


15 COMMON ERRORS IN VALUATIONS
And How to Effectively Deal with Cross-Examination Issues

MARCUM
ACCOUNTANTS ▲ ADVISORS

Presented by:
Sean Saari, CPA, ABV, CVA, MBA
Stefanie Jedra, CPA
Daniel Roche, CPA/ABV, ASA

marcumllp.com

Learning Objectives



After completing the session, participants will be able to...

- Identify common errors in valuations and their impact on value
- Understand how common errors in valuations should have been addressed
- Effectively cross-examine opposing experts on common errors in valuations

"In the long run, men hit only what they aim at." – Henry David Thoreau

MARCUM
ACCOUNTANTS ▲ ADVISORS

2
0914000N

Quote of the Day

"There is no such thing as an absolute value in this world. You can only estimate what a thing is worth to you."

Charles Dudley Warner 1829-1900, American Writer



A Quick Primer on Valuation

Three valuation approaches are required to be considered in every valuation analysis (each with its own commonly-used valuation methodologies)

- Asset approach
 - Adjusted Net Asset Method
- Income approach
 - Capitalization of Cash Flow/Earnings Method
 - Discounted Cash Flow Method
- Market approach
 - Guideline Transaction Method
 - Guideline Public Company Method



15 Common Valuation Errors

1. Confusing equity value and enterprise value
2. Failure to properly consider normalizing adjustments
3. Assuming net income = net cash flow
4. Reliance on reported historical cash flow
5. Unsustainable relationship of capital expenditures to depreciation
6. No consideration of net working capital requirements
7. Assuming reductions in debt into perpetuity
8. Failure to consider mid-period discounting
9. Unsupportable long-term growth rate
10. Not tax-affecting pass-through entities
11. No consideration of adjustments to guideline public company multiples
12. No consideration of market approach
13. Neglecting the impact of cash and debt
14. Improper reconciliation of valuation approaches
15. Misapplication of marketability discount studies

Confusing Equity Value and Enterprise Value

1

Equity Value = Value of Equity Ownership

Enterprise Value = Equity Value + Debt – Cash

Equity Value = Enterprise Value – Debt + Cash

If the income or market approach applied uses a pre-interest expense benefit stream (EBIT, EBITDA, Revenue, etc.) to determine value, it will typically produce an enterprise value, not an equity value.

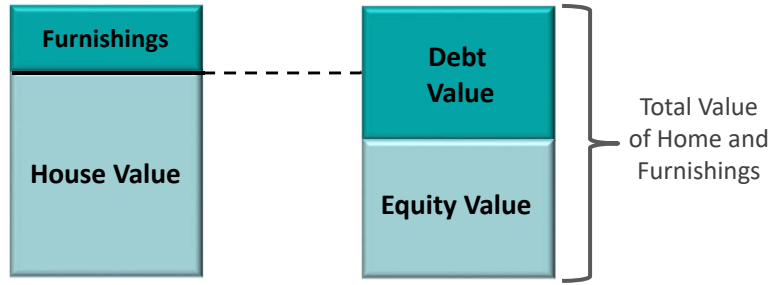
The market approach is often based on enterprise values expressed as a multiple of EBITDA or revenue, so adjustments must be made to the determined enterprise value to reach an equity value.

Misinterpreting an enterprise value as an equity value will often result in an inflated value.



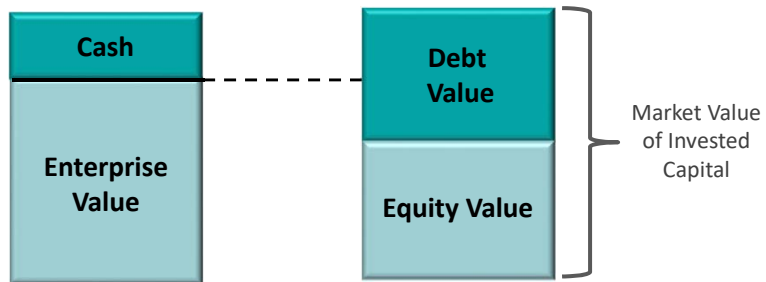
Confusing Equity Value and Enterprise Value

1 How the Value of Your Home is an Enterprise Value



Confusing Equity Value and Enterprise Value

1 Reconciling Equity Value to Enterprise Value



Failure to Properly Consider Normalizing Adjustments

2 Normalizing adjustments are made to a company's historical income statements for non-recurring or discretionary items in order to reflect the true underlying economics of the business.

