Developing Discount and Cap Rates in a Troubled Economy: New and Emerging Views on Old Issues

April 30, 2009

Teleconference Handbook

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Panelists:
Ron Seigneur, MBA, CPA/ABV/CFF, CVA,
Don DeGrazia, CPA/ABV/CFF, and Stacy Preston Collins, CPA/ABV, CFF

Please note: This Handbook does not qualify for self study CPE credits.

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Teleconference Panelists Biographies

Ronald L. Seigneur, MBA, CPA/ABV, CVA

Ronald L. Seigneur, MBA, CPA/ABV, CVA is a partner in Seigneur Gustafson LLP, a CPA firm located in Lakewood, Colorado. He holds the AICPA specialty designation of Accredited in Business Valuation (ABV), and is a Certified Valuation Analyst (CVA) with the National Association of Certified Valuation Analysts. He has published over 100 articles on business valuation, commercial damages, leadership, and related subjects. Ron has developed & taught a number of intermediate and advanced business valuation courses for the AICPA, NACVA, state Bar Associations; and currently serves as the chair of the AICPA BV Webcast production team. Ron has been qualified and provided testimony as an expert witness in several jurisdictions on a wide range of issues ranging from complex business valuations, forensic investigations, and various forms of economic damages. Ron has served appointments as trustee, mediator, arbitrator, special master of the court, as well as serving as an expert for the Colorado State Board of Accountancy and Colorado Attorney General. He is co-author of the 1300+ page treatise on business appraisal titled *Financial Valuations: Applications and Models*, published in 2006 by John Wiley & Sons. He is a past chair of the AICPA ABV Credential Committee and has been a member of the AICPA BV Committee, the AICPA Consulting Services Executive Committee, past chair of the NACVA Professional Standards Board, and past Treasurer of the Colorado Society of CPAs. Mr. Seigneur was inducted into the AICPA Business Valuation Hall of Fame in 2006, is a fellow of the College of Law Practice Management and has been an adjunct professor at the University of Denver College of Law for over 18 years where he teaches financial, management and leadership courses. He has a Bachelor of Arts in Hotel, Restaurant and Institutional Management from Michigan State University, and a Master of Business Administration in Corporate Policy and Finance from the University of Michigan.

Donald J. DeGrazia, CPA, ABV

Don is a graduate of LaSalle University and is licensed as a CPA in New Jersey and Pennsylvania. He is a senior shareholder in the firm and a member of the American Institute of CPAs, the New Jersey Society of CPAs, the Institute of Business Appraisers, and is the Chairman of the Business Valuation Committee of the New Jersey Society of CPAs. He has attained an Accreditation in Business Valuation (ABV) from the American Institute of CPAs signifying experience and expertise in the valuation of businesses. He also specializes in federal and state taxation, multi-state taxation, matrimonial taxation, and tax nexus issues.

Don has provided court and arbitration testimony in various matters, including matrimonial, minority stockholder, and economic damages litigation, as well as bankruptcy proceedings, and has been qualified as an expert witness by the federal and state courts. He has prepared valuation reports for businesses and professional practices for purposes of estate planning and compliance, succession planning and mergers & acquisitions. He has also prepared damage study reports in connection with stockholders, insurance claims, contract breach and lost profits litigation. Don has represented companies and stockholders in mergers, acquisitions, sales, and startups of businesses and professional practices.

Don has chaired and been a frequent speaker and panelist at various national and international conferences and webinars as well as state and local seminars conducted by the AICPA, the NJSCPA, the PICPA, the American Bar Association, the New Jersey Administrative Office of the Courts, and the New Jersey Institute for Continuing Legal Education covering business and professional practice valuation, forensic accounting and federal taxation.

He is Global Chairman of Integra International, Inc., a worldwide association of independent accounting and consulting firms. He is past president and a member of Integra's Americas, Asia and Australia board.

Stacy Preston Collins, CPA/ABV

Stacy Preston Collins, CPA/ABV is a Managing Director at Financial Research Associates, with offices in Pennsylvania, New Jersey and New York. She has provided expert testimony on business valuation and forensic accounting issues in several states.

Ms. Collins' experience includes marital dissolution cases, corporate litigation, estate planning valuations and transactions. She has co-authored courses on business appraisal and has presented valuation and forensic accounting topics to financial professionals, attorneys and judges in many forums.

Ms. Collins was a faculty member at the American Bar Association's Family Law Advocacy Institute in Houston, Texas from 2003 to 2005 and in 2007, and has been active in the Institute's annual Mock Trial since 2000. She participated as an instructor/mentor at the American Academy of Matrimonial Lawyers' Institute for Training Family Law Associates in 2006-2007.

Ms. Collins is a member of the American Institute of Certified Public Accountants (AICPA), the Pennsylvania Institute of Certified Public Accountants and the New Jersey Society of Certified Public Accountants. She holds the Accredited in Business Valuation (ABV) designation from the AICPA and is a member of the AICPA's Family Law Task Force. Ms. Collins is also a Candidate of the American Society of Appraisers.

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Send questions to:
TC-Questions@BVResources.com

PROGRAM OVERVIEW

- Developing discount and cap rates had been a subject of discussion and debate in the valuation community even before the current economic crisis.
- Today's troubled economy is causing appraisers and other financial analysts to re-think their assumptions in developing discount and cap rates

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TWO SCHOOLS OF THOUGHT

- Due to the recent depth and breadth of the current recession, there are certain attributes of cost of capital determinations that require fundamental change
- All recessions end, some are deeper and longer than others, and, for the most part, it is appropriate to "stay the course" in terms of the proper approach to developing cost of capital indications

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ISSUES FOR DISCUSSION

- **Risk Free Rates**
- **Economic Benefit Stream**
- **Equity Risk Premiums**
- **Specific Company Risk**
- **Cost of Debt**
- **Capital Structure & Leverage**

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WHAT THE EXPERTS SAY: McKINSEY

McKinsey

"Our analysis finds no evidence that the long-term price of risk has increased over its historical levels – even though short term capital is difficult to obtain."

"Why the Crisis Hasn't Shaken the Cost of Capital", Richard Dobbs, Bin Jiang, and Timothy M. Koller, *McKinsey Quarterly*, December 2008, reprinted with permission

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RISK-FREE RATES

- Long-term Treasury rates are at historic lows
- What are appraisers doing to deal with this?
- Are appraisers using longer-term data, or current rates in their analysis?
- Research from Dr. Aswath Damodaran (http://pages.stern.nyu.edu/~adamodar/)

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RISK-FREE RATES

CHANGE IN RATE SPREAD

The interest rate spread between short-term and long-term Treasury bonds is widening; so is the spread from T-bonds to corporate bonds.

	1 yr	10 yr	20 yr	BAA
12/95	5.31%	5.71%	6.12%	7.49%
12/00	5.60%	5.24%	5.64%	8.02%
12/05	4.35%	4.47%	4.73%	6.32%
12/08	0.49%	2.42%	3.18%	8.43%

- **(per www.federalreserve.gov)**

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RISK-FREE RATES

What if there is inflation in the future?

"Inflationary expectations are incorporated into interest rates at any given point in time."

Lisa Cruikshank, "Challenges in Determining a Cost of Capital in Today's Environment", to be published Summer 2009, American Academy of Matrimonial Lawyers' "News and Information" Newsletter

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ECONOMIC BENEFIT STREAM

- Is History a Predictor for the Future?
- Consideration of Short Term or Long Term?
- Effect on Weighting?
- See Ron Seigneur's Article, "Using Alternative Weighting Schemes to Project an Economic Benefit Stream", reprinted with permission from *Financial Valuation and Litigation Expert (February 2009)*

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 Developing Discount & Cap Rates in a Troubled Economy: New and Emerging Views on Old Issues

Ibbotson/Morningstar vs. Duff & Phelps

Which data source should be used:

- Ibbotson/Morningstar
- Duff & Phelps
- or Both?

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Ibbotson/Morningstar vs. Duff & Phelps

Duff & Phelps - Equity Risk Premium

Characteristic	Company Size	Implied Portfolio	Premium over Risk Free Rate
Book Value of Equity - (a)	< $59 Mil	25	12.14%
5 - Year Average Net Income - (a)	< $3 Mil	25	12.97%
Total Assets - (a)	< $104 Mil	25	12.37%
5 - Year Average EBITDA - (a)	< $12 Mil	25	12.69%
Sales - (a)	< $91 Mil	25	11.96%
Number of Employees - (a)	< 172	25	12.35%
		Min	11.96%
		Mean	12.41%
		Median	12.36%
		Max	12.97%
Indicated Duff & Phelps Size Adjusted Equity Risk Premium			**12.36%**

Ibbotson - Equity Risk Premium

Equity Risk Premium - (b)	7.10%
Small Stock Risk Premium - (b)	5.82%
Indicated Ibbotson Size Adjusted Equity Risk Premium	**12.92%**

Cost of Equity Calculation

Risk Free Rate - (c)		4.40%
Equity Risk Premium		
Duff & Pehlps	12.36%	
Ibbotson	12.92%	
Average		12.64%
Company Specific Risk Premium - (d)		6.00%
Cost of Equity		**23.04%**

(a) Morningstar Inc., Duff & Phelps, LLC Risk Premium Report - 2008
(b) Ibbotson Associates - 2008, SBBI Yearbook - Valuation Edition
(c) 20 year T-Bill rate @ 4/1/08
(d) based on valuator judgment

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Morningstar - Custom Peer Group Builder

- A web-based valuation tool that:
  - Identifies companies with similar characteristics from the entire Morningstar database.
  - Uses Ibbotson Cost of Capital Yearbook methodology to create custom peer groups/industries
  - Calculates custom costs of equity, multiples, betas, and other financial ratios for these custom peer groups/industries (up to 300 separate metrics)

