

Fresh Approaches to the  
Business  
Valuation



Robert E. Blevans

Ronald S. Granberg

...or all about the

**BVE**

**“BVE” = Business Valuation Expert**

Don't just



LEAVE IT TO THE BVE

3

Warm Up



Purpose of  
Appraisal

4

## Warm Up



### Purpose

To determine a value to be used in division of CP

5

## Valuation Jeopardy



**Market Value  
for \$200**

**Investment Value  
for \$400**

**Asset Value  
for \$600**

6



## What is the Question?

1. **Market value**
2. **Investment Value**
3. **Asset Value**

7

**Market Value**

What could it be sold for?

**Investment Value**

What would I invest for this return?

**Asset Value**

What are the component assets worth?

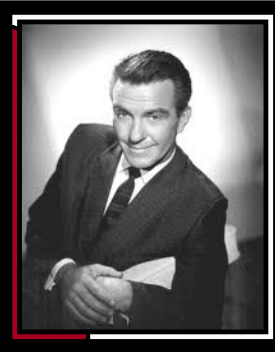
8

Guides for  
determining Value

*IRMO Lopez*

*IRMO Hewitson*

IRS Revenue Rulings  
59-60 & 68-609



*IRMO Lopez (1974)*  
38 Cal.App.3d 93:

Court must consider  
tangible assets, properly-  
aged accounts receivable,  
work in progress and “. . .  
goodwill of the practitioner  
in his law business as a  
**going concern.**”



Revenue Ruling 59-60  
is a wide-ranging  
business valuation  
touchstone.

(Revenue Rulings are  
not ordinarily  
mandatory authority.)



*IRMO Hewitson* (1983) 142  
Cal.App.3d 874, 887-888:

“Unless there is some  
statutory or decisional  
proscription on their use, the  
factors listed in Revenue  
Ruling 59-60 . . . should be  
consulted and used to  
evaluate closely held stock.”



Revenue Ruling 68-609 describes the “formula approach” in which normalized business earnings (reduced by a reasonable return on the value of the business’ tangible assets) are capitalized to determine goodwill.

13



Revenue Ruling 68-609: “The ‘formula’ approach may be used in determining the fair market value of intangible assets of a business only if there is no better basis available for making the determination.”

14

### Three areas for Cross-Examination:

1. Did BVE consider multiple approaches to value?
  - Did BVE properly determine Market Value?
  - Did BVE properly determine Investment Value?
  - Did BVE properly determine Asset Value using Excess Earnings?
2. Rev. Rul. 59-60 “other factors”
3. Organizations / Certifications

15

## The Ed Thomas principle of expert witness cross-examination



Don't do battle in the  
**expert's world . . .**  
. . . make the expert  
do battle in **your world.**

16



## Ed Thomas principle (preliminary steps)

Have BVE explain:

1. Tasks assigned
2. Steps taken
3. Conclusions reached

17

## Ed Thomas Q's

(in logical order)

1. What factors did you rely on?
2. What causes you to believe that Factor A is true?
3. If Factor A were not true, how would your opinion change?

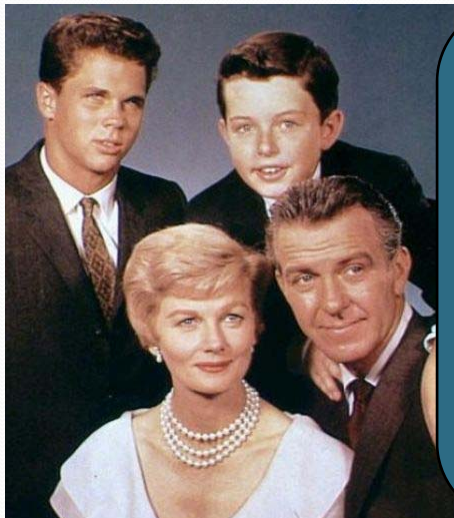
18

## Ed Thomas Q's

(in chronological order)

1. What factors did you rely on?
2. If Factor A were not true, how would your opinion change?
3. What causes you to believe that Factor A is true?