Common normalizing adjustments include:

- Officer compensation (over or undercompensation)
- Personal/discretionary expenses
- Related-party transactions at amounts other than FMV
- Non-operating income or expenses
- Non-recurring income or expenses

Determining normalizing adjustments requires professional judgment. Failure to properly consider normalizing adjustments can lead to either overvaluation or undervaluation.

Assuming Net Income = Net Cash Flow

3 Capitalization/discounting of net income instead of net cash flow can lead to overvaluation.

Capitalization/discount rates are meant to be applied to net cash flow, not net income.

Net income does not consider the impact of:

- Capital expenditures
- Changes in net working capital
- Changes in interest-bearing debt



Assuming Net Income = Net Cash Flow

3

	<u>Net Income</u>	<u>Net Cash Flow</u>
After-tax Net Income	\$ 2,000,000	\$ 2,000,000
Cash Flow Adjustments		
<i>Depreciation</i>	-	100,000
<i>Capital expenditures</i>	-	(105,000)
<i>Change in Net Working Capital</i>	-	(150,000)
<i>Change in Interest-Bearing Debt</i>	-	-
Net Cash Flow	2,000,000	1,845,000
Times: (1+Long-Term Growth Rate)	105.0%	105.0%
Benefit Stream to be Capitalized	2,100,000	1,937,250
Divided By: Capitalization Rate	20.0%	20.0%
Indicated Value	<u>\$ 10,500,000</u>	<u>\$ 9,686,250</u>
Amount of Overvaluation		\$ 813,750
Overvaluation %		8.4%

Reliance on Reported Historical Cash Flow

4

Just as relying on reported income without normalizations can lead to inaccurate valuation conclusions, so can relying on reported changes in historical cash flow.

Single-year amounts for the following may not be representative of long-term annual expectations:

- Capital expenditures
- Changes in net working capital
- Changes in interest-bearing debt

The distorting impact is amplified further if a straight average historical weighting is not being utilized.

Reliance on Reported Historical Cash Flow

4

	Year 1	Year 2	Year 3	Year 4	Year 5
After-tax Net Income	\$ 1,600,000	\$ 1,700,000	\$ 1,800,000	\$ 1,900,000	\$ 2,000,000
Cash Flow Adjustments					
Depreciation	100,000	100,000	100,000	100,000	100,000
Capital expenditures	(100,000)	(100,000)	(50,000)	(50,000)	(300,000)
Change in Net Working Capital	(150,000)	(150,000)	(150,000)	(150,000)	(600,000)
Change in Interest-Bearing Debt	-	-	-	200,000	(200,000)
Net Cash Flow	\$ 1,450,000	\$ 1,550,000	\$ 1,700,000	\$ 2,000,000	\$ 1,000,000
Weighting	0.0	0.0	0.0	0.0	1.0

MARCUM
ACCOUNTANTS • ADVISORS

13

0914000N

Reliance on Reported Historical Cash Flow

4

	Reported Cash Flow	Normalized Cash Flow
After-tax Net Income	\$ 2,000,000	\$ 2,000,000
Cash Flow Adjustments		
Depreciation	100,000	100,000
Capital expenditures	(300,000)	(105,000)
Change in Net Working Capital	(600,000)	(150,000)
Change in Interest-Bearing Debt	(200,000)	-
Net Cash Flow	1,000,000	1,845,000
Times: (1+Long-Term Growth Rate)	105.0%	105.0%
Benefit Stream to be Capitalized	1,050,000	1,937,250
Divided By: Capitalization Rate	20.0%	20.0%
Indicated Value	\$ 5,250,000	\$ 9,686,250
Amount of Undervaluation		\$ (4,436,250)
Undervaluation %		(45.8%)

MARCUM
ACCOUNTANTS • ADVISORS

14

0914000N

Capital Expenditures and Depreciation

5 In a capitalization of cash flow analysis, or in the terminal year of a discounted cash flow analysis, projected capital expenditures and depreciation expense should be correlated.

In many cases, capital expenditures are projected to exceed depreciation by the long-term growth rate.

When there is not a supportable relationship between capital expenditures and depreciation expense, it will result in overvaluation or undervaluation.

