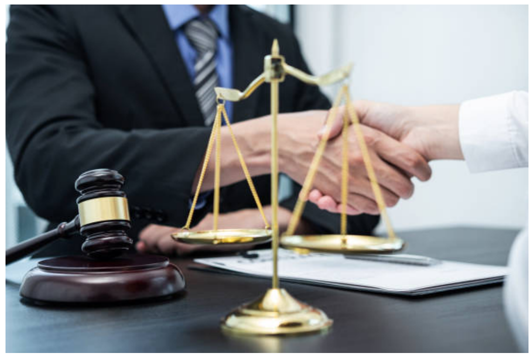
SUFFOLK ACADEMY OF LAW
The Educational Arm of the Suffolk County Bar Association
560 Wheeler Road, Hauppauge, NY 11788
(631) 234-5588



BASICS OF BUSINESS VALUATION

FACULTY:

Harold L. Deiters, III
CPA/ABV/CFF/CGMA, CFE, MAFF/CVA
Empire Valuation Consultants

Program Coordinator: Hon. John J. Leo, J.S.C.

January 18, 2023
Suffolk County Bar Association, New York

Like us on:

There's a whole new way to obtain your CLE certificate! It's fast, easy and best of all you can see the history of courses that you've attended!

Within 10 days of the course you attended, your CLE Certificate will be ready to view or print. Follow the instructions below:

1. Go to SCBA.org
2. Member Log In (upper right corner)
3. If you **do not** know your username or password, click the area below and enter your email that is on file with SCBA. Follow the prompts to reset your username and password.
4. After you log in, hover over your name and you will see "Quick Links". Below that you will see:

a. My SCBA
b. My CLE History
c. Update My Information
d. Update My Committees

5. Click on **My CLE History**, you will see the courses you have attended. Off to the right side you will see the Icon for certificates. You are now able to download the certificate, print it or save it. You may go to your history and review the courses you have taken in any given year!
6. **CLE certificates will no longer be mailed or emailed**. Certificates will be available within 10 days after the course.

EMPIRE
VALUATION CONSULTANTS

HAROLD L. DEITERS III, CPA/ABV/CFF/CGMA, CFE, MAFF/CVA
STATEMENT OF QUALIFICATIONS

Harold Deiters is a Senior Managing Director and the Managing Partner of the Long Island office of Empire Valuation Consultants. Mr. Deiters is a trained professional in preparing damage calculations, business valuations and performing forensic accounting. His experience covers economic damages, valuations for matrimonial and estate tax purposes, gift planning, shareholder disputes, and buy/sell agreements. He has extensive experience in tax return preparation, accounting and auditing both public and privately held companies, including manufacturing, wholesale and retail distribution, professional service organizations and not-for-profit organizations. In addition, Mr. Deiters has over 8 years of accounting experience in the private sector.

Professional Designations

- CPA – Certified Public Accountant
- ABV – Accredited in Business Valuation
- CFF – Certified in Financial Forensics
- CGMA – Chartered Global Management Accountant
- CFE – Certified Fraud Examiner
- MAFF – Master Analyst in Financial Forensics
- CVA – Certified Valuation Analyst
- Qualified to serve as Receiver and Accountant to Receiver pursuant to NYS Part 36

Professional Associations

- AICPA – American Institute of Certified Public Accountants
- NYSSCPA – New York State Society of Certified Public Accountants
- ACFE – Association of Certified Fraud Examiners
- NACVA – National Association of Certified Valuators and Analysts
- Nassau Suffolk Law Services Advisory Council
- AANG – Accountant/Attorney Networking Group, Board Member (Past President/Co-Founder)

Education

- BS – St. John's University, 1993

Trial Testimony

- New York State Supreme Court
- Federal Court

Employment Background

- Managing Partner of Long Island Office of Empire Valuation Consultants, concentrating on litigation support, business valuations and forensic accounting
- Partner-in-charge of Deiters & Associates, LLC
- Partner-in-charge of the litigation and valuation services group, Baker Tilly Virchow Krause, LLP (formerly Holtz Rubenstein Reminick LLP
- Controller, Appliance Corp of America, distributor of small kitchen appliances sold under the brand names of Betty Crocker, Haier and Wel-bilt.

- Manager, Dejana Industries & Affiliates, service company working in the areas of snow removal at major airports, municipality street cleaning and garbage removal.

- Supervisor, United Parcel Service, Fortune 500 Company specializing in worldwide package delivery.

Professional Activities

- National lecturer on business valuation, forensic accounting and economic damages for the National Association of Certified Valuators and Analysts
- Member of Master Analyst of Financial Forensics® (MAFF®) Subject Matter Expert Group
- Member AICPA National Accreditation Commission (NAC)
- Member of the American Academy of Matrimonial Lawyers Interdisciplinary Committee
- Endowment Chair of the Nassau County Bar Association WE CARE Advisory Board
- Member of the WE CARE Golf and Tennis Classic Committee
- Community Liaison Member – We Care Advisory Board
- Member of the WE CARE Advisory Grant Committee
- Past President of the NYSSCPA
- Past Vice-President of the NYSSCPA Statewide Board of Directors
- Former Board Member of the AICPA
- Past President of the Suffolk Chapter of the NYSSCPA
- Past Chairperson for the Cooperation with Attorneys Committee
- Founding Board Member of AANG
- Former adjunct professor at St. Joseph's College teaching principles of auditing
- Presented a monthly lecture series for the Nassau Academy of Law
- Past Member AICPA Certified in Financial Forensics (CFF) Credential Committee