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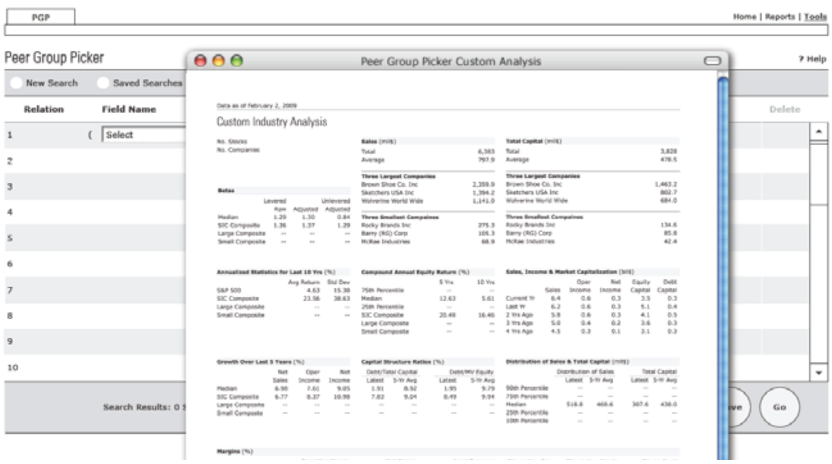
Morningstar - Custom Peer Group Builder



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Morningstar - Custom Peer Group Builder

- Phase I (Quarter 3, 2009)
  - Enables user to draw from the Morningstar database of over 10,000 publicly-traded US stocks
  - Form custom peer groups of any combination of companies; roll them up into custom peer groups/industries
  - Generate up to 300 datapoints for the custom peer groups, including cost of capital estimate using 5 different models, capital structure, betas (raw, adjusted, unlevered), etc.

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Morningstar - Custom Peer Group Builder

- Phase II (Quarter 1, 2010)
  - Add “alikeness” testing using Morningstar “Style Box” technology.
- Phase III (Quarter 2, 2010)
  - Add private company financial data
  - Add private company transaction data.

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10th decile split into 4; distressed companies removed

- 10a
- 10b

10w, 10x, 10y, 10z

Remove Distressed Companies

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10th decile split into 4; distressed companies removed

- New research study done with the Center for Research in Security Prices (CRSP) at the University of Chicago.
  - Identifies “distressed” companies in the CRSP standard NYSE/AMEX/NASDAQ Deciles using Morningstar “Distance to Default” technology.
  - Forms a Distressed Company Portfolio
  - Splits the CRSP 10^{th} Decile into 10w, 10x, 10y, and 10z.

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Ibbotson Supply Side Report

- Supply side equity risk premia calculated over all time periods
- Supply side equity risk premium based size premia calculated over all time periods
- Supply side equity risk premium based industry risk premia

Buildup Method

Example 1: $k_s = r_f + ERP_{Hist} + SP_{Hist} + IRP_{Hist}$

Example 2: $k_s = r_f + ERP_{SS} + SP_{Hist} + IRP_{Hist}$

Example 3: $k_s = r_f + ERP_{SS} + SP_{SS} + IRP_{SS}$

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EQUITY RISK PREMIA

"Now that the access to data has been democratized, and we face a much more even playing field, there is no reason to believe that any service has an advantage over any other, when it comes to historical premiums. Analysts should no longer be allowed to hide behind the defense that the equity risk premiums they use come from a reputable service and are thus beyond questioning."

Aswath Damodaran, Stern School of Business, "Equity Risk Premiums (ERP): Determinants, Estimation and Implications", September 2008 (with an October update reflecting the market crisis), (http://pages.stern.nyu.edu/~adamodar/)

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WHAT THE EXPERTS SAY: GRABOWSKI

- **Roger Grabowski – White Paper**
  - "Problems with Cost of Capital Estimation in the Current Environment – Update", reprinted with permission
  - Edited version (reflecting edits through Feb. 25, 2009) of the article that appeared in the *Business Valuation E-Letter*, Issue 13-05 and an update to an article that appeared in the *Business Valuation E-Letter*, Issue 12-44, published by the American Society of Appraisers

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GRABOWSKI WHITE PAPER

Excerpt:

"Traditional methods typically employed in estimating the COEC [Cost of Equity Capital] and the WACC are subject to significant estimation and data input problems…Likely temporary aberrations in several of the inputs to traditional models during this period of economic crisis require analysts to apply more rigor and scrutiny in developing the cost of capital estimate."

GRABOWSKI WHITE PAPER – SIX ISSUES

- Consideration of Treasury Bond Yields
- Assessment of ERP Trends
- Developing Meaningful Betas
- Reliance on Sustainable Leverage Ratios
- Use of after-tax cost of debt
- Need for reasonableness checks

GRABOWSKI WHITE PAPER

Excerpt:

"This author suggests that, given current market conditions, one should consider using an estimated ERP of 6.0 percent, the upper end of the range of the research on long-term (normal) ERP. As expected economic conditions improve and stock prices increase; ERP can be expected to decrease in the future."

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EQUITY RISK PREMIA

- See also: Pastor, Lubos and Stambaugh, Robert F., "Are Stocks Really Less Volatile in the Long Run?" (February 17, 2009).
- Study concluded stock returns are more volatile over the long term than was previously thought

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EQUITY RISK PREMIA (continued)

- Overview of the Butler-Pinkerton Model
- Morningstar's "Peer Group Picker" Tool

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BETA CO-EFFICIENTS

- Potential problems with using a beta co-efficient in CAPM or Modified CAPM
- How can changes in the public markets impact the valuation of a closely-held business?

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CAPITAL STRUCTURE & LEVERAGE

- Use of Invested Capital Models
- Assessment of Debt Burden
- Implications of using WACC re: capital structure/leverage

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INTEREST RATES & TAX-EFFECTING

- In the WACC model, interest expense typically is tax-impacted.
- What if the business is operating at a loss – at least for the short term?

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FOCUS – SMALL BUSINESSES

- What different aspects and approaches exist in the current economic environment?
- Degree to which business is affected by recession
- Selection of relevant approaches/methods
- Specific company risk

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FOCUS - INTERNATIONAL

- What are those outside the US focusing on in the current climate?
- Outlook – US & Beyond
- Damodaran – Risk Free Rates, ERP (http://pages.stern.nyu.edu/~adamodar/)
- Country Risk Assessments - *The Economist* and other Sources
- International Financial Reporting Standards (IFRS)

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LIQUIDITY DISCOUNTS

- Liquidity vs. Marketability
- Issues: cost of trading, bid-ask spreads, liquidation periods
- High trading volume or thinly traded?
- Large firms vs. small firms
- Hedging strategies – “dribble out” methods
- *Estate of Gimbel*; *Litman* cases
- Ashok Abbott and others

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PREMISE OF VALUE

- What if the subject company has going concern issues?
- How would this affect the assessment of its cost of capital?

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Developing Discount & Cap Rates in a Troubled Economy: New and Emerging Views on Old Issues
Business Valuation Resources
April 30, 2009/10:00 a.m. PDT

Blake Lyman: Welcome to *Developing Discount and Cap Rates in a Troubled Economy: New and Emerging Views on Old Issues*, a BVR teleconference featuring Ron Seigneur, Don DeGrazia, and Stacy Preston Collins. I am Blake Lyman, Professional Program Manager for BV Resources.

Developing discount and capitalization rates in a changing marketplace can be tricky in the best times; in these difficult, troubled, and desperate economic times however, the rules by which this process is completed are now being challenged under the microscope of regular market conditions and unforeseen changes to the marketplace. While many traditional models such as CAPM, Modified CAPM, and the Buildup Model, are still fully appropriate to utilize, their inputs now require extra justification.

Joining us today to discuss these and other issues are three distinguished valuation specialists. Ron Seigneur is Partner at Seigneur Gustafson LLP, a CPA firm in Lakewood, Colorado. He holds the AICPA specialty designation of accredited in business valuation and is a certified valuation analyst with National Association of Certified Analysts. He has published over a hundred articles on business valuation, commercial damages, leadership, and related subjects.

Don DeGrazia is a graduate of LaSalle University and is licensed as a CPA in New Jersey and Pennsylvania. He is a senior shareholder at Gold Gocial Gerstein LLC and a member of the American Institute of CPAs, the New Jersey Society of CPAs, the Institute of Business Appraisers, and is the chairman of the Business Valuation Committee of the New Jersey Society of CPAs.

Stacy Preston Collins, CPA/ABV, is a managing director at Financial Research Associates with offices in Pennsylvania, New Jersey, and New York. She has provided expert testimony on business valuation and forensic accounting issues in several states. Her experience includes marital dissolution cases, corporate litigation, estate planning, valuations and transactions.

We are thrilled to have Ron, Don, and Stacy join us today. You can read much more about them on the webpage for today's teleconference.

Before we begin, I would like to lead you through the details of our teleconference. Your attendance to this 100-minute presentation is eligible for two CPE or 1.5 CLE credits. In order to receive these credits you must complete a brief survey on today's teleconference at the conclusion of our presentation. A link to our survey is included with your registration email which included instructions on how to dial in today. A link is also available on the reading page for today's teleconference. That page has been updated with updates to presentation materials and new reading materials and we encourage you to check back. The survey will be active for five business days and will require you to fill in three four-digit CPE codes. Simply write down the codes as they are read and fill them in when asked in the survey. I will read the CPE codes three times during today's teleconference. One hour through the presentation, at the conclusion of the presentation, and right now.

The three four-digit CPE codes for today's teleconference are: 7963, 2891, and 5674. Once again, 7963, 2891, and 5674.

We will be taking questions during the session today by email only. Please send questions to *tc-questions@bvresources.com.* With that, we welcome Ron Seigneur, Don DeGrazia, and Stacy Collins.

Ron Seigneur: Thank you Blake. I appreciate that introduction as well as the housekeeping information for folks who are on the call today. I would encourage folks to send their questions as we go through today's discussion. We will try to get to as many of those as we can, but I have found that in past experience sometimes we can't get to everyone's question.

This is a very timely topic. I am thrilled to be here, particularly with Stacy and Don as the fellow panelists. It seems as we went to put the topic together we started seeing things in our view of the landscape that just kept building on what we thought we could talk about today. I think we have a pretty robust program.