19



**The BVE  
and  
the Market  
Approach**

20

## Did the BVE Properly Evaluate and Apply the Market Approach?

### What is the Market Approach?

- Comparing sales of businesses similar to the subject business
- Much the same way single family residences are valued
- It tries to answer the question: “what could this business be sold for?”

21

## Did the BVE Properly Evaluate and Apply the Market Approach?



### What “Comps” did the BVE consider?

Private vs. Public?

Do “comps” even exist?

22

Did the BVE Properly Evaluate and Apply the Market Approach?

Did the BVE investigate the terms and circumstances of Comparable Sales?

- Arm's length
- Not a distressed sale

23

Did the BVE Properly Evaluate and Apply the Market Approach?

Did the BVE appropriately adjust the Comparable Sales?

1. For time of sale?
2. For size of company?
3. For control or minority interest?
4. For financing terms?

24

**Did the BVE Properly Evaluate and Apply the Multiplier Method of the Market Approach?**

Did the BVE use appropriate income flow?

Gross receipts, net income,  
net cash flow

Did the BVE use appropriate statistics?

Pratts Stats, Bizcomps,  
Institute of Business Appraisers

25



**The BVE  
and  
the  
Investment  
Approach**

26

Did the BVE Properly Evaluate and Apply the Investment Approach?

What is the Investment Approach?

- Applies to the entity as a whole
- How much would an investor pay for these earnings?
- Determine capitalization rate

**The risk factors are critical!**

27

Did the BVE Properly Evaluate and Apply the Investment Approach?

What should the BVE have done?

1. Determine appropriate **earnings**
2. Determine the appropriate **capitalization rate**

28

## Investment Approach: Step 1

1. Determination of earnings requires **normalization of earnings** (more on this later).

29

Should the following  
reduce earnings?

<b>Interest?</b>	<b>No</b>
<b>Taxes?</b>	<b>No</b>
<b>Depreciation?</b>	<b>No</b>
<b>Amortization?</b>	<b>No</b>

30

**The  
result is  
“EBITDA”:**

**Earnings  
Before  
Interest  
Taxes  
Depreciation  
Amortization**

31

## **Investment Approach: Step 2**

**2. The capitalization rate is determined with the buildup method.**

**(more on this later).**

32





## The BVE and the Asset Approach

33

The familiar “Excess Earnings Approach”  
is a Hybrid Approach

### Step 1

- Determine tangible assets’ values
- A “Market Approach”

### Step 2:

- Determine goodwill value
- An “Income Approach”

34



## Asset Approach Step 1

### Determining the values of TANGIBLE ASSETS

35

### Did the BVE Properly Evaluate and Apply the Asset Approach?

- Real estate appraisals  
(don't forget leaseholds!)
- Equipment – may need appraiser
- Accounts Receivable – Age/Tax Affect
- Inventory adjustments
- Intellectual property (discussed here  
although not “tangible”)

36



## Asset Approach Step 2

---

### Determining the **GOODWILL**

37

Did the BVE Properly Evaluate and  
Apply the Asset Approach?

What should the BVE have done?

1. Determine appropriate **excess earnings**
2. Determine the appropriate **capitalization rate**

38

## Which Spouse Wants **High** Reasonable Compensation?

	<b>In Spouse Wants</b>	<b>Out Spouse Wants</b>
Business Value	Low	High
<b>Excess Earnings</b>	<b>Low</b>	<b>High</b>
Reas Comp / Perks	<b>High</b>	Low

39

### Normalize Earnings by Adjusting for:

1. Non-recurring revenue
2. Non-recurring expenses
3. Reasonable Compensation/Perks
4. Depreciation
5. IRC Section 179
6. Inventory - COGS

40

## Five-factor cap rate build-up method

### *The Lawyer's Business Valuation Handbook*

by Shannon Pratt and  
Alina V. Niculita  
(see Chapter 8)



41

## Five-factor cap rate build-up method

The five factors:

