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Introduction to Business Valuation

Interested in expanding your understanding of business valuation theory? This document presents a general overview of core business valuation concepts and will help you to get greater benefit from the work product of Firm Advisory Ltd.

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1. Valuation Approaches and Methods Explained

Essentially, all appraisals to determine value have their basis in the principle of substitution, which states, "The value of an item tends to be determined by the cost of acquiring an equally desirable substitute."

1.1. Premise of Value

The International Glossary of Business Valuation Terms defines the concept of premise of value as *"an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation;*

There are two fundamental bases on which a company may be valued:
- As a going concern
- As if in liquidation

The appraisal concept of 'highest and best use' requires an appraiser to consider the optimal use of the assets being appraised under current market conditions. Business appraisal theory recommends that unless otherwise instructed, if a business will command a higher price as a going concern, then it should be valued as such. Conversely, if a business will command a higher price if it is liquidated, then it should be valued as if in orderly liquidation.

1.2. Overview of Valuation Approaches

Going concern value assumes that the company will continue in business and looks to the company's earning power and cash generation capabilities as indicators of its value. Appraisers use three traditional approaches when assessing a business:

- The market approach
- The earnings or income approach
- The asset-based approach

Under each approach, specific valuation methods are available for use. Appraisal standards suggest that an appraiser test as many methods as may be applicable to the facts and circumstances of the property being appraised. It is then up to the appraiser's informed judgment as to how the results will be reconciled in delivering a final estimate of value.

1.3. Market Approach

The market approach uses information from the transactions of comparable businesses or value parameters of publicly traded companies as a basis for estimating the value of a business. When applied to the appraisal of common stock, consideration may be given to the financial condition and operating performance of the business being appraised relative to those of publicly traded companies in the same or a similar line of business and subject to similar economic, environmental, and political factors. This method may have limited applicability in appraising smaller closely held businesses when there is a lack of reliable information concerning sales of comparable privately held businesses and the unavailability of comparable publicly traded companies that can be used as guideline companies.

1.4. Earnings (Income) Approach

The earnings approach, which is income oriented, assumes that an equally desirable substitute for the business being appraised is one that has similar investment characteristics. This approach involves estimating the level of normal continuing earnings of a business, determining the applicable relationship between earnings and value, and then converting the expected earnings into an estimate of value. Generally, the approach is based on either historical or future earnings, depending on whether historical earnings are considered representative of the expected future earnings of the business.

Oftentimes, industries have appraisal formulas that are used to estimate the value of a business. Usually, these industry methods are expressed as a rule of thumb such as a multiple of revenue, earnings, units, assets, or equity. Rules of thumb are not recognized as acceptable methods for professional appraisal purposes because every valuation engagement has unique attributes.

1.5. Asset-Based Approach

The asset-based approach is based on the premise that one form of an equally desirable substitute for the business being appraised would be a duplicate of the underlying assets of the business. As applied to the appraisal of common stock, the asset-based approach calls for the summation of the fair market value of each individual asset and a reduction of that aggregate by the total liabilities of the business.

The asset-based approach is generally most appropriate for appraising several types of closely held businesses:

- Businesses that are non-operating, such as holding companies
- Businesses that do not have an established earnings history, such as start-up companies and businesses with highly volatile earnings
- Businesses that are not profitable or marginally profitable

The asset-based approach is particularly appropriate when the ownership interest being appraised has the ability to liquidate or sell the underlying assets of the business. Generally, the approach is not appropriate for appraising minority interests in a business.

1.6. Applicability of Approaches

The three approaches are not mutually exclusive but are somewhat interrelated. The appraisal process is composed of integrated, interrelated, and inseparable techniques and procedures designed to produce a convincing and reliable estimate of value.

It is important to note that the preliminary estimates of value may require modification to reflect the respective rights of the stockholders:

- A control premium may be applied when the ownership interest being appraised represents a controlling interest.
- A discount for lack of control may be applied when the ownership interest being appraised represents a minority interest.
- When the ownership interest represents the shares of a closely held business, a discount for lack of marketability may also be applied to recognize the lack of a ready market of buyers and the resultant lack of liquidity.

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2. Standards of Value

"It is not enough to state that the appraisal will determine the 'value' of what is being appraised. The term value has many different meanings in the valuation field. One of the first lessons to be learned relates to what are called 'standards of value'. These are also called 'definitions of value'. Before an assignment can be started, it is imperative that the standard of value that will be used in the assignment be clearly defined…"[1]

The most frequently used standards of value are fair market value, fair value and investment value.