With that I am going to lead to the first question. I am going to point this one to Don. Don, could you start us off by giving just a brief overview of today's topic and why it is timely?

Don DeGrazia: Sure, Ron, I would be happy to. Certainly there is no question that we are experiencing both a challenging and a very unusual time in our economy. For many of us, we have not experienced such an economy in the past and certainly not in our professional careers.

We have developed many tried and true methods of valuation. We have developed methodologies to develop discount and capitalization rates. These are now being questioned. Current economic data causes us to question the applications methodologies and some of the results that we may get initially seem counterintuitive.

Today we want to try to examine some of those issues and relate them to the development of a discount rate.

Ron Seigneur: Excellent. Stacy, maybe you could spend a few moments recapping the basic elements we normally consider in developing cost of capital indications.

Stacy Collins: Sure, Ron. Part of the fun in preparing for this session was we had a chance to review a lot of different current articles that have been put together on these issues. We bounced ideas amongst ourselves. Really, I have to say that just about every underlying assumption in cost of capital has been discussed and is maybe having an opportunity to be reexamined right now given the climate that we are in.

In terms of cost of equity, there has been a lot of discussion about risk-free rates and what appropriate rates to use these days. There is a lot of discussion on equity risk premiums. Of course, specific company risk always comes up in terms of cost of debt.

The implications of whether the interest rate should be tax affected or not, particularly for companies that may not be paying taxes these days, and again, the weighting between cost of debt, cost of equity, that goes into the weighted average cost of capital model. All these things right now are being looked at a little bit closer perhaps than they had before to see if the assumptions we've been using up to this point are still making sense.

Ron Seigneur: Thank you. Blake, if I could ask you to move forward. There is the list of components that Stacy has just taken us through. Each of these is going to be a part of today's discussion. I will just make a couple of comments to build on a couple of things that Stacy said.

In my practice, it seems like when I started doing this 15, 20 years ago, the risk free rate was always the given, the easy one. Then we move forward into the other elements of cost of capital. Now we are even questioning risk free rates and whether we use today's risk free rate or some long term proxy. We will come back to those issues, but I think it shows how even the things we have taken for granted so many years in our practice are now coming back into areas that we need to question. There are differences between valuation professionals.

Don, I am going to point a question to you. What do you see in today's economic environment that impacts traditional approaches in developing cost of capital as associated with valuation of a closely-held business?

Don DeGrazia: Ron, before I get into that, I would just like to echo what Stacy said. It amazed me how much the quantity of high quality, first class information was out there on this topic as we started to develop it – from academia and from practice. I encourage our audience to read this information because you will find it very helpful to your everyday work.

Ron, to answer your question, there are just several issues out there that we have to contend with. First of course, we are talking about closely-held and family businesses. We know we don't have access to public capital if public capital was even available with the economy the way it is.

We have had and still have to a great extent seized credit markets. The ability for closely-held companies to even get credit which was so easily obtained before has really become a problem. We have what has been called a flight to quality and consequently we have U.S. Treasuries now with yields from zero to less than three percent or maybe just a little over three percent at times depending on the term of that investment that we can look at as a risk free rate.

When we think about a zero percent return and what impact that has on what we've considered to be a risk free rate of return, it is very, very mind-boggling to me.

Recently from an economic standpoint, we faced disinflation. We have warnings of deflation and really now we also have an economy that is being guided with fiscal and monetary policy coming from Washington and the Fed that traditionally has led to periods of inflation. We have some pundits on CNBC, Bloomberg, that will talk about hyperinflation in the future.

We have all these competing interests or competing outcomes to deal with as we are trying to develop earning streams and expectations of the future, because valuation, of course, is just that – an expectation of the future.

We face an economy reduced demand for products and services, the effect of those reduced demand for products and services is less jobs, less employment, less earnings. It creates somewhat of a vicious cycle.

I think one of the things we really have to be aware of is that we are not only talking about the discount rates here, we should also be thinking about the numerator with the earning stream, because that is very, very unpredictable now. Since valuation is about the future, the ability to try to forecast or predict those earnings that will be capitalized or discounted depending on the income approach used, really is very, very important. It has always been important but perhaps is a little more difficult now than it has been in the past.

Ron Seigneur: To add to that Don, I was reading a *Business Week* last night and an article on the prospects for inflation versus deflation versus stagflation in the months and years ahead. The views by the three different market watchers that are each predicting the three different scenarios going forward. I tend to think that there is a high prospect for inflation; many of us do and wonder when and how that will happen.

We could have a situation where we have rising prices and inflation, but at the same time the deflationary impacts in having a stagflation type period. All that needs to be taken into account as we try to think through this.

I am going to move on to the next slide and ask Stacy to talk a little bit about an article that I believe is included in the ancillary reading materials from McKinsey and Company titled “Why the Crisis Hasn’t Shaken the Cost of Capital: The cost of capital has not Increased so far in the downturn and didn’t in past recessions.”

Stacy, could you highlight what McKinsey has to say about the impact on our current recession to the cost of capital?

Stacy Collins: Sure. The materials are in the set of articles that the participants can access. We appreciate McKinsey making them available. The article is from December of last year.

What the authors examined, they took each of the various assumptions in the weighted average cost of capital model and looked at them and tried to assess what effect the current economy is having on them. They analyzed the relationship of profits to share prices. They found there was no significant change in the long term cost of equity capital.

They analyzed, which probably everyone listening to this knows, that the interest rate spread has been widening. They tried to think about some of the reasons why. Their conclusion seemed to be that the spread had been unsustainable low in the past. They felt that the change in the interest rate spread was more of aversion to normality than anything and that it was a function of increasing demand for treasuries, not that bonds are getting risky, but there is more of a demand for treasuries.

They looked at the levels of debt in companies and pointed out, putting financial companies aside, that non-financial companies in the S&P 500 had less debt now than they did in the last 40 years, or at least at the time of this writing.

They felt that overall that the cost of capital hadn't really changed in any material way, although they pointed out at the end of the article that it was unclear what the effect of the potential rising inflation or short term deflation would have on that. But it is kind of an interesting take on some of the issues that we are dealing with here.

Ron Seigneur: I think it is going to be a bookend to some degree because a little further in we are going to talk about some of the thoughts that Roger Grabowski has espoused in a recent white paper that is also, and we appreciate Roger making that white paper available; it has been the basis for a couple of articles he has published recently where he challenges folks to say that things have indeed changed. I kind of see the McKinsey piece saying, "Yeah, we've looked at this. Recession has come and gone. We don't see any long term impact on cost of capital." At least, that was my takeaway from their read.

I think we are going to see some differing opinions as we work through our discussion.

Stacy Collins: I totally agree with that.

Ron Seigneur: Don, I am going to come back to you and ask a question. We have a slide up here on risk free rates that I made mention of. We have a 20-year Treasury note that most of us have used as a proxy for the risk free rate in our buildup models of different varieties. The current Treasury note rate is about 200 basis points lower than what the risk free rate has been historically. Applying this component within a buildup or CAPM model would result in a discount rate that is also 200 basis points below what would otherwise be derived if all else is held constant.

How do you see business appraisers dealing with this particular aspect?

Don DeGrazia: Ron, I think that is one of the key and fundamental questions of the whole session. When you think about it, really the concept of a lower or desired rate of return, risk adjusted rate of return, in this economy is very counterintuitive. The building block as you pointed out a few minutes ago of our buildup is a risk free rate.

Still the best example of a risk free rate of course is U.S. Treasury. Then depending on our personal philosophies of what term or length we use, you are anywhere from a zero percent return up to maybe 300 basis points.

I think that first and foremost you really have to recognize the counterintuitive nature of the situation. I first revert back to 5960. One of the most important things I take out of 5960 every time I read it is the concept of judgment. We have to apply our judgment here and see, "Is this really a situation where there is a difference from the past?" We have always heard new economy; we've heard value businesses based on burn rate, forget traditional businesses. These are all kinds of things that really didn't materialize, yet here we are faced with a situation where we have a seemingly counterintuitive outcome.

I look at 5960 and the judgment issues as still being the basic bedrock of what we do.

The opposite of that is if you just use a cookbook approach to valuation, "Well, I'll take my risk free rate, I'll add my equity risk premium, I'll put a specific company risk on top of that. I will adjust for size, and that is my discount rate. That must be it," I think that probably you are going to find yourself in trouble somewhere along the line.

This very turbulent economy and seized credit markets; to me it is counterintuitive that it would produce a less risky cost of capital.

We know that Pratt tells us, and most of the business valuation books will tell us, that risk is really the likelihood of receiving the expected return in the expected time period. I would go further to say that there is really nothing in our economy now that would suggest to me that we are valuing businesses in a less risky time.

Intuitively, how would I come up with a lower discount rate, and ultimately, if it is a capitalization of earnings, a capitalization rate? I think that we have to recognize that there is really no empirical data now telling us precisely what to do. It is going to come back to judgment.

As you mentioned in Grabowski's excellent treatise, he talks about this flight to quality. As a consequence, that has driven down the rates that have triggered their yield. What Roger does, he suggests ignoring what he defines as the spot yield and using an average long term Treasury bond yield of perhaps 4.5 percent, and using that until such time as the rates return to normal, if there is such a thing as normal.

We have an expectation that 4.5 percent, 5.5 percent, if you look at the data. He in many respects is suggesting a break from empirical data while we have this temporary abhorrent period.

Ron Seigneur: That is helpful. I would also point to another resource that is in the ancillary materials. It is an article that was authored by Michael Goldman in the NACVA Business Valuation Examiner. The title of his article is "Market Turmoil May Require New Ways to Build up Cost of Capital." My read of Mr. Goldman's article, which is very well done, basically says that things have fundamentally changed. Our return to normal, and this is my takeaway, is maybe a different normal than what we have been used to in the last ten, twenty years or longer.