- Risk-free rate
- Equity Risk Premium
- Size Premium
- Industry Risk Premium
- Specific Company Risk Adjustment

42

## Cap Rate Buildup Method

Equity Discount Rate  
= 16.4%

Specific Company  
Risk Adjustment 2.0%

Industry risk premium 0.3%

Size Premium 2.7%

Equity Risk Premium 7.1%

Risk-free Rate 4.3%

43

A Cap Rate is Simply the  
Inverse of a Multiplier

Multiplier	Inverse	Cap Rate
1	1/1	1
2	1/2	.5
3	1/3	.33
4	1/4	.25
5	1/5	.2

44

## Which Spouse Wants a **High** Multiplier? A **High** Cap Rate?

	In Spouse Wants	Out Spouse Wants
Multiplier	Low	<b>High</b>
Capitalization Rate	<b>High</b>	Low

45

### Evidence Code section 721(b):

... a witness testifying as an expert ... may not be cross-examined in regard to the content ... of any ... treatise ... or similar publication unless any of the following occurs:

- (1) The **witness referred to, considered, or relied upon** such publication in arriving at or forming his or her opinion.

46

**Evidence Code section 721(b):**

(2) The publication has been **admitted in evidence.**

(3) The publication has been **established as a reliable authority** by the testimony . . . of the witness or by other expert testimony or by judicial notice.

47



**The BVE  
and  
Revenue  
Ruling 59-  
60's "other  
factors"**

48



Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

Subparagraphs  
(a) through (h)  
in Rev. Rul.  
59-60



49

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)



(a) The nature of the business and the history of the enterprise from its inception.

50

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(b) The economic outlook in general and the condition and outlook of the specific industry in particular.



51

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(c) The book value of the stock and the financial condition of the business.



52

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(d) The earning capacity of the company.



53

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(e) The dividend-paying capacity.



54

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(f) Whether or not the enterprise has goodwill or other intangible value.



55

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(g) Sales of the stock and the size of the block of stock to be valued.



56

Did the BVE Properly consider the “other factors” of Rev. Rul. 59-60? (The Catchall)

(h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.

57



**The BVE's  
Organizations  
and  
Certifications**

58

Other Areas for Cross-Examination

The BVE's Organizations

The BVE's Certifications

SSVS 1 and USPAP  
Appraisal Standards

59

Different Certifications May Have Similar Names

Don't Confuse



The Beave



The Bieb

60

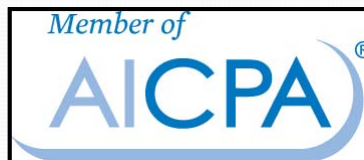
# Familiarize Yourself with:

The Four Certifying Organizations

The Twelve Certifications

61

## The Four Certifying Organizations:



62



<http://go-iba.org/>

1. **AIBA**--Accredited by IBA
2. **CBA**--Certified Business Appraiser
3. **MCBA**--Master Certified Business Appraiser
4. **FIBA**--Fellow of the Institute of Business Appraisers
5. **BVAL**--Business Valuator Accredited for Litigation.

63



6. **AM**--Accredited Member
7. **ASA**--Accredited Senior Appraiser
8. **FASA**--Fellow of the American Society of Appraisers

<http://www.appraisers.org>

64





National Association of Certified  
Valuators and Analysts

9. **AVA**--Accredited Valuation Analyst
10. **CVA**--Certified Valuation Analyst
11. **GVA**--Government Valuation Analyst

<http://nacva.org/>

65



12. **ABV**--Accredited in Business  
Valuation.