Awards/Recognitions

- Honored by the WE CARE Golf & Tennis Classic of the Nassau County Bar Association – 2016
- Awarded the 2015 Access of Justice Pro Bono Provider by the Nassau County Bar Association
- Listed as Who's Who in Forensic Accounting by the Long Island Business News – 2015
- Awarded the 50 Around 50 Award from Long Island Business News – October 2015
- Listed as Who's Who in Accounting from Long Island Business News (2014 – 2016)
- Awarded "40 Under 40" up-and-comers in business, *Long Island Business News – 2004*

Basics of Business Valuation

Suffolk Academy of Law

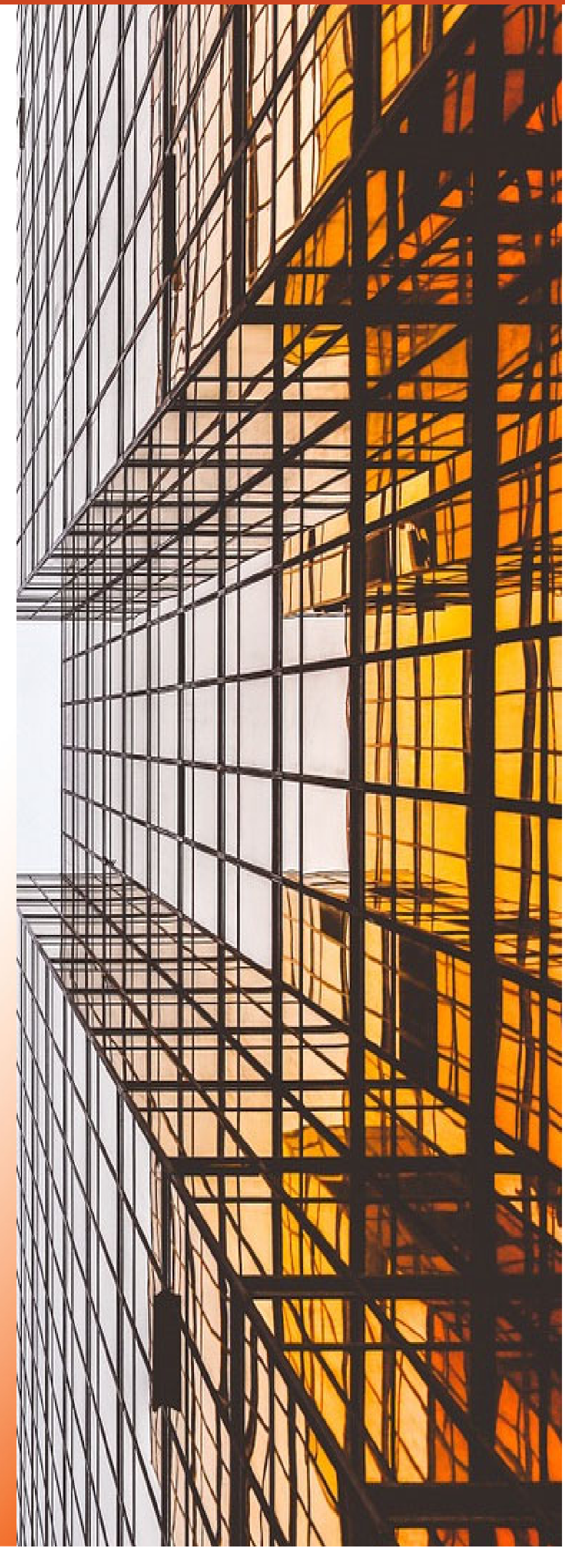
January 18, 2023

Presented by:

Harold L. Deiters III,
CPA/ABV/CFF/CGMA, CFE, MAFF/CVA

Senior Managing Director

Privileged & Confidential



10 Key Valuation Considerations

- Standard / premise of value
  1. Standard of Value
  2. Premise of Value
- Valuation Approaches
  3. Valuation Approaches
- Earnings level
  4. Determination of Earnings
  5. Proper Adjustments

EMPIRE VALUATION CONSULTANTS

10 Key Valuation Considerations

- Assessment of risk

  6. Use Discount Rate Data
  7. Understand Drivers of Value

- Adjustments

  8. Appropriate Level of Value
  9. Application of DLOC
  10. Application of DLOM

EMPIRE VALUATION CONSULTANTS

Consideration #1

Standard of Value

Standard of Value

Dependent on type of valuation

Fair Market Value	Fair Value	Investment Value	Intrinsic Value
Estate Planning	Dissenting Shareholder Actions Minority Oppression/ Dissolution Actions	Transactions	Stock Transactions- Buy/Sell/Hold
Gift/Estate Tax	Accounting Standards FASB		
Matrimonial			

EMPIRE
VALUATION CONSULTANTS

Fair Market Value

Fair Market Value is defined as follows per Internal Revenue Service Revenue Ruling 59-60:

“the price at which a property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts."