It is kind of leaning more to Roger Grabowski's points in his recent articles in terms of saying, and I guess I am trying to recap here, that maybe we do keep this at 4.5 percent until the risk free rate settles down if that indeed does happen. You can't just proceed blindly without potentially making adjustments in other areas.

We do have a slide that is up on the screen that just shows the variability of the different rates between a one-year bond rate, a ten-year bond, a 20-year, and a bond that is a BAA-rated bond and how those have changed. It is interesting to see how the bond prices have actually gone up a bit while the other rates have gone down.

I will also make brief mention that I had a wonderful opportunity as part of my state's CPA society to be a part of what is called CPAs on the Hill, where we were all in Washington D.C. on Tuesday. Each of the states had their representatives who are members of AICPA counsel up on Capital Hill meeting with their elected senators and members of the house on a broad range of financial issues.

One thing that was coming up in our discussion Tuesday with the Colorado House members that I spoke with is the term systemic risk regulator and do we need to create one. Staffers for the Congress, men and women who we were speaking with were tossing the term out to us saying, "There are legislations being bantered about in terms of whether or not the federal government needs to create something called a systemic risk regulator."

I thought that was an interesting corollary, if you will, because they are trying to figure out what systemic risk is in relation to the financial markets and whether they need to do something from a legislative standpoint, which frankly scares the heck out of me. In any event, they are focused on risk at that level, if you will.

I am going to go back one slide. In this slide, on the fourth bullet, we have a highlight for Dr. Damodaran's website. He is a Professor of Finance at New York University and is very prolific with valuation issues. I am going to ask Stacy to talk a little bit first by mentioning that you can go to his website which is *www.Damodaran.com*. There are some white papers that Dr. Damodaran has posted up on his website.

One of those is titled, "What is the Risk Free Rate? A Search for the Basic Building Block." Stacy, could you give us a quick recap of that particular white paper.

Stacy Collins: Sure, I would really encourage the audience to go to that website that Ron just mentioned and download this article. It is about 30 pages long. I am kind of fascinated by the fact, and I think Ron started off by saying risk free is something that a lot of people kind of took for granted. It was kind of a knee jerk – use this number, use this number, pull it out of a book.

It seemed to me that the more we talked and the more articles and research we looked at, that the issue of risk free is getting a lot of scrutiny, particularly right now. Maybe it is overdue, I don't know, but there are a lot of points that Damodaran makes in this article, kind of examining what makes an investment risk free.

There is a lot of discussion on the affect of the currency that is being used and making the point, which seems reasonable to me, that you need to match your cash flows with the risk free rate you are using in terms of currency. Maybe when you are not necessarily able to do that, when you need to use a risk free rate in another currency, maybe you need to convert your cash flows into that other currency.

It raises some concerns about the potential for double counting. When you use risk free rates in some countries, they have an above average level of risk because perhaps imbedded in those risk free rates is some level of default risk. It talks about the ways to strip that out to some extent.

It then goes into a little bit more discussion about things going on in the U.S., comments about there being two schools of thought. One is that Treasury rates are to some extent volatile and change over time. There is another school of thought that says, "Well, they mostly stay in a so-called normal range. Deviations to that are corrected over time."

The point that I thought was kind of interesting, and he says it over and over again, and it makes sense, is that to some extent a lot of this issue depends on the length of period you are looking at. The potential problem or downside with adjusting is that what is "normal" may be in the eye of the beholder, it may be a different view to the Grabowski piece, and obviously their valuation consequences to adjusting the risk free.

You may need to look at the underlying fundamentals if you start tweaking these things, what is the expectation for inflation, etc.? There is a warning in there against bringing in idiosyncratic views on what the analyst has towards this. I guess there are really two schools of thought on this one that you need to adjust the risk free to reflect a longer term perspective. The other is obviously to keep it what it is.

We haven't quite gotten into this yet in the discussion, but maybe consider tweaking some other assumptions in the model. It is a really good, very interesting article. I would really encourage everyone to get it and look at it.

Ron Seigneur: Thank you, Stacy. I am going to lift up a question that has been submitted by one of our listeners. This comes from Johann Demay in Antwerp, Belgium. His question is for the risk free rate, we are talking about a 20-year Treasury bond. He is indicating that in Belgium they would use a five-year rate on a government bond. Why would we use 20 years? That's his question.

I am going to take the first shot at answering that and then see what Don and Stacy have to offer. When I was first learning business valuation and was exposed to the work by Roger Ibbotson and the studies he has done on the equity risk premia and otherwise when he was studying for his doctorate, he was studying methods to derive the equity risk premia.

He was looking at that as the returns required on a fully diversified portfolio of a group of publicly-held stocks above a risk free rate. In his initial studies that reached back to 1926 purposefully to bring in the period leading up to the Great Depression, all of his indications in his research used a 20-year Treasury bill as his proxy for a risk free rate. So the published data that most folks in valuation, at least that I interact with, utilize as now published by Morningstar, use a 20-year Treasury bill as their proxy for a risk free rate to determine the incremental equity risk premia.

You can go back and you can do your own math with the data that is provided in the Morningstar book and elsewhere to determine the equity risk premia using longer or shorter horizons, but that is the data point that Roger Grabowski used. It is interesting to note that at that point, 20-year Treasury bill was the most common long term U.S. Treasury instrument. They stopped issuing 20-year Treasury bills quite some time ago. Most folks have used the current yield on a 30-year Treasury bill that has 20 years left to maturity to find that risk free rate.

But that is one reason why I think so many of use that as our risk free rate proxy.

Stacy Collins: I guess you are also trying to match the time horizon of the investment. There is a little bit of discussion, we haven't quite gotten to it yet, but one of the other articles that Dr. Damodaran has on his website talks about this exact issue in a question.

Some people use short term; some people use T-bills; some people use bond rates. There are some of the pros and cons of each of those underlying assumptions.

Don DeGrazia: Ron, I think I would like to echo what Stacy said there, but first of all, I extend a welcome to my friend Johann from Antwerp. He is a member of our international accounting association. Johann, I will see you in two months time.

I think Stacy touched on it. One school of thought is that an investment in a closely-held business has a long term horizon. That long term horizon can approximate a 20-year period, a little more or a little less. You are effectively matching the intended holding period of the investment with the risk free rate. That is just another school of thought that I have encountered and I think has some merit.

Ron Seigneur: There are a number of questions that have come in. I am just going to read them all off and then we can maybe have a few comments and move forward.

Here is a question: Are you comfortable with a risk free rate of say four percent? Next question: Do you have thoughts on using LIBOR as a proxy for risk free rates? Do you have thoughts on using sovereign default swaps to access risk free rates?

I think we have one more here: If you read the BVR Economic Update for the fourth quarter of 2008, it points out that risk free rate is unusually low and they project the rate to return to historic levels later in 2009 “around 4.5 percent to 5.0 percent.” What is your perspective on this?

We have a number of questions where folks are saying, “Where should we be on our risk free rate?” I also see another one here: Please note that there are no 20-year Treasury bills.

I think I have indicated those. They were Treasury notes first of all. They haven’t issued 20-year Treasury notes for 20 or 30 years. That is why people either have to go to the Federal Reserve Bank site in St. Louis to get their calculated returns on a 20-year Treasury note or use the yields on a 30-year note with 20 years left to maturity.

We have several questions that have come in saying, "What is our perspective on what rates to use?" I will tell folks that I am using the current 20-year Treasury rate that is 200 basis points lower in the cost of capital determinations that we have been doing. We are adjusting for what we think is higher risk elsewhere in our buildup of our rate determinations. That is just how our shop is currently handling it.

Stacy Collins: That's right. We have had some debate as well. At this point we are still looking at the current risk free rates as the best indicia. I worry a little bit when that assumption gets tweaked like Dr. Damodaran said. To some extent the assumptions that you make may be depending on your own perspective on things. I suppose, like Ron is doing, we are reexamining some of our other assumptions in the model and seeing whether those need to be tweaked.

Don DeGrazia: Ron, I think I am in the same school of thought there, but I will mention that last night Stacy and I were together at a really informal group meeting of about 20 or so experienced business appraisers in the New York, New Jersey, and Pennsylvania area. This topic came up.

I think, and Stacy, you can agree or disagree, but the general consensus was that we ought not to be tinkering with the empirical data and that we have lived with this methodology. It is in our minds tried and true. To selectively toss it aside may not be the right thing. There were folks who agreed with the concept of going to a normalized or a levelized 4.5 percent rate, maybe a little higher or lower, on an interim basis until things return to "normal," to which response is, "Define normal."

But I think the consensus amongst the group generally was that we probably shouldn't throw our methodology and our empirical data overboard for the basis of this particular financial situation.

Stacy Collins: It was pretty clear that there is more scrutiny on all these assumptions than perhaps there has ever been. It makes sense to certainly understand the underlying assumptions you are making in these models. I think you are right Don, I don't think there was any conclusion that we should abandon some of the empirical data that is out there, just be more aware of what you are using and why.

Don DeGrazia: If there was an opinion to do that, it was a minority opinion to move to a normalized rate.

Ron Seigneur: The slide that we currently have up on the screen kind of points out the flipside of this. If we do have an inflationary time somewhere in our future, and we see "risk free rates" that are 200, 300, 400 basis points higher than historical averages, what do we do on the flipside of this discussion? Are there any comments on that, Stacy or Don?

Don DeGrazia: The slide we have here I think is from Lisa.

Stacy Collins: Yes, it is from my partner, Lisa Cruikshank.

Don DeGrazia: I believe it was Professor Damodaran who also suggested that inflationary expectations really are in the interest rate at any point in time because you are dealing with nominal rates and you are not necessarily dealing with real rates or inflation adjusted rates.

I think you have to believe that it is built in there, then you get into the issue of the numerator again. What is the effect of inflation on the earnings of the company and what are the long term expectations for earnings or cash flow, whatever your selected earning stream would be for that particular engagement.

Stacy Collins: We haven't touched on that, but that is a really important point. We are spending a lot of time appropriately talking about the rates, but the numerator is something that needs a lot of scrutiny, too.