2.1. Fair Market Value

Fair market value is the most commonly used standard in business appraisal engagements. The *International Glossary of Business Valuation Terms*, adopted by all of the major business appraisal organizations, defines fair market value as:

"The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "price" should be replaced with the term "highest price".}"

2.2. Fair Value

"The definition has been developed from case law primarily in dissenting and oppressed shareholder actions. This concept is also used in many corporate dissolution statutes…

…One of the fundamental differences between fair value and fair market value is that in the former situation there is rarely a 'willing seller'. Most courts are concerned with the concept of fairness, and as a result the valuation is intended to be 'equitable' for the disadvantaged party." 2

2.3. Investment Value

"The investment value of a closely held company is the value to a particular buyer, as compared with the population of willing buyers, as is the case in fair market value. This is one of those instances where the appraiser will determine the value to a particular person, instead of the hypothetical person…

…Investment value is being examined more closely by many of the family courts as the standard of value that is appropriate in divorce situations. In a divorce, the elements of fair market value are rarely present; the owner is not a willing seller, nor will there be a sale."[3]

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[1] Gary Trugman, Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses. (New York: American Institute of Certified Public Accountants, Inc., 1988), p. 57

[2] Gary Trugman, Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses. (New York: American Institute of Certified Public Accountants, Inc., 1988), p. 61

[3] Gary Trugman, Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses. (New York: American Institute of Certified Public Accountants, Inc., 1988), p. 62

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3. The 8 Valuation Factors

As per industry standard, business valuation professionals consider 8 key factors when determining value of a business interest. These factors are described in *Revenue Ruling 59-60*, the authoritative guidance issued by the *Internal Revenue Service* for the appraisal of closely held businesses and are reflected in the guidance given to industry professionals in other jurisdictions.

The factors to be considered are:
1. The nature of the business and the history of the enterprise from its inception;
2. The economic outlook, in general, and the condition and outlook of the specific industry, in particular;
3. The book value of stock and the financial condition of the business;
4. The earnings capacity of the company;
5. The dividend-paying capacity;
6. Whether or not the enterprise has goodwill or other intangible value;
7. Sales of stock and the size of the block of stock to be valued;
8. The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over the counter.

4. Control: Majority and Minority Interests

Identification of the level of control held by the subject interest is very important. Control refers to the ability to manage or control the business. A minority interest, by definition, does not have control.

The layperson may incorrectly believe that a minority interest is worth its proportionate interest in a business. This is seldom, if ever, correct. For example, a 20% interest in a business valued at $100,000 is not likely to be worth $20,000. Instead, it is likely to be worth less than $20,000. Minority interests in a business are typically worth less, often a lot less, than the proportionate share of the business.[4]

4.1. Adjustments for Discounts and Premiums

Before doing the weighting and reconciliation of the indicated values in order to determine the final estimate of value, the need for any adjustments for discounts and premiums must be reviewed. First, it should be noted that businesses are not bought and sold after applying discounts and premiums. Instead, discounts and premiums are the result of using less-than-perfect data to measure value.[5] It is critical to identify the base or level of value for each indicated value before discussing valuation discounts or premiums.[6] This is necessary as some appraisal methods generate a level of value with characteristics different from the base or level of value needed for the valuation. In cases such as this, a discount or premium must be applied to move the indicated value to the desired base or level of value.[7]

[4] Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. Guide to Business Valuations. (Fort Worth: Practitioners Publishing Business, 1999) Ninth Edition, Volume 2, p. 8-15, paragraph 803.4.

[5] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. xxi.

[6] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 346.

[7] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. 2.

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The standard of value used in the valuation has a very large impact on the magnitude of any applicable discounts and premiums or on whether or not discounts and premiums should be applied at all. Using the fair market value standard of value, the specific ownership interest being valued is being valued "as is," including any control or marketability characteristics of the ownership interest. Because of this, minority interests in closely held companies are valued to reflect their lack of control and lack of marketability characteristics.[8] In some states, family law courts use the investment value standard of value. In these cases, the attempt is to identify what is called "value to the owner" or the marital community instead of value in exchange as is the case in a fair market value standard of value. In cases such as this, when the company is family owned, there may be no minority discount for a minority owner because through family attribution, the owner is assumed to be part of a control group.[9]

