergence to the market mean and companies with mean margin being valued as steady-state companies, while companies with margins lower (higher) than the market to be valued higher (lower) than predicted by the Gordon formula because of the margin reversion effect. The market valuation of individual small privately held companies proved to be consistent with both concepts. Companies with margins close to the mean were valued with price-to-sales (P/S) multiples consistent with the IPCPL cost of capital, and the valuations of the rest of the companies were in line with the margin reversion effect.[1]

1 To be precise, the companies with margins close to the mean were valued with P/S multiples consistent with the IPCPL cost of capital and the same average market perpetual profit growth rate as used by the IPCPL authors. This does not mean that the IPCPL cost of capital is not applicable to the rest of the companies. Rather, it means that the market average profit growth rate is not applicable to them, so an appraiser dealing with such a company and constructing a Discounted Cash Flow (DCF) Model should take this into account by assuming a profitability dynamics that will get the profit margin close to the industry norm before applying the Gordon formula.

THE IPCPL AND MARGIN REVERSION

The Implied Private Company Pricing Line (IPCPL; a description of which can be found in *Business Valuation Update*)[2] model consists of three elements: Data Point 1, which represents cost of capital derived from 500 small privately held companies from Pratt's Stats information on acquisition prices and company financials (called IPCPL 500); Data Point 2, which represents the cost of capital based on micro-cap publicly traded companies;[3] and a constant arbitrage line connecting Data Point 1 and Data Point 2. Data Point 1 is what is in the scope of this paper.

In analyzing Data Point 1, the authors of the IPCPL found that the IPCPL 500 companies were collectively in a steady state, therefore allowing for the application of the Gordon formula to estimate the cost of capital. All small companies were considered one big quasi-company that was assumed to be valued by the market using the following Gordon formula:

$$P = \frac{FCFF_1}{r - g}$$

where $FCFF_1$ stands for the cash flow in the first period after the valuation (acquisition) date, r for the cost of capital, and g for the aggregate growth rate of this quasi-company. By solving this equation, the authors of IPCPL were able to estimate the market average cost of capital for small companies:

$$r = \frac{FCFF_1}{P} + g$$

The model thus represents a market-implied approach, which, unlike the widely used Build-Up Method (which attempts to extrapolate the cost of capital of private companies by applying a set of arbitrary premiums to that of public companies), makes it possible to consistently deal with several issues:

- Unsystematic risk (private company investors cannot be considered fully diversified or being able to fully diversify)
- Liquidity differences between public and private companies
- The existence and magnitude of a small stock premium marginal buyer (which is likely to be a pass-through entity) taxes
- Optimal capital structure and respective unleveraging and releveraging beta (as Data Point 1 already takes into account an optimal market clearing price capital structure across the market)

Therefore, by using the IPCPL Model for small private companies an appraiser does not have to start from the cost of capital for public companies (which is irrelevant for small private companies because they do not have access to public markets) and add a set of adjustments that are not theoretically justified and are criticized by academicians.[4]

But when looking at small privately owned companies, one could ask the following questions: What is the nature of assumptions the market uses in valuing them? Which companies are valued consistently with the same Gordon formula (that is, the same growth rate and the same cost of capital) as the whole universe of IPCPL 500? Which companies are valued differently?

In theory, companies with profit margins close to the mean should, on average and other things being equal, be in a steady state, like the whole IPCPL 500 universe, and their market valuation should, on average, be in line with the IPCPL cost of capital and growth rate.

Companies with higher than average profit margins should be expected to see their profitability decline over time (as any competitive advantage period is limited). Thus, valuing them like steady-state companies with the IPCPL cost of capital and growth assumptions would lead to overvaluation, so we should expect lower valuation in the market data. Conversely, for the companies with below-average margins we should, other things being equal, expect valuations to be higher than for the steady-state companies, because the market expects profitable growth for young companies and the turnarounds of mature ones, both leading to the profit margin reversion to the mean over time.

This logic lets us empirically test both the IPCPL cost

2 See http://www.bvresources.com/pdfs/IPCPLDownload.pdf.
3 Based on the Fama French Three Factor Model with a conversion Ko premium to private company basis based on costs of going and staying public.
4 Examples of critics of the Build-Up Method can be found in the description of IPCPL cited above.

of capital and the concept of margin reversion. By arranging companies in the market by their operating profit margin, we could observe the market valuation line (based on the market data) and steady-state valuation line, which represents the hypothetic valuation of the company based on the IPCPL cost of capital and constant growth rate. If both IPCPL cost of capital and the margin reversion concept are correct, these two lines should intersect at the point of average margin.

TESTING

To test the aforementioned hypothesis, 840 data points on private companies transactions were sourced from the Pratt's Stats database across all available time periods available (years 1997 to 2014) for companies with revenues within the $2.5–ten million range (excluding doctors' offices), bought by a private buyer, and the owner compensation substituted for the market level.[5] The average revenue in the sample was six million dollars, and the average operating profit margin was 8.2%.

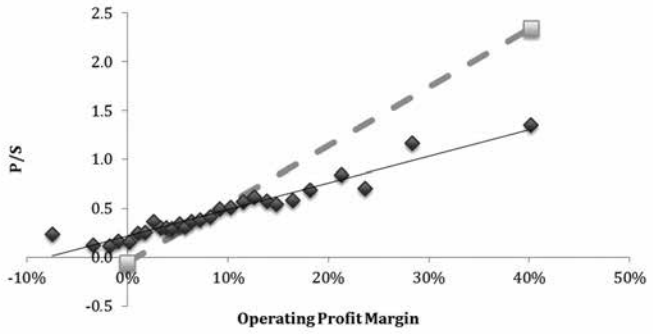
The price-per-share (P/S) ratio was considered to be a dependent variable and the operating profit margin an independent one.

All data points were sorted by operating margin and then divided into twenty-eight groups where median P/S and median operating profit margin were calculated. The resulting twenty-eight points were used to build a linear regression (solid line in Fig. 1), which represent the median market valuation (P/S multiple) for each operating profit margin level.

The reasoning for dividing into groups was as follows:

- The purpose of this paper is to analyze the link between the operating profit margin and the P/S multiple. However, other factors affect this multiple, such as systematic risk, unsystematic risk, and debt capacity.
- The omission of those variables from the OLS regression would create biased and inconsistent results.
- Instead, median profit margin and median P/S in each group were used to "average out" the influence of those factors; median was chosen because of its robustness to outliers and to the skewness created by nonlinear relationships.[6]

FIGURE 1



Market Valuation (Solid) and Steady-State Valuation (Dashed) Lines

The regression line equation is y 5 $2.73x$ + 0.21, leading to the average P/S multiple for a company with the average operating profit margin (8.2%) of 0.44. To check if this multiple is consistent with the IPCPL, the following Gordon-Growth Model equation should be resolved:

$$(1)\ \frac{P}{S} = \frac{(m(1-t) - gc)(1+g)(1+r)½}{r-g}$$

where m denotes the operating profit margin, t the tax rate, g the growth rate, c the invested capital-to-sales ratio, and r the cost of capital.[7] Under the average operating profit margin of 8.2%, the cost of capital can be estimated from the above equation to be 14.8%,[8] which perfectly corresponds to the current IPCPL cost of capital of 15.4% for a six million

5 Adjustment of the owner compensation was calculated in the same way as in IPCPL (IPCPL calculations, including this adjustment are available at http://www.biz-app-solutions.com/IPCPL.asp). Importantly, the test con- ducted in this paper and IPCPL Data Point 1 requires a high minimum business size so that the owner compensation adjustment methodology has no material impact on the result since typical market compensation as a percentage of revenue declines with business size.

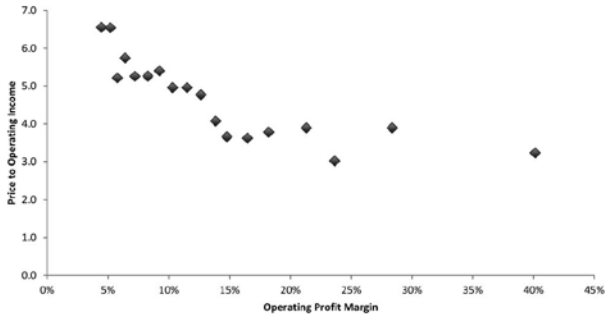
6 See Bob Dohmeyer, Herbert Kierulff, and Janae Castell, "Mean, Median, Harmonic Mean: Which Is Best?" *Business Valuation Update* 21 (January 2015):1, on the robustness of median to the skewness created by the nonlinear relationships.

7 This equation is a standard Gordon Growth formula (where the starting cash flow is estimated as the after-tax profit of Sm–(12t) minus the amount of Sgc, which is needed to support the growth), except for the last term of $(1+r)^{1/2}$, which arises because we solve for internal rate of return based on midperiod cash flow.

8 Assuming a marginal tax rate of 35%, growth rate of 2.8%, and invested capital-to-sales ratio of 20%; accessed at http://www.bvmarketdata.com/defaulttextonly.asp?f5IPCPL, February 15, 2015.

dollar company[9] (the difference of 0.6% equals the present-day adjustment, which is included in the IPCPL, but not in the above equation). This is a strong indication that the original IPCPL Data Point is an accurate estimation.

FIGURE 2



The Negative Relation between the Price to Operating Income Multiple and Operating Profit Margin Demonstrating the Margin Reverse Effect

To further demonstrate the margin reversion in action, the dotted line was constructed, which shows how the P/S multiple would behave if all companies, independent of their profit margin levels, were valued with equation (1) using the same parameters (r, g, t, c) as in IPCPL. This line can be called a "steady-state line" because this equation can be valid only in a steady state. It can be seen from Figure 1 that for low-margin companies, actual market valuation is higher than what the steady-state line predicts, and vice versa for high-margin companies, because of the effect of margin reversion.

Another way to observe the margin reverse effect is to compare the price to operating income multiple for companies with different operating profit margins. Figure 2 demonstrates the negative relation between the multiple and the margin.