<http://www.aicpa.org>

66

## Ranking of Difficulty to Obtain

Difficulty	Designation
1 <sup>st</sup> (most difficult)	ASA
2 <sup>nd</sup>	CBA
3 <sup>rd</sup>	ABV
4 <sup>th</sup> (easiest)	CVA

Source: Spring 2002 Issue of "Business Appraisal Practice"  
<http://www.hydebvp.com/Explaining%20Alphabet%20Soup..pdf>

67

## Two Sets of Appraisal Standards

**"SSVS 1"  
for all CPAs\***

**"Statement on  
Standards for  
Valuation  
Services, No. 1"  
by the AICPA**

**"USPAP"  
for ASAs**

**"Uniform Standards  
of Professional  
Appraisal Practice"  
by the ASA  
Appraisal  
Standards Board**

\* Including ABVs

68



## Postscript:

Does Family Code section 771(a) prohibit a BVE's goodwill valuation from considering the business' future profitability?

69

Family Code section 771(a):  
“The earnings and accumulations of a spouse . . . while living separate and apart from the other spouse, are the separate property of the spouse.”

70

Don't just



LEAVE IT TO THE BVE

**DOES FAMILY CODE SECTION 771  
PROHIBIT A GOODWILL VALUATION  
FROM CONSIDERING THE BUSINESS'  
FUTURE PROFITABILITY?**

**Facts:**

Husband and Wife are divorcing. Husband will purchase Wife's half interest in the community property business that he operates. Husband wants a low business value, whereas Wife wants a high business value. The business' profitability has grown significantly in recent years, and Wife seeks to introduce evidence that this growth will continue in the future. Husband has filed a motion in limine to exclude evidence of future profitability.

**Arguments by Counsel:**

- Wife's Attorney:* Your Honor, Wife requests your findings regarding the value of the business take into consideration the likelihood that its profitability will increase substantially in the future.
- Husband's Attorney:* Husband objects to the introduction of such evidence on the ground that any consideration of it by the court would be improper.
- Wife's Attorney:* Business and Professions Code section 14100 defines business goodwill as "the expectation of continued public patronage."
- The court should recognize the undeniable facts that: a) future patronage means increased future profitability; and b) increased future profitability means increased current value.
- Husband's Attorney:* Business and Professions Code section 14100 doesn't apply to marital dissolutions. In fact, by its own terms Business and Professions Code section 14000 is limited to Business and Professions Code, Division 6. Business and Professions Code section 14000 is clearly inapplicable to a family law proceeding.
- Wife's Attorney:* If family court decisions are to be realistic, they must consider all of the valuation factors that business appraisers consider.
- Husband's Attorney:* If the valuation were to consider the business' future profitability, the court would be violating Family Code section 771(a), which provides: "The earnings and accumulations of a spouse . . . while living separate and apart from the other spouse, are the separate property of the spouse." Whatever my client does with the business in the future must inure to his sole benefit.

- Wife's Attorney:* An appraiser cannot determine an appropriate capitalization rate without considering the business' risk, and the appraiser cannot determine the business' risk without considering its future. A business with a bleak future is riskier and deserves a high cap rate (meaning a low value). On the other hand a business looking forward to rising profits, such as the subject business, deserves a low cap rate (meaning a high value).
- Husband's Attorney:* *In re Marriage of Lopez* (1974) 38 Cal.App.3d 93, 107-108, stated: “. . . in marital cases the expectancy of future earnings is not synonymous with, nor should it be the basis for, determining the value of ‘goodwill’ of a professional practice, but is simply a factor to consider in deciding if such an asset exists. [And, Your Honor, the following passage should be emphasized:] A community property interest can only be acquired during the marriage, and it would be inconsistent with that philosophy to assign value to the postmarital efforts of either spouse.”
- Wife's Attorney:* Counsel places emphasis on the quotation's second sentence. I place emphasis on the quotation's first sentence: “. . . in marital cases the expectancy of future earnings is . . . a factor to consider in deciding if [goodwill] exists.”
- Husband's Attorney:* *In re Marriage of Rives* (1982) 130 Cal.App.3d 138, 150, stated: “The potential income approach used by wife's expert witness was based entirely upon the expectation of future efforts of husband and as such was an improper means of valuing goodwill.”
- Wife's Attorney:* *Rives* doesn't apply here because, unlike the expert in *Rives*, our expert isn't basing her opinion of value “entirely upon the expectation of future efforts of” Husband. Our expert is basing her opinion only *partially* upon the expectation of future efforts of Husband.
- Husband's Attorney:* I cite *In re Marriage of King* (1983) 150 Cal.App.3d 304, 309: “The difficulty with wife's expert's methods of evaluating goodwill is that the future income . . . is the major and controlling factor in attaining the goodwill figure selected by such expert. [¶] The philosophy of the community property system is that a community interest can be acquired only during the time of the marriage. It would then be inconsistent with that philosophy to assign to any community interest the value of the postmarital efforts of either spouse. \* \* \* Since a community interest can only be acquired during the time of the marriage, the value of the goodwill must exist at the time of the dissolution and that value must be established without dependence on the potential or continuing net income of the professional spouse. (*In re Marriage of Fortier* [(1973) 34 Cal.App.3d 384, 387-388 [109 Cal.Rptr. 915].]; *In re Marriage of Foster* (1974) 42 Cal.App.3d 577, at p. 582 [117 Cal.Rptr. 49].)”
- Wife's Attorney:* *King* is also distinguishable. Unlike in *King*, future income isn't “the major and controlling factor in attaining the goodwill figure selected by” our expert. It is merely one of the many factors our expert used.

