BVR
What It's Worth
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BUSINESS VALUATION UPDATE
TIMELY NEWS, ANALYSIS, AND RESOURCES FOR DEFENSIBLE VALUATIONS

What to Know From the 2023 ASA International Conference

A big turnout—about 600 appraisers (which included 150 online)—from all disciplines attended the 2023 American Society of Appraisers International Conference recently in New Orleans. This was a hybrid event (on-site and online), but, at all the sessions we attended, speakers were live and on-site. Here are some big-picture highlights, and there is more detailed coverage of certain sessions in this issue and in the November issue of *Business Valuation Update*. These briefs are from just some of the many sessions we attended, and we'll have more coverage in future issues.

ASA matters. Johnny White, ASA CEO, welcomed the group and gave an update on ASA matters, including a focus on the organization's strategic plan, which is built around three "pillars": (1) membership; (2) education; and (3) branding. There is a new public relations campaign to spur membership, particularly among younger practitioners. Educational content has been increased with the addition of more on-demand learning and specialty conferences (such as on ESOPs, litigation, fair value, and more). The ongoing PR campaign is also focusing on elevating the ASA brand in the appraisal profession (e.g., brand logos have been sent to all members). White also reminded the crowd that student membership in the ASA is free, and he urged members to visit their alma maters to promote the profession. He also congratulated the current crop of "Rising Stars" (see the sidebar).

Take risks. A fabulous keynote by Nick Talbot, CEO of the International Valuation Standards Council (IVSC), told of how he got through a few near-death experiences, including being on Mount Everest in an avalanche. It was a humorous but motivating take on living a "life less usual" (he was born with cystic fibrosis and had a life expectancy of 16 years). His bottom-line message: Set one outlandish goal, and go for it. Don't be afraid to take risks, and always keep improving your thinking.

Along those lines, we point out a recent new book, *The Art of Valuation,* which is a wonderful collection of essays by top veteran experts from overlapping valuation disciplines who tell stories that go beyond the technical issues and get into the heart of appraisal. In essence, the stories inspire practitioners always to strive to improve their thinking about valuation to elevate their own work and the profession as a whole. BVR had the book at its booth in the exhibit hall, but we do not offer it—it is available from The Appraisal Foundation (see the footnote for a link).[1]

Challenge the data. During times of uncertainty, analysts should challenge the data they are using, advised Carla Nunes and Jim Harrington, both with Kroll, during their session on valuations amid high inflation. They discussed current economic conditions and provided some latest

1 appraisalfoundation.org/imis/ItemDetail?iProductCode=475&Category=PUB&WebsiteKey=e12b6085-ff54-45c1-853e-b838ca4b9895.

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estimates for key inputs that analysts can consider using in their valuations. No matter what data you use, use the data to develop your own opinion—and take a step back and make sure that your overall assumptions make sense. For instance, during the height of COVID-19, some data pointed to a cost of equity that was lower than prepandemic levels—which did not make sense (see the article on their session in this issue for more details).

Kroll has not changed its recommended U.S. equity risk premium (ERP), which stands at 5.5%, when developing USD-denominated discount rates as of June 8, 2023. This is matched with the higher of a "normalized" risk-free rate of 3.5% or the spot 20-year U.S. Treasury yield as of the valuation date. Currently, the spot rate is definitely higher, so that's the rate to use for now, the speakers said.

Divorce tips. There was a large crowd at a session on valuation issues in marital dissolution cases. This is understandable because the speakers were two well-known veteran valuation experts, Jay E. Fishman (Financial Research Associates) and Ken Pia (Marcum), as well as an experienced family law attorney Michael Mosberg (Mosberg Sharma Stambleck Gross). One key point they made was to assume all valuations will end up in litigation, so watch your emails (even internal ones)—they are the items most frequently asked for during discovery. Based on common errors they see experts make, they offered some other good pieces of advice:

- Preparation for trial begins as soon as you get the engagement;
- Have a "scope" discussion with the attorney at the outset (but the methodology you will use will determine the path you will take);
- Don't come to legal conclusions in your valuation report—legal opinions are for the attorney to make;

- Watch out for conflicting positions you've taken in your prior cases (also in articles you've written or presentations you've made);
- Lose your "trial ego" when going into a settlement; and
- Be careful what you say to the attorney—they could be on the other side in the next case and use what you told them against you.

