## CUITCHICS

About the Editor	xvi
About the Authors	xviii
Acknowledgments	XXX
Preface	xxxii
CHAPTER 1	
Introduction to Financial Valuation	1
Who Values Businesses?	1
Purpose of a Valuation	2 3 3 3 5 5 5 5
Professional Valuation Organizations	3
Standards of Value	3
Fair Market Value	3
Investment Value	5
Intrinsic Value	5
Fair Value (State Rights)	5
Fair Value (Financial Reporting)	5
Premise of Value	6 7
Principles of Appraisal Practice	7
Dates	7
Approaches to Value	8
Valuation Procedures	8
Summary	9
Addendum 1—Valuation Checklist/Ready Reference	4.0
(Revenue Ruling 59-60)	10
Addendum 2—International Glossary of Business Valuation Terms	18
CHAPTER 2	
Standards of Value	27
Introduction	27
How Standard of Value Can Affect the Final "Number"	29
Premises of Value	30
Common Standards of Value	31
Common Operational Premises Underlying the Standard of Value	36
Application of Specific Standards of Value	38
Fair Value in Shareholder Dissent and Oppression	42
Control Premiums	43
Immediately Before	44
Unless Exclusion Would Be Inequitable	44
Extraordinary Circumstances	45

Contents	vi
Comcomo	

Current and Customary Techniques	45
Standard of Value in Divorce	46
Fair Value in Financial Accounting	52
Measurement	52
Conclusion	54
CHAPTER 8	
Research and its Presentation	55
Obtaining Internal Information	55
A Directive from the Internal Revenue Service	55
Research Techniques and Planning the Search	57
Information Sources: Business Financial Databases	61
Economic Research	62
Selected Sources of Economic Information	63
Industry Research	64
Selected Sources of Industry Information	65
Guideline Company and Transaction Research	66
Sources for Publicly Traded Company Data	66
Guideline Transaction Databases	67
Presenting Research in a Report	68
Other Sources of Information	68 69
Summary Addendum 1 Valuation Information Request (VIR) Constal	70
Addendum 1—Valuation Information Request (VIR) General Addendum 2—Management Interview-Operations	76
Addendum 3—Management Interview-Operations Addendum 3—Management Interview-Financial Review	80
Addendum 4—Industry Research Form	83
Addendam 4—madsity Research Form	03
CHAPTER 4	05
Financial Statement and Company Risk Analysis	<b>85</b> 8 <i>5</i>
Historical Financial Statement Analysis	86
Length of Financial History to Be Used Spreading Financial Statements in Columnar Format	86
Adjustments to Financial Statements	86
Normalization of Historical Financial Statements	89
Unusual, Nonrecurring, and Extraordinary Items	89
Nonoperating Items	90
Changes in Accounting Principle	90
Nonconformance with GAAP	91
Tax Affecting the Earnings of Subchapter	71
S Corporations and Other Adjustments	91
Degree of Ownership Interest	92
Normalization Adjustments	92
Common Sizing Normalized Financial Statements	96
Ratio Analysis (Quantitative Analysis)	103
Comparative Analysis	104
Risk Analysis (Qualitative Analysis)	107
Macroenvironmental Analysis	114
Addendum 1—Commonly Used Financial Ratios:	
Application to Ale's Distributing	115

CHAPTER 5	
Income Approach	121
Fundamental Theory	121
Basics of Income Approach—"A Fraction"	122
Income Approach Methodologies	123
Normalization Process	124
Adjustments for Ownership Characteristics	124
Adjustments for GAAP Departures and Extraordinary,	
Nonrecurring, and/or Unusual Items	127
Adjustments for Nonoperating Assets and Liabilities	
and Related Income and Expenses	128
Adjustments for Taxes	129
Adjustments for Synergies from Mergers and Acquisitions	130
Determination of Future Benefits Stream (Cash Flows)	131
Defining the Benefit Stream	131
Defining Net Cash Flow	132
Use of Historical Information	134
The Capitalized Cash Flow Method	139
The Discounted Cash Flow Method	143
Terminal Value	149
Capitalized Cash Flow Method (Revisited)	156
Excess Cash Flow Method	157
Conclusion	167
Addendum I—Application of the Direct Equity Method (DEM)	
and the Invested Capital Method (ICM)	168
Addendum 2—Dealing With Debt	175
CHAPTER 6	
Cost of Capital/Rates of Return	181
Three Variables	181
Characteristics of Cost of Capital	182
Investor Expectations as Quantified by the Cost of Capital	182
Cost of Capital Equals Discount Rate	183
Cost-of-Capital Methods	183
More on the Basic Concepts	183
Discount Rate, Capitalization Rate, and Anticipated Growth	184
Growth	184
Relationship Between Risk and Cost of Capital	190
Types of Risk—Another View	193
Risks in a Small Business	194
Methods for Developing Cost of Capital	194
Size Premiums	202
Methods to Articulate Unsystematic Risk	209
Other Issues	219
Capital Asset Pricing Model Method	221
Development of the Weighted Average Cost of Capital	228
Price/Earnings Method	230
Adjustments to the Price/Earnings Ratio	232 235
Arbitrage Pricing Theory Risk Rate Component Model FKA Build-Up Summation Model	233
THE TABLE AND INCOME IN TABLE 1 TO A DESCRIPTION OF THE INTERIOR OF THE INTERI	4.1(1