Ron Seigneur: We are going to go to that next as a matter of fact. I will maybe lead off on the next discussion area. The economic benefit stream – most of what we talk about on the concept of it developing capital indications for discount rates or capitalization rates, give us the basis to apply in simple math a numerator and denominator concept.

We are talking about how to determine what the appropriate rate, but then we have to apply that rate to an economic benefit stream in most circumstances. We are using history as a predictor of the future when trying to derive that value using Don's definition of what risk is in terms of the likelihood of receiving the expected amount of return in the expected time period on a future kind of orientation.

The point here is the effect of rethinking that side of the equation. There is an article that I wrote that was published in the Financial Valuation of Litigation Expert newsletter just in February that is titled "Using Alternative Waiting Schemes to Project an Economic Benefit Stream."

Here I gave some examples of saying that historically, and I am going to go back to Business Valuation 101 where you look at the text that we all have in our library and the courses we have gone through. Typically the example that is used when we are looking at historical benefit streams is to do the normalization process and then let's set up a model and use a "five, four, three, two, one" weighting. We put five times as much emphasis on the current period as we do five periods ago, as a way to say the more recent historical period is probably a better indicator of what is going to happen next year than what happened the year prior or five years prior.

I think that is all being called into question as well. We are seeing so many industries in turmoil. The big players are going sideways, like Chrysler today, like General Motors and others like them. When we are talking about cost of capital, I don't know how much we can avoid the tough questions of, "What do we do once we come up with a cost of capital indication?"

The point I make with my article is that we have to rethink the paradigm on the benefit stream and whether we need to toss it all our the window, using the trailing 12 months, use a waiting scheme that might be something that is using our professional judgment. I will just give some examples recently where we have had cases where we have said, "Here are the prior five years. We have all that information. We have gone through and done all the qualitative and the quantitative analysis to allow us to feel comfortable that we can defend the adjustments we need to make to those benefit streams."

In the final analysis we are going to use two times the most recent period and one times the year before and zero on the three years prior to that even though it is good information and we have it adjusted. It is radically different if we use a "five, four, three, two, one," or we use just the most recent period or we use a simple average of five years.

The article gives the example of the different indications using a stable cost of capital but playing around with the weighting of the benefit stream. We are not spending a lot of our discussion time today on that other half of the equation if you will, but it is something that I think we need to keep in focus as we talk about rate determinations in terms of a rate that is going to be applied to what.

In today's environment we have this paradigm as well that we struggle with where in certain venues like divorce, tax related valuations, there has been a reluctance to embrace future benefit streams, to use a discounted present value concept because those are speculative; they are in the future. We are stuck with the historical stuff, but we are in a world today especially in this turbulent marketplace where the historical trends may have not relevance to what is going to happen in the future.

Don or Stacy, do you have any thoughts there?

Don DeGrazia: No, I think I have to agree with you. I think it comes to judgment as well. To simply go in and do a "five, four, three, two, one" weighting because that is what we have done in the past to not be aware of what is going on in the economy, what the expectations are, really makes it into a cookbook type of valuation and not something that is really going to benefit the preparer or the user.

Stacy Collins: It is going to be interesting as we get more and more current valuation dates on our cases to see whether practitioners are putting more emphasis on their industry research, which in theory we should all be doing as part of our valuations and try to get a handle on underlying assumptions like growth and risk, the outlook for a given industry, etc.

As we focus on what is known, knowable, or reasonably foreseeable in trying to compute or estimate what that future earning stream is going to be, I think looking at what is published as of a given point in time is going to be helpful.

I recall doing a homebuilder a year or two ago where the industry research was very helpful in that. Obviously there is some judgment involved but I think it is going to behoove us to look at some of those assumptions closely.

Ron Seigneur: Excellent. Let's move forward into another area that I think is of critical importance to have some discussion on. The slide that we have up is titled Ibbotson versus Morningstar. Actually, that should be Ibbotson/Morningstar versus Duff & Phelps. I don't know if it is a 'versus' but it is comparing two primary sources of data that a lot of valuation analysts use to derive some of the elements they use in building up their cost of capital indications.

Don, I know many business appraisers have historically relied on what we refer to as the Ibbotson buildup method to develop discount rates and more recently we have seen the emergence of the Duff & Phelps data that has been produced by Roger Grabowski and David King who know work with Duff & Phelps, in using that Duff & Phelps data as a primary source for cost of capital indications. Could you take a few moments and walk us through these and comment on which you prefer?

Don DeGrazia: Sure, and Ron, I echo your thought there about the designation 'versus.' I think if it is versus it is a very friendly competition because there is a lot of interplay between the information in many respects. Regardless of which you use, both are excellent sources of empirical data and extremely helpful in assisting us in preparing business or professional practice valuations.

They assist us in obtaining really two things: the equity risk premium, if you will, which is the difference between the risk and return on equity versus debt, and of course, on the issue of size premium.

Talking first about Ibbotson or Morningstar, the Ibbotson data covers a period from 1926 through now, 2008, where Duff & Phelps is from 1963 until 2008. One difference you may find that may be relevant is that the Ibbotson data takes us back through and before the Depression where Duff & Phelps begins in 1963. But both sources provide very strong support for that position that smaller companies are more risky than larger companies. There are exceptions of course with individual companies, but generally speaking, we have the general premise that the smaller the company the riskier it is.

To try to quantify that size risk, Ibbotson analyzes data in 10 size-oriented groups, each having 10 percent of the New York Stock Exchange companies with other public companies interspersed based on size. They call these 10 size groups deciles.

As we travel down the deciles we see the empirical data clearly shows us that the return in excess of a risk free rate increases, so the size premium as we like to call it, grows based on the smaller size of the companies as we go down the 10 deciles.

It also in the past few years has provided what they call 10A and 10B which breaks the 10th decile into two parts effectively giving you the smallest from zero to five percent and from six to ten percent of the companies.

There is certainly a lot of commentary that the 10B data which is substantially increased over 10 or 10A, includes the companies in the toughest situation. The Ibbotson data measures size on the basis of market capitalization. One of the complaints about the 10B portion of the deciles is that formally very large companies which are now very small market capitalization companies recognizing their significant distress and certainly now is no more an appropriate time to look at that, a lot of the hardest hit companies, the most distressed, the bankruptcies, those types of companies are in that 10B portion of the deciles.

That may not be a representative sample. When valuing our small closely-held companies, all or most of which are in the size parameters of 10B, so we have to be aware of that. Again, the Ibbotson values or measures only on the basis of market capitalization.

Duff & Phelps also is a size-oriented data source, but it uses 25 what they call portfolios rather than the 10 deciles which of course gives you a four percent increment on market based companies. The data there also leads to a size suggested equity risk premium.

The very significant difference is that the Duff & Phelps material measures eight different quantifications of size. Market value of equity, book value of equity, five-year average net income, market value of invested capital, total assets, five-year average EBITDA, sales, and number of employees.

It gives you a wider range of analysis rather than just market capitalization. I would say in closing on this session that we try to use both in our reports. We may average them; we may look at a range and select within the range. But we found that generally speaking that the data derived from both tend to be very, very close. The difference between the data developed is generally quite small.

Stacy Collins: We use both in our shop, too. I don't know about you folks, but the more people I talk to it seems like a lot of practitioners out there are doing that now.

Ron Seigneur: I've moved to the next slide, and again I want to note that the title really should be – Roger Ibbotson and his crew have joined up in Morningstar so they are part of the Morningstar organization. As Don also mentioned, this really isn't a Morningstar versus Duff &

Phelps, but just comparing and contrasting the two different data sets.

To highlight what Don said, the data in both Morningstar and Duff & Phelps comes from the same data set, from CRSP, the Center for Public Securities Research. I can't remember exactly what the acronym stands for. They divided up that data differently into the 25 strata, and Duff & Phelps using the eight different sets of criteria that Don mentioned.

On the screen we have an example which is actually taken from a sanitized example from a report that we rendered a while back where we developed our cost of equity and showing how we have used both Ibbotson and Duff & Phelps to develop our indications of the equity risk premium.

Then taking a simple average of those two based on our judgment, adding that to the risk free rate, adding a company specific risk premium which is a whole separate issue which we haven't touched on yet, to come up with our indication of the cost of equity capital in this particular example. It gives an example, and this is not meant to be the tried and true method. It is one that has worked for us.

You can see what we have done over on the Duff & Phelps side. We have used six of the eight different sorts based upon the size of our target to come up with the premium over the risk free rate in that time period. Then we have looked at the minimum and the maximum, the mean and the median, taken the median as our simple median of those six indications for what we call the indicated Duff & Phelps size adjusted equity risk premium.

Compare that to the indicated Ibbotson size adjusted equity risk premium, and then that is how we have taken that to what is in the box down below to come up with our overall indication of equity capital. Again, this is just intended to give an example of how the two data sources can be used in this particular framework to derive an overall indication of cost of capital.

I am going to spend a few minutes talking about a few slides that have some new information that is emerging from Morningstar. I have had some discussions recently with Jim Harrington who is in charge of their valuation products at Morningstar. There are two or three things that are coming out within the next few months from Morningstar that I think are going to be great tools for us as business analysts.

One is something until just recently was called the Peer Group Pickers; it is now called the Peer Group Builder. This is not yet released but Jim expects this to be out and available by the third quarter of this year if not before. It is a web-based valuation tool that allows the analyst to go in through the Morningstar database and come up with their own selection of a peer group using public companies initially.

Their intent is to add some private company data eventually, but not in the first iteration of the offering. To take public companies by industry, by whatever, by SIC code, however the analyst wants to pick from the universe of publicly traded companies, build their own peer group, build that up. It will calculate cost of equity, data coefficients, and other financial rations for those peer groups that are compiled by the individual analysts. Again, I haven't seen it in application, but I know Jim and his staff are just really excited about what this tool will give to folks like us that might be able to use these to come up with a different approach to how we build up our equity risk premia and size premia and other metrics that are used in the valuation process.