Capital Expenditures and Depreciation

	<u>Reasonable Relationship</u>	<u>Excess Depreciation</u>	<u>Excess CapEx</u>
After-tax Net Income	\$ 2,000,000	\$ 2,000,000	\$ 2,000,000
Cash Flow Adjustments			
<i>Depreciation</i>	100,000	300,000	100,000
<i>Capital expenditures</i>	(105,000)	(105,000)	(300,000)
Change in Net Working Capital	(150,000)	(150,000)	(150,000)
Change in Interest-Bearing Debt	-	-	-
Net Cash Flow	1,845,000	2,045,000	1,650,000
Times: (1+Long-Term Growth Rate)	105.0%	105.0%	105.0%
Benefit Stream to be Capitalized	1,937,250	2,147,250	1,732,500
Divided By: Capitalization Rate	20.0%	20.0%	20.0%
Indicated Value	\$ 9,686,250	\$ 10,736,250	\$ 8,662,500
Amount of Overvaluation (Undervaluation)		\$ 1,050,000	\$ (2,073,750)
Overvaluation (Undervaluation) %		10.8%	(21.4%)

No Consideration of Net Working Capital Requirements

6 Ignoring required net working capital balances can result in either overvaluation or undervaluation depending on the specific of the company being valued and its net working capital balance as of the valuation date.

Accountants often think of net working capital as simply current assets minus current liabilities.

For valuation purposes, net working capital is typically calculated on a cash-free, debt-free basis (and also excludes current non-operating assets/liabilities).

No Consideration of Net Working Capital Requirements

6 Common issues seen in practice related to net working capital:

- Net working capital requirements are not considered at all
- Net working capital requirements are not based on historical company levels or those of comparable companies
- Excess (deficient) net working capital balance as of the valuation date is not considered

Best practices to consider:

- Calculate and consider the historical net working capital levels of the company being valued and of guideline companies (typically measured as a % of revenue)
- Set a required / target net working capital balance as of the valuation date from which excess (deficient) net working capital can be measured
 - This is standard practice in M&A transactions

No Consideration of Net Working Capital Requirements

6

	NWC Not Considered	NWC Considered
After-tax Net Income	\$ 2,000,000	\$ 2,000,000
Cash Flow Adjustments		
Depreciation	100,000	100,000
Capital expenditures	(105,000)	(105,000)
Change in Net Working Capital	-	(150,000)
Change in Interest-Bearing Debt	-	-
Net Cash Flow	1,995,000	1,845,000
Times: (1+Long-Term Growth Rate)	105.0%	105.0%
Benefit Stream to be Capitalized	2,094,750	1,937,250
Divided By: Capitalization Rate	20.0%	20.0%
Indicated Value Prior to Excess (Deficient) NWC	\$ 10,473,750	\$ 9,686,250
Less: Deficient Net Working Capital	-	(160,000)
Indicated Value	\$ 10,473,750	\$ 9,526,250
Amount of Overvaluation		\$ 947,500
Overvaluation %		9.8%

No Consideration of Net Working Capital Requirements

6

Historical Net Working Capital Summary										
	Year 1	%	Year 2	%	Year 3	%	Year 4	%	Year 5	%
Revenue	\$ 9,000,000	100.0%	\$ 11,000,000	100.0%	\$ 10,500,000	100.0%	\$ 11,000,000	100.0%	\$ 12,500,000	100.0%
Current Assets										
Cash	n/a		n/a		n/a		n/a		n/a	
Accounts Receivable	2,425,332		2,185,664		2,898,745		3,185,241		3,281,563	
Inventories	314,252		430,214		258,277		254,100		265,992	
Total Current Assets	2,739,584		2,615,878		3,157,022		3,439,341		3,547,555	
Current Liabilities										
Accounts Payable	268,286		382,344		383,726		407,368		519,915	
Line of Credit	n/a		n/a		n/a		n/a		n/a	
Current Portion of Notes Payable	n/a		n/a		n/a		n/a		n/a	
Accrued Expenses	78,629		95,431		134,473		120,477		62,618	
Total Current Liabilities	346,915		477,775		518,199		527,845		582,533	
Net Working Capital ("NWC")	\$ 2,392,669	26.6%	\$ 2,138,103	19.4%	\$ 2,638,823	25.1%	\$ 2,911,496	26.5%	\$ 2,965,022	23.7%
NWC (5-Year Average)		24.3%								
NWC (5-Year Median)		25.1%								