Contents

Cost-of-Capital Issues Related to Use of the	0.00
Excess Cash Flow Method	237
Addendum 1—Cost of Capital Controversies:	2.10
It's Time to Look Behind the Curtain	240
CHAPTER 7	
Market Approach	259
Overview	259
Type of Value Obtained	261
Advantages and Disadvantages of the Market Approach	262
Choosing Guideline Companies	263
Basic Implementation	266
Sources and Characteristics of Guideline	
Company Data and DMDM Data	266
Information Sources	267
More Information on Transaction Databases	267
Advantages and Disadvantages of the Guideline Company	2.0
Transaction Method	269
Publicly Traded Companies	270
Information Sources for Industry "Comps"	272
Stock Prices and Numbers of Shares Outstanding	272
Advantages/Disadvantages of Public Company Data	273
Characteristics of Publicly Traded Companies	273
Financial and Other Indicators	277
Sample Size Matters	279
Comparable Companies' Information Dates	279
Basic Financial Indicators	280
Displaying the Information	281
Adjustments to the Guideline and Subject Companies	286
Income Adjustments	286
Balance Sheet Adjustments	288
Effects of Adjustments on Value	290 291
Concluding Remarks on Choosing Comparables	
Calculating Standard Pricing Multiples	291 292
Equity Versus Invested Capital	292
Financial Statement Measures	293
Computation of Multiples	296
Matching Price to Parameter	296
Dispersion of Pricing Multiples	297
Applying the Valuation Multiples	300
Concluding Thoughts on Value	301
Using the Pricing Multiples for Growth	304
Adjusting the Guideline Multiples for Size Summary	308
Jumilary	300
CHAPTER 8	308
Asset Approach	309
Fundamental Theory	310
Applicability Premise of Value	312
FIGURE OF VALUE	012

CONTENTS

Control Versus Minority	312
Built-in Gains	313
General Steps in the Asset Approach	315
Liabilities	321
Unrecorded Assets and Liabilities	322
Built-in Gain	322
Conclusion	325
Addendum 1A—Built-in Gains Taxes: Business	
Valuation Considerations, Part I	326
Addendum 1B—Built-in Gains Taxes: Business Valuation	
Considerations, Part II	332
Addendum 2—Understanding Real Estate Appraisals	340
Addendum 3—Understanding Machinery and Equipment Appraisals	349
Addendum 4—Revenue Procedure 77-12	363
CHAPTER 9	
Valuation Discounts and Premiums	365
Levels of Value	366
Classifying Discounts	369
Discounts for Lack of Control and Control Premiums	371
Discounts for Lack of Marketability	380
Empirical Evidence of Marketability Discounts	382
Detailed Studies	411
Quantitative Tools	416
Other Discounts	424
Analysis of Premiums Accorded Voting Versus Non-voting Stock	431
Discounts and Premiums Summary	432
CHAPTER 10	
Report Writing	451
USPAP Engagements	451
Types of Valuation Engagements and Related Reports	452
Complete Valuation Report	453
Other Business Valuation Reports	462
Sample Report	462
Addendum—Sample Valuation Report, Valuation of the Common	
Stock of Acme Measurement Devices, Inc., as of May 31, 2008	463
CHAPTER 11	
Business Valuation Standards	548
History of Valuation Standards	543
Government Action	543
Organization of the USPAP Standards	545
USPAP Business Valuation Standards (2010/2011)	546
Other Business Valuation Standards and Credentials	552
Summary	555
Addendum 1—Standards: A Summary	
of the AICPA's New BV Standards	556

