Selected Valuation and Damages Terms

Book Value Method –a valuation method that uses the net worth of a company determined by either its balance sheet assets or the replacement cost of its balance sheet assets – minus liabilities. The legal term for what accountants call the "Cost Method."

Calculation Engagement or Report – a type of valuation report that is limited in scope to a calculation of value. Not a comprehensive analysis and does not meet standards for an expert report.

Capitalization of Earnings Method – a valuation method that assumes either that the earnings of a business constitute an annual percentage return on the value of the business or, more accurately, that the present discounted value of all of the business's earnings into the future is the current business value. The legal term for what accountants call the "Income Method."

Comparable Sales Method – also referred to by accountants as the Market Method, a valuation method that relies on recent sales of similarly situated businesses. Because such prices are not estimates but actualities, the comparable sales method is generally preferred as the most realistic proof of fair market value but only when it is properly available. The legal term for what accountants call the "Market Method."

Cost of Capital – see **Discount Rate**

Daubert – a U.S. Supreme Court case that set the standards for courts to allow expert testimony judged by Qualifications, Reliability and Helpfulness. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993)

Discounted Cash Flow (DCF) Method – an "Income" method of valuation based on cash flows from future operations. There are 3 steps:
1. an estimation of net cash flows that will be generated over a projected period;
2. computation of a terminal or residual value equal to the future value of the cash flows beyond the projection period; and
3. the application of a discount rate (estimated cost of capital) to reduce to present value the projected net cash flows and the estimated terminal or residual value.

Discount Rate – the "opportunity cost," that is, the expected rate of return (or yield) that an investor would have to give up by investing in available alternative investments that are comparable in terms of risk and other investment characteristics. The discount rate is the cost of capital for that particular category of investment. The discount rate is determined by market conditions as of the valuation date as they apply to the specific characteristics of the subject contemplated investment.

DLOM – Discount for Lack of Marketability, also referred to an illiquidity discount, is a reduction in value based on a lack of a public market for interests in the company or for other restrictions placed on the sale of those interests.

DMIN – Discount for Minority Ownership, also referred as a discount for lack of control, is a reduction in value to reflect the fact that the owner of a minority interest cannot control the daily activities or policy decisions of an enterprise.

EBITDA – Earnings Before Interest, Taxes, Depreciation, and Amortization

Exit Multiple Method - assumes that a business will be sold for a multiple of some market metric at the end of the term certain in the DCF method. Cf. **Gordon Growth Model.**

Fair Market Value (FMV) – what a typical (hypothetical) willing buyer will pay to a typical (hypothetical) willing seller, with neither being under undue influence to transact and both begin fully informed of the facts.

Fair Value – the amount that will fairly compensate an owner who was involuntarily deprived of the benefit of an asset – generally, FMV without discounts. Additionally, the Financial Accounting Standards Board (FASB) offers a definition of “fair value” which is the GAAP and financial reporting equivalent of “fair market value”, as follows: “The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced liquidation sale.” (FASB No. 142 ¶23).

Franchise Disclosure Document (FDD) – a

Goodwill – an intangible asset arising as a result of name, reputation, customer loyalty, location, products and similar factors.

Gordon Growth Model – also known as the Perpetual Growth Model, assumes that a business will continue to generate cash flows at a constant rate forever using the formula:

$$\text{Terminal Value} = \frac{\text{Final Projected Year Cash Flow X (1+Long-Term Cash Flow Growth Rate)}}{\text{(Discount Rate – Long-Term Cash Flow Growth Rate)}}$$

The formula simplifies the practical problem of projecting cash flows far into the future. But the formula rests on the assumption that the cash flow of the last projected year will stabilize (with or without stable growth) and continue at the same rate (or growth rate) forever. Cf. **Exit Multiple Method**.

Highest and Best Use - the legally permissible and reasonably feasible present use, or series of future uses, that will result in the greatest economic benefit to the owner or user of the property.

Income Method – valuation method based on the earnings power or cash generation capabilities of the enterprise being appraised.

Item 19 – section of the FDD where franchisors have the option to give Financial Performance Representations (formerly known as “Earnings Claims”).

Multiple of Earnings – a corollary of the Market or Comparable Sales Method that applies an industry rule of thumb multiplier to current net income. Although popular and simple to use as a valuation tool, this shorthand method has many weaknesses and may lead to the under valuation of a company with high growth potential.

Net Present Value – the value of future earnings reduced by a discount rate.

Normalizing Adjustments – non-recurring income and/or expense items that require pro forma adjustments to the financial results for valuation purposes. Examples include excess compensation, personal expenses run through the business, and Payroll Protection Program loans.

Revenue Ruling 59-60 – IRS ruling that defines the price at which the 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 relevant facts. See**Fair Market Value** .

Standard or Definition of Value – defines what type of value is being estimated. The alternative standards of value generally answer the question: value to whom?

Synergistic Value or Acquisition Value – the price a particular identified buyer would be expected to pay for an asset with consideration given to any unique benefits of the asset to the identified buyer.

Tax Affecting – a valuation assumption which applies a discount to the projected cash flow of pass-through entities like S corporations or LLCs on the assumption that they should be paying corporate taxes like a C Corporation.

Terminal Value – using the DCF valuation method, the value of future cash flows at the end of a finite or infinite term. See also, **Gordon Growth Model** and **Exit Multiple Method.**