No Consideration of Net Working Capital Requirements

6

Required Net Working Capital as of Valuation Date	
Weighted Average Revenue	\$ 12,500,000
Times: Projected NWC as a % of Revenue	25.0%
Required NWC as of Valuation Date	\$ 3,125,000
Actual NWC as of Valuation Date	\$ 2,965,022
Less: Required NWC as of Valuation Date	(3,125,000)
Indicated NWC Surplus/(Deficit)	\$ (159,978)
NWC Surplus/(Deficit) (Rounded)	\$ (160,000)
Projected Annual Change in Net Working Capital	
Weighted Average Revenue	\$ 12,500,000
Divided by: (1 + Long-Term Growth Rate)	105.0%
Revenue for Change in NWC Calculation	11,904,762
Multiplied by: Projected NWC as a % of Revenue	25.0%
Implied NWC Required at End of Year Prior to Valuation Date	2,976,191
Less: NWC Required as of Valuation Date	(3,125,000)
Projected Annual (Investment) Reduction in NWC	\$ (148,809)
Projected Annual (Investment) Reduction in NWC (Rounded)	\$ (150,000)

MARCUM
ACCOUNTANTS • ADVISORS

21

0914000N

Assuming Debt Reductions in Perpetuity

7

If a capitalization of earnings / cash flow method is being applied, debt should not be projected to decline in perpetuity – eventually it will be paid off.

Assuming debt reductions into perpetuity will result in an undervaluation of the business.

If future repayments of debt are expected, they are typically more accurately modeled as follows:

- The application of a discounted cash flow analysis that can incorporate projections until the point that the debt balance is repaid or stabilizes
- The application of a debt-free income approach in which an enterprise value of the company is determined, from which the current debt balance can be subtracted to reach an equity value

MARCUM
ACCOUNTANTS • ADVISORS

22

0914000N

Assuming Debt Reductions in Perpetuity

7

	Year 1	Year 2	Year 3	Year 4	Year 5
After-tax Net Income	\$ 2,100,000	\$ 2,205,000	\$ 2,315,250	\$ 2,431,013	\$ 2,552,564
Cash Flow Adjustments					
Depreciation	105,000	110,250	115,763	121,551	127,629
Capital expenditures	(110,250)	(115,763)	(121,551)	(127,629)	(134,010)
Change in Net Working Capital	(157,500)	(165,375)	(173,644)	(182,326)	(191,442)
Change in Interest-Bearing Debt	(500,000)	(500,000)	(500,000)	(500,000)	-
Net Cash Flow	1,437,250	1,534,112	1,635,818	1,742,609	2,354,741
Present Value Calculation					
Number of Years in PV Factor	0.5	1.5	2.5	3.5	4.5
PV Factor (25% Discount Rate)	0.8944	0.7155	0.5724	0.4579	0.3664
Present Value of Cash Flow	\$ 1,285,515	\$ 1,097,721	\$ 936,397	\$ 798,022	\$ 862,677

Indicated Value	
Sum of Present Value of Cash Flow	\$ 4,980,332
Terminal Value	4,529,053
Indicated Value (End-of-Period)	\$ 9,509,385

Terminal Value	
Year 5 Cash Flow	\$ 2,354,741
x Growth Factor	105.0%
Available Cash Flow	2,472,478
x Residual Multiple	5.00
	12,362,390
x PV Factor	0.3664
= Residual Value	4,529,053

Assuming Debt Reductions in Perpetuity

7

	Debt Repayments In Perpetuity	Appropriate Debt Changes
After-tax Net Income	\$ 2,000,000	
Cash Flow Adjustments		
Depreciation	100,000	
Capital expenditures	(105,000)	
Change in Net Working Capital	(150,000)	
Change in Interest-Bearing Debt	(500,000)	
Net Cash Flow	1,345,000	
Times: (1+Long-Term Growth Rate)	105.0%	
Benefit Stream to be Capitalized	1,412,250	
Divided By: Capitalization Rate	20.0%	
Times: Mid-Period Adjustment Factor	111.8%	
Indicated Value	\$ 7,894,478	\$ 9,509,385
Amount of Undervaluation		\$ (1,614,907)
Undervaluation %		(17.0%)

Failure to Consider Mid-Period Discounting

8 Sometimes, valuation experts will utilize end-of-period discounting in discounted cash flow analyses, which typically leads to undervaluation.

Companies do not receive cash flow only on the last day of the year (as indicated by end-of-period discounting).

Mid-period discounting reflects the fact that cash flow is typically generated relatively evenly throughout the year.