The presenters offered much more advice, and we will have more coverage of this session in a future issue.

SAFE investments. Simple agreements for future equity (SAFEs) have been a popular financing structure for startup companies (a good number of attendees have had some experience with them), but more mature companies are now using them, said Marina Kagan (PwC), who co-presented with Amir Alerasoul (Valuation Research Corp.). One reason for this is that the basic idea behind a SAFE instrument—which was developed as an alternative to convertible notes—is that it is generally supposed to convert into the next round of financing, and it is structured in a way that you do not have to specify the value of the company when you invest. You participate in the next round possibly at preferential terms. With the decline in public market valuations, many private companies are looking to raise funding without necessarily doing a down round or specifying the current value. The presenters covered the basic types of SAFE instruments and models that can be used for their valuation. They are called "simple," but, from a valuation standpoint, they are anything but that, they said.

ASA Rising Stars for 2023 Honored in New Orleans

BVR, along with the BV recruiting firm Borrowman Baker, co-sponsored a cocktail reception for the winners of the 2023 Rising Stars (those under 40 years of age) award who were announced at the 2023 ASA International Valuation Conference in New Orleans. The award winners for 2023 are:

- Tom Keesey (Suncorp Valuations);
- Cazmier Tymoch (Ellin & Tucker);
- Lauren Walter (gemologist at Lauren O. Inc.);
- Johanna Crowley (rail appraisal, Biggs Appraisal);
- Joseph Joyce (Harry Davis & Co.);
- Melissa Sachs (personal property, Sachs Fine Art Services); and
- Josia Hippolyte (real property, Bank of Saint Lucia Limited).

Our congratulations to the winners!

Three-stage DCF. Ongoing research is providing data that support the use of the three-stage discounted cash flow (DCF) model. During his session, Roger Grabowski (Kroll) gave an update on the research he is doing along with Dr. Ashok Abbott (West Virginia University) concerning growth (they will publish a paper). In last month's issue, we presented some of their findings, notably that different industries have different growth rates.[2] Also, the expected long-term growth rate should reflect "organic" growth (without the effect of acquisitions). Many analysts use long-term real GDP growth plus expected inflation in their terminal values, but that is wrong, they say. Also, many analysts use the same long-term growth rate for all industries, which is also wrong.

Their research also shows company growth rates from the public market in three stages: high growth, stabilized (or transitory) growth, and

2 "New Research Finds That Industries Have Different Growth Rates," *Business Valuation Update*, Vol. 29, No. 11, November 2023.

long-term growth. This supports the use of the three-stage DCF, which should be used more, Grabowski advised. "We gravitate too much to the two-stage DCF," he said. This is especially true for high-growth companies—they don't typically go from high-growth right to a long-term rate. There's a transition, which represents the second stage of the three-stage model.

FLPs. Bruce Johnson (Munroe, Park & Johnson Inc.) does a lot of work with minority interests in family limited partnerships (FLPs) and limited liability companies (LLCs). He advised appraisers to use the income and market approaches to value minority, nonmarketable interests and that includes FLPs and LLCs. The net asset value (NAV) approach has a number of problems, including that courts have rejected it for FLPs.

Johnson was involved in two IRS audits (both turned out in favor of the taxpayer), and his advice is to use two approaches (income and market) for the business interest, two methods to determine rates of return (CAPM, buildup, etc.), and more than two methods for determining a discount for lack of marketability. He also mentioned two landmark tax cases in which he was the expert witness: *Estate of Elsie J. Church* and *Estate of Emily Klauss*.[3] He also advised analysts to work closely with legal counsel (e.g., to understand rights of liquidation and control), cite authoritative texts, and footnote all assumptions.