IMPLICATIONS FOR PRACTITIONERS

Two points can be taken away from the results presented in this paper:

- This independent test indicates that IPCPL is a reliable source for small private companies' cost of capital (it is important to note not only that this paper focuses on individual companies level where as IPCPL operates with aggregate data, but also that the sample size was bigger and covered a longer time span than the IPCPL sample);
- The market expects profit margins to reverse toward[10] the mean. Hence, the same should apply to the appraiser. A DCF Model should end with a steady state where profitability is checked against industry norms and/or possibilities of new entrants. It is up to the appraiser to employ strategic analysis to judge how long a specific company will be able to defend its competitive advantage before it reaches the steady state.[11]

OTHER COMMENTS

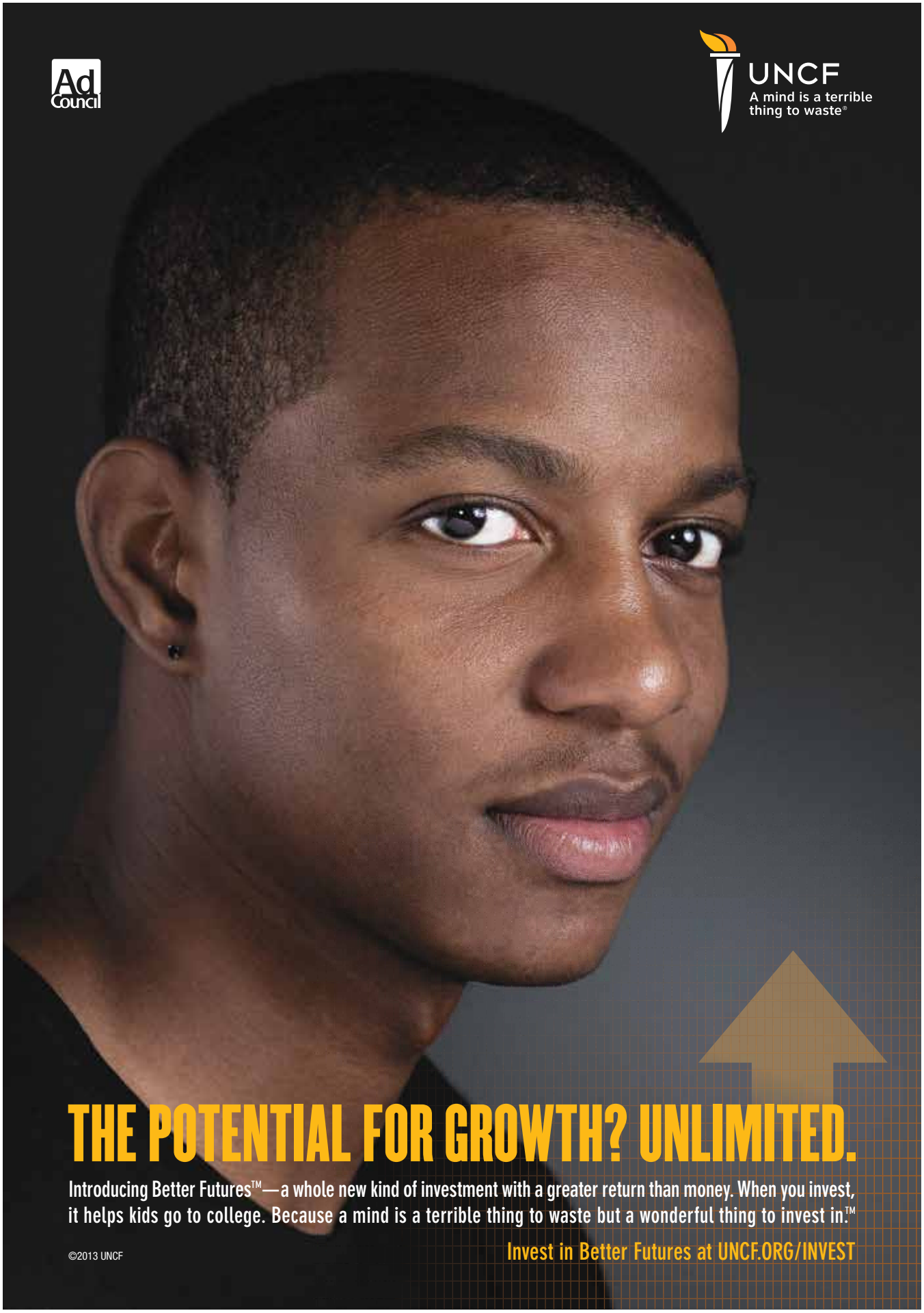
Although the single-company steady-state margin regression approach used here gives the same result as the current IPCPL aggregating method, the approach suggested here should be more accurate over time because: (a) the regression has a larger sample size, and (b) the median grouping regression technique excludes outliers and bad data whereas the aggregating approach relies on outliers and bad data to offset on average. VE

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9 According to the IPCPL version available as of February 15, 2015.

10 Although this paper is probably the first to illustrate the margin reversion in the context of the IPCPL Model, the reversion itself was discovered by several studies. See, for example, Bob Dohmeyer and Herbert Kierulff, "A Forgotten Statistical Concept Tells Why Your Multiple May Be Wrong," *Business Valuation Update* 20 (November 2014):1.

11 Some practical guidance on how to take the dilution of competitive advantage into account is provided by Aswath Damodaran, "Return on Capital (ROC), Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications," July 2007, accessed at http://people.stern. nyu.edu/adamodar/pdfiles/papers/returnmeasures.pdf, February 15, 2015.


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VALUATION

Case Study (Part II): Applying The Capitalization Rate

By Pasquale Rafanelli, CPA, ABV, CVA, CBA, ASA, CFE, MAFF

In the last article, we discussed what a capitalization rate is and how an expert can arrive at the capitalization rate, including the four methods one can use in arriving at the discount rate. We also discussed, in detail, the first two methods: the Build-Up 1 and Build-Up 2 Methods.

As a summary, the concluded discount rate using the Build-Up 1 method was seventeen percent and the concluded discount rate using the Build-Up 2 Method was eighteen percent.

Below is a summary of the formulas for each method and how to properly apply the methods to determine the discount rate in order to arrive at the appropriate CAP rate.

Method	Formula
Build-Up 1 (CRSP Deciles Size Premia)	Ke = Rf + RPm + RPi + RPs+ RPc
Build-Up 2 (Risk Premium Report)	Ke = Rf + RPm+s + RPc + ERP Adjustment
CAPM	Ke = Rf + β X (RPm) + RPs + RPc
WACC	WACC = (Ke X We) + (Kd(pt) [1 - T] X Wd)

K_e = Cost of equity
R_f = Risk-free rate
RP_m = Equity risk premium (ERP)
RP_i = Industry risk premium
RP_s = Size premium
RP_c = Company-specific risk premium
B = Beta
RP_{m+s} = Equity (market) risk premium plus size premium combined
ERP Adjustment = adjusted to account for the difference between the forward looking ERP that the valuation expert has selected and the historical ERP
W_e = Weight of common equity capital in the capital structure
$K_{d(pt)}$ = Cost of debt capital (pre-tax)
T = Income tax
W_d = Weight of debt capital in the capital structure

From this point on, we will discuss the factors above in detail in order to arrive at the discount rate for the cost of equity using the Capital Asset Pricing Model (CAPM). Once we have a thorough understanding of how to determine the discount rate using the cost of equity, we will then discuss the discount rate using the Weighted Average Cost of Capital (WACC).

CAPM

One of the primary differences between CAPM and the Build-Up Methods is the introduction of market or systematic risk[1] for a specific stock as a modifier to the equity risk premium.

Risk Free Rate – R_f

We discussed this in detail in the previous article and for purposes of the example in this article, I have chosen to use four percent which is equivalent to both the ten-year average and the recommended rate in the *Valuation Handbook*.

1 Market risk is measured by a factor called beta.

Equity Risk Premium - RP_m

We discussed this in detail in the previous article and for purposes of the example in this article, I have chosen to use five percent which is equivalent to the Duff & Phelps recommended ERP conditional rate in the *Valuation Handbook*.

Size Premium - RP_s

We discussed this in detail in the previous article and for purposes of the example in this article, I have chosen to use the micro-cap 9-10 as shown in Appendix 3 of the *Valuation Handbook* of 3.74 percent.

Beta

Beta is a measure of the systematic risk of a stock. In other words, it is the tendency of a stock's price to correlate with changes in the market. By definition, the market beta is 1.0. A company with a beta equal to 1.0 has the same risk as the market. Thus, a beta greater than 1.0 is more risky than the market, and alternatively a company with a beta less than 1.0 is less risky than the market. Beta plays a role in the CAPM as a modifier to the ERP.

Beta estimates are generally derived from return data of publicly traded securities. If an expert is valuing a closely held business or a non-public business, then they would use the beta estimates of publicly traded securities as a proxy.

Beta, like the cost of capital, is a forward-looking concept. There are two general ways for estimating betas:[2]

1. A direct beta estimate for a public company comes from regressing excess returns of the public company's stock on the excess returns of a market portfolio over a look-back period.

2. A proxy beta for a closely held business or non-public can be estimated as follows:

- Identify the business in which the subject operates
- Identifying guideline public companies and estimating their levered betas
- Unlevering the guideline public company beta estimates to get estimates of unlevered betas
- Taking an average, or weighted average, of these unlevered betas. The weights are based on the relative values of the business in which the subject entity operates
- Levering the beta estimate using an appropriate debt-to-equity ratio

It is important to note, the most widely used techniques for estimating beta generally use historical data over a look-back period. It is recommended the valuation expert calculates their own beta, but if the expert chooses to not calculate the beta, then they need to ensure that when selecting the appropriate beta, all guideline companies are selected from the same source. Each financial reporting service utilizes different methodologies in the way they measure beta. Therefore, to help avoid an apple-and-orange mixture and prevent skewing the concluded beta, all guideline companies must come from the same source. The *Valuation Handbook* obtains its betas from the S&P 500. Exhibit 5.7 of the *Valuation Handbook* list the betas and industry risk premiums by SIC code.

For purposes of this article, we have referred to Exhibit 5.7 of the *2015 Valuation Handbook—Guide to Cost of Capital* for SIC code 5065 and have determined that the appropriate beta is 1.46.

APPLICATION OF THE CAPM METHOD

Below we will recap the formula and the metrics we ascertained previously in the article as well as following the calculation through.

Method	Formula
CAPM	Ke = Rf + β X (RPm) + RPs + RPc

K_e = *Cost of equity*
R_f = *Risk-free rate*
B = *Beta*
RP_m = *Equity risk premium (ERP)*
RP_s = *Size premium*
RP_c = *Company-specific risk premium*

	CAPM
Rf	4.00%
Beta	1.46%
RPm	5.00%
RPs	3.74%
RPc	2.00%

2 Pratt, Shannon P., Cost of Capital, Applications and Examples, John Wiley & Sons, Inc., Fifth edition, 2014, page 204.

$K_e = R_f + \beta X (RP_m) + RP_s + RP_c$
$K_e = 4\% + (1.46 X 5\%) + 3.74\% + 2\%$
$K_e = 4\% + 7.3\% + 3.74\% + 2\%$
$K_e = 17.04\%$

Using the CAPM, the cost of equity (discount rate) is 17.04 percent, which for purposes of this article, I have rounded to seventeen percent.