There is a slide here that looks like it is giving an example of the Peer Group Builder. This is Peer Group Picker. This is something that Jim provided to me to give me to provide to you to give a sense of how it is going to look and feel once it is operative. I don't have a lot of details on it but I do expect that you are going to be seeing a lot of information coming from Morningstar on these tools. I am going to give a reference; I don't know if it is on the ancillary reading page or not.

If you go to *CCRC.Morningstar.com*, it will get you to the section of the Morningstar website which is quite robust, for the Cost of Capital Resource Center which is what CCRC stands for. That will get you to the site where you can currently get the data coefficients, you can get cost of capital by certain types of industries, by SIC codes, and by some of the other data from the SDBI books going back to 1999, the first issue of the valuation edition.

The Peer Group Builder is not yet there on that site, but that is where you will find it. You might make mention of that. I am not here to pitch Morningstar, but we do use their resources. Ibbotson is now part of Morningstar.

Here is a slide that shows that by the third quarter of this year it is going to allow the user to draw from the Morningstar database of over 10,000 publicly-traded U.S. stocks, put together any peer group of any combination of those companies, roll them up into your own peer group, and from that generate 300 data points. I'm not quite sure what those 300 data points will consist of, but it sounds like there are going to be a lot of things there on capital structure, beta coefficients, the different types of betas that will come from that peer group.

It sounds like an interesting tool that is going to be coming out. I have no idea what the cost is going to be, but it is something that I will definitely be keeping my eyes open for.

Stacy Collins: Ron, if I could just jump in a minute. There has been a question posed that is somewhat on point to what you are discussing. There had been a question from Charlie Reins awhile back saying, "When performing a valuation, if your analysis has determined that a guideline public company method is not appropriate due to lack of comparable entities, what is your thought about using the industry risk premium in your buildup even though you determine public companies were not comparable?"

There was an interesting comment. When I saw that question I was reminded of a section in the Michael Goldman article that I know Ron mentioned earlier. It made a point kind of similar to what we are talking about. In some cases it may be more germane to use that industry risk premium than in others. I think the point in Mr. Goldman's article was looking at some SIC codes that the data may be very helpful.

I think the example he gave was mortgage bankers and brokers, looking at the industry risk premium for that. That industry is something unto itself and is really affected in the current economy in terms of deriving an appropriate equity risk premium. Looking at what is going on in that industry is probably a very important consideration.

I have to say that I don't typically put a lot of emphasis in the industry risk premia. My sense is that is something that has been more fleshed out as more and more later editions of Ibbotson come out. My sense initially was that as that was published, the quality and quantity of the data in some SIC codes was maybe a little bit better than others, and how you determine the appropriate SIC code. There were a lot of questions that I think were getting fleshed out as more and more later editions were coming out.

I guess my view, to get back to the question, is it may be very helpful in some circumstances, and others, not so much.

Ron Seigneur: Let me chime in on that Stacy, because I have some specific thoughts there. I think this can be a key learning point for the folks listening. Maybe it will just confuse them more. But we have looked long and hard at the industry risk premia that Ibbotson has been publishing. I had some pretty extensive discussions with Jim Harrington's predecessor, Mike Barad, when they were first producing those in terms of, "What does it mean to me as a business analyst trying to apply this stuff to a closely-held business, typically a small to midsize company?"

You are exactly right. When they first came out, the data points were pretty darn skinny. They have added to them every year. When they first came out I think they were primarily two-digit SIC codes, so they were just the really general industries. Then they have expanded them to three-digit and in a few cases four-digit SIC codes.

You also have to look at the population in each data point because they won't publish it if it doesn't have at least five entities that make up that industry risk premia calculation. If you look at some of the specific data points between years, there has been a lot of volatility in the industry risk premia data from year to year.

You can learn from that because I think that can be an indication that there is a lot of volatility in that particular industry. But there are also some learning points. We had a discussion on this in another learning thing I did a couple of years ago that if you look at the industry risk premia for restaurants, it has historically been a negative industry risk premia, meaning that if you just used it in the standard buildup model, you reduce your cost of capital when you are valuing a restaurant.

Well, I grew up in the restaurant business and I can tell you that I can't think of hardly anything that is more risky than a closely-held restaurant. But what is happening there? The data points that are being used to develop that industry risk premia are H. Brinkers, McDonalds, Denny's, and the large chains that have less risk because there are differences. There are extreme differences in how the fundamentally operate within that industry versus a closely-held mom and pop restaurant.

There is one learning point. I think the other is – in Michael Goldman's article he talks about the coming need, and again I am paraphrasing, to take a much harder look at the industries that a business is operating in, and whether it is a favored industry for regulatory reasons, for social reasons, and otherwise. Make your determinations accordingly.

Here is my learning point. I would be interested to hear what you two think. A lot of us are looking for the easy way out. "We are being told we need to look at the industry more, harder, because that is what is happening in this economy." Some industries are going sideways; some are going completely south; some are doing okay.

It drives us to say, "I am going to put more emphasis on the industry risk premia." My thought is that unfortunately we can't do that. We need to take the industry into account more. I think more than ever in our quantitative and qualitative analysis, but it is going to be more through our expressions of professional judgment in terms of maybe specific risk that we apply because of the industry of a particular target.

Are there any other thoughts there?

Stacy Collins: I think the industry has to be reflected somewhere. As I was saying before, the whole issue of what is known, knowable, or reasonably foreseeable I think is going to become more significant on a lot of our valuations in terms of where the company was in the downturn at a given point in time, and what the outlook was at a particular date.

It is easy to lose sight of the fact that the industry research we should be doing on our cases or may be a really helpful indication of what assumptions you might put together for growth and risk and things like that. We are kind of saying the same thing. It has to be reflected somewhere.

Don DeGrazia: Ron, I think you are right and Stacy as well. One thing that I would suggest briefly and certainly for our participants, Michael Porter's book on competitive analysis talks about industry and analysis and the importance of industry. It is quite a detailed methodology. I think that has been championed recently by Warren Miller with his work on when industry matters.

I am not sure I would really be comfortable just accepting an industry premium, much as you suggested about restaurants and the negative industry premium, I can tell you that on the accounting side of our practice, I don't think we have ever had a long term client that was a restaurant. That is not because they chose other accountants, they just didn't survive. To find a negative premium on a restaurant industry relative to what you said and the large chains suggests that the difference is not between industries, but the difference is across industries and is so important.

As a consequence, just picking an industry and applying that premium without considering such things as differences in the industry trends itself, and even geographic issues, I think you can go astray just blindly using that industry premium.

Ron Seigneur: I want to take a moment here and let Blake come back on the line and give out the CPE codes once again.

Blake Lyman: Thank you, Ron. The three CPE codes for today's teleconference are: 7963, 2891, 5674. Once again the three four-digit CPE codes for today are: 7963, 2891, 5674. As a reminder, please send questions to *tc-questions@bvresources.com.* Don, Ron, and Stacy, I also wanted to make a mention that the websites you have been mentioning for Dr. Damodaran, the Morningstar Cost of Capital Resource Center, and other resources are all available on our reading page for today's teleconference.

Ron Seigneur: Thank you, Blake.

Don DeGrazia: Ron, could I address one question or maybe two questions. I will use one question to answer another question. My friend Johann asked a question, "If you are not in the United States and you are dealing with trying to develop a risk free rate, would you use U.S. Treasuries?"

I think if you do you are probably going to produce another element of risk and that risk is currency fluctuation which of course we don't suffer if we are valuing a business within the United States and using Treasury bonds or notes as our risk free rate.

One of our questions came from Hugh Osborne. He suggested that a source might be swap interest rates. He cited a source there as being *The Financial Times* published by ICAP LLC. It gives information on major currencies like the dollar, the euros, yens, pound and sterling. That is one source of information I am aware is out there. I do read *The Financial Times* a couple times a week. His question actually answered another question. I think the answer to Hughes question would certainly be something to consider, particularly in an international engagement.

Johann, I think that is responsive to your concern, that would you use a U.S. Treasury note to value a company in Europe for instance. I think that creates some problems if you do.

Stacy Collins: I would also mention that the Damodaran white paper on risk free rates touches on some of what Don is talking about. I would recommend the audience to take a look at it.

Don DeGrazia: I think that is the addendum at the very end.

Stacy Collins: Exactly, yes.

Ron Seigneur: I am going to run us through the rest of these new Morningstar resources so we can try to stay on our timeline. The slide we currently have up shows the planning that they have for their peer group builder project that is going to add private company data and private company transaction data. They are targeting that for the middle of next year to be added in to that resource.

Something else that I have recently become aware of through Jim Harrington is they are taking the 10th decile that several years ago they split between the A and B stratus, the upper and lower ends of that decile, to give equity risk premia indications that caused quite a buzz. There were about 600 basis points difference between 10A and 10B that has continued to exist.

If you read the pages in the SBBI Valuation Edition to clarify the stocks, bonds, bills, and inflation book that Ibbotson, now Morningstar, publishes, it has originally been called the Classic Book which has a red cover. Then in 1999 they took that same information, added some data points and some analysis and discussion that relates to valuation. They now have the blue covered book that is called the Business Valuation Edition.

In the Business Valuation Edition, they have taken the 10th decile for their equity risk premium and split that between an A and B strata. They are now going to be moving later this year to split that 10th decile into four stratus that they are calling the W, X, Y, Z, the four quartiles of the 10th decile.

They are using a process that they are in the process of refining and testing because they want to make sure that they think it has statistical validity, removing the distressed companies out of the 10th decile in those four quadrants, that they will be splitting the data points in. They are doing that because of the distress that is in the current economy, but also because of the continuing discussion and argument that the 10B strata of the 10th decile had a lot of issues in it in terms of companies that were about ready to fall out of the public market that had large bid/ask spreads, that had certain indications of distress in therefore those were reasons not to use the 10B.

Although a lot of valuation practitioners have been kind of conflicted because if you look at the 10B strata and you look at the market cap of the companies that are in it, it gets you down much closer to those $5, $10 million closely-held companies that many of us spend so much time addressing from a valuation standpoint.