*Husband's Attorney:* *In re Marriage of Duncan* (2001) 90 Cal.App.4th 617, 633-634, stated: “. . . the court may not value business goodwill by ‘any method that takes into account the postmarital efforts of either spouse.’ [citing *King*] However, ‘a proper means of arriving at the value of such goodwill contemplates any legitimate method of evaluation that measures its present value by taking into account some past result.’ [citing *Foster*] In this regard, the value of goodwill existing at the time of marital dissolution is separate and apart from the expectation of the spouses' future earnings.”

*Wife's Attorney:* If counsel had read the remainder of the paragraph just quoted, counsel would have noted that *Duncan's* footnote 12 approves of the application of Business and Professions Code section 14100 to divorces, stating: “Valuing goodwill necessarily takes into consideration future income because the definition of ‘goodwill’ is ‘expectation of continued public patronage.’ [citing Bus. & Prof. Code, §14100 and *King*]”

*Husband's Attorney:* An analogy between valuation of a business and valuation of publicly-traded stock will illustrate the situation. As the court knows, Wife is being awarded 200 shares of community property Apple stock, which is currently trading at \$550 per share. How would Wife respond if Husband were to argue, “Your Honor, I request you value the Apple stock at \$1,000 per share, because Apple has announced that in the near future it release a new, highly-desirable product”? Wife would insist on the current \$550-per-share value and complain that a \$1,000-per-share value would both: a) be speculative, and b) violate Family Code section 2552(a)'s requirement that assets be valued “as near as practicable to the time of trial.” The Apple stock example illustrates the reason why postmarital profitability *cannot be considered* when a business value is determined.

*Wife's Attorney:* To the contrary, the example illustrates why postmarital profitability *must be considered* when a business value is determined. Stock analysts always consider the future. In counsel's Apple stock example, the marketplace's established \$550-per-share price is already based on the anticipated profitability of the upcoming product. The current price of a stock contemplates the business' future profitability, the same way the current value of a business must contemplate a business' future profitability. No one can assess the value of either type of asset while wearing blinders. Nobody buys the past. Everybody buys the future.

*The Court* Very well. The matter stands submitted.

**TOOLKIT**  
**Effective Cross-Examination Strategies**  
**for the Business Valuation Expert**

Robert E. Blevans  
Ronald S. Granberg

**Literature:**

*The Lawyer's Business Valuation Handbook: Understanding Financial Statements, Appraisal Reports and Expert Testimony, Second Edition*

by Shannon Pratt and Alina V. Niculita (\$208.71)

[http://www.amazon.com/Lawyers-Business-Valuation-Handbook-Understanding/dp/1604428031/ref=sr\\_1\\_16?s=books&ie=UTF8&qid=1356441054&sr=1-16&keywords=shannon+pratt](http://www.amazon.com/Lawyers-Business-Valuation-Handbook-Understanding/dp/1604428031/ref=sr_1_16?s=books&ie=UTF8&qid=1356441054&sr=1-16&keywords=shannon+pratt)