Failure to Consider Mid-Period Discounting

8

End-of-Period	Year 1	Year 2	Year 3	Year 4	Year 5
After-tax Net Income	\$ 2,100,000	\$ 2,205,000	\$ 2,315,250	\$ 2,431,013	\$ 2,552,564
Cash Flow Adjustments					
Depreciation	105,000	110,250	115,763	121,551	127,629
Capital expenditures	(110,250)	(115,763)	(121,551)	(127,629)	(134,010)
Change in Net Working Capital	(157,500)	(165,375)	(173,644)	(182,326)	(191,442)
Change in Interest-Bearing Debt	-	-	-	-	-
Net Cash Flow	1,937,250	2,034,112	2,135,818	2,242,609	2,354,741

Present Value Calculation					
Number of Years in PV Factor	1.0	2.0	3.0	4.0	5.0
PV Factor (25% Discount Rate)	0.8000	0.6400	0.5120	0.4096	0.3277
Present Value of Cash Flow	\$ 1,549,800	\$ 1,301,832	\$ 1,093,539	\$ 918,573	\$ 771,602

Indicated Value	
Sum of Present Value of Cash Flow	\$ 5,635,346
Terminal Value	4,050,908
Indicated Value (End-of-Period)	\$ 9,686,254

Terminal Value	
Year 5 Cash Flow	\$ 2,354,741
x Growth Factor	105.0%
Available Cash Flow	2,472,478
x Residual Multiple	5.00
	12,362,390
x PV Factor	0.3277
= Residual Value	4,050,908

Failure to Consider Mid-Period Discounting

8

Mid-Period	Year 1	Year 2	Year 3	Year 4	Year 5
After-tax Net Income	\$ 2,100,000	\$ 2,205,000	\$ 2,315,250	\$ 2,431,013	\$ 2,552,564
Cash Flow Adjustments					
Depreciation	105,000	110,250	115,763	121,551	127,629
Capital expenditures	(110,250)	(115,763)	(121,551)	(127,629)	(134,010)
Change in Net Working Capital	(157,500)	(165,375)	(173,644)	(182,326)	(191,442)
Change in Interest-Bearing Debt	-	-	-	-	-
Net Cash Flow	1,937,250	2,034,112	2,135,818	2,242,609	2,354,741

Present Value Calculation					
Number of Years in PV Factor	0.5	1.5	2.5	3.5	4.5
PV Factor (25% Discount Rate)	0.8944	0.7155	0.5724	0.4579	0.3664
Present Value of Cash Flow	\$ 1,732,729	\$ 1,455,492	\$ 1,222,614	\$ 1,026,995	\$ 862,677

Indicated Value	
Sum of Present Value of Cash Flow	\$ 6,300,507
Terminal Value	4,529,053
Indicated Value (Mid-Period)	\$ 10,829,560

Terminal Value	
Year 5 Cash Flow	\$ 2,354,741
x Growth Factor	105.0%
Available Cash Flow	2,472,478
x Residual Multiple	5.00
	12,362,390
x PV Factor	0.3664
= Residual Value	4,529,053

End-Of-Period vs. Mid-Period Comparison	
Indicated Value (Mid-Period)	\$ 10,829,560
Indicated Value (End-Of-Period)	9,686,254
Amount of Undervaluation	\$ 1,143,306
Undervaluation %	10.6%

Unsupportable Long-Term Growth Rate

9

The long-term growth rate used in the income approach can have a material impact on value.

Long-term growth rates typically should not exceed 5%-6%:

- 2%-3% Inflation
- 2%-3% Real GDP growth

Long-term growth rates in excess of 5%-6% imply that the company will actually grow to be larger than the economy as a whole into perpetuity, which is not supportable and results in overvaluation.



Unsupportable Long-Term Growth Rate

9

	<u>Reasonable Growth Rate</u>	<u>Inflated Growth Rate</u>
After-tax Net Income	\$ 2,000,000	\$ 2,000,000
Cash Flow Adjustments		
Depreciation	100,000	100,000
Capital expenditures	(105,000)	(105,000)
Change in Net Working Capital	(150,000)	(150,000)
Change in Interest-Bearing Debt	-	-
Net Cash Flow	1,845,000	1,845,000
<i>Times: (1+Long-Term Growth Rate)</i>	<i>105.0%</i>	<i>110.0%</i>
Benefit Stream to be Capitalized	1,937,250	2,029,500
<i>Divided By: Capitalization Rate</i>	<i>20.0%</i>	<i>15.0%</i>
Indicated Value	<u>\$ 9,686,250</u>	<u>\$ 13,530,000</u>
Amount of Overvaluation		\$ 3,843,750
Overvaluation %		39.7%