EMPIRE
VALUATION CONSULTANTS

Consideration # 2

Premise of Value

Premise of Value

- Going Concern
- Value as an Assemblage of Assets
  - Assets not in current use (i.e., manufacturing facility)
- Value as an Orderly Disposition (e.g., Orderly Liquidation). Expect FMV as you wind–down the business
- Value as Forced Liquidation (less than normal exposure to secondary market for assets)

Consideration # 3

Valuation Approaches

EMPIRE
VALUATION CONSULTANTS

Understanding Valuations

3 APPROACHES

- Asset
- Market
- Income

3 VARIABLES

- Economic Benefit
- Risk involved in receiving the benefit
- Growth Potential

EMPIRE VALUATION CONSULTANTS

Asset Approach

ABC REAL ESTATE HOLDING CORPORATION		
DECEMBER 31, 20XX		
(000's Omitted)		
	Historical Book Value	**FMV**
Assets		
Cash & Marketable Securities	$ 15,000.0	$ 15,000.0
Accounts Receivable (net)	100.0	100.0
Total Current Assets	15,100.0	15,100.0
Fixed Assets		
Equipment Net of Depreciation	150.0	500.0
Land and Property	970.1	29,677.1
	1,120.1	30,177.1
Total Assets	$ 16,220.1	$ 45,277.1
Liabilities and Capital		
Accrued Expenses	$ 500.0	$ 500.0
Total current liabilities	500.0	500.0
		*
Tax on Built in Gains		11,090.6
Long-term debt	14,000.0	14,000.0
Total Liabilities	14,500.0	25,590.6
Net Tangible Assets (NAV)	$ 1,720.1	$ 19,686.5

* C Corp. with known holding period.

EMPIRE VALUATION CONSULTANTS

Market Approach

- Look to Guideline Public Companies and Private Transactions

- Look to companies similar in nature to Subject Company (NAICS/SIC Code)

- Analyze guideline companies adjustments: nonrecurring items, non-operating items, accounting differences

EMPIRE
VALUATION CONSULTANTS

Market Approach

- Guideline Public Companies
- Private Transactions

Financial Indicator	**Earnings: $ 1 ,000,000**
X Multiple	**Multiple: 12**
= Value	**Value: $12,000,000**