Daubert. Attorney David Bolls (Leigh Law Group PC), who did a nice session that gave an overview of the *Daubert* standard, made an interesting remark. He has had experts look at a particular case and say, "I want this job, but I'm not the best expert for this case." Bolls was so struck by this response that he made sure to write down that expert's name and call the expert first when the right engagement came up. In other words, don't be afraid to turn down an engagement that is not in your wheelhouse.

Someone in the audience asked about exclusion rates. Of the three most common financial experts (economists, accountants, and appraisers), appraisers had a 38% exclusion rate in 2021, followed by accountants (32%) and economists (27%), according to an ongoing PwC study.[4] Over the 22 years of the study, appraisers have the highest exclusion rate (44%) of the three. The exclusion rate includes full and partial exclusions.

IRS targets. There were two sessions on the IRS and the kinds of valuation issues that are on the agency's radar. In his session, Mike Gregory (Michael Gregory Consulting LLC) told the audience that discounts continue to be the No. 1 red flag that triggers an IRS audit. Gregory is a former IRS manager who worked at the agency for almost 30 years on valuation matters and continues to interact with the agency (he has over 70 contacts there). Make sure you have a clear and complete explanation that supports your discount estimates, whether they be for marketability or control, Gregory advised. We point out that we have heard the same remarks directly from IRS officials.

He also mentioned the hiring binge the IRS has been on, including adding more business valuation analysts. The government shutdown, budget cutbacks, and the pandemic have created a staff shortage, so the agency now has much fewer agents doing valuation work—about half of what it had back during the 2008 economic downturn. The Inflation Reduction Act gave the IRS a big funding boost, but the staff situation means that the quality of the audits will suffer and the agency will not be able to meet audit quantity goals.

In their session on IRS estate/gift tax valuation targets, Marissa Pepe Turrell (Marcum) and tax attorney Stephanie Loomis-Price (Perkins Coie

3 *Church v. United States (I),* 2000 U.S. Dist. LEXIS 714; and *Estate of Klauss v. Commissioner,* T.C. Memo 2000-191; both opinions and case analyses are available at *BVLaw*; bvresources.com/products/bvlaw.

4 pwc.com/us/en/services/consulting/deals/assets/daubert-study-2022.pdf.

LLP) said that tax affecting remains a target (see the article elsewhere in this issue), as well as built-in capital gains (there is a split in the circuits), and matters involving Chapter 14 of the Internal Revenue Code (still "alive and well," the speakers said). Chapter 14, which covers Sections 2701 through 2704, was enacted to prevent perceived abuses of the tax system with respect to valuations related to family limited partnerships and similar structures. In 2017, regs were proposed for Sec. 2704 designed to curb estate valuation discounts for minority interests, but, after a public hearing during which many in the valuation profession spoke, the proposed regs were withdrawn.

ESG ratings and returns. Carla Nunes (Kroll) did another session, along with Adam Smith (PwC), on the role valuation professionals can play in the future of the environmental, social, and governance (ESG) phenomenon. Kroll recently released its new ESG and Global Investor Returns Study, which found that companies with better ratings generally outperformed those with lower ratings over the 2013-to-2021 period.[5] Globally, "ESG leaders" earned an average annual return of 12.9%, compared to an average 8.6% annual return "laggard" companies earned—about a 50% premium in terms of relative performance by top-rated ESG companies, the study says. This holds true for the U.S., where the "ESG leaders" earned an average annual return of 20.3%, compared to a 13.9% average annual return "laggard" companies earned.

The study analyzes the relationship between a company's total stock returns (dividends plus capital appreciation) and its MSCI ESG ratings over the 2013-to-2021 period. The study examines over 13,000 publicly traded companies across a variety of geographies and industries and their ESG ratings to determine the correlation of ESG ratings to company performance.

We attended more sessions than we've covered here, and we will do a similar recap of those other sessions in future issues.

Next year's ASA conference will be in Portland, Ore., Sept. 15-17, 2024. ◆

5 kroll.com/en/insights/publications/cost-of-capital/esg-global-investor-returns-study.