WACC

The WACC is mostly used when a valuation expert is trying to arrive at an investment value of the company rather than the fair market value of the company. This is mostly done in highly leveraged situations to understand the value of the operations separately from the currently debt-burdened equity. It is important to note, the WACC can be used in all valuation situations and is not limited to valuing only highly leveraged companies.

The WACC Method is based on the cost of each capital structure net of any corporate taxes. The most common assumptions made by analysts to help determine the WACC are:[3]

1. The market value of debt capital equals its face value or carrying value on the balance sheet; and

2. The ratio of debt capital to equity capital in recent years is representative of the appropriate current capital structure. The events of the financial crisis that began in 2008 proved both of these commonly made assumptions can be wrong. In computing WACC for a non-public company, one important problem is there is no market for the securities, thus the expert has to estimate market values in order to compute the capital structure weightings. As a result, the weights for common equity can only be determined at the end of the valuation. This methodology requires using an iterative[4] calculation process.

Let's take a look at the WACC formula using information pertaining to Griffin in order to arrive at the discount rate. $WACC = (K_e X W_e) + (K_{d(pt)} [1 - T] X W_d)$ where:

K_e = Cost of equity
W_e = Weight of common equity capital in the capital structure
$K_{d(pt)}$ = Cost of debt capital (pre-tax)
T = Income tax
W_d = Weight of debt capital in the capital structure

The cost of equity was discussed above and is determined through one of the three methods: Build-Up 1, Build-Up 2, and CAPM. For purposes of this article, we have selected a cost of equity of eighteen percent which is the cost of equity that was calculated using the Build-Up 2 Method.

Most times a company's long-term debt is attached to a mortgage or note obligation with an interest rate. When this happens, the cost of debt (pre-tax) would be the interest rate. A lot of times though, the debt is not attached to a note making it a little harder to determine the cost of debt. One way is to go to the 10K's of similar companies, both in nature and capital structure (i.e., revenues debt, equity, etc.), and see what they are borrowing debt at. This could be time consuming and might not paint an accurate picture if the right companies are not selected. Another way is to go to the Moody's Baa bond rating and see what the interest rate is at the valuation date. To this rate, the expert would need to determine if it is appropriate to add a debt premium to account for the additional required rate of return associated with a debt investment by market participants in the subject company. Griffin's debt was attached to a note with an interest rate of ten percent. For purposes of this article, we will use a cost of debt pre-tax rate of ten percent, which is the interest rate associated with the debt of Griffin.

The next piece is to determine the weight of the common equity. Let's discuss this in conjunction with the weight of debt. As mentioned above, the company had long-term debt of $2,828,300 and equity of $31,174,500. Therefore, the weight to apply to the cost of equity is 91.7 percent ($31,174,500 / $34,002,800) and the weight to apply to the cost of debt is 8.3 percent ($2,828,300 / $34,002,800).

Griffin's income tax rate is thirty-five percent.

Now that we have all of the individual components, let's apply the formula to arrive at our discount rate:

	WACC
Ke = Cost of Equity	18.0%
We = Weight of common equity capital in the capital structure	91.7%
Kd(pt) = Cost of debt capital (pre-tax)	10.0%
T = Income Tax	35.0%
Wd = Weight of debt capital in the capital structure	8.3%

$WACC = (K_e X W_e) + (K_{d(pt)} [1 - T] X W_d)$
$WACC = (18\% X 91.7\%) + (10\%[1-35\%] X 8.3\%)$
$WACC = (16.5\%) + (6.5\% X 8.3\%)$

3 Pratt, Shannon P., Cost of Capital, Applications and Examples, John Wiley & Sons, Inc., Fifth edition, 2014, page 548.

4 Pratt, Shannon P., Cost of Capital, Applications and Examples, John Wiley & Sons, Inc., Fifth edition, 2014, page 562 discusses the iterative process.

WACC = (16.5%) + (0.6%)
WACC = 17.1%

Using the WACC, the cost of equity (discount rate) is 17.1 percent, which for purposes of this article, I have rounded to seventeen percent.

EXAMPLE SHOWING THE FOUR CONCLUDED METHODS AND CONCLUDED VALUES

As a summary, we have calculated the discount rates and the capitalization rates under the four methods as shown below:

	Build-Up 1	Build-Up 2	CAPM	WACC
Discount Rate	17%	18%	17%	17%
Growth Rate	3%	3%	3%	3%
Capitalization Rate	14%	15%	14%	14%

As you can see under this example, the four discount rates and ultimately the capitalization rates, came relatively close to each other. If applied properly, approaches should be relatively close in most cases. There are some exceptions; for instance, under the WACC, a heavy debt company might result in a lower discount rate.

The Build-Up 2 Method (which is only higher by one percentage point) with everything else being equal, would result in an increased value of approximately $670,500, as shown below.

This is why it is imperative to properly apply the methodology when determining the discount rate to not overvalue or undervalue the business.

CONCLUSION

As valuation experts, we are tasked with selecting the appropriate method on each engagement and properly applying the methodology in order to arrive at the true value of the business. This sometimes can be a very cumbersome and time consuming, especially when the methods provide drastically different results. Is one method better than the other? The answer is no, they each have their own pros and cons and may not be applicable in each and every situation. On top of this, we all have our clients and their agendas, and it is very easy to select the one that meets their needs. As a valuation expert, we need to be unbiased, which is why it is imperative to be consistent in our selection of the method and the methodology we imply in arriving at the concluded discount rate. If we are not consistent, we leave

Discounted Cash Flow Analysis	2015	2016	2017	2018	2019	Terminal Period
Cash flow available to equity	1,461,400	1,486,000	1,507,000	1,529,000	1,553,200	1,599,800
Discount Rate	18%	18%	18%	18%	18%	18%
Growth Rate						3%
Capitalization Rate						3%
Cash flow to be discount factor	1,461,400	1,486,000	1,507,000	1,529,000	1,553,200	10,665,300
Present value discount factor	0.920575	0.780148	0.661142	0.560290	0.474822	0.474822
Discounted cash flow, founded	1,345,300	1,159,300	996,300	856,700	737,500	5,064,100
Cumulative discounted cash flow	1,345,300	2,504,600	3,500,900	4,357,600	5,095,100	**10,159,200**

Discounted Cash Flow Analysis	2015	2016	2017	2018	2019	Terminal Period
Cash flow available to equity	1,461,400	1,486,000	1,507,000	1,529,000	1,553,200	1,599,800
Discount Rate	17%	17	17	17	17	17%
Growth Rate						3%
Capitalization Rate						14
Cash flow to be discount factor	1,461,400	1,486,000	1,507,000	1,529,000	1,553,200	11,427,100
Present value discount factor	0.924500	.0790171	0.675360	0.577231	.0493360	.0493360
Discounted cash flow, founded	1,351,100	1,174,200	1,017,800	882,600	766,300	5,637,700
Cumulative discounted cash flow	1,351,100	2,525,300	3,543,100	4,425,700	5,192,000	**10,829,700**

the door open on cross examination to be questioned on the inconsistent use and application in arriving at the discount rate; which could make the expert come off as being biased, and ultimately hurt the case and the experts reputation.

Therefore, in conclusion, it is essential to be consistent in the use, methodology, and application of determining the discount rate, as well as to assess the reasonableness of the concluded rate, regardless of the purpose of the valuation report. VE

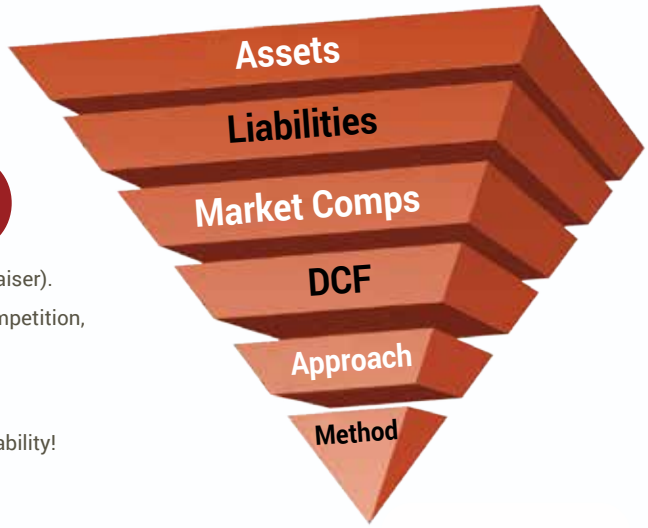


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PRACTICE MANAGEMENT

GENERALISTS BEWARE—FRANCHISED AUTOMOTIVE DEALERSHIPS ARE A DIFFERENT BREED

By Travis Flenniken, CFA, CVA; and Matt Stelzman, CVA, MAFF, ASA

Any appraiser who has discussed value with an auto dealer has heard the term "blue sky." The term is thrown around in the dealership industry as frequently as debits and credits in an accounting firm, but what does it really mean and how is it useful?

The automotive dealership industry is unique in many ways. In this highly regulated industry, each dealership enjoys a quasi-monopoly or oligopoly in its respective market due to the manufacturer's ability to dictate the physical location at which their brand can be sold. This regulation translates into an obvious brand dependency by the individual dealer. Another unique aspect is, the actual economic benefit to owners is often difficult to track due to the use of off balance sheet businesses and because financial statement items often vary depending on for whom they are prepared. Perhaps the most unique aspect of the industry, and most relevant from a valuation perspective, is how dealership acquisitions are structured and financed.

Generally, all dealership M&A negotiations center on the goodwill value in the business, unlike most other industries where buyers and sellers wrangle over the market value of the assets (or in valuation-speak, Market Value of Invested Capital [MVIC]). Stated another way, the MVIC is equivalent to the summation of the market price of fixed assets, working capital, and goodwill. Dealership acquisitions are different in that they do not include working capital; the buyer must invest additional capital beyond the purchase price to run the business. They are also different in that the largest asset group, inventory, is not financed by the standard components that make up MVIC—equity and long-term debt.

Blue sky is the term used within the dealership industry for a dealership's value. The term is so common, it is often written into the dealership's buy-sell agreement, stating explicitly that the valuator identify blue sky value. Investment banks specializing in dealership transactions publicize quarterly blue sky pricing multiples, which often vary by brand. A valuation of an automotive dealership that does not explicitly identify blue sky is deficient from the perspective of most dealership industry professionals.

SO WHAT IS THE BIG DEAL?