EMPIRE
VALUATION CONSULTANTS

Income Approach

- A company is worth no more than the PV of its future earnings

- Single Period

$$\frac{CF \times (1+g)}{k-g}$$

CF = cash flow

k= Discount Rate

g= Growth

k-g = Capitalization rate

$$\frac{\$1{,}000{,}000 \times (1+.03)}{.218 - .03}$$

Value = $5,478,700

- Multiple Period : Discounted Future Cash Flow

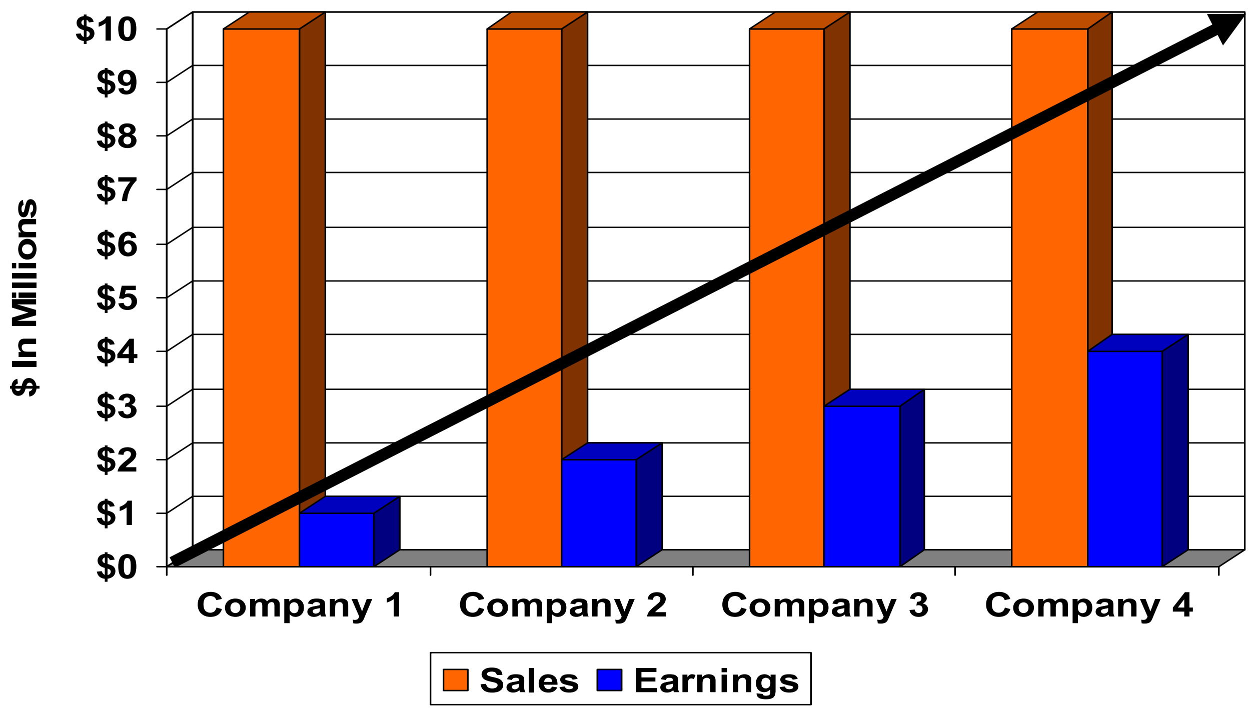
EMPIRE
VALUATION CONSULTANTS

Consideration # 4

Determination of Earnings

EMPIRE VALUATION CONSULTANTS

Enhanced Earnings = Greater Value



Determination of Earnings

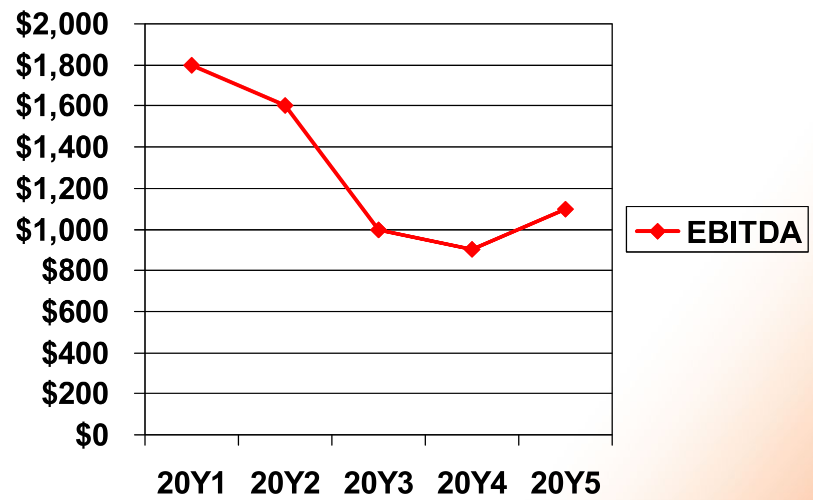
	20Y1	20Y2	20Y3	20Y4	20Y5
EBITDA ($000s)	$1,800	$1,600	$1,000	$900	$1,100

2 Yr. Avg. $1,000

3 Yr. Avg. $1,000

5 Yr. Avg. $1,280

5 Yr. Wgt. Avg $1,140



EMPIRE
VALUATION CONSULTANTS

Consideration # 5

Proper Adjustments

Normalized Earnings

ADJUSTMENTS TO REPORTED EARNINGS

1. For owners characteristics (control/minority)
   - Reasonable Compensation, Perquisites
2. For GAAP departures, extraordinary, non-recurring / unusual items
   - Cash/accrual, fires, relocation, legal fees related lawsuit
3. Non-operating assets, liabilities and related income and expense
   - Real estate, marketable securities, cash
4. Taxes
   - Tax effecting a Pass-Through entity (S Corporation)
5. Synergies from mergers and acquisitions

EMPIRE VALUATION CONSULTANTS

Normalizing Adjustments

	Compensation	Perquisites	Non-recurring Exp.	Rent
Per Financial Statements	$500,000	$55,000	$150,000	$340,000
Normalized	300,000	5,000		$240,000
Adjustment	$200,000	$50,000	$150,000	$100,000

Normalized Earnings

Without Adjustments

EBITDA (2 yr. Avg) :

$1,000,000

Multiple: 5X EBITDA

Value: $5,000,000

With Adjustments

EBITDA (2 yr. Avg):	$1,000,000
Add back:	
Excess Reasonable Comp	200,000
Perquisites	50,000
Cost discontinued business	150,000
FMV rent Adjustment	100,000
Adjusted EBITDA	$1,500,000
Multiple	5X EBITDA
Value:	$7,500,000

50% increase in value

Tax Adj. for Flow Through Entities

- Walter L. Gross, Jr., et ux, et al. v. Commissioner, T.C. Memo. 1999-254, No. 4460-97
- Estate of John E. Wall v. Commissioner, T.C. Memo 2001-75
- Estate of William G. Adams, Jr. v. Commissioner, T.C. Memo. 2002-80
- Estate of Heck v. Commissioner, T.C. Memo. 2002-34, 83 T.C.M. (CCH)1181

Not tax affecting earnings, nearly doubles the value.

EMPIRE
VALUATION CONSULTANTS

Consideration # 6

Appropriate Capitalization Rate

EMPIRE VALUATION CONSULTANTS

Lower Risk = Greater Value

How to Measure Risk

- Cost of Capital
  - ➢ **Build up approach**
  - ➢ **Capital Asset Pricing Model**
- Debt Structure – Debt/Equity
  - ➢ **WACC**

Source of ERP and Size Premium

CRSP Data formerly (Ibbotson Data / Morningstar)

- One size fits all approach – Market capitalization
- 10 deciles

Duff & Phelps Data

- 8 Multiple Measures
  - **MV equity**
  - **BV equity**
  - **MVIC**
  - **5 year avg. EBITDA**
  - **5 year avg. Net income**
  - **Total Assets**
  - **Sales**
  - **# employees**
- 25 rankings to choose from

EMPIRE VALUATION CONSULTANTS

Key Variables in Estimating the Cost of Capital*

	Value
Yields (Riskless Rates)	
Duff and Phelps Recommended Risk-Free Rate	3.00%
Long-term (10-year) U.S. Treasury Coupon Bond Yield	1.69%
Long-term (20-year) U.S. Treasury Coupon Bond Yield	2.00%
Long-term (10-year) U.S. Treasury Coupon Bond Yield	2.17%
Equity Risk Premium	
Duff and Phelps Recommended (The Duff & Phelps Normalized Rate may only be used with the Duff & Phelps Recommended ERP)	5.5%
Long-horizon expected equity risk premium (historical) large company stock total Returns minus long-term government bond income returns	6.91%
Long-horizon expected equity risk premium (supply side): historical equity risk Premium Minus price-to-earnings ratio calculated using three-year average earnings	6.14%

* Duff & Phelps Cost of Capital Navigator (as of October 31, 2019)

EMPIRE VALUATION CONSULTANTS

Key Variables in Estimating the Cost of Capital (cont'd.)

