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Timely news, analysis, and resources for defensible valuations.

BVR
What It's Worth

Business Valuation Update Yearbook 2017



What It's Worth

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Introduction

For over 20 years, *Business Valuation Update* has presented the latest thinking in methodologies as well as up-to-date news and analysis, changes in regulations and professional standards, leading conferences, publications of interest, and practice-building ideas. We have continued this tradition, and here are some highlights of what you'll see in this yearbook.

Section I. Business Valuation Approaches, Methods, and Entity-Specific Issues

Business Valuation Update is committed to the idea that, if the business valuation profession is to advance, it must be open to new ideas, techniques, and methodologies. There must also be challenges to conventional thinking and a fostering of healthy debates.

The debate over the discount for lack of marketability heated up over the application (or misapplication) of a DLOM in New York statutory appraisal actions. An article, "NY's Unfair Application of Shareholder-Level Marketability Discounts," triggered comments by readers who agree the problem lies with judges who lack training in valuation concepts and often build their value determinations on questionable or stale precedent. A number of follow-up articles appeared, including "Definitional Problem Underlies N.Y. Courts' Unfair DLOM Stance" and "DLOMs in N.Y. Fair Value Cases: Private Company Discounts Are Not Caused by Lack of Marketability."

This debate triggered a call for action for the profession to speak with one voice and eliminate the confusion over the use of discounts. One valuation expert offers up some nomenclature and—more importantly—a framework that he hopes will help in developing a common language that could be used in valuation reports in an article titled "Adjustment Mapping and the Public-vs.-Private-Company Discount Debate."

BVU followed the continued interest in the implied private company pricing line (IPCPL), a model designed to better estimate the cost of capital for small private companies (those with revenues below \$150 million). The model was first introduced in 2012, and *BVU* ran a series of articles starting in 2013. An article titled "Debate Rekindles Over Private Company Cost of Capital Model" covers certain aspects of the model that have been called into question and the responses by the IPCPL developers.

Other new methodologies and approaches were highlighted in several articles, such as “A Quantitative Model Evolves for Determining Passive Appreciation,” “Multifactor Scorecard Analysis Helps With Debt-Versus-Equity Problem,” and “Simplified MUM for Determining Personal Goodwill.”

As the year came to a close, the most talked about issue was the issuance of the controversial proposed IRC Section 2704 regulations designed to curb estate valuation discounts for minority interests. The valuation community was shocked over the scope of the proposed rules, which would apply to family-owned operating businesses as well as asset-holding entities that are perceived to be pushing the envelope in terms of discounts. Appraisers were also stunned over how the regs essentially redefined long-accepted definitions of “fair market value,” “marketability,” and “control.” Two articles cover this: “Proposed Sec. 2704 Regs Fly in the Face of BV Theory and Tax Law” and “Groundswell Builds as IRC Sec. 2704 Regs Sink In.”

Other articles of note deal with cost of capital, damages, ESOPs, internet domain valuation, economic obsolescence, and determining reasonable compensation. Attendance at the valuation conferences was brisk over the past year, and several articles provide recaps as well as some detailed coverage.

Section II. Industry-Specific Valuation

A challenge to traditional thinking on valuing hotels was presented in “Hotel Valuation: Breaking the Rules—But Getting it Right!” This article explains why the dominant method for the appraisal of hotels is contrary to the main methods used for the appraisal of other real estate-centered enterprises (RECEs) and is therefore flawed.

In terms of emerging industries, the legal marijuana business took the spotlight as eight new states approved marijuana initiatives amid the presidential election. That brings the total to 28 states and jurisdictions that now allow legal marijuana business in some capacity. The article titled “Coping With the Challenges of Valuing a Cannabis-Related Firm” discusses the nuances of appraising these firms.

A lot has been going on in healthcare, and *BVU* attended the AICPA’s conference devoted to this industry (see “AICPA Conference Covers Healthcare Valuation Challenges and Opportunities”). A different approach to measuring the fair market value of physician compensation is designed to help ward off a crackdown by the government, which has been winning False Claims Act (FCA) lawsuits against a number of hospitals, reaping hundreds of millions of dollars in fines. The lawsuits have emerged out of the trend of hospitals acquiring medical practices, and the FMV of physician compensation is a key element of these cases. Instead of paying physicians the median compensation, hospitals could set fair market value compensation based on the resource-based relative value scale (RBRVS). This is covered in “New Approach to FMV of Physician Pay Could End Hospital Woes.”

Other healthcare-related articles of interest include “How to Avoid Harsh HIPAA Penalties When Doing Healthcare Valuations,” “Valuation Characteristics and Methodologies for Urgent Care Centers,” and “IRS Reasonable Compensation Job Aid: Healthcare Perspective.”

A number of articles discuss particular valuation aspects of specific industries, including accounting firms, oil and gas, franchises, architectural/engineering firms, veterinary practices, and wealth management firms.