*Ibbotson SBBI Classic Yearbook 2012: Market Results for Stocks, Bonds, Bills, and Inflation 1926-2011 (SBBI Yearbook)*

by Morningstar (\$275.13)

[http://www.amazon.com/s/ref=nb\\_sb\\_ss\\_i\\_1\\_4?url=search-alias%3Dstripbooks&field-keywords=sbbi+valuation+edition+2012+yearbook&srefix=sbbi%2Cstripbooks%2C214](http://www.amazon.com/s/ref=nb_sb_ss_i_1_4?url=search-alias%3Dstripbooks&field-keywords=sbbi+valuation+edition+2012+yearbook&srefix=sbbi%2Cstripbooks%2C214)

*Standards of Value: Theory and Applications*

by Jay E. Fishman, Shannon P. Pratt and William J. Morrison (\$131.50)

[http://www.amazon.com/Standards-Value-Applications-Jay-Fishman/dp/0471694835/ref=sr\\_1\\_7?s=books&ie=UTF8&qid=1356441330&sr=1-7&keywords=shannon+pratt](http://www.amazon.com/Standards-Value-Applications-Jay-Fishman/dp/0471694835/ref=sr_1_7?s=books&ie=UTF8&qid=1356441330&sr=1-7&keywords=shannon+pratt)



*Uniform Standards of Professional Appraisal Practice (USPAP)*

by the ASA Appraisal Standards Board (\$75.00)

<http://www.appraisalfoundation.org/>

*Statement on Standards for Valuation Services (SSVS) 1: Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*

by AICPA (\$139.00)

[http://www.amazon.com/Statement-Standards-Valuation-Services-SSVS/dp/B002NSQT2U/ref=sr\\_1\\_3?s=books&ie=UTF8&qid=1356442353&sr=1-3&keywords=Statement+on+Standards+for+Valuation+Services](http://www.amazon.com/Statement-Standards-Valuation-Services-SSVS/dp/B002NSQT2U/ref=sr_1_3?s=books&ie=UTF8&qid=1356442353&sr=1-3&keywords=Statement+on+Standards+for+Valuation+Services)

### **Authorities:**

#### **Evidence Code section 721:**

(a) Subject to subdivision (b), a witness testifying as an expert may be cross-examined to the same extent as any other witness and, in addition, may be fully cross-examined as to (1) his or her qualifications, (2) the subject to which his or her expert testimony relates, and (3) the matter upon which his or her opinion is based and the reasons for his or her opinion.

(b) If a witness testifying as an expert testifies in the form of an opinion, he or she may not be cross-examined in regard to the content or tenor of any scientific, technical, or professional text, treatise, journal, or similar publication unless any of the following occurs:

(1) **The witness** referred to, considered, or **relied upon such publication** in arriving at or forming his or her opinion.

(2) The publication has been admitted in evidence.

(3) **The publication has been established as a reliable authority by the testimony or admission of the witness or by other expert testimony or by judicial notice.**

**Evidence Code section 801:**

If a witness is testifying as an **expert**, his **testimony** in the form of an opinion is **limited to such an opinion as is:**

(a) Related to a subject that is sufficiently beyond common experience that the opinion of an expert would assist the trier of fact; and

(b) **Based on matter** (including his special knowledge, skill, experience, training, and education) perceived by or personally known to the witness or made known to him at or before the hearing, **whether or not admissible that is of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates**, unless an expert is precluded by law from using such matter as a basis for his opinion.

**Evidence Code section 803:**

**The court** may, and **upon objection shall, exclude testimony in the form of an opinion that is based in whole or in significant part on matter that is not a proper basis for such an opinion.** In such case, the witness may, if there remains a proper basis for his opinion, then state his opinion after excluding from consideration the matter determined to be improper.