Decile	Market Cap of Smallest Company (in millions)		Market Cap of Largest Company (in millions)		Size Premium (Return in Excess of CAPM)
Mid-Cap 3-5	$	2,996.003	$	13,455.802	0.89%
Low-Cap 6-8	$	730.047	$	2,992.251	1.58%
Micro-Cap 9-10	$	2.455	$	727.843	3.39%
Breakdown of CRSP Deciles 1-10					
1-Largest	$	29,428.909	$	1,073,390.566	-0.30%
2	$	13,512.960	$	29,022.867	0.52%
3	$	7,275.967	$	13,455.802	0.81%
4	$	4,504.066	$	7,254.230	0.85%
5	$	2,996.003	$	4,503.549	1.28%
6	$	1,961.831	$	2,992.251	1.50%
7	$	1,292.791	$	1,960.201	1.58%
8	$	730.047	$	1,292.224	1.80%
9	$	325.360	$	727.843	2.46%
10-Smallest	$	2.455	$	321.578	5.22%
Breakdown of CRSP 10th Decile					
10a	$	185.418	$	321.578	3.71%
10w	$	250.270	$	321.578	2.89%
10x	$	185.418	$	250.248	4.68%
10b	$	2.455	$	184.785	8.25%
10y	$	109.462	$	184.785	6.85%
10z	$	2.455	$	109.406	11.14%

* Duff & Phelps Cost of Capital Navigator (2019 based on 2018 Data)

EMPIRE VALUATION CONSULTANTS

Industry

- Full Information Beta 1.38% SIC 3577
- Median Vasicek-Adjusted Beta 1.38% SIC 3577
- A Beta of 1.38% equals an industry risk premium of
  - Duff and Phelps Recommended ERP - 2.09%
  - Historical ERP – 2.63%
  - Supply-Side ERP – 2.33%

➢ **Composed of 13 companies**

➢ **Includes very large companies**

- Xerox Corp
- Astronova, Inc
- HP, Inc
- Eastman Kodak, Co
- Zebra Technologies, CP – CL A

EMPIRE VALUATION CONSULTANTS

Determination of Discount Rates

- Risk free rate: should be long term rate and approximate "going concern" nature of business
- ERP: Compensates investor for added risk of equities over bonds
- Size Premium: More risky than "blue chips"
- Industry Premium: Industry compared to market
- Company Specific Factors: key man

Rf =	3.00%
ERP =	5.50
Size =	5.22
Industry	<u>2.09</u>
	15.81%
Co. Specific	6.00%
Total Discount	21.81%
Rounded	21.80%

EMPIRE VALUATION CONSULTANTS

Discount Rate to Capitalization Rate

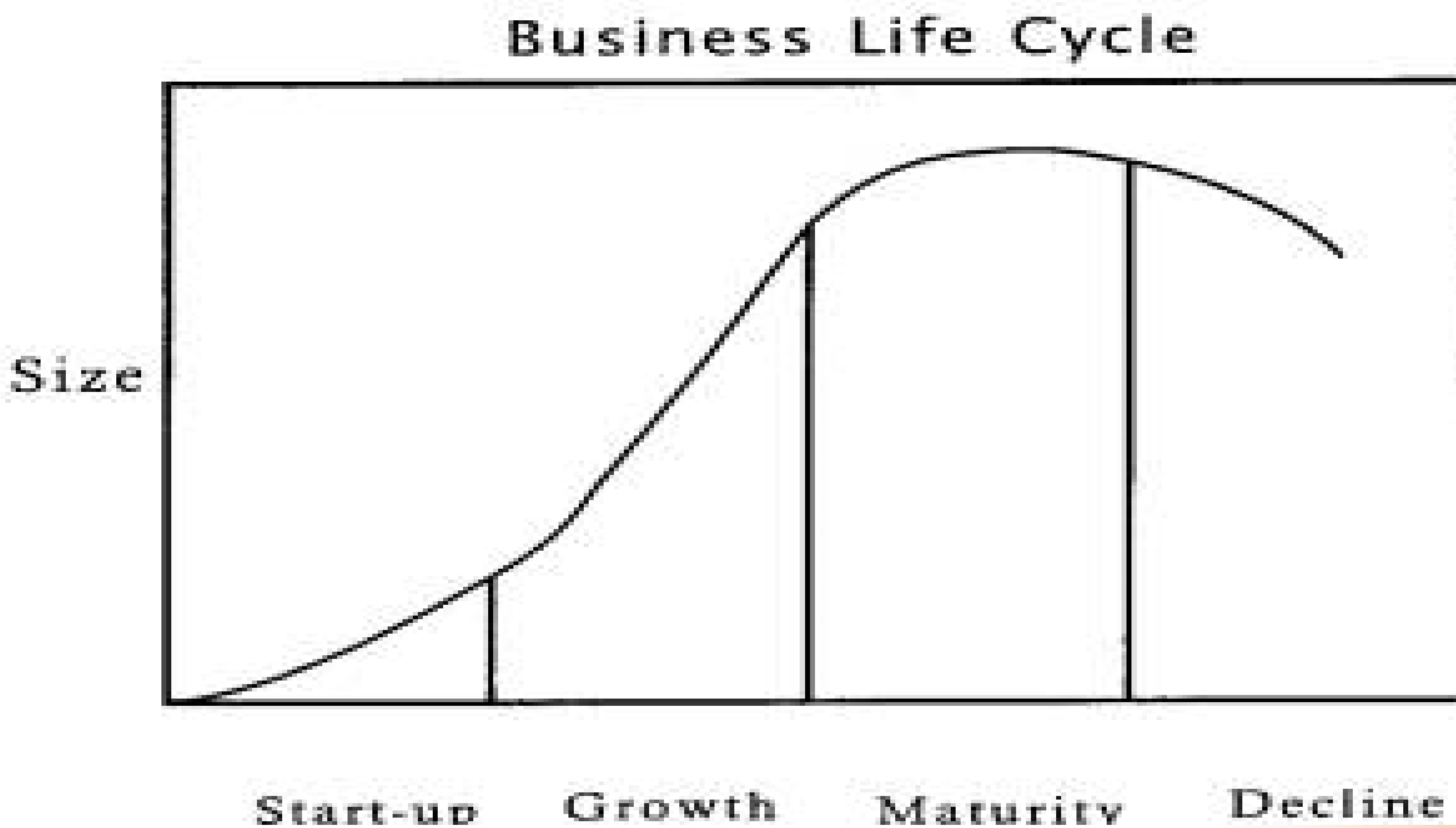
- Discount Rate less Growth Rate is Capitalization Rate