Not Tax-Affecting Pass-through Entities

10

Although pass-through entities (LLCs, S Corps, Partnerships) do not pay income taxes at the company level, income taxes are still levied on the company's earnings - just at the owner level

The data used to support the discount rate utilized in the income approach is based on after-tax cash flow



Not Tax-Affecting Pass-through Entities

10 Typically, distributions are made to at least cover the owners' flow-through tax liability, similar to a C corporation paying taxes at the entity level.

If the impact of income taxes is not considered for pass-through entities, it will result in a significant overvaluation.

Not Tax-Affecting Pass-through Entities

	Tax Affecting	No Tax Affecting
Pre-tax Net Income	\$ 2,666,667	\$ 2,666,667
Income Taxes (25%)	(666,667)	-
After-tax Net Income	2,000,000	2,666,667
Cash Flow Adjustments		
Depreciation	100,000	100,000
Capital expenditures	(105,000)	(105,000)
Change in Net Working Capital	(150,000)	(150,000)
Change in Interest-Bearing Debt	-	-
Net Cash Flow	1,845,000	2,511,667
Times: (1+Long-Term Growth Rate)	105.0%	105.0%
Benefit Stream to be Capitalized	1,937,250	2,637,250
Divided By: Capitalization Rate	20.0%	20.0%
Indicated Value	\$ 9,686,250	\$ 13,186,250
Amount of Overvaluation		\$ 3,500,000
Overvaluation %		36.1%

No Guideline Public Company Multiple Adjustments

11

Guideline public companies are often significantly larger and less risky than the subject company being valued.

It is important to consider adjustments to the guideline public company multiples for differences in size, risk and projected growth rates compared to the company being valued.

If adjustments are not made to the guideline public company multiples, there is a significant likelihood of overvaluation.

No Consideration of Market Approach

12

Within the market approach there are two methods that are typically used

- Guideline transaction method
- Guideline public company method

Valuation analysts may indicate that the market approach is not applicable in an engagement for a handful of reasons

- “Too few comparable transactions/public companies”
- “The transactions/public companies identified in the industry are not comparable to the company being valued”
 - “The guideline public companies are too large compared to the company being valued”

No Consideration of Market Approach

12

Some valuation analysts do not use the market approach because they do not know how to apply the approach or do not have access to the requisite data (it can be expensive for subscriptions to the necessary databases).

In many cases the market approach can be applied, even if it is simply as a cross-check if the available data is not robust.

If the market approach is not applied, there is no check on the income approach value, so it leaves more opportunity for manipulation of the concluded value.

Sometimes the market approach really cannot be applied, but this should be the exception rather than the rule.

No Consideration of Market Approach

12

Debunking excuses for not applying the market approach:

- “Too few comparable transactions/public companies”
 - The following data sources are often relied upon to provide the data necessary to apply the market approach:
 - Pratt’s Stats
 - Mergerstat
 - Pitchbook
 - Capital IQ
 - Fetch XL
- We have been involved in engagements in which opposing experts say that there are no comparable transactions, but we found in excess of 400 transactions to use in the market approach

No Consideration of Market Approach

12

Debunking excuses for not applying the market approach:

- “The transactions/public companies identified in the industry are not comparable to the company being valued.”
 - There is no “exact” comp; the market approach calls for an analysis of multiples for the industry in general
- “The guideline public companies are too large compared to the company being valued”
 - Guideline public company multiples can be adjusted for differences in size and risk compared to the company being valued (see #11)

Neglecting the Impact of Cash and Debt

13

While many valuation experts look closely for potential non-operating assets or liabilities, they sometimes fail to account for the impact of a company’s cash and debt.

Income and market approaches do not typically explicitly take into account a company’s cash or debt balances unless adjustments for them are made:

- If an income-based approach indicates a value of \$10,000,000 before debt is taken into account, we would expect arrive at different equity values if the company has (1) no debt; (2) \$2,000,000 of debt; (3) \$10,000,000 of debt; or (4) some other amount of debt

Failing to account for a company’s cash and debt balances can lead to either overvaluation or undervaluation depending on the net balance of the two items.

Improper Reconciliation of Valuation Approaches

14

Value conclusions are typically more supportable when the values indicated by both the income and market approach are consistent.



