



## BUSINESS VALUATION ADVISOR

*Commentary on the business of business valuation  
for estate planning professionals and business owners*

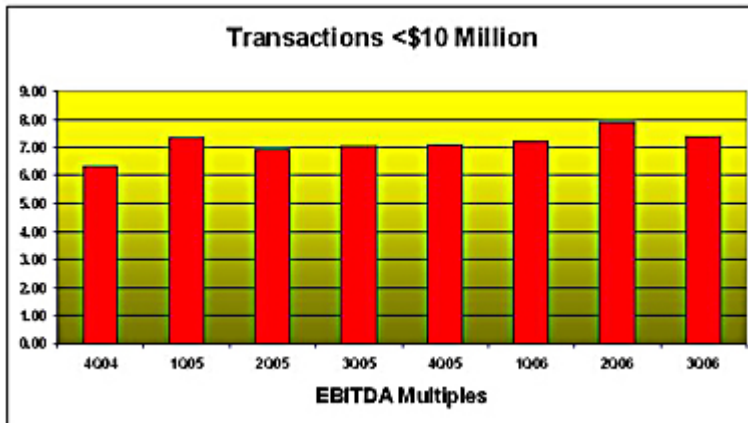
This newsletter is for the information of attorneys, financial planners and business owners who deal with business valuation issues and are interested in the current thinking in business appraisal. It is not a "how to" publication, but more of an explanation of a complex professional service.



### COMMENTARY

#### VALUING PRIVATELY-HELD STOCK - FOR THE NEXT GENERATION

Operating companies pose unique challenges to valuation analysts as each is unique in its own industry segment and no two are alike. For some family owned and operated businesses, the next generation is the exit plan. How do you get the stock to them, yet ensure that your personal retirement is secure?



Whether it is an A-B recapitalization, a trust arrangement or outright gifts of voting stock, the stock will require valuation. Stocks of privately-held companies are as high as they were in the 90's and family organizations would be gifting shares at the top. Companies are selling in a range of 6-9X EBITDA – about 30% higher than in the doldrums of 2001-2002. Fortunately, a conservative top-line valuation, proper succession and tax planning, and the reduction in value through discounts make this a less painful undertaking. Most company shares are transferred as minority interests over a period of years. Discounts for minority interests are about 15% (all industry average) at present. Privately-held companies are also entitled to a discount for lack of marketability. These discounts usually run from as low as 20% to a high of 45%, depending upon

#### THE TUCKER & MELTZER DIFFERENCE

Tucker & Meltzer Valuation Advisors are independent business valuation advisors. We provide no other services (accounting, legal, financial planning or investment). Tucker & Meltzer represents an economical alternative to more expensive accounting and large valuation firms. We offer accurate, well documented, up to date, and market based value comparisons and promise an exceptional turn-around time. We have the experience and knowledge to handle the tough jobs and we look forward to having the opportunity to work with you.

#### Announcing . . .



Brooke and Anne attended the 2006 AICPA National Business Valuation Conference in Austin, Texas in early December.

Great conference. Keynote speaker was Sherron Watkins, a former VP at Enron, on "What Went Wrong."

shareholder restrictions. Applied together, these discounts can reduce the value of the stock by as much as 50%. □

## VALUATION PERSPECTIVES

### DISCOUNTS FOR LACK OF MARKETABILITY REDUX.

We return to the Discount for Lack of Marketability (DLOM) as it is the discount that most tax courts love to hate. Simply put, an interest in a publicly traded security is more marketable (liquid) than a privately-held interest (private company or FLP). Discounts range widely (20% - 40% usually) and are very difficult to document. It is this lack of real time, real world documentation that engenders the most controversy in court decisions. Each circumstance in which a valuation expert opines as to the marketability discount, there is a difference of opinion by the opposing expert and neither side has any truly concrete method for determining such a discount. The discount is an estimate based on the best available market information and as interpreted by the valuation expert – therefore the discount is HYPOTHETICAL.