Some discounts and premiums apply to an entire entity, others apply only to specific blocks of ownership. These are typically distinguished as entity level discounts and premiums versus "shareholder" level discounts and premiums.[10] "Shareholder" level discounts and premiums often apply to partnerships, limited liability companies, and other entities that do not issue "stock." Examples of entity level discounts and premiums are key person and environmental liability discounts. Shareholder level discounts and premiums are most commonly encountered in business appraisals. The most often encountered are control premiums, minority interest discounts (perhaps more clearly referred to as discounts for lack of control), and marketability discounts (also known as discounts for lack of marketability).[11] Some marketability discounts are taken from control level values, others from minority ownership levels. In order to distinguish between the two, discounts from control level values will be called illiquidity discounts[12] and discounts from minority or non-controlling levels of value will be called discounts for lack of marketability.[13]

4.2. Control Premium

Some appraisal methods produce an indicated value that is based on a non- controlling basis. In these cases, a control premium must be applied to move the indicated value from a non-control value to a control value for use in an appraisal of a controlling interest. A control premium is based on the premise that a controlling interest in a company has the ability to do many things that a non-controlling or minority interest cannot do.

[8] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. 14.

[9] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. 14.

[10] Shannon P. Pratt. Business Valuation Discounts and Premiums. (New York: John Wiley & Sons, Inc., 2001), p. 3.

[11] Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. Guide to Business Valuations. (Fort Worth: Practitioners Publishing Company, 1999) Ninth Edition, Volume 2, p. 8-14, paragraph 803.3.

[12] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 416.

[13] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 394.

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A controlling interest has the ability, among others, to:

- Appoint management.
- Determine management compensation and perquisites.
- Set policy and change the course of business.
- Acquire or liquidate assets.
- Select people with whom to do business and award contracts.
- Make acquisitions.
- Liquidate, dissolve, sell out, or recapitalize the company.
- Sell or acquire Treasury shares.
- Declare and pay dividends.
- Change the articles of incorporation or bylaws.
- Block any of the above actions. [14]

Lacking the ability to control things such as the aforementioned, a minority interest would be worth less money to a "willing buyer" than a control interest. Some companies do not fit into this pattern for a variety of reasons. Each situation must be looked at on a case-by-case basis.

4.3. Discount for Lack of Control

When appraising a minority (non-controlling) interest, the need for the application of a Discount for Lack of Control depends on the specific appraisal method employed. For example, when using a Discounted Cash Flow Method or a Single Period Capitalization income method, whether or not the appraiser adjusts the income stream generally determines if a Discount for Lack of Control is necessary.

If control type adjustments are made to the income stream, then a Discount for Lack of Control is typically necessary. However, if no control type adjustments are made to the income stream (or those made are those applicable to a minority interest), the income stream is applicable to a minority (non-controlling) interest. Therefore, no Discount for Lack of Control should be applied.

4.4. Discount for Lack of Marketability

The concept of marketability refers to the relative level of difficulty required to exchange a business interest for economic benefit.

A variety of studies have been made to try to quantify discounts for lack of marketability. According to Gary Trugman in his book, *Understanding Business Valuation*, the average marketability discount ranges between 25% and 45%.[15] Chris Mercer in his book *Quantifying Marketability Discounts*, states *"marketability discounts can range from very small (in the range of 5% to 10%) to quite large (60% to 80% or more)."*[16]

Determination of the appropriately sized marketability discount is a key part of the professional business appraiser's skill set.

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[14] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. Valuing a Business: The Analysis and Appraisal of Closely Held Companies. Fourth Edition. (New York: McGraw-Hill, 2000), p. 365-366.

[15] Gary Trugman, Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses. (New York: American Institute of Certified Public Accountants, Inc., 1988), p. 373.

[16] Z. Christopher Mercer. Quantifying Marketability Discounts: Developing and Supporting Marketability counts in the Appraisal of Closely Held Business Interests. (Memphis, Tenn: Peabody Publishing, LP, 1997), p. 29.

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4.5. Illiquidity Discount

For valuing a controlling interest in a company, a marketability discount must be identified that will be sufficient to convert the Control Marketable Value to a Control Non-Marketable Value.

This discount should approximate the cost of taking the company public, if this is feasible, or the cost involved in selling the company if a public offering is not feasible.

5. International Glossary of Business Valuation Terms[17]

To enhance and sustain the quality of business valuations for the benefit of the business valuation profession and the users of the services of its practitioners, the below identified societies and organizations whose members provide business valuation services have adopted the definitions for the terms included in this glossary.