It is typically not appropriate to give weight to an asset approach value if both the income and market approach values are higher.

Giving weight to the asset approach when the income and market approach values are higher will result in undervaluation.

The reconciliation process requires professional judgment.

Improper Reconciliation of Valuation Approaches

14

Inclusion of Asset Approach in Weighting				
	Adjusted Net Asset Method	Capitalization of Cash Flow Method	Guideline Transaction Method	Guideline Public Company Method
Value of the Company's Equity	\$ 5,000,000	\$ 55,000,000	\$ 45,000,000	\$ 60,000,000
Weighting	25.0%	25.0%	25.0%	25.0%
Weighted-Average Value of the Company's Equity	\$ 41,250,000			

Exclusion of Asset Approach in Weighting				
	Adjusted Net Asset Method	Capitalization of Cash Flow Method	Guideline Transaction Method	Guideline Public Company Method
Value of the Company's Equity	\$ 5,000,000	\$ 55,000,000	\$ 45,000,000	\$ 60,000,000
Weighting	0.0%	50.0%	25.0%	25.0%
Weighted-Average Value of the Company's Equity	\$ 53,750,000			

Inclusion vs. Exclusion of Asset Approach Value Comparison	
Indicated Value (Including Asset Approach Weighting)	\$ 41,250,000
Indicated Value (Excluding Asset Approach Weighting)	\$ 53,750,000
Amount of Undervaluation	\$ (12,500,000)
Undervaluation %	(23.3%)

Misapplication of Marketability Discount Studies

15

Restricted stock and pre-IPO studies are often used to support lack of marketability discounts for non-controlling, non-marketable ownership interests.

The level of control impacts the applicable lack of marketability discount.

Using the restricted stock and pre-IPO studies to support a marketability discount for a controlling ownership interest is inappropriate/unsupported and will result in an undervaluation of the ownership interest.

If a lack of marketability discount is being applied to a controlling ownership interest, it is often supported by cost of flotation studies.

MARCUM
ACCOUNTANTS • ADVISORS

41

0914000N

Profitability Not Considered in Applying Revenue Multiples

B

In applying revenue multiples, it is important to take into account the profitability of the subject company in relation to the guideline companies.

O

A company that turns \$100 of revenue into \$20 of EBITDA should be worth more than one that turns that same \$100 of revenue into \$10 of EBITDA (all else being equal).

N

Blindly applying a median/average revenue multiple if the subject company is more/less profitable than the guideline companies (and has similar risks) will result in a skewed valuation conclusion:

U

- Overvaluation when the subject company is less profitable than the norm
- Undervaluation when the subject company is more profitable than the norm

S

MARCUM
ACCOUNTANTS • ADVISORS

42

0914000N

Summing It Up

After completing the session, participants will be able to...

- Identify common errors in valuations and their impact on value
- Understand how common errors in valuations should have been addressed
- Effectively cross-examine opposing experts on common errors in valuations



MARCUM
ACCOUNTANTS • ADVISORS

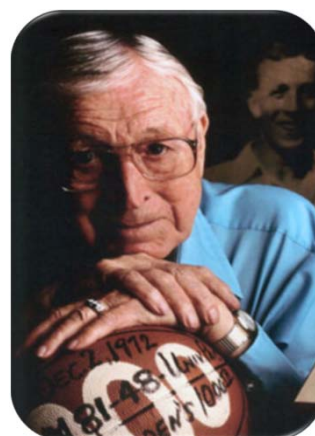
43

0914000N

Closing Quote

“It’s the little details that are vital. Little things make big things happen.”

– John Wooden



MARCUM
ACCOUNTANTS • ADVISORS

44

0914000N

Sean R. Saari, CPA/ABV, CVA, MBA

Partner – Valuation and Litigation Support

Sean Saari is a partner in the Advisory Services group. He helps clients address their valuation, litigation support, tax, financial reporting, strategic planning and business advisory needs.

Mr. Saari assists valuation and litigation support clients by developing credible and defensible analyses and he has testified as a financial and valuation expert numerous times. He has a practice concentrated in the areas of business valuations, litigation advisory services, domestic disputes, shareholder disputes, financial reporting, complex damages analysis and modeling, strategic planning, succession and estate planning, and mergers and acquisitions.