So there was an appeal, if you will, to the 10B. There will be to the lower end of these four quadrants because the size of the public companies that makes up those data points. If Morningstar can make a convincing argument that they have satisfactorily cleansed that data from companies that are truly in distress, that may be very meaningful for us to use those particular data points to derive our equity risk premia.

Here is another slide that talks about what is in that 10th decile. It is just a little bit more about where it comes from. They will be splitting that up. I understand from Jim that it is in the process now of being tested. He also indicated to me that when this information comes out, he mentioned that in some fashion they intend to publish a supplement to the current valuation edition of the SBBI to get this information out to practitioners prior to the next full issue of the SBBI that typically comes out around March of the year. That is something that if you are a current subscriber to the SBBI Valuation Edition, this information will be coming to you when it is made available.

The last item that Jim is also pretty excited about and something that I have had a chance to technically look at and comment on for him and his staff is the supply side report. Historically, using what we continue to call an Ibbotson buildup model or probably more now a Morningstar buildup model, if you take a risk free rate, whatever that is subject to the discussion we've had, add to it an equity risk premium, a size premium, and an industry risk premium, to come up with a cost of capital prior to any additions for unsystematic risk.

We have gotten that until recently from the historic data sets that have been produced by Ibbotson in their publications. More recently they have been producing an equity risk premium that is based upon supply side theory. This is overly simplified, but the market, the PE ratios are overstated. On a going forward basis we need to adjust the equity risk premia based upon historical data points to come up with something that has more of an indication of what market followers think the price earnings spreads will be going forward.

But that has created a problem because example two is if you use the traditional model, you are using a supply side equity risk premium together with a historical based size premium and a historical based industry risk premia. What they are about ready to release is a full set of data that allows you to use a supply side concept for all three of the empirical data points. You can continue to use the historical, or you can use the supply side, but you can avoid being in example two where you are apples and oranges in terms of the concepts underlying the empirical data that you are drawing from.

I understand that is quite close to being released. I saw that the format and the content of the report a few weeks ago; I thought it was pretty good stuff. That is something to keep an eye out for.

I am going to round back now to Stacy and back to Dr. Damodaran and another white paper that he has talked about in terms of his views on equity risk premiums. Maybe Stacy you could take just a few moments and highlight what his thoughts are in that area.

Stacy Collins: Sure. This is another article that is on Damodaran online. It is about a 75-page white paper. The concept he starts off with is that it is surprising how “haphazard” (his word) estimating equity risk premiums remains in practice. This is very similar to his white paper on risk free rates. It drills down into all of the various issues and assumptions that go into the equity risk premium, how they relate to risk free rates.

It starts off saying, “Look, there are a few different ways of quantifying.” You can survey subsets of investors and managers to get a sense of what their expectations are for future returns. You can assess historical premiums related to risk free which we have talked about. He makes the point that seems to be a consensus that is the best way of estimating.

But you can also try to estimate forward looking premiums based on prices of traded assets. It goes through each of these assumptions. It talks about the time period that you are looking at in terms of the historical returns if that is what you are doing.

What do you compare it to? What level of risk free are you looking at? Are you looking at T-bills, T-bonds, etc.? How do you quantify the average returns over time? He makes the point, not surprisingly, that all of these things are choices, intentional or not I suppose, that you make as the practitioner in terms of developing your rate.

There is a lot of stuff in the white paper on international cost of capital rates and different ways of trying to quantify that, questioning whether some of the countries risk premium data that is out there. Is it appropriate to consider that or can you diversify it away? Are the risks embedded in the cash flows instead of the equity risk premium?

He then goes into some examples of estimating the more forward looking premiums. There is a section near the end of the article that has an update for some of the events in September or October of last year. It estimates that between mid-September and mid-October, the more forward looking premiums changed from 4.2 percent to 6.4 percent just in a month.

It then goes further to quantify the changes in the forward looking in one day which ranged from 6.1 percent to 6.6 percent. It is an interesting article. It makes the point similar to what we are talking about, drilling down into each of the various assumptions and the implications of the choices that are made on each.

Ron Seigneur: Thank you, Stacy. I am going to move forward to come back to Roger Grabowski's white paper, "Problems with Cost of Capital Estimation in the Current Environment." This is an update that Roger has allowed us to reprint. We thank him for that. I know, Don, we have already touched upon this paper. It is quite robust. I think it is well worth reading. It is available on the reading page.

Roger takes us through six points. I was wondering if you could take a few moments and just give us a quick synopsis of those six areas he has identified.

Don DeGrazia: Sure, Ron. I think to a great extent this will summarize what we have covered so far, but still leave us more information to cover. Certainly his first consideration is that Treasury bond yields are typical risk free benchmark or likely temporarily low. I know there are some people who have problems with the issue of adjusting or modifying what the data gives us, but his opinion is that the Treasury bond yields are at least temporarily on a low side.

He also goes on to say, and it is interesting, that it is very likely that the equity risk premium has increased as the stock market has declined. So we have that issue as well. While the market is declining, the equity risk premium is likely increasing.

We all know that by looking at our investment portfolios and our retirement plans that the market has taken a substantial pounding. Highly leveraged and certainly financial service sectors have been hit especially hard. As a result, our traditional ways of estimating betas using the CAPM method are potentially flawed and may be giving us faulty risk estimates using the CAPM method.

Again, this is hopefully a temporary situation from his view and something that we just have to be aware of. Again, that concept of using a cookbook approach may not be the best way to proceed.

I think he very accurately points out that because current leverage ratios on some companies are so high, they are likely unsustainable in the long term. Certainly, when we are considering what the future capital structure of that company may be, what it has now may not be sustainable into the future. We have to recognize that and we might have to make adjustments there in terms of our valuation assumptions.

We also, and we touched on this, you have to recognize that many companies, most companies, are losing money now. Perhaps I exaggerate by saying "most companies" but certainly many companies are losing money now. That assumption that we can use an after tax cost of debt in developing our WACC (Weighted Average Cost of Capital) rates may not be valid because we don't know how long what he calls the interest shield, how long it will be before that will be a benefit to companies again.

Inputting a 40 percent tax rate and dropping the cost of debt down by tax effect may not be valid certainly for a capitalization approach and may have to be adjusted on the basis of a discounted cash flow (DCF) model. We have real concerns there.

Finally, he concludes by saying that valuation is not a cookbook. You must test your cost of capital for reasonableness. Don't just accept the computation because you made the computation and you followed the guidelines or the theory. Test it for reasonableness. Does it make sense?

Ron Seigneur: There is an excerpt at the end of the white paper that we've quoted on this slide. This author suggests that, given the current market conditions, one should consider using an estimated equity risk premium of six percent, the upper end of the range of the research on the long-term "normal" ERP. As expected economic conditions improve and stock prices increase; ERP can be expected to decrease in the future.

It is an interesting observation that Mr. Grabowski is making in terms of his position. Again, keep in mind that this paper was produced the February 4, 2009. As Stacy pointed out with her example, things can change almost daily right now. I guess I just say that to warn listeners to not lock into a six percent rate and say it is bulletproof.

Stacy Collins: I would say for any listeners that maybe feel a little bit overwhelmed by all of the research out there and how to best drill down into some of this, that getting Roger's article and reading it through I think would be a useful exercise.

Ron Seigneur: I will make a corollary point here. There is an article that I had read which was also in the January/February 2009 Value Examiner from NACVA. I don't if this was on the reading page. I don't know if we had permission for it, but it is something that folks might want to seek out. It is titled "Cost of Capital in Valuation of Stock by the Income Approach Updated for an Economy in Crisis."

It is actually by Roger Grabowski and Shannon Pratt. It is a well written article. It talks about a lot of things that are happening in the bankruptcy courts and court case precedence there. One takeaway that I got was that we are all under – at least I am very cognizant of Daubert challenges – so here we are in an area. And I think this is just a general comment that is coming from left field in terms of our agenda. We are trying to get our arms around what we ought to use in this market for each particular assignment.

We have some articles of some thinking here that is challenging us frankly to move away from some of the traditional thinking and traditionally embraced methodologies and data sets in developing this particular element – cost of capital. As we move away from some of these traditional methods, I'll call it, we do have probably a higher risk of being challenged. "Hey, Ron, novel concept you are applying here to come up with your risk free rate or your equity risk premium. Explain that and tell me where that is academically sound under Daubert and the elements that you have there."

I guess I just put that on the table as we are trying to embrace some of these new elements and new thinking in this current economy that we still have to keep that in mind as well.

We have an article that is also quoted. Pastor, Lubos and Stambaugh: "Are Stocks Really Less Volatile in the Long Run?" That is a good source of reference. It is a study that concluded that stock returns are more volatile over the long run as previously thought. We are seeing more volatility in that. That is an article that you can look at for that particular point of view.

We have just about 15 or 20 minutes left in our call, so I am trying to push forward a bit so we cover the key elements that we had on our agenda.

On this slide here we have already talked about Morningstar's Peer Group Picker which is now called the Peer Group Builder Tool that will be emerging at some point later this year. We have an overview of the Butler-Pinkerton Model. Stacy, could you take just a couple of moments and give us an overview of what that is and how it can be used in cost of capital determinations.

Stacy Collins: Sure. Just briefly, it is a model that estimates the company specific risk premium and the total cost of equity for a company. Its developers consider it as an objective quantification of this measure using guideline companies. And in full disclosure, I am aware that Business Valuation Resources provides this, but it is my understanding that up to 12 guideline companies can be researched at a time.

It is an attempt to quantify what is hereto foreseen as been unquantifiable. The data is updated daily. I should tell you again just in full disclosure, I personally have not used it. It is a product that is out there.

Ron Seigneur: We have a question. "As the focus of this seminar is on closely-held and family businesses, I was surprised that there was no mention made of the Duff & Phelps data on the three fundamental measures of company risk."

I am not quite sure what that question is getting at. There was also another question that related to Duff & Phelps. In the example page that I had from one of our valuations, it was, "Why did we only use six of the eight different sorts that are available from Duff & Phelps?"