Under standard valuation theory, most appraisers would assume that to obtain a blue sky value, one would just subtract the book value of assets from the MVIC. However, with a dealership, it is not that simple. The valuator must consider how dealerships are capitalized to produce an accurate MVIC. The following example will demonstrate the dilemma.

Table 1 shows a Standard Capitalized Earnings Model, with a twenty-two percent cost of equity and a 3.3 percent after-tax cost of debt. The assumed capital structure of the hypothetical buyer is 50/50—equity/long-term debt. This produces a Weighted Average Cost of Capital (WACC) of 12.65 percent. With a growth rate of 4.76 percent (derived from the Livingston Survey published by the Federal Reserve Bank of Philadelphia), we arrive at a capitalization multiple of 12.67.

TABLE 1: STANDARD CAPITALIZED EARNINGS MODEL

Cost of Equity Capital	
Total Cost of Equity Capital	22%
Cost of Debt Capital	
Average Pretax Cost of Debt	5.50%
Estimate Tax Rate	40.0%
After-tax Cost of Debt	3.30%
Capital Structure	
Equity Weighting	50.00%
Debt Weighting	50.00%
Total Invested Capital	100.00%
Weighted Average Cost of Capital (WACC)	**12.65%**
Less: Long-term Growth Rate	−4.76%
Capitalization Rate	**7.90%**
Capitalization Multiple (1/Capitalization Rate)	**12.67**

Assume the dealer's EBIT is approximately $535,000. In general, dealerships spend very little on capital expenditures (capex), so to keep it simple in the example below, assume capex and depreciation offset. Expect the dealership to reinvest in working capital (more on how this is determined later). Table 2 shows the indication of MVIC.

TABLE 2: INDICATION OF MVIC

Development of Ongoing Cash Flow to Invested Capital	
Ongoing EBIT	$535,551
Less: Estimated Tax Rate/Liability	(214,220)
Subtotal	321,331
Add/Subtract: Ongoing Depreciation/Capital Expenditures	–
Less: Expected Necessary Increases in Working Capital	(40,560
Ongoing Cash Flow to Invested Capital (Earnings Power)	280,770
Ongoing Cash Flow to Invested Capital (Earnings Power) for Next Year	294,121
Capitalization Multiple (rounded)	12.67
Indicated Market Value of Invested Capital (MVIC)	$3,725,409

An MVIC of $3.7 million results in approximate EBIT of 7x which is perhaps not out of the realm of reasonableness. However, in an attempt to "back into" blue sky, tangible assets are deducted, producing a negative number, as indicated in Table 3. Note that inventory is listed separately from working capital.

TABLE 3: TANGIBLE ASSETS—DEDUCTED

Ongoing Cash Flow to Invested Capital (Earnings Power) for Next Year	$294,121
Capitalization Multiple (rounded)	12.67
Indicated Market Value of Invested Capital (MVIC)	3,725,409
Less: New Unit Inventory	(4,780,162)
Less: Net Fixed Assets	(1,050,143)
Less: Working Capital (does not include new unit inventory)	(853,000)
Blue Sky Value	$(2,957,896)

The problem with this model is not that the multiple was too low, but rather, the model does not reflect how dealerships are actually capitalized.

THE BLUE SKY METHOD

In our quest to isolate a blue sky value that does not rely exclusively on industry rule of thumb multiples, we have developed a methodology that takes into consideration the nuances of dealership acquisition structures. The Blue Sky Method does not abandon traditional approaches related to capitalizing a company's earnings, but rather, incorporates certain adjustments that line up the appropriate cost of capital with the assets being purchased.

In a transaction, buying a dealer's inventory is like buying cash. Dealers generally do not consider new inventory part of the "deal" in a transaction because new vehicle inventory is typically 100% financed with floor plan debt. In addition, inventory fluctuates with seasonality, which can affect blue sky under the Traditional Capitalized Earnings Approach. Even though inventory typically comprises eighty percent or more of total assets, the primary value transferred in an acquisition is not on a dealer's balance sheet, but rather, is inherent in the franchise rights to the store.

Because a dealership's new vehicle inventory is typically financed with floor plan debt, the acquirer's cost of capital is tied only to the equity and debt required to purchase blue sky, fixed assets, and to invest in working capital. This being the case, once cash flow is capitalized using the correct cost of capital, we deduct fixed assets and required working capital from MVIC to arrive at a blue sky value.

One important factor to consider is that floor plan debt is not a source of capital. Therefore, the interest expense related to floor plan debt should be considered an operating expense, rather than a financing expense. As such, the ongoing cash flow to invested capital should be *after* consideration of floor

plan interest expense. To highlight that floor plan interest expense is included in the calculation of ongoing cash flow to invested capital, we employ the acronym EBIT (afpi), which is earnings before interest and taxes, but after floor plan interest.

In Table 4, we develop ongoing cash flow to invested capital from EBIT (afpi), apply the same capitalization multiple to arrive at MVIC, and then deduct fixed assets and working capital to arrive at a Blue Sky value. One key aspect to note is that EBIT (afpi) is less than EBIT because floor plan interest expense is included.

TABLE 4: DEVELOPMENT OF ONGOING CASH FLOW TO INVESTED CAPITAL

Ongoing EBIT (afpi)	$500,000
Less: Estimated Tax Rate/Liability	(200,000)
Subtotal	300,000
Add/Subtract: Ongoing Depreciation/Capital Expenditures	–
Less: Expected Annual Investment in Working Capital	(40,560)
Ongoing Cash Flow to Invested Capital (Earnings Power)	259,440
Ongoing Cash Flow to Invested Capital (Earnings Power) for Next Year	271,776
Capitalization Multiple (rounded)	12.67
Indicated Market Value of Invested Capital (MVIC)	3,442,384
Less: Net Fixed Assets	(1,050,143)
Less: Working Capital (does not include new unit inventory)	(853,000)
Blue Sky Value	$1,539,241

The resulting blue sky value is 3.1 times ongoing EBIT (afpi). While a dealer may not understand EBIT (afpi), he will understand a blue sky value of 3.1 times pretax earnings—this is the language used by dealers when buying or selling a dealership.

An additional adjustment inclusive of the Blue Sky Method is the treatment of working capital. Unlike in a traditional acquisition, working capital is never acquired in a dealership purchase. When acquiring a dealership, the buyer must invest working capital into the business at a level that is satisfactory with the manufacturer. Rather than deducting the company's current working capital balance from MVIC to arrive at a blue sky value, deduct the manufacturer-required level of working capital. This figure is typically found on the monthly "dealer statement" provided to the manufacturer. To arrive at the annual investment in working capital, we simply take the rate of growth and multiply it by the manufacturer-required working capital.

CALCULATING EQUITY

The Blue Sky Method combines the Adjusted Capitalized Earnings Method with the Adjusted Net Asset Value Method. To calculate the dealership's equity value, simply add the indication of blue sky to the adjusted net asset value. Table 5 shows the calculation of equity value.

TABLE 5: CALCULATION OF EQUITY VALUE

The Blue Sky Method	Description	Value
Capitalization of Cash Flow Method	Blue Sky	$1,539,241
ANAV Method	Net Assets	$2,060,759
Conclusion of 100% Market Value of Equity		$3,600,000

The Blue Sky Method is a method that uses the Traditional Income Approach to valuation, but with adjustments to reflect how dealerships are actually traded in the industry. There are other valuation professionals who have published similar methodologies for dealerships, but fall short of employing actual market variables critical to the Traditional Earnings Capitalization Method. For example, some valuation firms will cite a blue sky multiple to earnings, published in a broker's newsletter, when estimating a blue sky value. This value is then added to net asset value to calculate equity. While citing industry experts for "rule of thumb" purposes is acceptable, for valuation purposes, this method is inadequate.

CONCLUSION

A Generalist that ventures into a dealership valuation engagement should consider using the Blue Sky Method. There are other unique aspects of dealership valuations to consider—the thirteenth month statement, last-in-first-out (LIFO) inventory method, poor performing stores garnering relatively higher acquisition multiples, and off balance sheet operations, just to name a few. Tread carefully and get familiar with these issues so the valuation report meets the client's expectation, and is still compliant with applicable valuation standards. VE



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BUT WAIT, YOU FORGOT THE MARKET APPROACH!

The one method you rarely see used in a valuation of an automobile dealership is the Market Approach. Unless the valuation is for a large dealership group, guideline public company values are of little use. The smallest of the six public companies have a market capitalization in excess of one billion dollars. The Guideline Transaction Method is not viable because most of the transactions listed in the commonly-used databases are not brand-specific, or include a mix of multiple brands within one transaction. In addition, there is no way to know the required working capital investment for each, or if the inventory was adjusted to FIFO, among other complexities. Most of the transactions listed occurred during a time of consolidation in the late 1990s when many of today's public dealership companies became public and began to acquire dealerships. The thought among industry professionals is that purchase prices were unreasonably high during this period.



ACADEMIC REVIEW

Contemporary Research in Valuation and Forensic Accounting

By Peter L. Lohrey, PhD, CVA, CDBV

The purpose of this column is to provide the readers of *The Value Examiner* summaries of contemporary research in valuation and forensic accounting. The manuscripts covered are selected from numerous academic research outlets that include relevant topical coverage of valuation and related forensic accounting issues. The objective is to illustrate the core of this novel research while increasing awareness among the community of the subject matter.

Readers are encouraged to send relevant manuscripts or working papers for consideration to Jim DiGabriele, PhD, at Montclair State University jim@dmcpa.com or digabrielej@mail.montclair.edu with "**Academic Research Brief"** in the subject line.

IMPACT OF SEC DISCLOSURE MONITORING ON FAIR VALUE ESTIMATES

Authors: Daniel Bens, Mei Cheng, and Monica Neamtiu, INSEAD, The University of Arizona, Baruch College – CUNY.

Source: *The Accounting Review,* Vol. 91, No. 2, March 2016, pp.349-375

Summary

Bens, Cheng, and Neamtiu (BC&N) assess whether SEC actions by way of issuing fair value comment letters to registrants, results in reductions of ambiguity in the interpretation of a firm's fair value estimates. The authors believe that registrants who are sent SEC comment letters focusing on their fair value disclosure policies will undergo reductions in investor uncertainty pertaining to their fair value estimates. Their results support this proposition, as the correlations between Level 2 and Level 3 fair value assertions—which are more opaque than Level 1 fair value assertions—and the extent of uncertainty was significantly reduced. This study provides a greater understanding of market participants' assessment of fair value disclosures by examining the role of SEC oversight.

