

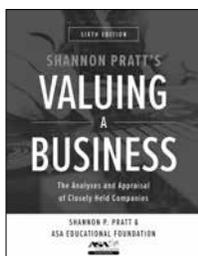
BUSINESS VALUATION UPDATE

TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

BOOK REVIEW:

Valuing a Business—The Analysis and Appraisal of Closely Held Companies, 6th Edition

By Harold G. Martin Jr., Keiter (Richmond, Va., USA)



Following Shannon Pratt's recent passing, many well-deserved tributes have been written regarding his contributions to the profession of business valuation, as well as more than a few personal anecdotes. I have my own story to share that illustrates Shannon's consideration of fellow appraisers and willingness to help others progress in their careers. In 2001, I presented for the first time at the AICPA National BV Conference in Las Vegas. The topic of my presentation was the cost of capital, and I introduced an iterative model for computing the weighted average cost of capital. Later on, I ran into Shannon in between sessions and introduced myself. I mentioned that I had read his first edition of *Cost of Capital* and asked whether he might be interested in reviewing the model I had developed. Shannon responded that, if I would forward him a draft after the conference, he would be pleased to review it. Now, at the time, I was in the early stage of my valuation career and Shannon was someone who many considered the "father" of the profession. Given our relative standing, I was unsure as to how he might receive my work. However, after reviewing my model, Shannon included it in the 2nd edition of *Cost of Capital*. Needless to say, I was completely overwhelmed as this was my first opportunity to contribute to a published text and, further, having my work included alongside Shannon's helped

jump-start my career in valuation. It also began a professional relationship that we maintained over the next 20 years. I have heard many other professionals share similar stories regarding Shannon's willingness to help them, too. I have never forgotten Shannon's consideration and have tried to emulate his generosity by "paying it forward" to others over the course of my own career. Given Shannon's contributions to the profession and what he has meant to many fellow appraisers, what better way to honor his memory than for the ASA Educational Foundation to oversee the publication of the new 6th edition of *Valuing a Business*?

Background and genesis of the new 6th edition.

Most practitioners are familiar with prior editions of Shannon's *Valuing a Business*. The first edition of the text, which was published in 1981, was the primary reference source for business appraisers at the time. Since then, four additional editions have been published, the most recent of which was the fifth edition in 2008. Many practitioners consider this text to be one of the most comprehensive treatises on the valuation of closely held businesses and is often cited in professional articles, journals, court cases, etc. However, given the evolution of valuation theory and applications, the issuance of new standards by professional organizations, etc., this edition was due for an update.

Enter the ASA Educational Foundation. Following Shannon's retirement, the ASA agreed to assume responsibility for publishing future

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editions of *Valuing a Business*. In preparing the new 6th edition, the ASA assembled some of the foremost practitioners in the business valuation profession as contributing authors and technical reviewers, as well as three of the most respected names in the profession to serve as editors: Jay E. Fishman of Financial Research Associates, Roger J. Grabowski of Kroll LLC, and Jeffrey S. Tarbell of Houlihan Lokey.

Purpose and intended audience. As with the prior editions, the new 6th edition is primarily designed to serve as a reference text for experienced business appraisers, an introductory text for beginning appraisers as well as academic and professional accreditation courses, and a guide for nonappraisers such as business executives and attorneys who use or evaluate business appraisals. The text is presented in a style similar to the earlier editions and is easy to read, well-organized, and illustrated with numerous exhibits and examples.

Consideration of differing schools of thought. As most appraisers are aware, there is consensus among the majority of appraisers in some areas in valuation. However, there are also alternative schools of thought in many other areas. The editors have considered this issue and, where there is consensus, have noted this. Where there are differing opinions, the editors have solicited input from a group of well-known and highly respected technical reviewers and presented alternative perspectives. Further, the courts also have issued differing opinions on certain valuation issues, and the editors have presented these opinions in the relevant chapters for consideration by the reader.

Updates and new information. The new 6th edition has been significantly expanded and includes substantive updates to the material presented in the prior edition, as well as new chapters presenting selected topics not previously discussed. The text is organized into eight parts with related material presented in each part. The following presents a summary of the

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more significant updates as well as the new material.

'Part I: State of the Profession, the Engagement and Basic Theory.' An updated discussion of the professional organizations that promulgate business valuation standards, including the ASA, AICPA, CBV, NACVA, and RICS, is presented in Part I.