Discount	21.8%
Less: Growth	3.0%
Capitalization Rate	18.8%

Long-Term rate of inflation 2 - 3%

EMPIRE VALUATION CONSULTANTS

Higher Growth = Greater Value



Incorrect Use of Growth Rate

U.S. vs. Hall

- *Federal Court – NY Southern District*
- *Criminal / Jury Trial*
- *Start- up company in health club business*
- *Discount Rate 22%*
- *Historic Growth 20%*
- *Capitalization Rate 2%*

Consideration # 7

Understanding Drivers of Value

EMPIRE VALUATION CONSULTANTS

CHECK LIST OF VALUE DRIVERS

ADD VALUE

- ❑ Turnkey
- ❑ Not dependent on owner(s)
- ❑ Organizational structure in place
- ❑ Quality, knowledgeable staff and management
- ❑ Good labor relations
- ❑ Low employee turnover
- ❑ Many suppliers (domestic and overseas)
- ❑ Sales spread among customers
- ❑ Lock in Sales through contracts or repeat business
- ❑ Product differentiation – using leverage
- ❑ Private Label products
- ❑ Ability to differentiate services
- ❑ High barriers to entry
- ❑ Low threat of substitute products
- ❑ Access to capital and financing
- ❑ Available working capital

DECREASE VALUE

- ❑ Fragmented operations
- ❑ Dependent on owner(s)
- ❑ No level of supervision other than owner
- ❑ Low level of training/knowledge
- ❑ Poor labor relations, high turnover
- ❑ Dependent on key suppliers
- ❑ High sales concentration on few customers
- ❑ Limited personal contact with customer
- ❑ Commodity product or service
- ❑ No product differentiation
- ❑ Low barriers to Entry
- ❑ High threat of substitute products
- ❑ Limited or faulty access to capital and financing
- ❑ Insufficient working capital