Motivation for the Study

Fair value accounting has been one of the most controversial topics in accounting ever since it was introduced as SFAS 157 (ASC 820)—which became effective for accounting periods beginning after November 15, 2007. ASC 820 created three separate levels of inputs to obtain fair value estimates for measuring assets and liabilities at fair value.

Previous studies (by Song, Thomas, and Yi, 2010; Goh, Li, Ng and Yong, 2015) determined that fair value estimates which are subject to greater measurement ambiguity through the use of Level 2 and Level 3 estimates are perceived to be less reliable measures of value by investors. Riedl and Serafein (2011) found that firms which owned a greater proportion of obscure financial assets possessed higher information risk and higher costs of capital. BC&N expand on these prior studies by investigating whether SEC enforcement actions improve market participants' opinions of the quality of fair value disclosures.

Digest of Findings

BC&N used the SEC comment letter process to capture the regulatory oversight and application of fair value disclosure requirements. They identified comment letters sent by the SEC staff to public company filers during SEC reviews of mandatory filings. Their focus centered on the comment letters which explicitly named accounting or disclosure weaknesses regarding fair value measurements and/or their estimates.

BC&N manually collected fair value footnote disclosures from 10-K filings immediately before and after letters were issued for a random sample of 100 comment letter firms and 100 non-comment letter firms between 2007 and 2012. They then created three separate multivariate regression models to examine the specific determinants needed to estimate the likelihood of receiving a fair value comment letter

from the SEC. They combined three research designs—predicted model for changes in uncertainty, cross-sectional analyses based on variation in letter characteristics, and differences-in-differences—to measure whether assumed reductions in information uncertainty regarding Level 2 and Level 3 fair value assets were driven by SEC comment letters.

Their results revealed that comment letter firms displayed greater post-comment letter improvements in their fair value disclosures—measured by the length of the fair value footnote and the number of separate Levels 1, 2, and 3 fair value categories—than did non-comment letter firms. This also served to reduce the variance in the uncertainty measures for Level 2 and Level 3 fair value assets. Finally, the effect of SEC enforcement was most pronounced during the period 2007 to 2009; suggesting that investors placed a greater emphasis on fair values, thereby stressing the increased importance of SEC monitoring during periods of economic instability.

Conclusions and Implications

BC&N find that public companies who are sent SEC comment letters which focus on their fair value disclosure policies undergo reductions in investor uncertainty—after the comment letters are issued. Their results reveal that the firms who receive comment letters display greater post-comment letter improvements in their fair value disclosures—measured by the length of the fair value footnote and the number of separate Levels 1, 2, and 3 fair value categories—when compared to non-comment letter firms. They suggest the SEC monitors firms proficiently so that the quality of fair value disclosures are noticeably increased.

EVALUATION OF THE IMPLIED PRIVATE COMPANY PRICING LINE MODEL IN APPRAISAL PRACTICE

Author: Peter C. Dawson
Source: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2666677

Summary

The author begins by asserting that the Implied Private Company Pricing Line (IPCPL) Model was designed to estimate a consistent present value discount rate for a 100% control interest in a private, closely held operating company with revenue less than $150 million under the Fair Market Value Standard (FMVS). He then investigates whether its use would provide a more reliable present value discount rate than either the Adjusted Capital Asset Pricing Model (ACAPM) or the Build-Up Method (BUM).

This article examines three fundamental facets of the applied use of the IPCPL Model that have not been considered in previous literature: 1) Does the IPCPL Model eliminate a significant portion of subjective modifications required to be made when using guideline private company transactions? The model's adjustments for key marketability differences are supposedly built into the private company transaction prices, eliminating the need for a valuation analyst to subjectively quantify and apply adjustments; 2) Do the private company transaction prices reflect the FMVS—since they are "actual market clearing prices;" 3) Does the model's cost of capital estimate replicate the Hypothetical Investor's true opportunity cost?

Motivation for the Study

The IPCPL Model created by Dohmeyer and Butler (2012) and Dohmeyer, Butler, and Burkhart (2013)—hereafter referred to as (DB&B)—was created to eliminate "five pitfalls"[1] associated with the use of public company market data under the ACAPM and the BUM. DB&B believe that their Model is "significantly more reliable than extrapolating traditional stock market returns to private company cost of capital" under the ACAPM and BUM. Dawson points out that the IPCPL Model is an application of the Guideline Company Method (GCM) of the Market Approach to valuation.

The primary innovation introduced by the IPCPL model is the use of data from completed transactions—100 percent control interests in closely held private companies[2]—used to calculate a guideline price to pre-tax operating income multiple which is comparable to what is required by the FMVS.

Digest of Findings

Dawson found that the IPCPL Model suffers from at least three significant difficulties. Further, two of the weaknesses he found most probably show that the model's application would not significantly reduce the total dollar value of subjective appraiser corrections vis-à-vis the ACAPM and BUM. Based on further investigation into the application of the IPCPL Model, Dawson found there were several idiosyncratic adjustments in the form of: 1) guideline private company transaction selection criteria,

1 The five pitfalls are considered to be: 1) Not knowing how to estimate the higher unsystematic risk that is priced into the market for small private companies; 2) The difficulty with observing the illiquidity discount for private companies; 3) The highly complex and controversial small stock premium; 4) Pass Through Entity (PTE) Models failure to incorporate the marginal buyer or price-setting investor inherent in the FMVS framework; 5) The difficulty with and the potential for measurement error when estimating capital structure, market borrowing rates, and relevered betas.

2 DB&B rely solely on a pre-determined chosen subset of the Pratt's Stats private company transaction data which they refer to as the "IPCPL 500".

and 2) adjustments to the guideline private company transaction prices and financial data.

He found that individual fine-tuning had to be made to convert actual private company transaction prices to their FMVs. Dawson states, "The private company transaction prices, as well as the embedded price adjustments contained in them, are not negotiated under competitive Fair Market conditions. They are not FMV. The claimed benefit of using these market prices in the IPCPL Model's application—that large subjective adjustments in the COC calculation would be eliminated—is illusory."

Finally, Dawson found that the application of the IPCPL Model calculated a drastically inflated present value discount rate—ceteris paribus.

Conclusions and Implications

Dawson explores three new aspects of the IPCPL Model's application which had not received attention in previous literature. He addresses the "five pitfalls" which the model claims to eliminate when using publicly traded company market data under the ACAPM and BUM. His results found that: 1) The IPCPL did not eliminate a significant portion of the subjective adjustments built into private company transaction prices; 2) Application of the IPCPL Model did not prove that private company transaction prices reflect FMV; and 3) The IPCPL Model's cost of capital computation did not reflect the Hypothetical Investor's true opportunity cost under the FMVS.

AN EVALUATION OF ASSET IMPAIRMENTS BY AUSTRALIAN FIRMS

Authors: David Bond, Brett Govendir, and Peter Wells (University of Technology Sydney, Sydney, NSW, Australia)
Source: http://onlinelibrary.wiley.com/journal/10.1111/(ISSN)1467-629X

Summary

This study examines how Australian managers have been implementing regulation AASB 136, which requires the impairment of assets. In addition, the authors analyze whether the implementation of this rule by managers can be considered non-discretionary. The period covered by this study runs from 2000 to 2012.

They find some evidence that realized asset impairments result from regulatory requirements. However, for the majority of firms which displayed at least one visibly recognizable sign of impairment, they are not acknowledging asset impairment, and it is often delayed when it does occur. The timing of these recognized impairments appear to be highly discretionary. The authors point out that the identification of asset impairment increased after the transition to IFRS in Australia, yet the majority of firms still do not recognize asset impairment.

This study extends the asset impairment literature and provides insights into whether the presence of indicators of impairment manifests in the recognition of asset impairments, and whether the measurement of aggregate asset impairments is reflective of the determinants of recoverable amount. It also adds to the literature evaluating accounting conservatism by studying the nature and the cause of non-discretionary conservatism.

Literature Considered in the Study

The authors begin the literature review by addressing the extensive literature examining asset impairment. Strong and Meyer (1987) were the first to look at the realization of asset impairment. Cotter et al., (1998) found evidence that asset impairments were associated with a firm's performance and economic characteristics.

Several studies which have examined stock price reactions to asset impairment have provided mixed results. The variation in stock price reactions have been attributed to the type of assets being impaired along with worries about the timeliness of asset impairment realization (Francis, et al., 1996: Collins and Henning, 2004; Jarva, 2009; Muller et al., 2010).

Many other studies have considered whether discretion in the determination of asset impairment has been opportunistically motivated (Elliot and Shaw, 1988; Francis et al., 1996; Cotter et al., 1998; Riedl, 2004; Beatty and Weber, 2006; Christensen et al., 2008; Garrod et al., 2008; Jarva, 2009, 2014). The results from these studies have been fairly consistent across different countries and regulatory environments—suggesting that asset impairment is most often opportunistically motivated.

A significant body of literature has developed assessing conservatism in financial statements, and these studies contain congruence with the impairment literature. Both areas of study emphasize the impact of management discretion on financial reporting outcomes (Ahmed et al., 2002; Nikolaev, 2010) and the impact of governance mechanisms (Ruddock et al., 2006; AbuGhazaleh et al., 2011). The authors point out the primary difference is that incentives are usually depicted

as being efficient in the conservatism literature and opportunistic in the impairment literature.

Digest of Findings

The authors used eight separate linear regression models to test the following hypotheses:

(H_{1a}): Indicators of impairment and the recognition of asset impairments

(H_{1b}): Determination of recoverable amount and measurement of asset impairments

(H_{2a} and H_{2b}): Distinguishing and non-discretionary conservatism

(H_{3a} and H_{3b}): Impact of regulatory change

They selected a potential sample of 11,208 firm-years from *Morningstar DataAnalyis* for the period between 2000 and 2012 so that there were an equal number of years before and after the adoption of IFRS in Australia, which became fully effective on July 1, 2007. Businesses in agriculture, financial services, and real estate investment (3651 firm-years) were excluded due to the fact that the application of fair value accounting standards may not cause changes in asset values due to impairment. Firms that were deemed to have unreliable information were also removed (368 firm-years) resulting in a final sample of 5,842 firm years.

The statistical results from this study provide four contributions to the existing literature on asset impairment. First, it showed there is little evidence that Australian firms have been complying with the regulatory requirements for impairing assets. Second, they found very few firms recognized asset impairment, so it is very difficult to label the recognition of asset impairments as non-discretionary. Third, in spite of finding an association between asset impairments and the relevant factors to the determination of the recoverable amount, firms are neither recognizing nor realizing asset impairments. Finally, despite the fact that recognized asset impairments reflect the regulatory requirements, the decision of when to recognize asset impairments appears to be quite discretionary.

