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The Value Examiner®

A PROFESSIONAL DEVELOPMENT JOURNAL *for the* CONSULTING DISCIPLINES

SPECIAL ISSUE

On The Cover

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Special Issue: Valuing Sports Teams

Autumn. The days are growing shorter, the nights are crisper, and the thrill of a home run competes with the completion of a forward pass and a perfect jump shot. This Special Issue of *The Value Examiner* takes a critical look at how baseball, basketball, and football teams are valued.

In This Issue...

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VALUATION

Exploring the Major League Baseball Value Explosion

By Donald Erickson, ASA

From 2000 to 2005, Major League Baseball teams were selling for much less than National Football League teams, i.e., typically under $200 million. Most of the MLB teams were showing losses at the time, and there was limited interest in buying the teams that did come up for sale. But the buying and selling environment has changed dramatically in 2012, with the Los Angeles Dodgers selling for over $2.15 billion in a spirited auction with sixteen initial bidders.[1]

What has caused this explosion in MLB prices and do these high prices make sense?

In this article, I attempt to answer this question as I discuss MLB franchise price/value changes in the last fifteen years and whether these dramatic jumps in prices/values make economic/market sense.

First, I illustrate actual transaction prices for MLB teams in the early 2000s. I then show the significant increases—starting in 2008—leading to the blockbuster $2.15 billion Dodgers deal in 2012.

I then demonstrate the value changes published by *Forbes Magazine* and discuss key economic changes in the industry (i.e. MLB) that have contributed to these price jumps of twice—and sometimes three times—the 2005 prices for MLB franchises.

Finally, I explore the actual financials for the Texas Rangers and a history of the prices paid for the Rangers over the years.

For definition purposes, when we discuss values, we are always discussing enterprise (equity + debt), not equity values, and when we discuss revenue multiples, we are discussing total revenues from team/franchise and stadium interests, but excluding regional sports network (RSN) interests.

DEAL PRICES AND MLB VALUES ESTIMATED BY *FORBES MAGAZINE*

As Chart 1 shows, enterprise prices for MLB teams from 2000 to 2005 were less than $200 million, except for the 2004 Dodgers deal, which came in at $430 million. In 2006, two transactions increased to the low $400 million range. In 2008, a San Francisco Giants deal indicated $700 million, and the Chicago Cubs in 2009 were sold for over $800 million. In 2009 during the "Great Recession," a smaller market team, the San Diego Padres, transacted at $500 million. Also in 2009, the Texas Rangers sold at $595 million during a bankruptcy bidding war. Finally, the chart shows the big jump with the bankruptcy auction prices of the L.A. Dodgers and their stadium and land at $2.15 billion in 2012.

CHANGES IN REVENUE MULTIPLES

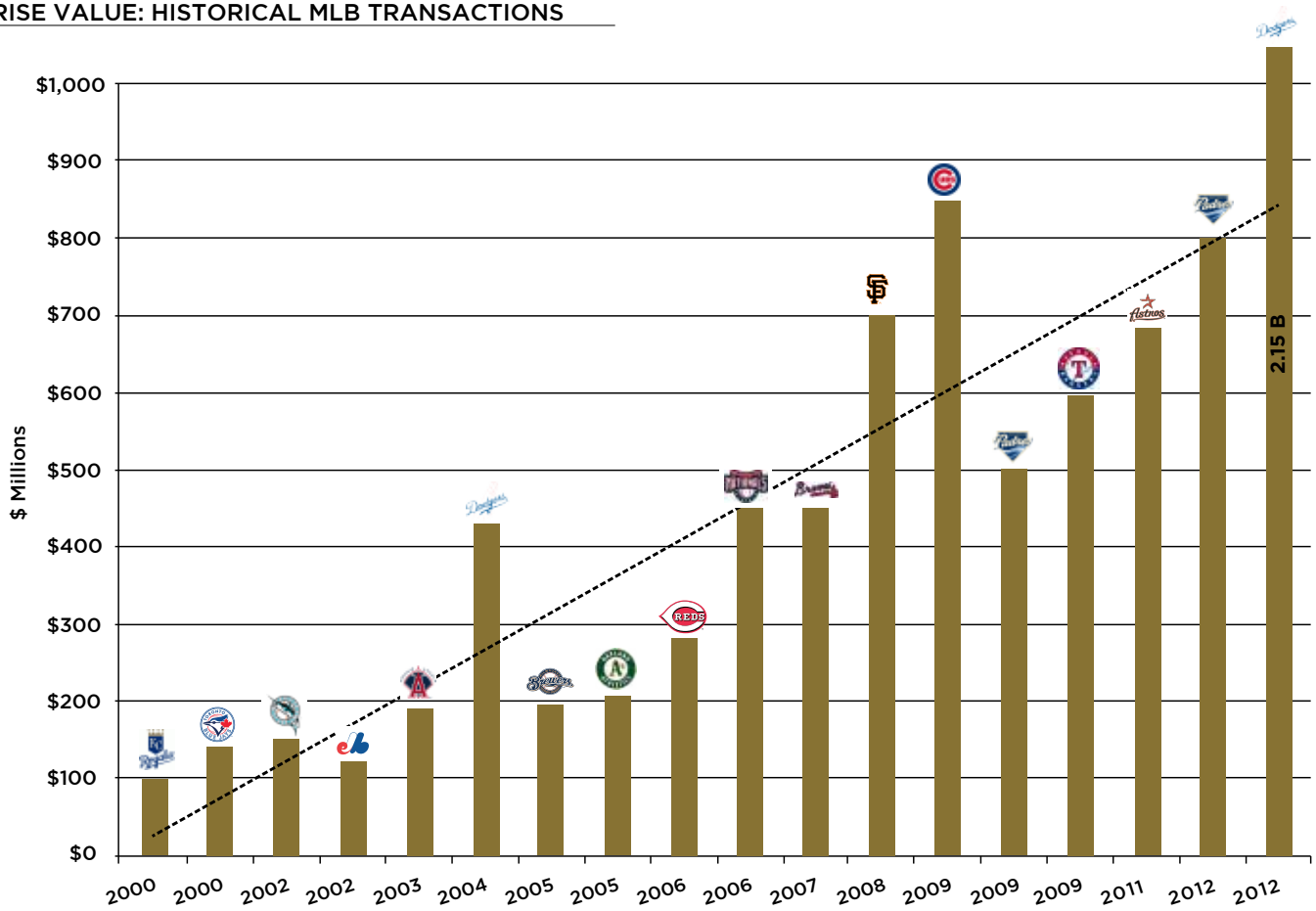
Unlike entities in other industries, major league sports teams are usually valued using a market approach rather than an income approach. Most of their enterprise values are referenced as a multiple of team and stadium revenues.