- American Institute of Certified Public Accountants
- American Society of Appraisers
- Canadian Institute of Chartered Business Valuators
- National Association of Certified Valuation Analysts
- The Institute of Business Appraisers

The performance of business valuation services requires a high degree of skill, and imposes upon the valuation professional a duty to communicate the valuation process and conclusion, as appropriate to the scope of the engagement, in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to the business valuation practitioners who are members of the listed societies, organizations, and others performing valuations of business interests or securities by further memorializing the body of knowledge which constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

ADJUSTED BOOK VALUE – the value that results after one or more asset or liability amounts are added, deleted, or changed from their respective financial statement amounts.

APPRAISAL – See Valuation.

APPRAISAL APPROACH – See Valuation Approach.

[17] Source: the Appraisal Institute

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APPRAISAL DATE – See Valuation Date.

APPRAISAL METHOD – See Valuation Method.

APPRAISAL PROCEDURE – See Valuation Procedure.

ASSET (ASSET-BASED) APPROACH – a general way of determining a value indication of a business, business ownership interest, or security by using one or more methods based on the value of the assets of that business net of liabilities.

BENEFIT STREAM – any level of income, cash flow, or earnings generated by an asset, group of assets, or business enterprise. When the term is used, it should be supplemented by a definition of exactly what it means in the given valuation context.

BETA – a measure of systematic risk of a security; the tendency of a security's returns to correlate with swings in the broad market.

BLOCKAGE DISCOUNT – an amount or percentage deducted from the current market price of a publicly traded security to reflect the decrease in the per share value of a block of those securities that is of a size that could not be sold in a reasonable period of time given normal trading volume.

BUSINESS – see Business Enterprise.

BUSINESS ENTERPRISE – a commercial, industrial, service, or investment entity, or a combination thereof, pursuing an economic activity.

BUSINESS VALUATION – the act or process of determining the value of a business enterprise or ownership interest therein.

CAPITAL ASSET PRICING MODEL (CAPM) – a model in which the cost of capital for any security or portfolio of securities equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the security or portfolio.

CAPITALIZATION – a conversion of a single period stream of benefits into value.

CAPITALIZATION FACTOR – any multiple or divisor used to convert anticipated benefits into value.

CAPITALIZATION RATE – any divisor (usually expressed as a percentage) used to convert anticipated benefits into value.

CAPITAL STRUCTURE – the composition of the invested capital of a business enterprise, the mix of debt and equity financing.

CASH FLOW – cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a definition of exactly what it means in the given valuation context.

CONTROL – the power to direct the management and policies of a business enterprise.

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CONTROL PREMIUM – am amount (expressed in either dollar or percentage form) by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise.

COST APPROACH – a general way of estimating a value indication of an individual asset by quantifying the amount of money that would be required to replace the future service capability of that asset.

COST OF CAPITAL – the expected rate of return (discount rate) that the market requires in order to attract funds to a particular investment.

DISCOUNT– a reduction in value or the act of reducing value.

DISCOUNT FOR LACK OF CONTROL – an amount or percentage deducted from the pro rata share of value of one hundred percent (100%) of an equity interest in a business to reflect the absence of some or all of the powers of control.

DISCOUNT FOR LACK OF MARKETABILITY – an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

DISCOUNT RATE – a rate of return (cost of capital) used to convert a monetary sum, payable or receivable in the future, into present value.

ECONOMIC LIFE – the period of time over which property may generate economic benefits.

EFFECTIVE DATE – See Valuation Date.

ENTERPRISE – See Business Enterprise Equity Net Cash Flows – those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and reflecting increases or decreases in debt financing.

EQUITY RISK PREMIUM – a rate of return in addition to a risk-free rate to compensate for investing in equity instruments because they have a higher degree of probable risk than risk-free instruments (a component of the cost of equity capital or equity discount rate.)

EXCESS EARNINGS – that amount of anticipated benefits that exceeds a fair rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated benefits.

EXCESS EARNINGS METHOD – a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets obtained by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See Excess Earnings.

FAIR MARKET VALUE – the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "price" should be replaced with the term "highest price".}

FAIR VALUE – the proportionate amount of the total entity value without regard to discounts to reflect a minority position (for lack of control or lack of marketability attributable to the minority position).

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FORCED LIQUIDATION VALUE – liquidation value at which the asset or assets are sold as quickly as possible, such as at an auction.

GOING CONCERN – an ongoing operating business enterprise.

GOING CONCERN VALUE – the value of a business enterprise that is expected to continue to operate into the future.

GOODWILL – that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

GOODWILL VALUE – the value attributable to goodwill.