The authors close their study by pointing out one critical limitation to this study: asset impairments were evaluated with firm-level information, rather than by using cash generating unit (CGU) information. VE



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LITIGATION CONSULTING

Court Corner

By Peter Agrapides, MBA, CVA

APPRAISAL

Transbay Auto Service, Inc. v. Chevron

807 F.3d 1113; November 30, 2015
United States Court of Appeals for the Ninth Circuit, Judge Tallman

Transbay Auto Service, Inc. and Chevron disputed a multi-million dollar purchase of a gasoline service station in San Francisco. Chevron argued that the station's $2.3 million price constituted a bona fide offer under the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. 2802(b)(3)(D)(iii). However, Transbay rejected this argument and urged the court to preserve the jury verdict awarding it almost half a million dollars as compensation for overpayment.

Central to the argument was the district court's decision to exclude—at trial—a third-party appraisal of the property. This valuation was significantly higher than either of the appraisals commissioned by the parties. The court used the possession plus test in developing its conclusions.

In this case, the court held: 1) When a party acted in conformity with the contents of a document—e.g., by giving an independent appraisal to a lender in support of accomplishing its objective to secure a commercial loan—such an action constituted an adoption of the statements contained therein, under Fed. R. Evid. 801(d)(2)(B), even if the party never reviewed the document's contents; 2) The record provided sufficient foundational facts for a jury to reasonably conclude the buyer adopted the valuation contained in an appraisal that he allegedly did not read, and the appraisal should have been admitted under Rule 801(d)(2)(B) because the buyer manifested an intent to adopt the appraisal because he went to the bank with the hope of inducing it to provide him with a loan, and, as part of this inducement, he provided the bank with the appraisal; 3) The evidentiary error merited a new trial.

The lower court's ruling was vacated, and the case was reversed and remanded to the trial court for a new trial.

BUSINESS VALUATION

Leone v. Owsley

2015 U.S. App. LEXIS 20580; November 25, 2015
United States Court of Appeals for the Tenth Circuit, Judge Seymour

In 2012, appellant Charles D. Leone II resigned his position as a principal of Madison Street Partners, LLC (MSP). According to the terms of MSP's Operating Agreement, fellow principals Steven Owsley and Drew Hayworth elected to buy Leone's interest in MSP. The agreement required the purchase price to be set at fair market value, as determined in good faith by MSP's managers, Mr. Owsley and Mr. Hayworth (Managers). After receiving valuations from two independent valuation firms, the Managers proposed a purchase price of $135,850. Mr. Leone rejected this offer.

Mr. Leone sued the Managers in federal district court. He contended the proposed purchase price was far below market value. He also asserted claims for breach of contract and breach of the implied covenant of good faith and fair dealing. The Managers moved for summary judgment on both claims, arguing Mr. Leone's claims were barred by their good faith reliance upon the value set by the independent valuation firms.

The district court granted the motion. On appeal, Mr. Leone contended the district court misapplied the law regarding express and implied good faith obligations. He also asserted the court incorrectly held bad faith requires a tortious state of mind. Finally, he presented sufficient evidence of bad faith to survive summary judgment.

The appeals court held: 1) Plaintiff claimed that the proposed purchase price for his interest in an LLC was far below market value. The district court properly articulated the requirements under Delaware law for a finding of "bad faith" on the part of defendant LLC managers; 2) In moving for summary judgment, the managers failed to satisfy their burden of demonstrating they relied in good faith on two valuation firms because genuine disputes of material fact existed as to their conduct relating to the valuation process as well as the valuation result itself; 3) Without the rebuttable presumption of good faith in relying on the outside valuations, and given the existence of fact issues regarding the managers' good faith, the district court erred in granting summary judgment for the managers on their affirmative defense based on the statutory safe harbor provision, Del. Code Ann. tit. 6, § 18-406.

The lower court's ruling was reversed and the issue was remanded to the trial court.

MERGER

Brinkley v. Commissioner

2015 U.S. App. LEXIS 21838; December 16, 2015
United States Court of Appeals for the Fifth Circuit, Judge Prado

Brian Brinkley was a co-founder of Zave Networks, Inc. (Zave). After serving in an independent contractor capacity for Zave for a number of years, Brinkley became a salaried employee in 2010. A portion of his compensation was in the form of restricted stock grants. His initial stake in Zave amounted to 9.8 percent of the company. Brinkley made elections under Section 83(b) of the Code with respect to all stock grants that were not vested.

Eventually, as is common with early-stage companies, subsequent infusions of capital by outside investors served to dilute Brinkley's ownership stake in Zave. Brinkley threatened to leave the company if his interest fell below three percent, and Zave issued to him additional stock grants to accommodate his three percent interest.

By the fall of 2011, Google, Inc. (Google) began negotiations to acquire 100 percent of Zave. Brinkley was not involved in the negotiations, but Google did require, as part of the negotiation, that Brinkley turn over all his intellectual property and become a Google employee in the event of an acquisition. Brinkley's interest at this point was below three percent.

In connection with the Google negotiations, Zave management explained to Brinkley that his equity interest was worth approximately $800,000. Brinkley disagreed with this assertion, in light of his expectation to share in at least three percent of the deal proceeds (i.e., a minimum of $2.79 million). Zave acceded to Brinkley's request and drafted a letter agreement that required Zave to pay Brinkley, upon consummation of the transaction, an amount equal to 3.3 percent of the ninety-three million dollar deal consideration, less any amounts paid directly to Brinkley for his stock.

Brinkley did not accept the initial offer. Moreover, he was told by his tax advisors that the proposed arrangement would likely result in the proceeds being taxed as ordinary income. Following further negotiations, Zave and Brinkley came to an agreement whereby Zave would pay Brinkley "as consideration, $3.1 million of the ninety-three million dollar purchase price offered by Google in exchange for: (i) all of [petitioner's] shares, warrants and options of [Zave stock]; and (ii) [petitioner's] execution of a Key Employee Offer Letter and Proprietary Information and Inventions Assignment Agreement with Google as required in the Merger provided that any payments were subject to all applicable tax withholdings."

Brinkley eventually reviewed drafts of the merger agreement but did not consult the schedules and did not consult with his tax advisors. He signed a shareholders' consent agreeing to Zave's entering into the merger agreement. The schedules to that agreement, in fact, identified Brinkley as a deferred compensation recipient. Following the transaction, Zave prepared spreadsheets indicating Brinkley's stock was worth $787,671 and that he was to receive $1,879,779 in deferred compensation.

As a result of the tax withholdings, Brinkley became aware of the way in which his former employer was treating the proceeds. He then had his tax advisors send a letter to Zave demanding a correction of the tax reporting position. Zave did not respond to the demand. Subsequently, Brinkley

reported a long-term capital gain of $2,476,455 and reporting the withheld taxes as "estimated tax payments" on his 2011 federal tax return. He also included with the return a copy of his letter agreement with Zave as well as an explanation of the "mischaracterization" effected by Zave.

In the eventual court case, the court held: The Commissioner of Internal Revenue properly found a federal income tax deficiency and assessed an accuracy related penalty on the taxpayer because the evidence supported a finding that the taxpayer had mischaracterized funds he received as a result of the merger between his company and another company as long-term capital gain under I.R.C. §§ 1(h), 1221(a), 1222(3) rather than ordinary income and that the taxpayer did not make a good faith effort to assess his tax liability under I.R.C. § 6664 and could not reasonably rely on his advisers. The ruling of the lower court was affirmed.

PATENTS

Commonwealth Scientific v. Cisco Systems

2015 U.S. App. LEXIS 20942; December 3, 2015
United States Court of Appeals for the Federal Circuit, Judge Frost

In *Commonwealth Scientific and Industrial Research Organisation v. Cisco Systems, Inc.* (Fed. Cir., Dec. 1, 2015), the Federal Circuit established important new guidelines for the calculation of "reasonable royalty" damages for standards-essential patents (SEPs), even in the absence of the patent holder's commitment to license on reasonable and nondiscriminatory (RAND) terms.

CSIRO, a leading Australian governmental research organization, obtained U.S. Patent 5,487,069 in 1996, claiming techniques for addressing "multipath" problems in wireless signal processing. These techniques were later incorporated into IEEE's 802.11a (Wi-Fi) standard, first published in 1999. In connection with the approval of 802.11a, IEEE requested, and CSIRO provided, a Letter of Assurance under which CSIRO committed to license the '069 patent to manufacturers of 802.11a-compliant products on "reasonable and nondiscriminatory" (RAND) terms. When later versions of 802.11 were developed, IEEE again requested that CSIRO commit to license the '069 patent on RAND terms. CSIRO, however, refused to issue such additional assurances.

In 2001, Cisco acquired Radiata, Inc., a company founded by a former CSIRO scientist to manufacture wireless chips. Radiata had entered into a Technology License Agreement (TLA) with CSIRO in 1998, under which Radiata paid CSIRO royalties for use of the '069 patent based on a percentage of Radiata's chip sale prices. These royalties ranged from one percent to five percent of the chip price, depending on sales volume. When Cisco acquired Radiata, it inherited the TLA and paid CSIRO approximately $900,000 in royalties over the next several years. Cisco stopped paying royalties under the TLA in 2007, when it discontinued the use of Radiata chips in its products. Cisco and CSIRO negotiated for several years regarding an ongoing license for the '069 patent, but could not reach an agreement and CSIRO sued Cisco for infringement in 2011.

In this patent infringement action, the court held: 1) The district court did not violate apportionment principles in employing a damages model that took account of the parties' informal negotiations with respect to the end product; 2) The district court erred because it did not account for standardization; 3) The district court failed to account for the possibility that the $0.90 and $1.90 per unit rates that it used as a starting point may themselves be impacted by standardization; 4) Because many of the district court's reasons for discounting the TLA were flawed, the instant court directed the district court on remand to reevaluate the relevance of the as-amended TLA in its damages analysis. The lower court's ruling was vacated and the issue was remanded for redetermination.

STOCKS

Dorrance v. United States

2015 U.S. App. LEXIS 22820; December 30, 2015
United States Court of Appeals for the Ninth Circuit, Judge McKeown

The court was asked to consider cross-motions for summary judgment based on the opposing facts in this case. In 1995, the plaintiffs formed the Dorrance 1995 Legacy Trust (the Trust), which in turn purchased five life insurance policies in 1996. The policies were purchased with The Prudential Insurance Company of America (Prudential), Sun Life Assurance Company of Canada (SunLife), Phoenix Home Life Mutual Insurance Company (Phoenix), Principal Life Insurance Company (Principal), and Metropolitan Life

Insurance Company (MetLife). In the aggregate, the policies provided $87,775,000 in coverage. The Trust purchased the policies in anticipation the benefits would provide liquidity to pay the plaintiffs' estate taxes upon their death, so that Plaintiffs' heirs would not need to liquidate the family stock portfolio to pay such taxes.