Addendum 2—IRS BV Guidelines Checklist, Internal	
Revenue Service, Engineering Program, Business	
Valuation Guidelines 4.48.4	565
CHAPTER 12	
Valuation of Pass-Through Entitles	573
Introduction	573
Standard of Value	574
Historical Backdrop	575
Current Status of Debate	576
Controlling Interests in Pass-Through Entities	580
Controlling-Interest Studies	582
Summary: Controlling Interests in Pass-Through Entities	590
Tax Rates	591
Noncontrolling Interests in Pass-Through Entities	593
Treharne Model	594
Van Vleet Model	598
Mercer Model	606
The Quantitative Marketability Discount Model	611
Grabowski Model	614
Summary: Non-Controlling Interest in Pass-Through	
Entity Theory	624
Bibliography	627
Addendum—A Summary Approach to PTE Valuation	631
CHAPTER 13	
Estate, Gift, and Income Tax Valuations	639
Valuations in Estate and Gift Taxes	639
Selected Internal Revenue Code Provisions	639
Selected Treasury Regulations	641
Selected Revenue Rulings	644
Valuations for Income Taxes	676
Addendum—Valuation Checklists/Ready Reference	70200
(Revenue Rulings 59-60, 77-287, and 93-12)	684
CHAPTER 14	
Valuation of Family Limited Partnerships	699
Family Limited Partnership Uses	699
Tax Advantages	700
How Family Limited Partnerships Are Formed	700
Other Characteristics of Family Limited Partnerships	702
State Law, Property Rights, and Their Importance	
to the Valuation Process	702
Improper Formation Can Create	
Problems for Partners	704
Valuation of Family Limited Partnership Interests	705
New Developments in Chapter 14	717
Tiered Discounts	720
Illustrative Case Study	733

CONTENTS

CHAPTER 15	
Summary of Tax Court Cases Issues	748
Tax Cases	743
CHAPTER 18	
Shareholder Disputes	788
History of Shareholder Disputes	789
Causes of Action	790
Standard of Value	792
Valuation Date	795
Future Appreciation or Depreciation	795
Entire Fairness	795
Valuation Methodology	797
Valuation Adjustments	799
Recent Court Case	802
Court Case Caveats	804
Conclusion	805
CHAPTER 17	
Employee Stock Ownership Plans	807
Introduction to Employee Stock Ownership Plans	807
Need for Valuation Services	808
Feasibility of an ESOP	809
How ESOPs Are Used	809
Security Laws and the ESOP	810
Tax Advantages of ESOPs	810
Differences in Entity Structure	810
Important Differences in Share Ownership	
(ESOP versus Other)	811
Adequate Consideration: How and Why It Works	812
ESOPs and Plan Contributions	813
General Considerations for ESOP Loans	813
ESOPs That Include Debt	814
Accounting Standards and ESOPs with Debt	815
Section 415 Limits	818
Criteria for Valuing ESOP Shares	819
End-of-Year and Mid-Year Conventions	819
Considerations in the Calculation of the	
Terminal Value	819
Adjustments for Lack of Marketability	820
Adjustments for Control or Lack of Control-Minority Interest	820
Voting and Other Rights of the ESOP Shareholders	822
Repurchase Requirement, the Put Right-What	
and How to Deal with It?	822
Penalties for an Improper Valuation	824
Valuation Conclusion: Writing a Conclusion	824
Information Sources	825

Contents

CHAPTER 18	
Valuation in the Divorce Setting	829
Standards of Value in Divorce	829
Premise of Value—Going Concern	831
Premise of Value—Liquidation	831
Goodwill—The Battleground for Divorce Valuations	832
Defining Goodwill	832
State Interpretations on Including Goodwill in the Marital Estate	833
Personal versus Entity (Enterprise) Goodwill	833
Dividing Goodwill into Personal and Entity Components	835
Applying the Factors to Separate Goodwill	836
Role of Noncompete Agreements in Determining Personal	
versus Entity Goodwill	840
Personal Goodwill in Commercial Businesses	840
Valuation of the S Corporation and Other Pass-Through Entities	
in Divorce Valuations	841
Restrictions on Data	842
Range versus Specificity	842
Professional Standards in a Divorce Settlement	842
Role of Standards	842
Statement on Standards for Valuation Services No. 1 (AICPA)	843
Other Standards	843
Daubert Challenges in Divorce	843
Valuation Methodology and the Application of Discounts	0.4.4
in Divorce Valuations	844
Avoid Double Counting	844
When an Interest Is Considered Control	044
in a Divorce Setting	844
Family Aggregations in Divorce Settings	845
Partnerships, LLCs, LLPs, and Family Entities in a Divorce Setting	845 846
Liquidity Myth in Pass-Through Entities	846
Divorce Valuation and Bankruptcy	847
Summary	04/
CHAPTER 19	
Valuation issues in Small Businesses	849
What Is a Small Business?	849
Financial Statement Adjustments	852
Qualitative Factors Affecting Value	855
Valuation Methods	856
Reasonableness Tests	861
Summary	862
obertour voice €	
CHAPTER 20	2020040
Valuation Issues in Professional Practices	863
Types of Practices	864
Purpose of Valuation	868
Professional Goodwill and Practice Goodwill	868
Select Case Law for Marital Dissolution	. 869