INCOME (INCOME-BASED) APPROACH – a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated benefits into a present single amount.

INTANGIBLE ASSETS – non-physical assets (such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities and contracts as distinguished from physical assets) that grant rights, privileges, and have economic benefits for the owner.

INVESTED CAPITAL – the sum of equity and debt in a business enterprise. Debt is typically a) long-term liabilities or b) the sum of short-term interest-bearing debt and long-term liabilities. When the term is used, it should be supplemented by a definition of exactly what it means in the given valuation context.

INVESTED CAPITAL NET CASH FLOWS – those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

INVESTMENT RISK – the degree of uncertainty as to the realization of expected returns.

INVESTMENT VALUE – the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is "Value to the Owner"}

KEY PERSON DISCOUNT – an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

LEVERED BETA – the beta reflecting a capital structure that includes debt.

LIQUIDITY – the relative ability to convert assets to cash or to pay a liability.

LIQUIDATION VALUE – the net amount that can be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced".

MAJORITY CONTROL – the degree of control provided by a majority position.

MAJORITY INTEREST – an ownership interest greater than fifty percent (50%) of the voting interest in a business enterprise.

MARKET (MARKET-BASED) APPROACH – a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that

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compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

MARKETABILITY – the relative ability to convert assets to cash very quickly and at a minimal cost.

MARKETABILITY DISCOUNT – See Discount for Lack of Marketability.

MINORITY DISCOUNT – a discount for lack of control applicable to a minority interest.

MINORITY INTEREST – an ownership interest less than fifty percent (50%) of the voting interest in a business enterprise.

NET BOOK VALUE – with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities of a business enterprise as they appear on the balance sheet (synonymous with Shareholder's Equity); with respect to an intangible asset, the capitalized cost of an intangible asset less accumulated amortization as it appears on the books of account of the business enterprise.

NET CASH FLOW – a form of cash flow. When the term is used, it should be supplemented by a qualifier (for example, "Equity" or "Invested Capital") and a definition of exactly what it means in the given valuation context.

NET TANGIBLE ASSET VALUE – the value of the business enterprise's tangible assets (excluding excess assets and non-operating assets) minus the value of its liabilities. {NOTE: in Canada, tangible assets also include identifiable intangible assets}

NON-OPERATING ASSETS – assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "Redundant Assets"}

ORDERLY LIQUIDATION VALUE – liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

PREMISE OF VALUE – an assumption as to whether a business enterprise or intangible asset will be valued in liquidation or as a going concern.

PORTFOLIO DISCOUNT – an amount or percentage that may be deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that may not fit well together.

RATE OF RETURN – an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

REDUNDANT ASSETS – {NOTE: in Canada, see "Non-Operating Assets"}

REPORT DATE – the date conclusions are transmitted to the client.

REPLACEMENT COST NEW – the current cost of a similar new property having the nearest equivalent utility to the property being valued.

REPRODUCTION COST NEW – the current cost of an identical new property.

RESIDUAL VALUE – the prospective value as of the end of the discrete projection period in a discounted benefit streams model.

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RISK-FREE RATE – the rate of return available in the market on an investment free of default risk.

RISK PREMIUM – a rate of return in addition to a risk-free rate to compensate the investor for accepting risk.

RULE OF THUMB – a mathematical relationship between or among variables based on experience, observation, hearsay, or a combination of these, usually applicable to a specific industry.

SPECIAL INTEREST PURCHASERS – acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

STANDARD OF VALUE – the identification of the type of value being utilized in a specific engagement.

SUSTAINING CAPITAL REINVESTMENT – the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

SYSTEMATIC RISK – in relation to the market, the risk that is common to all risky securities and cannot be eliminated through diversification. In relation to an investment, the uncertainty of future returns resulting from the tendency of a security's returns to respond to swings in the broad market.

TERMINAL VALUE – See Residual Value.

UNLEVERED BETA – the beta reflecting a capital structure without debt.

UNSYSTEMATIC RISK – the uncertainty of future returns because of characteristics of the industry, the individual company, and the type of investment interests, that can be avoided through diversification.

VALUATION – the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

VALUATION APPROACH – a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

VALUATION DATE – the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

VALUATION METHOD – within approaches, a specific way to determine value.

VALUATION PROCEDURE – the act, manner, and technique of performing the steps of an appraisal method.

VALUATION RATIO – a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

WEIGHTED AVERAGE COST OF CAPITAL (WACC) – the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.