That is a judgment aspect answering that second question first, that we look at the eight data sets. We try to figure out which ones we think are most appropriate to use for the particular target we are looking at. Sometimes we may not have the data to say, "We don't know total employees." That is one of the eight sets that are provided in the Duff & Phelps data. So if we don't have it for our target, it is hard for us to draw the comparatives.

There wasn't anything specific in terms of why I use six versus eight, but I know there have been instances where we have used less than six.

In looking at this question that just came in, I am trying to get my arms around it. I think we have covered Duff & Phelps in terms of what it is trying to measure.

Let's see what else we have here. I am going to move forward a couple of slides. I am going to come back here to Don. One thing that I have been thinking about quite a bit is the turmoil in the public markets, it sure seems that the use of beta coefficients is cost of capital determinations using a CAPM model or a modified CAPM model is kind of fraught with pearl.

How might we help listeners make some sense of how the changes in the public markets are impacting valuations of closely-held businesses?

Don DeGrazia: Ron, I think that is a great question there. First before I move into the direct answer, I will tell you that I have been a little concerned about public company information certainly in the very volatile period which was the last half of 2008 and into 2009 in terms of guideline public company approaches even because the volatility has just been so significant. We are not ignoring it, but again it gives you more cause for concern.

But that is a different topic. The issues with beta coefficients, certainly public markets have been volatile. There have been huge declines in value across industries and of course across markets.

Going back to a great source of information was Roger Grabowski's article. He points out again something that I mentioned before. The S&P 500 and other market entices have been really disproportionately impacted by two sectors, the financial stocks and then highly leverage companies. Low leveraged companies where non financial stocks have been hit, but they generally have not been as volatile and not as greatly affected.

With all sectors down, it has impacted more of these financials and heavily leveraged companies. In some respects that causes the non-financials with the non-highly leveraged companies to appear to be less risky by comparison. While these companies' risk profiles really haven't changed relative to the overall economy, it appears that they are less risky when you compare to a market that is over-weighted in financials.

You get this appearance of reduced risk when maybe there is not reduced risk. Roger also mentions that in 2008, and I think it is probably pretty obvious into 2009, that the markets in general have been looking for a new equilibrium; especially the financials and heavily leveraged companies have found historic lows. It appears that the companies that are not in these sectors are less risky when really their position with respect to the market really hasn't changed when you consider the overweight impact of financials in similar markets.

He suggests that looking back into mid 2008 and forward probably wouldn't give you a reliable indicator of future data. Despite decreased earnings, the companies themselves really have the decreased beta while the market beta was rising. The risk really hasn't decreased yet it appears that it has.

He has suggested, at least to visualize that situation, to graph the betas and look at it before the impact of the significant market decline. Look through the market decline into what will emerge hopefully as essentially a new equilibrium, what he calls the repricing period, and see when betas on sample companies for instance may have stabilized and maybe begin to track the market as a whole again.

I think he is consistent with his thoughts on modifying the equity risk premium, modifying the risk free rate. He is suggesting that you perhaps have to look at a longer term beta in terms of an estimate rather than using something that you might just develop by looking at a shorter period of time which is the highly affected most volatile point in the market.

The whole issue of beta and guideline public companies really has not escaped us of course. It is something we have to consider when we decide if we go with our tried and true methods.

Ron Seigneur: I am going to move forward a few slides, which I have already done. We only have about five minutes or so left. I would like to touch on both the focus on small business valuations on one end and international valuation issues on the other end. I am going to direct that question to Stacy first and then Don to comment on those two areas generally, as a wrap up.

Before doing that, I am going to take another question that has been submitted to us. This one is, “If the industry risk premium is not used in the buildup method, don’t you think it appropriate to reflect current economic conditions in the company specific risk premium?”

I will start off by answering that I really see that as being the unsystematic risk premium that in many instances does embrace more. It is the company and the industry that the company operates within, so by all means I think that you can embrace a risk adjustment, if you will, for a lot of what we have been talking about for the particular target and the risk associated with that target operating within a certain industry that is also subject to risk elements that aren’t elsewhere captured in the method that you are using to build up your overall rate determinations.

Stacy Collins: I would just be careful because the risk free rate may have some consideration, I think as we talked about before, of future expectations in terms of inflation and whatnot. I would just be a little bit careful in terms of potential for double count. I think where Ron was going, and I completely agree, is more in terms of the outlook for an industry in total, but in terms of the outlook for the economy as a whole, I would just keep that in mind.

Ron Seigneur: In one of the areas that we are skipping over that really dovetails into this, Stacy and Don, is the access that a company has to traditional capital sources. We haven't had time to delve into the companies that may historically had access to banks, lines of credit, that they could count on for operating purposes, in expansion and otherwise, and now they are back trying to figure out how they capitalize the enterprise at ground zero just to keep it alive and being able to get into the next operating period.

Let's spend just a few minutes talking, as I said, about the impact on small businesses. I don't know if we have a common definition of what constitutes a small business, but those closely-held businesses at the smaller end of the scale.

Stacy, maybe you could make a few comments on your perspective on what cost of capital means when you are focused on a smaller enterprise.

Stacy Collins: Just as an overlay to this issue, Ron, my recollection is that we spent a lot of that webcast on small businesses talking about valuation engagements versus calculation engagements. We talked a lot about it because we were getting tons of questions from the audience on that issue.

I think it is going to behoove all of us to give thought to these issues in terms of some of the underlying assumptions, start off with the calculation engagement which is more limited scope, perhaps more back of the envelope, in some cases may morph into a more detailed and comprehensive valuation where perhaps more of these considerations get scrutinized.

I think these issues just make the job harder at a time when I think a lot of us are getting calls for, if anything, more limited scope engagements. That is certainly a challenge to a lot of us.

Having said that, one obvious area that I think the small businesses are impacted is the development of the numerator. Ron, you touched on this earlier, but for companies that don't have projections and perhaps barely have good historical financial data, it presents even more of a challenge to develop what an appropriate estimation of future cash flows is going forward.

The other thing I am seeing is what the right level of debt to equity is. Companies that are heavily in debt right now and maybe they are planning to get out of it later, what is a normal level? Those are three things that come to mind that I have been seeing on some cases. I am sure some people in the audience may be dealing with this as well.

Ron Seigneur: As Stacy knows, that can be a subject for a whole separate discussion. Stacy, myself, and Gary Trugman have done sessions on valuations of closely-held businesses focusing on those types of issues in depth. I would like to spend just a couple minutes having Don comment on the international scene. He has already responded to a couple of questions from one of his colleagues.

I know that Don is involved with Integra which is a consortium of international accounting firms. I know, Don, you have had some folks you have been involved with who deal in valuation on more of the international scope, so maybe you could kind of help us wrap things up with a few comments there.

Don DeGrazia: Sure, Ron. I would be very happy to. One of the things that membership and participation in Integra has done is really open my eyes to the differences in not just currency but the differences in industry and business, in operating models, regulation. It is just very, very different in different parts of the world.

Certainly Europe and Latin America face issues that we don't face or perhaps we have already faced. My friend Johann was kind enough to give me some information from his European perspective. He is in Antwerp. As past president of Integra in Europe, he knows all the members quite well and travels quite frequently throughout Europe.

I think his comment was, and it was an interesting one, that there is no homogenization in Europe. There are many things that we take for granted almost. Some of the great documents available to us, and treatises by Roger Grabowski, by Shannon Pratt, by Jim Hitchner, stuff Ron has written, and certainly in your office Stacy, Jay Fishman, Les and yourself, all the information that is out there, doesn't exist to nearly the extent it does in Europe or in Latin America.

For example, despite the existence of the EU and the euro for 10 or 11 years with the euro, they still have a fragmented market. Language barrier still exist and it continues to persist, and different government policies.

One interesting comment he made is that there is no recognition of the specialty in BV that we have here in the United States. It is very much an open and unregulated industry. He views that to some extent as a barrier in valuing small or closely-held companies. He points out the fact that we really don't have the empirical data that – there is so much information that we can access right off the BVR website. In terms of historical data there is very little cross-border information available and they don't have the data that we have. It makes things much more difficult.

Then trying to use our data and modify it into a European specific, a Latin American specific, or Australia specific sources is really not terribly valid. I think also to a certain extent, we are waiting for the crisis to pass and things to return to normal, where in other parts of the world they are asking the question, "What's next? How will things be structured when this crisis is over?" There are some different perspectives for valuation professionals and folks doing what we do in different parts of the world.

Ron, if I have a minute or two left, I will just suggest that there is some information out there. I think it is on our information page, but the Country Risk Rating Method, the Ibbotson International Cost of Capital Reports, and Ibbotson International Risk Premia Reports, which I believe are chapter nine in the Ibbotson book.

Let me just quote it right here. Chapter nine beginning on page 117 has a whole section on information and data available to people involved in international valuations. The fellow I mentioned before the data source from the *Financial Times* that will provide us with the risk free rate using swaps in different currencies.

I think it is more of an entry level situation, certainly in Europe than it was here, maybe back where we were 20 years ago as we developed all the methodologies and the information that we have. It is really an area of great opportunity. I would encourage people to the extent that they can get involved that it really is an opportunity.

Ron Seigneur: Thank you, Don. I want to use this moment to conclude our discussion for today. I will make mention that the one article by Roger Grabowski and Shannon Pratt is indeed available on the reading page, so you can find that there as well.

We have had a good discussion I believe. There are a few areas that we didn't have time to cover. There are a few questions that we haven't had an opportunity to respond to, but our time is up. I want to be considerate of the folks who have this scheduled.

I want to thank Stacy Preston Collins and Don DeGrazia both for their time and their input today. With that I will conclude today's teleseminar and turn it back to the operator.

Blake Lyman: Thank you, Ron. This concludes our presentation today. BVR would like to thank Ron Seigneur, Don DeGrazia, and Stacy Preston Collins for their expertise as well as all of our listeners for attending.

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