**Evidence Code section 816** (although this section specifically applies only to real estate appraisals – see Evidence Code section 811 – it may be cited as part of an argument by analogy):

**When relevant to the determination of the value of property, a witness may take into account as a basis for his opinion** the price and other terms and circumstances of **any sale or contract to sell and purchase comparable property** if the sale or contract was freely made in good faith within a reasonable time before or after the date of valuation. In order to be considered comparable, **the sale or contract must have been made sufficiently near in**

**time** to the date of valuation, and **the property sold must be located sufficiently near the property being valued, and must be sufficiently alike** in respect to character, size, situation, usability, and improvements, to make it clear that the property sold and the property being valued are comparable in value and that the price realized for the property sold may fairly be considered as shedding light on the value of the property being valued.

***Smith v. Workmen’s Compensation Appeals Board (1969) 71 Cal.2d 588, 593:***

[A]n expert’s opinion ... which assumes an incorrect legal theory cannot constitute substantial evidence....”

***Dozier v. Shaprio (2011) 19 Cal.App.4<sup>th</sup> 1509, 1519:***

After a witness has denied at his or her deposition having reached opinions on a particular subject, the defendant is entitled to rely on that disclaimer “until such time as appellant disclosed that [the expert] had conducted a further investigation and had reached additional opinions in a new area of inquiry.” (Kennemur v. State of California (1982) 133 Cal.App.3d 907, 920.) When counsel is not notified when the opposing party's expert witness formulates post-deposition opinions to be offered at trial, the witness is “in effect not made available for deposition as to the further opinions ....” (Jones v. Moore (2000) 80 Cal.App.4th 557, 565.) “ [T]he very purpose of the expert witness discovery statute is to give fair notice of what an expert will say at trial....’ ” “When an expert is permitted to testify at trial on a wholly undisclosed subject area, opposing parties ... lack a fair opportunity to prepare for cross-examination or rebuttal.” (Easterby v. Clark (2009) 171 Cal.App.4th 772, 780, quoting Bonds v. Roy (1999) 20 Cal.4th 140, 147)

## Sample Examination Questions

### 1. Definition of value:

- a. What definition of value did you use for the subject appraisal?
- b. What is the source of that definition of value?
- c. Why is that definition of value appropriate for the subject appraisal?

### 2. Expert's engagement:

- a. Describe in detail the development of your engagement, including initial contact engagement letter, description of assignment, all communications with counsel, all draft opinions, etc.
- b. What experience do you have appraising businesses in the subject industry?

### 3. Legal principles

- a. In your opinion, are any legal principles applicable to family law business appraisals?
- b. In your opinion, are any legal principles applicable to the subject appraisal?
- c. Did you apply any legal principles to the subject appraisal?
- d. Did you decide which legal principles to apply the subject appraisal, or did Opposing Counsel give you the legal principles to apply?
- e. [If expert decided which principles to apply]:
  - i. Name each principle you applied.
  - ii. Explain the manner in which you applied each principle.

- iii. Explain the reasons you decided that each applied principle represented current law.
  - iv. Explain the reasons you decided that each principle should be applied to the subject appraisal.
- f. [If Opposing Counsel decided which principles to apply]:
- i. Did Opposing Counsel provide you the legal principles in writing or orally?
    - 1. [If Opposing Counsel provided the principle in writing] Produce each such writing.
    - 2. [If Opposing Counsel provided the principle orally] State the contents of each conversation in which Opposing Counsel provided the principle.
- g. If orally: specify what Opposing Counsel told you.

**4. Approaches to value:**

- a. What approaches to value did you apply?
- b. Why did you apply those approaches?
- c. What approaches to value did you not apply?
- d. Why did you not apply those approaches?
- e. Does the subject company own any assets not needed to support its operations?
- f. If so, how did you treat those assets in your valuation?

**5. The income approach:**

- a. Did you use a discounting method or a capitalization method?
- b. What income variable did you choose to discount or capitalize?
- c. What is the definition of that income variable?
- d. Why is that income variable better than some other measure of income?
- e. Explain exactly how you calculated your equity discount rate.
- f. What sources did you use to determine the amount of the income variable that you capitalized?
- g. What steps did you take to determine that this amount of the income variable is a reasonable, normalized level of income?

