



WHAT'S IT WORTH?

For Business Owners, Corporate Officers, & Their Advisors

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Detecting Valuation Errors

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INSIDE THIS ISSUE

Detecting Valuation Errors

Determining a valuation report's worth

Meet the Valuation and Transaction Services Group

An update on new services offered by our team

"Valuation has been called both an art and a science"

Valuation has been called both an art and a science. A well-researched, soundly reasoned valuation report can be instrumental in generating a settlement agreement in a dispute. But what is the single most important factor in determining a report's value to your case? Usually, it's the valuator's expertise, rather than the report's cost or the firm's reputation.

Competence means more

A competent valuation professional approaches an assignment from a well-informed business perspective. Such an expert sees beyond the numbers, formulas and theories and clearly communicates his or her value opinion's bases.

But in many larger firms — even those with sterling reputations — economics dictate that partners parcel out valuation assignments to staff with varying degrees of training and experience. Staffers short on business experience may not know how to dig deep to uncover relevant information about the company being valued. So knowing how to evaluate an individual valuator's ability to defend his or her report is important.

As judges and opposing counsel look more critically at valuation reports, boilerplate write-ups or one-size-fits-all approaches no longer hold up under scrutiny. An experienced preparer knows what does — and what doesn't — make sense in a given situation.

Some common mistakes

Understanding the quality and the composition of the earnings stream being valued is critical to arriving at a fair opinion. An inexperienced (or biased) preparer may:

- Apply price/earnings (P/E) multiples to earnings streams or time periods that are not comparable. For instance, he or she may apply the average P/E ratio for Fortune 500 manufacturing companies to the earnings stream of a \$1 million service company, or use the risk-free cost of capital on a small company.
- Commingle pre- and post-tax data. This may take the form of applying a post-tax P/E ratio to a pre-tax income stream.
- Rely on industry averages without adequate analysis. This analysis would include examining how the subject company relates to the industry.

“The analyst should always be asking, “Does this make sense?.”

In addition, an inexperienced preparer sometimes relies exclusively on historical financial statements, failing to perform site visits or question management about the entity’s future prospects. Small businesses’ historical financial statements are frequently systematically distorted (for example, understated earnings) — usually to reduce taxes or prepare for a pending divorce.



Exclusively relying on these statements generates an equally distorted opinion of value. The analyst should always be asking, “Does this make sense?”

Differences of opinion also often arise among valuation experts as to capitalization rates and discounts. Common mistakes here include:

- Using rates from inconsistent time periods,
- Applying rates on “safe” investments to small businesses (which are inherently much riskier), and
- Mistaking historical results for required rates of return.

Discount mistakes include:

- Applying a discount or premium to an inapplicable level of value,
- Ignoring the rules of the jurisdiction for which the report was prepared, and
- Applying a discount without understanding the data and procedures used in compiling the underlying discount studies.



Valuation questions or needs? Contact Dave Moser to arrange a free consultation

Other typical inaccuracies include reports that are too brief and don't adequately explain the expert's thought process and failure to understand what entity is being valued (assets vs. stock, which assets and liabilities are included, multiple entities covered in one opinion).



First things first

The first thing you should do when evaluating a valuation report is check the preparer's credentials. Then look for the common mistakes outlined here. This will help you evaluate the report's usefulness in supporting your case.

"The first thing you should do when evaluating a valuation report is check the preparer's credentials"

Meet the Valuation and Transaction Services Group

By: Dave Moser, Director Valuation & Transaction Services

I hope you have enjoyed our complimentary newsletter. **If you would like to add a client or friend to the distribution list, or join our monthly e-mail newsletter, please e-mail: dmoser@coulterjustus.com** with "Subscribe" as the subject.

Our Valuation and Transaction Services team has over 60 years of combined experience involving more than 1,000 projects, and continues to be the largest and most experienced full time valuation group in East Tennessee. We understand the significant financial and emotional impact our services play in client's lives, and are excited to offer a full range of transactions services.

In addition to business valuations throughout North America and Internationally, we provide M&A advisory services for substantial private firms, as well as a host of real estate advisory services including: cost segregation studies, real property tax appeals, lease audit and negotiation, and feasibility analysis.

David G. Moser, ASA, CEI

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David is a certified member of the American Society of Appraisers (ASA) and has over 34 years experience in the valuation profession. Before joining Coulter & Justus in 1996, he served as partner and director in charge of valuation with Ernst and Young and in management positions with two other international valuation firms. He has considerable experience in valuations, cost segregation studies, and as an expert witness.

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Renee joined Coulter & Justus in 1999 and has over ten years of business valuation experience. She has valued businesses for purposes including mergers, estate tax and gifting, litigation, bankruptcy reorganization, and in performing cost segregation analysis. Renee also has troubled business turnaround and controllership experience in addition to tax and audit experience.

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Having closed several hundred thousand feet of real estate deals, Chris specializes in commercial real estate consulting, appealing real property tax assessments, and business valuation. Chris holds an MBA from the University of Notre Dame Mendoza School of Business, as well as the CCIM (Certified Commercial Investment Member) designation.

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Sven has over 13 years experience in investment banking and business valuation, including mergers and acquisitions. He joined Coulter & Justus in 2003 and has an MBA with an emphasis in Finance from New York University's Stern School of Business and also holds the CM&AA (Certified Merger & Acquisition Advisor) designation.

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