All of the policies were purchased with mutual insurance companies. In a mutual insurance company, the policyholders have an interest in the company itself in addition to holding a policy. This interest provides the policyholder with certain rights, including the right to vote on corporate decisions and the right to receive the mutual company's surplus should the company liquidate. The plaintiffs described these rights as "ownership" rights, while the Defendant describes them as "membership" rights.

The five mutual life insurance companies demutualized through processes that began in 1998, 1999, and 2000, and culminated in 2000 or 2001. In the process of demutualization, a mutual company changes its corporate structure into that of a stock company, often through a procedure governed by state statute. Policyholders must vote to approve a demutualization before the process can proceed. Prior to seeking policyholder approval, at least one of the companies promised policyholders that if they voted for demutualization, premiums would not increase; and in fact, none of the premiums the plaintiffs paid increased after demutualization.

When the companies demutualized, policyholders (including the plaintiffs) retained their policies and continued to pay the same premiums. They no longer, however, held mutual rights, and therefore could not vote on corporate decisions and had no interest in the surpluses of the new companies. In exchange for the lost mutual rights, the companies provided policyholders with the option of receiving stock in the new companies or receiving a cash payment in lieu of stock.

When determining how much stock to give policyholders, the companies calculated a "fixed" component to correspond to policyholders' loss of voting rights, and a "variable" component designed to measure "the policyholders' contribution to the surplus of the company." Although the companies used slightly different methods to measure their policyholders' contribution to the company's surplus, all obtained independent actuarial opinions that the methods were "fair and equitable." The stock the Trust received during the demutualization had a total value of $1,794,771. The Trust sold all the stock on June 23, 2003, for an aggregate price of $2,248,806.

When the Trust received its IRS Form 1099-B, the form listed the basis in the Trust's stock as zero, consistent with IRS policy that policyholders have no basis in stock received by a policyholder during demutualization of a life insurance company. The plaintiffs paid the taxes owed, and subsequently filed for relief.

The defendant—the United States of America—filed a motion for summary judgment, arguing that no part of the plaintiffs' periodic payments for their original insurance policies was paid to acquire the mutual rights under the policy, and that all of the premium was paid to purchase the policy. As a result, under this theory, the plaintiffs would have had *no basis* in the stock that was provided in exchange for those rights.

The plaintiffs also filed a motion for summary judgment, arguing that the demutualization should be governed by the open transaction doctrine, which is employed in circumstances where the basis in property that is split cannot be allocated to the resulting assets. Under this theory, *all* of the proceeds from Plaintiffs' sale of stock would be considered return of capital from their premiums, and they would thereby owe no tax.

The court held: Taxpayers who received stock in life insurance companies through the demutualization process and who later sold that stock were not entitled to a refund of the capital gains tax they paid, as they did not have a basis in the stock. The taxpayers had a zero basis in the membership rights that were extinguished during the demutualization, as they were not charged a premium for those rights.

The court denied both the plaintiff's and the defendant's Motion for Summary Judgment. VE



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PRACTICE MANAGEMENT

Practicing Solo

"Practicing Solo" features interviews with our industry's seasoned sole practitioners. If you are itching to join the solo ranks, or striving to be more efficient and effective in your established one-person firm, this column offers you practical advice, steeped in experience from the trenches, that can move you forward.

By Rod P. Burkert, CPA, ABV, CVA

INTERVIEW: SHERYL BRAKE

I hope you enjoyed last issue's interview with Michael Gregory. Our interview series continues, with this issue featuring Sheryl Brake, CPA, CGMA, CVA, CEPA. Sheryl hails from Mead, Colorado—just north and east of Boulder, and south of Fort Collins. I've been through the area in our RV several times, and I can tell you that the scenery is spectacular.

Having worked previously for two CPA firms, where she worked her way up from staff accountant to partner, Sheryl struck out on her own in May 2015 when she launched Encompass Transition Solutions, LLC (www.encompasstransitions.com). Her practice sweet spot is women-owned companies wanting to align personal, business, and financial goals while maximizing the value of their businesses.



Sheryl Brake

This interview comes out as Sheryl is celebrating her one-year anniversary of going solo…so she offers a very fresh perspective about her practice and processes.

Rod: What was your first year like, and what would have made it better?

Sheryl: My first year as a solopreneur was a bit of an exploratory journey. After a successful twenty-nine-year career with a regional and then national CPA firm, I left the comfort of a position as partner and a regular paycheck to start my own consulting practice.

Truthfully, I had a lot of doubt around whether I was doing the right thing for myself, for my family, and for my future. Would I be able to get enough work? What kind of work would I have to take on? How long would it take to ramp up? I went through a lot of different emotions: fear, doubt, excitement, and liberation. You name it…I probably felt it.

I started off slowly, putting a foundation in place (website, business plan, etc.) and making new connections and re-establishing some old ones. I was pleasantly surprised at the amount of support that I got from colleagues, and even my old firm's clients. I had more opportunities and, with the help of some great relationships, my first year practice revenues exceeded my expectations. I am so grateful for everyone, including my husband, Mike, who supported me during this transition.

As things lined up, the fear and doubt lessened and I became more excited about this new chapter in my professional career. I started to feel rejuvenated; and what I realized was that I had rediscovered my creativity and passion—things I had somehow lost along the way.

As far as what would have made my first year better…that's a tough one, especially since my first year revenues exceeded my expectations. But if I have to say something, it would be that I wish had gone solo sooner. I had some self-doubts that turned out to be unfounded…and isn't that normally the case with these things?

Rod: Did you have a formal (or even semi-formal) business plan?

Sheryl: Yes, to semi-formal. Being the linear thinker that I am, I like to have my ducks (and processes) in a row, and so I had an informal plan written down. It wasn't perfect, but it was

a plan. I quickly learned that I would never perfect it (I could have worked on it forever). Soon, I realized I was spending too much time planning and not much doing—so I decided to just throw myself out there and work the plan as I went.

Rod: How did you first attract clients, and how did that strategy evolve over time?

Sheryl: Most of my clients come via referral from professional colleagues (bankers, lawyers, financial planners, and other professional advisors). At first it was a bit of a shotgun approach, but I spent much of the time determining my exit planning niche and then how best to get in front of it. Having done that, I have a much more strategic approach to focusing on specific marketing methods. That said, I am always refining my referral source development and developing a team of other professional advisors to work with.

Rod: What kinds of engagements did you start with?

Sheryl: I started initially with some consulting projects (like assisting a couple of small start-ups with their business planning, choice of entity selection, and accounting system set up) and reached out to some business owners who had expressed interest in exit planning. At first I was taking just about any work that came through the door (a scarcity mentality approach), but eventually realized that I needed to focus on my transition planning niche. I look at every opportunity for that potential, even if it is not in the immediate future.

Rod: Do you practice in a specialized niche today?

Sheryl: Exit planning…I call it transition planning. Subsets of this include business valuation (calculations), value creation, and sell side preparation.

Rod: What has been your best marketing tactic?

Sheryl: Definitely referrals. I am currently targeting referral sources that work with women-owned businesses nearing retirement age and how I can get introduced to them. My goal for this coming year is to work on a newsletter and get more traffic on LinkedIn.

Rod: How do you price work?

Sheryl: All of my work is retainer-based. I had no desire to keep track of my time and, after years of being measured by my billable hours, I decided to ditch our industry's long-standing practice. I also didn't want clients to worry about the clock. All of my clients have responded positively to this approach. Yes, clients figure out an effective hourly rate (sorta) but the fact that clients know what they will pay in advance puts their minds at ease.

I also have built into my pricing an incentive to engage with me more—the more "time" they retain me on a monthly basis, the lower the "effective" hourly rate. It's a win-win really. I am much more productive and have less administrative time with fewer clients. I am able to better predict my monthly income. While I have revenue goals, I decided going into this next year that if I make enough money to cover expenses, take reasonable compensation, enjoy what I am doing, lessen my stress, and have more time for family and my outside interests, then the number of billable hours is irrelevant.

Rod: How do you differentiate yourself from larger firms?

Sheryl: I only take on a handful of clients at any given time, so clients get highly personalized service from me.

Rod: Do you work from a home office or an "office" office?

Sheryl: I work from a home office and absolutely love it. My clients don't mind—I usually travel to them—and I don't miss the daily commute that I had previously.

Rod: What is your current mobile device?

Sheryl: I have an iPhone and iPad.

Rod: Describe your current computer workstation set up.

Sheryl: I have a laptop computer for mobility and use a dual monitor system when working at home.

Rod: Besides your phone and computer, any office hardware or software you just couldn't live without?

Sheryl: I could not live without my Outlook calendar and Microsoft OneNote (https://www.onenote.com). I use these programs daily to keep track of everything in my life, business and professional. Insightly (https://www.insightly.com) is another program I am bringing on board to keep better track of contacts, leads, opportunities, and projects—I am a visual person and want to see everything in one place, which Insightly allows me to do.

Rod: What do you listen to while you work?

Sheryl: Acoustical guitar, alternative, or classical music—anything soothing, really. Sometimes a little blues, jazz, or classics—Frank Sinatra, James Taylor, etc.

Rod: What tool(s) do you use to manage your to-do list?

Sheryl: OneNote, Outlook, and Insightly but, in a pinch, paper. Outlook and Insightly have some level of integration, and I am learning more about how to use these two programs together.

Rod: What are your best-cost saving ideas?

Sheryl: I try to use the free version of everything as long as I can, especially if I am just testing it out. If I can't live without it then I might consider the upgrade. Also, I issue all my reports and information in electronic format. I use very little paper/ink in my practice. I don't spend a lot on marketing. I designed and built my own website using Wix (http://www.wix.com).



Depending on her mood, Sheryl listens to Frank Sinatra or James Taylor while working in her office.

Besides the cost savings, this free website builder allowed me to use the creativity of my right brain.

Rod: How about your favorite productivity tip that saves you lots of time?

Sheryl: For me, that would be OneNote (or Evernote if your audience is looking for another option). I can easily type up an agenda for a meeting, send it directly to the client from OneNote, type meeting notes right on the agenda, and then send again to the client. Tags can also be added—to-do, follow-ups, and tasks—right in OneNote (and Evernote, too).

Rod: Early bird or night owl—what's your sleep routine?