**6. The market approach:**

- a. What sources did you use for selecting your guideline companies?
- b. Why did you use those sources?
- c. Why did you not use (e.g., Pratt's stats, BIZCOMPS or other references)?
- d. What adjustments, if any, did you make to the financial statements of the subject company for comparison with the guideline companies?
- e. What adjustments, if any, did you make to the financial statements of the guideline companies for comparison with the subject company?
- f. Why did you choose the particular valuation multiple (e.g., Market Value of Invested Capital/sales, Market Value of Invested Capital/EBITDA, price/earnings) that you used?
- g. Given the range of possible multiples, how did you choose this particular multiple for the subject company?

**7. The asset approach:**

- a. What assets/liabilities did you revalue?
- b. Why did you revalue them?
- c. What assets/liabilities did you not revalue?
- d. Why did you not revalue them?
- e. Did you bring any off-balance sheet-assets or liabilities onto the balance sheet?
- f. Why did you do that?
- g. Cash balances
  - i. Did you measure cash on the same date that you measured accounts receivable and accounts payable?
  - ii. Did you use reconciled cash balances?
- h. Inventory
  - i. What steps did you take to verify the amount of inventory?
  - ii. Is inventory included at cost, market value or book value?
- i. Accounts receivable
  - i. What collection efforts, if any, have been made?
  - ii. On what factors did you rely in aging the accounts receivable?
  - iii. Did you tax affect the accounts receivable?

**8. The excess earnings approach to goodwill:**

- a. What definition of earnings (e.g., net income, net cash flow) did you use?
- b. Why did you choose that definition of earnings?
- c. What definition of value did you use (e.g., fair market value or going concern value) for tangible assets?
- d. How did you calculate the market's rate of return on the net tangible assets?
- e. What items did you adjust in order to normalize earnings? For example, did you adjust:
  - i. Reasonable compensation?
    1. What standards did you use to determine reasonable compensation?
    2. On what information (e.g., industry data, recruiter/headhunter data, vocational evaluation) did you rely to determine reasonable compensation?
  - ii. Perks?
  - iii. Nonrecurring revenues?
  - iv. Nonrecurring expenses?
  - v. Above-market or below-market expenses?
- f. What factors did you rely on in determining the amount of each adjustment?



**9. Rules of thumb:**

- a. What is the source of your rule of thumb?
- b. Are you aware of any other sources of rules of thumb for this industry?
- c. What databases, if any, did you check to see whether actual transactions have taken place at the prices near this rule of thumb?
- d. Does your rule of thumb represent a cash value or a value on some sort of sale terms?

**10. Discounts and premiums:**

- a. Did your appraisal apply any discounts and/or premiums?
- b. Which discounts and/or premiums did you consider applicable to the subject appraisal?
- c. What factors did you rely upon to determine the amount of any discount or premium you applied?

**11. Reconciliation of valuation approaches:**

- a. What weight did you give to each approach in arriving at your opinion of value?
- b. What factors did you rely upon to weight each of the approaches in that manner?

**12. Financial statement adjustments:**

- a. Did you make any adjustments to the subject company's balance sheet?
- b. Did you make any adjustments to the subject company's income statement?
- c. Describe in detail each such adjustment.

**13. Industry analysis:**

- a. What data did you use to assess the current status of the relevant industry?
- b. What industry data, if any, did you consider particularly relevant to the subject appraisal?

**14. Circumstances of operating spouse:**

- a. How, if at all, would your appraisal be different if you assumed that the operating spouse has died?
- b. How, if at all, would your appraisal be different if you assumed that the operating spouse has retired?

**15. Limit expert's opinions to those disclosed during deposition**

- a. Have you now told me all of the opinions you formulated in connection with this case?
- b. Have you been asked to do any further work in this case?
- c. Other than trial testimony, do you anticipate doing any further work in this case?