Many valuation practitioners cite the 25+ lack of marketability studies commonly referred to as the IPO studies and the Restricted Stock Studies. Over the past two decades, these studies have documented investor behavior when confronted with illiquid stocks. The conclusions appear to be that a stock which cannot be sold for a period of up to two years would have about a 30% - 33% DLOM. The studies make no mention of an FLP interest that is likely to be illiquid for a period of ten years. Further, these studies, although widely accepted, are often not very comparable to the subject interests. What does a 2% interest in a real estate partnership have to do with an IPO?

Enter the Quantitative Marketability Discount Model (QMDM) [1] which was developed in 1997 by Mercer Capital. The QMDM is a discounted cash flow (present value) model that determines a range of marketability discounts of illiquid interests in

privately-held businesses. It is based on expected shareholder level cash flows and the risks associated with those cash flows. Some have called it a “black box,” yet it is the theory of investor behavior relative to returns and holding periods in a mathematical formula. We use the QMDM at T&M as a primary method of determining the DLOM and as a check on our other methods. While not yet fully vetted in tax courts, the QMDM is being used by the Internal Revenue Service as an important tool in the valuation toolbox. □

[1] Mercer, Z. Christopher, *Quantifying Marketability Discounts: Developing and Supporting Marketability Discounts in the Appraisal of Closely Held Business Interests* (Memphis, TN: Peabody Publishing, LP, 1997).

## CASES IN BRIEF

### BANKRUPTCY COURT DISQUALIFIES "MAVERICK" DCF ANALYSIS

In federal bankruptcy court in Delaware (In re Nellson



The next American Society of Appraisers – Maryland Chapter meeting will be a dinner meeting on February 13th at Blue Pointe Grill in Ellicott City. Call Brooke for details.

## ON THE SUBJECT OF DISCOUNTS

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**"SIMPLY PUT, AN INTEREST IN A PUBLICLY TRADED SECURITY IS MORE MARKETABLE (LIQUID) THAN A PRIVATELY-HELD INTEREST (PRIVATE COMPANY OR FLP)."**

## RECENT ASSIGNMENTS

Consulting Engineering – ESOP

IT Company – Sale

Real Estate FLP (3) – Gifts

Real Estate FLP – Estate

Medical Practice – Charitable Gift

Web Hosting – Recapitalization

Wholesale Lighting – Planning

## BUSINESS VALUATION ALERT

### IRS TURNS UP THE HEAT ON APPRAISERS

Appraisers are now subject to severe

Nutraceutical, Inc.), the court precluded the valuation report of a qualified expert, primarily because in his discounted cash flow (DCF) analysis of the debtors, he used a measure of EBITDA minus Cap Ex (capital expenditures) to determine terminal value. The Judge (Sontchi) found the untested, unprecedented method to be unreliable pursuant to Daubert. Under Rule 702, expert testimony must be reliable and relevant to be admissible. While a valuation expert may get the right answer, he also has to perform the valuation within the accepted methodologies. About \$400 million was at stake and the debtor's case was thrown out.

For a copy of the Memorandum Opinion, [click here](#). □



Tucker & Meltzer - Valuation Advisors is a business valuation firm focused on the needs of family limited partnerships and closely-held companies. The firm's founding partners have extensive experience and credentials in valuing closely-held and asset holding companies. We have performed over 300 valuations for companies in a large number of industries, reflecting our broad experience in accounting, finance, litigation services, valuation theory and capital transactions.

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**penalties under the Pension Protection Act of 2006 for over/under appraisals. There are over 15 million tax returns filed each year in which taxpayers report an event involving a valuation related issue. The primary areas focused on by the IRS review are non-cash charitable contributions and conservation easements.** □

## PRIVACY STATEMENT

**We take your privacy very seriously.** T&M sends periodic (not frequent) announcements and newsletters to our friends and associates. To opt out of this newsletter, and all other email communications, click [here](#) to unsubscribe to BVA. □