EMPIRE VALUATION CONSULTANTS

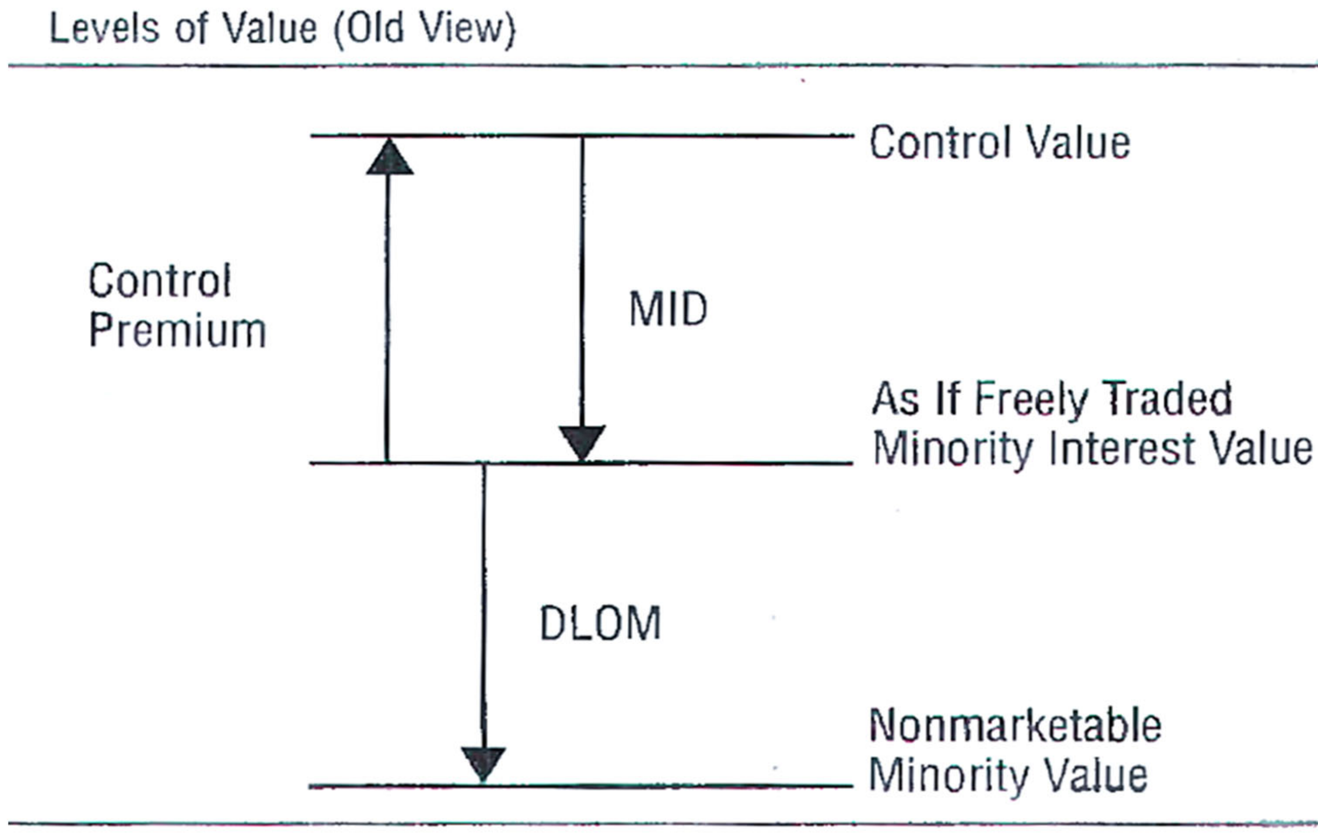
Consideration # 8

Appropriate Level of Value

EMPIRE VALUATION CONSULTANTS

Levels of Value

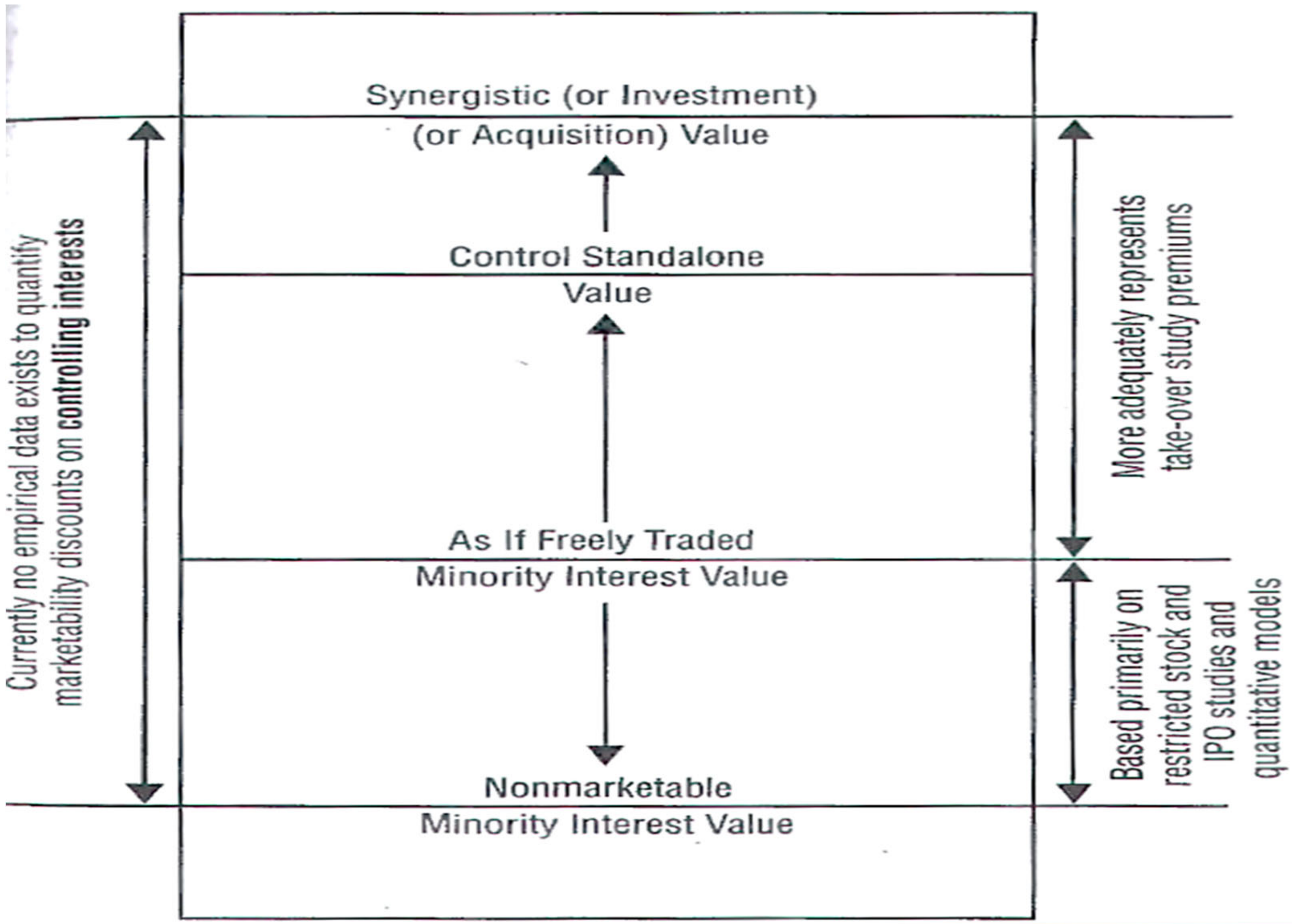
Old View – Simplistic



EMPIRE VALUATION CONSULTANTS

Levels of Value

New View



EMPIRE VALUATION CONSULTANTS

Consideration # 9

Application of Discount for Lack of Control (DLOC)

EMPIRE VALUATION CONSULTANTS

Discount for Lack of Control

- No empirical studies available
- M&A transaction data
- Differences between amounts paid for controlling vs. minority interests:
  - ➢ Statistics show premium for control of 14.7%
  - ➢ DLOC = 1 - 1/(1+premium) = 12.8%
  - ➢ Modify for Company Specific Factors: Shareholders' Agreement
- Consider Standard of Value – NO DLOC in BCL 1118 - NYS

EMPIRE
VALUATION CONSULTANTS

Consideration # 10

Application of Discount for Lack of Marketability (DLOM)