Sheryl: Definitely an early bird. My early mornings are spent with a cup of coffee in my art studio, painting—it is my daily mediation practice and helps me clear my head for the day ahead. Sleep is important to me, so I try to get between six and seven hours (I rarely sleep more than seven), and I don't use an alarm clock anymore—I usually wake up around 5:30 am.

Rod: Do you have liability insurance?

Sheryl: Yes, through the AICPA.

Rod: Do you have any office/admin staff?

Sheryl: Not currently, but I hope to hire someone part-time this year to help with some administrative items.

Rod: Do you have a support group to call on?

Sheryl: I have a number of colleagues I can call on within the profession to deal with specific valuation issues. But my practice and my life are so much more than that, so I also count on other strategic advisors, my life-long mentor, my personal coach, and of course, my husband to be helpful sounding boards when I need them.

Rod: Who reviews your work?

Sheryl: No one currently, but I am working on an arrangement with some other solo practitioners where we do some cross-review. I will set aside a report for a day and come back to it with fresh eyes to review. I also will print reports for editing; I find I catch typos and errors more easily using hard copy than reviewing on a screen.

Rod: How do you stay technically current with changes in the profession?

Sheryl: As a member of NACVA, the AICPA FVS, and the Exit Planning Institute, I read professional journals, attend CPE, and subscribe to a few newsletters as well. I also do a lot of reading outside of just industry journals, like books on leadership, emotional intelligence, change—anything really that will help me help my clients.

Rod: What non-BV business book have you read most recently or want to get to, and why?

Sheryl: *Managing Transitions* by William Bridges, PhD. While contemplating and going through my transition year at my prior firm, I found I was struggling a lot with change. It got me really curious about why I was struggling, so I have been reading a lot about this. I had an epiphany one day…that what I was feeling was probably a lot like what my clients were feeling as they contemplated exiting their business. So, I started reading about the issues of change and transition. Another great read on this subject is *Necessary Endings* by Dr. Henry Cloud. I think I can apply a lot of my own personal experience with transition and change to my practice and really help business owners with their own transition.

Rod: What's your work-life balance like?

Sheryl: Much improved over my previous work-life balance! Definitely more time for me, and everyone who knows me says I am happier and much more enjoyable to be around. I have taken up water color painting again, a real passion of mine that was neglected for thirty years. I do have periods when the workload is heavy and I am busier than I would like to be (when it rains it pours), but I am not working 24/7, so it is much more tolerable. And, I enjoy my clients.

Rod: What practice areas do you think offer the most promise to someone going solo now?

Sheryl: Any area where you can focus on a niche, really. If you can work into your niche, something you are really passionate about, even better. And, I think the more you focus on a narrow niche, the better. An added benefit to this is it makes it easier for referral sources to refer you. Think about it. How many CPAs does a referral source know? Lots. But how

many CPAs specializing in your niche does s/he know? Not as many. You can't be everything to everyone—so get really strong in one niche, but be flexible and pay attention to what is happening in the industry. Ask yourself, how can you adapt to the changing environment? And, get feedback/input from your clients. Even if there is a lot of promise with a particular practice area, you probably won't be very successful if you lack passion.

Rod: Finish this sentence: If I knew then what I know now, I would…

Sheryl: …have looked up from the public accounting world sooner, paid attention to the signals that were around me, and recognized there was a life full of opportunities waiting for me. A personal illness in 2009 really rocked my world and caused my priorities to shift. I was successful, but unhappy. It spurred me to do some deep soul searching and a lot of reading to find out why. As time went by, my available opportunities came into focus. And, here I am. VE

That's a wrap! Do you have a Practicing Solo issue you would like me to address? E-mail me at rod@practicebuilderacademy.com. Looking for advice on how to build your practice or redesign your life? Post your question on Practice Builder Academy TV at www.AskPBA.com.



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PRACTICE MANAGEMENT

How to Make Writing Part of Your Practice

By Nancy McCarthy, Senior Editor, The Value Examiner

At the NACVA/CTI 2016 Annual Consultant's Conference this past June, John DeRemigis, Senior Editor of *QuickRead*, P. Dermot O'Neil, Managing Editor of *National Litigation Consultant's Review*, and I gave a presentation on how writing for publication can be an important part of your practitioner's tool box. The purpose of the presentation was to give practitioners another way to enhance their business. This article gives a quick overview of the presentation and offers a few suggestions on how you can become a Subject Matter Expert (SME).

WRITING TO ENHANCE YOUR PRACTICE

Writing for publication is one way for you to share your thoughts and ideas on a topic. This, in turn, can help you attract clients and increase your business. It can also build your credibility and establish your authority in your field. And, as you develop and enhance your expertise, you have the potential to enhance your business by developing your reputation as the "go to" person in your industry.

However, saying you are a SME and being a SME is—to paraphrase Mark Twain—the difference between "lightening and a lightening bug." Before you can write with authority on a subject, you need to develop the tools to be the authority on a subject.

BECOMING A SUBJECT MATTER EXPERT

According to Malcolm Gladwell, author of *Outliers*, the "magic number of greatness"—the time it takes to become really good at anything—is 10,000 hours. When you work in a field you enjoy, when you learn from your colleagues and peers, and when you are able to challenge yourself, you are developing the skills you need to be a true SME. So, while you may have the education and experience to be knowledgeable in a particular area, there are other ways to enhance that knowledge. For example, you should consider devoting time to knowing as much about your subject as possible. Therefore, it is wise to:

- Keep up-to-date on changes and new developments within your business by taking courses and certification programs designed to enhance your knowledge
- Stay abreast of trends by reading industry leading authors
- Know a little bit about the current or most noteworthy SME's in your field
- Continue to network and discuss issues with colleagues and other interested parties
- Join industry associations that encourage you to network with other like-minded peers
- Explore LinkedIn for professional and interest groups
- Attend events with people and groups who are also interested in your subject

SHARING YOUR WISDOM

Once you feel confident that you know as much as you can about a subject, it is time to start sharing that wisdom. Spending the time learning, talking, and questioning, helps you to build a reputation; but you should also be looking for wider opportunities in which to communicate to others. This is called, "building your platform." It is the time to take advantage of any opportunities to write for your own company, or in industry journals, or even to become a guest blogger on an appropriate website. It is also a good time to look for opportunities to become a guest-speaker at industry events. All of these things help you to establish your expertise. Other outlets include:

webinars, podcasts, newspaper columns, speakers programs for the local chambers of commerce, or "Lunch and Learn" programs sponsored by organizations—or even your own firm. Topics for these programs can include (but are by no means limited to):

- Local issues such as local frauds, eminent domain issues, etc.;
- Court decisions in the tax court, local jurisdictions
- Discussions on current issues in legal, business valuation, tax valuation, forensic accounting, etc.

HOW SHOULD YOU WRITE

There are a few simple rules to follow when you start to write as part of your practice. First, you should always learn the submission guidelines of any publication with which you plan to work. Next, ask for a copy of their style guide. This will help you in terms of the way in which the publication wishes to receive your manuscript. In addition, you want to be seen as an SME, not as a sales person. Your challenge is to be informative, unique, and trusted. You also want to be viewed as a professional and as a colleague. This means that your source material needs to be credited and valid.

WHEN TO START BECOMING A SME

There is no "best time" to decide you are going to enhance your practice by writing for publication. As a practitioner, you are always learning. Once you have made the decision to write, no matter where you are in your business development cycle, let your connections work for you. Here are some tips to consider:

- Alert your state professional societies to let them know you would like to be a speaker. Provide them with topics with which you are familiar.
- Contact the business columnists at your local newspaper and let them know you can provide articles for the general public. This will also get you into the online version of the paper.
- Develop PowerPoint Presentations to use with Rotary Clubs, Lions Clubs, etc.
- Develop PowerPoint Presentations for law firms or bar association "Lunch and Learn" programs.
- Research social media, such as LinkedIn, blogs, and websites that have an audience receptive to your message.
- Contact professional associations—such as NACVA—to learn if they have digital or print publications that would accept your articles.

It is also a good idea to incorporate these platforms and concepts into your ongoing Business or Marketing Plans. Doing so will keep you focused and encourage you to stay on a schedule.

CONCLUSION

Becoming a SME and writing about what you know can help you build your practice. It helps you to stand out from the competition and it lets your clients know that you have something "extra." It is a powerful way to let the world discover who you are as a professional.

A good way to start is by contacting one of NACVA's publication editors to find out what type of articles they are looking for and if yours makes a good fit. For more information contact: VE

John DeRemigis, Senior Editor, QuickRead (JohnD1@nacva.com)

Nancy McCarthy, Senior Editor, Value Examiner (NancyM1@nacva.com)

P. Dermot O'Neil, Managing Editor, National Litigation Consultant's Review (damages@comcast.com)

D. Larry Crumbley, Senior Editor, Journal of Forensic and Investigative Accounting (dcrumbl@lsu.edu)



Nancy McCarthy is the senior editor of The Value Examiner. She has an MA from New York Institute of Technology (NYIT) and has taught at NYIT, NYU, and Middlesex Community College in New Jersey. She has been marketing director for several Wall Street firms over the past twenty-five years and is currently a freelance writer and editor. E-mail: Nancy M1@nacva.com

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Do You Want to Help Shape the Future of Business Valuators?

The Value Examiner is looking to expand its editorial board. We are looking for nominees—either self-nominated or a recommended nominee—to serve a two-year term (with a possibility of a second two-year term). Board members can be practitioners and/or academics with a solid understanding of business valuation. Board members are ambassadors for the publication and help identify article topics and potential authors. However, the main function of a board member is to participate in the PEER REVIEW process. Board members are also encouraged to submit articles for publication

The editorial board plays a vital role on this publication; not only does it shape the articles we publish by providing sage analysis of an author's work, it sets the policy and goals for the journal. Board members are active within the valuation communities, often play a role within NACVA, and are well respected professionals and/or academics.

The Value Examiner is a publication of the NACVA. It is devoted to current, articulate, concise, and practical articles in business valuation, litigation consulting, fraud deterrence, matrimonial litigation support, mergers and acquisitions, exit planning, and building enterprise value. We publish six times per year—our September/October issue is devoted to a single topic and our March/April issue highlights the upcoming NACVA/CTI Annual Consultant's Conference.

Interested candidates should send an e-mail summarizing their interest in participating on the editorial board that includes:

- A copy of your CV
- A recommendation from a friend, colleague, or client who is familiar with your work

The deadline for submission is August 1, 2016. Please send all submissions to:

Nancy McCarthy
Senior Editor
The Value Examiner
Nancy M1@nacva.com

Please put TVE EDITORIAL BOARD NOMINATION in the subject line.

Successful candidates will be notified by e-mail by September 30, 2016.

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