On the business advisory side, Mr. Saari helps clients proactively manage their businesses to plan and prepare for growth while staying on top of their tax and accounting compliance requirements. He is a frequent author and speaker on valuation, litigation advisory, business management and other financial topics.

Professional & Civic Affiliations

American Institute of Certified Public Accountants (AICPA)
 - ABV Exam Review Task Force, 2010
 Ohio Society of Certified Public Accountants (OSCPA)
 National Association of Certified Valuators and Analysts (NACVA)
 - Mentor Support Group, 2018 – Present
 - QuickRead Editorial Board, 2018 – Present

sean.saari@marcumllp.com ■ Phone 440.459.5865

MARCUM
ACCOUNTANTS • ADVISORS



SUBJECT MATTER

EXPERTISE

Business Valuations
 Litigation Advisory Services
 Domestic Disputes
 Shareholder Disputes
 Financial Reporting
 Complex Damage Analysis & Modeling

EDUCATION

Master of Business
 Administration with Honors
 Case Western Reserve
 University

Bachelor of Business
 Administration with Honors
 University of Notre Dame

45

0914000N

Stefanie A. Jedra, CPA

Senior Manager – Valuation and Litigation Support

Stefanie Jedra is a senior manager in the Firm's Advisory Services practice and works primarily out of Marcum's New York City and New Jersey offices. She appraises business interests and provides litigation support for a wide variety of clientele. Ms. Jedra's experience includes appraising companies/business interests for litigation (family law, commercial litigation, bankruptcy litigation) and non-litigation (estate and gift/tax/financial reporting) purposes.

Ms. Jedra joined Marcum in 2018 with over 6 years of experience in the industry. Her previous experience was primarily in business valuation, forensic litigation support, business interruption analyses, and other public accounting services. Ms. Jedra is a Certified Public Accountant licensed in New York and is a candidate for the Accredited Member ("AM") designation from the American Society of Appraisers.

Ms. Jedra graduated from Bucknell University with a Bachelor of Science degree in Business Administration in 2012, with a concentration in accounting and a minor in economics.

Professional & Civic Affiliations

New York Society of Certified Public Accountants (NYSCPA)
 American Institute of Certified Public Accountants (AICPA)
 American Society of Appraisers (ASA), New York City Chapter
 Secretary (July 2020 - Current)
 Vice President of Marketing (July 2019 – June 2020)

stefanie.jedra@marcumllp.com ■ Phone 973.646.3814

MARCUM
ACCOUNTANTS • ADVISORS



SUBJECT MATTER EXPERTISE

Business Valuation
 Litigation Support Services
 Forensic Investigations

EDUCATION

Bachelors of Science,
 Business Administration
 (Accounting Concentration)
 Bucknell University

46

0914000N

Daniel R. Roche, CPA/ABV, ASA
Partner – Valuation and Litigation Support

Daniel Roche is a partner and the National Business Valuation Service Line Leader for Marcum, LLP. He appraises business interests and provides litigation support for a wide variety clientele. Mr. Roche’s experience includes appraising companies and providing litigation support for family law matters and commercial litigation matters as well as non-litigation (estate and gift tax/financial reporting) purposes.

Mr. Roche joined Marcum in 2005 is a frequent presenter on business valuation topics, both within Marcum and externally at continuing legal education seminars. Mr. Roche holds the Accredited Senior Appraiser (“ASA”) designation from the American Society of Appraisers. He is also a Certified Public Accountant licensed in New Jersey and holds the Accredited in Business Valuation (“ABV”) credential from the American Institute of Certified Public Accountants.

Mr. Roche graduated Monmouth University with a Bachelor of Science degree in Business Administration (economics concentration) in 1999, and received his MBA from Rutgers University (finance concentration) in 2009. His education in economics and finance helps Dan provide unique insight in valuation and forensic engagements.

Professional & Civic Affiliations

American Society of Appraisers (ASA), National, Report Review Committee
 American Society of Appraisers (ASA), Northern New Jersey Chapter, Past President
 American Institute of Certified Public Accountants (AICPA)
 New Jersey Society of Certified Public Accountants (NJSCPA)

daniel.roche@marcumllp.com ■ Phone 973.646.3815



SUBJECT MATTER EXPERTISE

Business Valuation
 Family Law Litigation Support
 Intangible Asset Valuation
 Litigation Support Services
 Forensic Investigations

EDUCATION

Master of Business Administration, Finance
 Rutgers University

Bachelor of Science, Business Administration (Economics Concentration)
 Monmouth University



Questions?