'Part III: Business Valuation Approaches and Methods.' Discussion of the income approach and related discount rate has been significantly expanded. A new chapter that focuses on forecasting economic income has been added. The chapter includes discussion of forecasting revenues and expenses, as well as working capital, capital expenditures, depreciation, and debt for purposes of estimating net cash flow for the discrete forecast period and terminal period. Also included is a discussion of estimating long-term sustainable growth rates. The discussion of the discount rate has been presented in a stand-alone chapter and significantly expanded. This chapter presents estimation of the discount rates using alternative sources of empirical data, including CRSP data, as well as Kroll (formerly the Duff & Phelps) Cost of Capital Navigator data. In addition, there is new material presenting alternative adjustments to certain variables in the capital asset pricing model and buildup model, which Kroll advocates, such as a normalized risk-free rate and a conditional equity risk premium. Examples are provided that illustrate application of the different models and alternative data. The new material also includes a discussion of alternative models for levering and unlevering the beta based upon the assumed capital structure of the subject company.

The chapters on the market approach have been updated to include guidance on how to find guideline public companies using currently available online databases. Also included is an updated discussion of currently available transaction databases for use in applying the guideline transaction method.

'Part IV: Discounts, Premiums and the Value Conclusion.' The discussion of discounts for lack of control (DLOC) presents an updated assessment of the various degrees of control and the implications for quantifying the applicable discount for the subject interest being valued. In addition, the chapter on quantifying discounts for lack of marketability (DLOM) has been significantly expanded to include discussion of the new restricted stock studies and databases, such as the Stout Restricted Stock Study Database and DLOM Calculator, and alternative quantitative methods for estimating DLOMs, such as the Johnson/Park empirical method, nonmarketable investment company evaluation (NICE) method, and the DLOM Guide and Toolkit. Also presented is a discussion of alternative put option models (e.g., Chaffe, Longstaff, Finnerty, and Ghaidarov). Also included is an updated discussion of other entity-level discounts (e.g., discounts for built-in capital gain taxes) and shareholder-level discounts (e.g., nonvoting and voting stock).

'Part V: Writing and Reviewing Business Valuation Reports.' The sample business valuation report that many beginning appraisers use as a template has been updated to reflect changes in practice since the prior edition. In addition, the checklist for reviewing a business valuation report has been updated and expanded to include discussion of the minimum performance requirements for financial reporting. This section also includes a new chapter on the valuation of intangible assets that includes identification of the different types of intangible assets, reasons for valuing intangibles, and alternative valuation approaches for valuing intangible assets.

'Part VI: Valuing Specific Securities and Interests.' The valuation of specific securities and types of interests has been updated to include a new section on private promissory notes, as well as an expanded discussion on stock option pricing theory. Also included is an updated discussion on the tax affecting of pass-through entities, supported by related Tax Court cases.

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New chapters include the valuation of employee stock options, REITs, and other real property holding entities; real property with a business component; and complex capital structures focused on early-stage, venture capital-backed businesses supported by case studies.

'Part VII: Valuations for Specific Purposes.' Updated chapters include those for the valuation of gift, estate, and charitable contribution, as well as related Tax Court cases; buy-sell agreements; income tax purposes and related Tax Court cases; ESOPs and related court cases; shareholder and partner disputes and related court cases; marital dissolution, active versus passive appreciation, double dipping, enterprise versus personal goodwill, and related court cases; and financial reporting. New chapters include fairness opinions and solvency opinions.

Index and appendices. The index has been significantly expanded and the updated *International Glossary* published by the ASA, CBV Institute, RICS, and TAQEEM is included. A new online appendix is available to users that includes examples that were too voluminous for the printed text, updated data sources, and bibliographical references.

Summary. As an instructor for the AICPA National Business Valuation School for the past 14 years, one of the questions that students often ask me is what textbooks I would recommend for their valuation library. I have always included *Valuing a Business* on my short list as it presents

basic valuation concepts in an easy-to-understand manner for beginners, as well as discussion of more complex issues, including alternative schools of thought, for intermediate to advanced users. In addition, because the text was one of the very first treatises on business valuation and is widely known and recognized by both tax and civil courts, I often cite the text in my valuation reports to support my opinions. I am very pleased that the ASA Educational Foundation has elected to continue to oversee the publication of *Valuing a Business* for current as well as the next generation of business appraisers, and I highly recommend this text for all business appraisers.

Valuing a Business—The Analysis and Appraisal of Closely Held Companies, 6th edition, Shannon P. Pratt. Available from Business Valuation Resources, LLC, 111 SW Columbia St., Suite 750, Portland, OR 97201. 503-479-8200. bvresources.com. \$95, 1,248 pages including index, hardcover. ♦

Harold G. Martin, Jr., CPA/ABV/CFF, ASA, CFE, is partner-in-charge of Valuation and Forensic Services for Keiter in Richmond, Va., and an adjunct faculty member of The College of William and Mary Raymond A. Mason School of Business. He is a member of the AICPA Business Valuation Hall of Fame, co-author of *Financial Valuation: Applications and Models*, 1st, 2nd, 3rd, and 4th editions, a contributing author to *Cost of Capital: Estimation and Applications*, 2nd, 3rd, and 4th editions, and a member of the *Business Valuation Update* Editorial Board. He can be reached at hmartin@keitercpa.com.

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