Discounts Lack of Marketability

Restricted Stock Studies

Study	Years Covered	# of Transactions	Mean Discount	Median Discount
Two-Year Holding Period (Pre-1990)				
SEC, Overall Average	1966-1969	398	25.8%	24.0%
SEC, Non-reporting OTC Companies	1966-1969	112	N/A	32.6%
Gelman	1968-1970	89	33.0%	33.0%
Trout	1968-1972	60	33.5%	N/A
Moroney	Unknown	146	35.5%	33.0%
Maher	1969-1973	33	35.4%	33.3%
Standard Research Consultants	1978-1982	28	N/A	45.0%
Stout Risius Ross, LLC (2018)	1980-1989	58	23.2%	23.2%
Management Planning, Inc. (2011)	Pre-1990	79	30.5%	32.3%
Hertzel & Smith	1980-1987	106	20.1%	13.3%
Willamette Management Associates	1981-1984	33	N/A	31.2%
Silber	1981-1988	69	33.8%	35.0%
Two-Year Holding Period (Post-1990)				
Stout Risius Ross, LLC (2018)	1990 – 3/31/97	141	23.5%	21.0%
Management Planning, Inc. (2011)	1990 – 4/30/97	110	25.1%	22.5%
Bruce Johnson	1991-1995	72	20.0%	N/A
Columbia Financial Advisors, Inc.	1996-1997	23	21.0%	14.0%
One-Year Holding Period				
Columbia Financial Advisors, Inc.	1997-1998	15	13.0%	9.0%
Stout Risius Ross, LLC (2018)	4/1/97-11/15/07	169	25.3%	21.1%
Management Planning, Inc. (2011)	5/1997 – 2/2008	164	20.8%	16.6%
Trugman Valuation Associates, Inc.	1/1/07-11/15/07	46	17.9%	14.7%
Six Month Holding Period				
Trugman Valuation Associates, Inc.	11/16/07-12/31/08	34	18.4%	14.4%
Management Planning, Inc. (2011)	2/2008 – 2009	49	5.9%	5.0%
Stout Risius Ross, LLC (2018)	11/16/07-2018	28	18.5%	14.7%
Stout Risius Ross, Inc.	9/2005 to 5/2010	98	10.9%	9.3%

EMPIRE VALUATION CONSULTANTS

Discounts Lack of Marketability

Pre IPO Studies

Studies	Years Covered	Mean Discount	Median Discount
Emory	1980 - 2000	46.0%	47.0%
Willamette & Associates Studies	1975-2000	31.8%	50.4%
Valuation Advisors (Pre-IPO <2 years)	1980 - 2000	45.8%	50.7%
Valuation Advisors (Pre-IPO >2 years)	1980 - 2000	68.3%	80.5%

EMPIRE VALUATION CONSULTANTS

What Valuation Approaches Were Considered?

Under IRS Revenue Ruling 59-60, the expert must at least *consider* all 3 approaches - Market Approach, Income Approach, and Asset Approach.

Were the Valuation Approaches Appropriately Weighted?

Revenue Ruling 59-60 rejects the concept of simply averaging the values produced by each approach and instead instructs the expert to weigh each approach in coming to a final value. The weight given to a particular approach will depend on the type of business being valued.

EMPIRE VALUATION CONSULTANTS

Did the expert fail to recognize and properly adjust for a non-recurring event, such as a year of abnormally high or low earnings??

Vicinanzo v. Vicinanzo, 193 A.D.2d 962, 598 N.Y.S.2d 362 (3d Dept. 1993).

Sommer v. Sommer, 176 A.D.2d 1022, 575 N.Y.S.2d 178 (2d Dept. 1991).

EMPIRE VALUATION CONSULTANTS

Did the expert make appropriate adjustments to the company's revenue?

Stolow v. Stolow, 149 A.D.2d 683, 152 A.D.2d 559, 540 N.Y.S.2d 484 (2d Dept. 1989).

Beckerman v. Beckerman, 126 A.D.2d 591, 511 N.Y.S.2d 33 (2d Dept. 1987).

EMPIRE VALUATION CONSULTANTS

Did the expert use the correct reasonable compensation figure?

Stolow v. Stolow, 149 A.D.2d 683, 152 A.D.2d 559, 540 N.Y.S.2d 484 (2d Dept. 1989).

Douglas v. Douglas, 281 A.D.2d 709, 722 N.Y.S.2d 87 (3d Dept. 2001).

Did the expert use an appropriate multiple?

Hiatt v. Tremper-Hiatt, 776 N.Y.S.2d 112, 6 A.D.3d 1014 (3d Dept. 2004).

Did the expert use an appropriate capitalization rate?

IRS Revenue Ruling 59-60. "A determination of the proper capitalization rate presents one of the most difficult problems in valuation." "Among the more important factors to be taken into consideration in deciding upon a capitalization rate in a particular case are:

(1) the nature of the business;

(2) the risk involved; and

(3) the stability or irregularity of earnings."

Did the expert properly apply a key-man discount?

Keil v. Keil, 85 A.D.3d 1233, 926 N.Y.S.2d 173 (3d Dept. 2011).

Did the expert properly apply discounts for lack of marketability and lack of control?

Cooper v. Cooper, 84 A.D.3d 854, 923 N.Y.S.2d 596 (2d Dept. 2011).

Consideration to be made when preparing to cross-examine an expert:

- Hire your own expert
  - Rebuttal report
  - Cross examination questions

Questions?

Harold L. Deiters III,
CPA/ABV/CFF/CGMA, CFE,
MAFF/CVA

Senior Managing Director

hd@empireval.com

631.719.3456

EMPIRE
VALUATION CONSULTANTS