Section III. From the Courtroom

There was an ongoing stream of business valuation-related court case, and the most notable cases are identified in an article titled “10 Best Valuation Cases for 2015.” Litigation is an important and growing area for many valuation practices, and several articles provide advice in this area, such as “Attorneys Reveal Seven Surprising Views on Expert Depositions,” “Pitfalls for Expert Witnesses Doing a Valuation Report Review,” and “Recent Case Points Up Danger of the Discovery Trap.”

BVU was fortunate to be at a conference session that featured U.S. Tax Court Judge David Laro, whose remarks always deserve a great deal of attention (see “Judge Laro Toplines Panel on Hot Issues in Tax Valuation”).

Section IV. Business Valuation Profession and Practice Management

A number of articles reveal insights into valuation firm performance and practice development. For example, the article titled “Most BV Firms Expect 2016 Revenues to Top Last Year” points out that two-thirds of business valuation firms say they expect to do more business than the previous year. Most of the revenue is coming from certain areas, the top area being tax, gifts, and estates, which represents about one-third of total revenue on average. Other articles further examine the mix of practice revenue and the research sources that valuation firms prefer.

Other articles include a recap of developments in the valuation profession and several interviews with leading practitioners. A look at the profession outside the U.S. was revealed in “What Is the Practice of BV Like in the Middle East?” which features an interview with a local expert.

Section V. Reviews of Data Sources and New Books

The cornerstone book in the Duff & Phelps handbook series on cost of capital, the *Valuation Handbook - Guide to Cost of Capital*, went through a number of refinements and additions for its 2016 edition, such as an expanded Chapter 12, which provides detailed answers to questions practitioners submitted. For a review, see “What’s New and Noteworthy in the DP 2016 Valuation Handbook.”

There was a significant expansion to private-company business transaction data in *Pratt’s Stats*, and also a number of new features added, including 45 additional data fields, including fields dedicated to purchase price allocation, franchise designation, and real estate asset value. There’s also an enhanced ability to find more comps as transactions can now include up to three SIC or NAICS codes to reflect multiple lines of business. The search functionality was also improved, and you can now search by region, EBITDA, seller’s discretionary earnings, and more. An article

titled “Appraiser Review: How *Pratt’s Stats* Upgrades Improve Your Search for Comps” gives more details. Private transactions outside the U.S. are summarized in “Latest Data on Private-Company Transactions in the United Kingdom.”

Several new books of note were reviewed, including one on economic damages (“Book Review: *The Comprehensive Guide to Economic Damages*, Volume 1 and 2, 4th ed.,” and see also “Fannon and Dunitz Bridge the Gap in the Practice of Economic Damages.”). Three top valuation thought leaders (Shannon Pratt, Jay Fishman, and James Hitchner) released a book in Q&A format (“Book Review: *A Consensus View—Q&A Guide to Financial Valuation*”). In the healthcare area, a preview of a new edition of a valuation guide was provided (“Sneak Preview of New Material in the *BVR/AHLA Healthcare Valuation Guide*”).

Section VI. Data

Each month, *BVU* publishes the Cost of Capital Center, with selected general data such as the 20-day Treasury yield, long-term inflation estimate, Dow Jones Industrial P/E ratio on current earnings, and other data. Also published is Duff & Phelps premiums over the long-term risk-free rate.

Relatively new to the Cost of Capital Center are data related to a model that is designed to better estimate cost of capital for small private companies. This model uses the implied private company pricing line 2.0 (IPCPL), which is based on *Pratt’s Stats* data and is indexed directly to the IPCPL cost of capital. Published monthly is a private-company cost of capital index based on four company sizes (in terms of revenue). The index represents the after-tax cost of capital (calibrated for 35% tax rate and midperiod convention) for an average/typical risk company to be used on unlevered, after-tax expected free cash flows.

The yearbook amalgamates the monthly data from the Cost of Capital Center and presents it in tabular and chart form.

Many more articles of interest are in the yearbook than those mentioned above, many of which top valuation experts and thought leaders contributed. BVR thanks them for their contributions, and we look forward to keeping you posted on important developments in the business valuation profession.

Sincerely,



Andrew Dzamba
Executive Editor
Business Valuation Update



Trustworthy business valuations start here.

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Deal & Market Data

- Pratt's Stats
- Public Stats
- BIZCOMPS
- Economic Outlook Update
- Factset Mergerstat/BVR Control Premium Study
- The FMV Restricted Stock Study
- Valuation Advisors Discount for Lack of Marketability Study
- ktMINE Royalty Rate Data & License Agreements
- First Research Industry, State & Province Profiles
- Butler Pinkerton Calculator – Total Cost of Equity and Public Company Specific Risk Calculator
- Mergerstat Review & Mergerstat Review Monthly
- Valuation Handbook Risk Premium Toolkit
- Valuation Handbook – Guide to Cost of Capital
- International Valuation Handbook – Guide to Cost of Capital
- Valuation Handbook – Industry Cost of Capital
- BizMiner Industry Financial Reports
- PitchBook Guideline Public Company Comps Tool

News & Research

- Business Valuation Update
- Business Valuation Update Australia
- BVLaw
- Business Reference Guide Online

Training & CPE

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