XIV

Factors Affecting Value	872
Financial Statement Adjustments	876
Valuation Methods	879
Summary	882
Addendum 1—Management Interview Medical Practice (Sample)	884
Addendum 2—Management Interview Law Practice (Sample)	888
Addendum 3—Management Interview Accounting Practice (Sample)	891
CHAPTER 21	OOF
Valuation of Intangible Assets	885
Introduction	895
What Are Intangible Assets?	895
Why Intangible Assets Are Difficult to Measure	896
The Nature of Intangible Assets	897
Identification and Classification of Intangible Assets	897
Measurement of Intangible Assets	898
Business Combinations	899
The Acquisition Method	901
Intangible Asset Valuation Issues	903
Nature of Goodwill	908
Financial Reporting Disclosures—Selected Disclosure Requirements	915
Case Study: Determining the Value of Goodwill and Other	
Intangible Assets in a Business Combination	916
Addendum 1—Fair Value	961
Addendum 2—Intellectual Property	971
CHAPTER 22	
Marketing, Managing, and Making Money in a Valuation Services Group	975
Purpose and Overview	975
What Good Economics Looks Like	976
Operational Keys for Good Economics	978
Key Engagement Principles	980
Engagement Acceptance Process	981
Fees, Retainers, Billing, and Collection	982
Engagement Control	984
Litigation Services' Engagements	985
Conclusion	987
CHAPTER 23	
Business Damages	889
Role of the Law and Financial Experts	989
Legal Principles Governing Damages	990
Admissibility of Expert Opinions	992
Measure of Damages: Diminution of Value or Lost Profits	993
Differences Between Damage Computations and	773
Business Valuations	995
Can Business Damages Exceed the Fair Market Value	113
of the Business?	1004
Conclusion	1004
	- 000

XV

CHAPTER 24	
Other Valuation Services Areas	1007
A: Valuations for Public Companies and/or Financial Reporting	1007
B: Valuation Issues in Buy-Sell Agreements	1013
C: Valuing Debt	1021
D: Valuation Issues in Preferred Stock	1027
E: Restricted Stock Valuation	1034
F: Valuation of Early-Stage Technology Companies	1047
G: Valuation Issues Related to Stock Options	
and Other Share-Based Compensation	1058
H: Real Option Valuations	1080
I: Maximizing Shareholder Value	1088
Addendum 1—Rates of Return for Higher-Risk Companies	1095
CHAPTER 25	
Valuation of Healthcare Service Businesses	1097
Industry Background and Transition	1100
Healthcare Industry's Unique Attributes	1103
Overview of Considerations for Valuing Healthcare Entities	1115
Valuation Process	1116
Control Premiums and Minority Discounts	1122
Discounts for Lack of Marketability	1124
Valuation Issues for Specific Healthcare Industry Niches	1124
Public and Private Healthcare Services Companies by Niche	1133
Addendum 1—Valuation of Rocky Surgery Center, LP	1136
Addendum 2—Valuation of Paulie Hospital	1156
CHAPTER 26	4474
Special Industry Valuations	1171
A: Construction	1171
B: Radio	1184
C: Cable TV	1191 1202
D: Restaurants	1202
E: Bars and Nightclubs	1213
CHAPTER 27 Valuation Views and Controversial Issues: An Illustration	1217
The Report	1217
Introduction	1219
National Economic Outlook	1224
Regional Economic Data (as of December 8, 20X5)	1226
Local Economy	1227
Industry Outlook	1228
Financial Analysis of the Company	1229
Appraisal of Fair Market Value	1237
Lack of Marketability Discount	1259
Correlation of Values	1260
Total Conclusion of Value on a Marketable, Control Basis	1261
Inday	1983