The multiples in revenues paid for actual transactions in the early 2000s were in the 2.0 times to 2.5 times range, but recent deals have been over 4.0 times revenues. The recent 4.0 times multiple reflects anticipated growth in revenues since sophisticated and well-heeled buyers are anticipating significant future revenue growth.

1 Brian Solomon, "$2 Billion Dodgers Sale Tops List of Most Expensive Sports Team Purchases Ever," *Forbes Magazine*, March 29, 2012, http://www.forbes.com/sites/briansolomon/2012/03/29/2-billion-dodgers-sale-tops-list-of-most-expensive-sports-team-purchases-ever/.

CHART 1: HISTORICAL MLB DEAL PRICES

ENTERPRISE VALUE: HISTORICAL MLB TRANSACTIONS



Source: Proprietary

In Table 1, *Forbes* estimates are developed by *Forbes* editors utilizing public sources, their proprietary methods of estimating team revenues and expenses, and their judgment as to the valuation multiple to be applied to their revenue estimates.[3]

MLB VALUES ACCORDING TO *FORBES* MAGAZINE

TABLE 1: MLB VALUES ACCORDING TO FORBES MAGAZINE[2]

Team Name	Current Value ($mil)	Revenues ($mil)	Operating Income ($mil)	Revenue Multiple (rounded)
New York Yankees	$1306	$627	-47.3	4.0x
New York Mets	$824	$235	32.9	3.5x
Boston Red Sox	$816	$263	-19.1	3.1x
L.A. Dodgers	$694	$224	20.0	3.1x
Chicago Cubs	$642	$214	21.4	3.0x
L.A. Angels	$500	$200	15.2	2.5x
Atlanta Braves	$497	$199	28.1	2.5x
San Francisco Giants	$494	$197	19.9	2.5x
St. Louis Cardinals	$484	$194	21.5	2.5x
Philadelphia Phillies	$481	$192	14.3	2.5x
League Average	**$472**	**$183**	**16.4**	**2.6x**

2 Michael K. Ozanian and Kurt Badenhausen, "The Business of Baseball," *Forbes Magazine*, April 16, 2008, http: http://www.forbes.com/2008/04/16/baseball-team-values-biz-sports-baseball08-cx_mo_kb_0416baseballintro.html.

Note the remaining nineteen teams are shown on the NACVA website at http://www.nacva.com/examiner/14-SO-Charts.asp.

TABLE 2: 2014 *FORBES* MLB VALUES[4]

Team Name	Current Value ($ bil/mil)	Revenues ($mil)	Operating Income ($mil)	Revenue Multiple (rounded)
New York Yankees	$2.5 billion	$461	-9.1	5.4x
L.A. Dodgers	$2.0 billion	$293	-81.0	6.8x
Boston Red Sox	$1.5 billion	$357	25	4.2x
Chicago Cubs	$1.2 billion	$266	27	4.5x
San Francisco Giants	$1.0 billion	$316	53	3.2x
Philadelphia Phillies	$975 million	$265	-21	3.7x
Texas Rangers	$825 million	$257	-5	2.9x
St. Louis Cardinals	$820 million	$283	65	3.4x
New York Mets	$800 million	$238	2	3.1x
L.A. Angels	$775 million	$253	6	3.1x
League Average	**$811 million**	**$237**	**10**	**3.3x**

By 2014 (see Table 2), *Forbes* average MLB value estimate had jumped to $811 million and had a 3.3 times multiple. The values ranged from $2.5 billion for the Yankees to $485 million for the Tampa Bay Rays.

The average revenue estimates for the league have only increased from $183 million to $237 million or thirty percent. Yet the average valuation multiple increased from 2.6 times to 3.3 times causing the average team value to increase sixty-four percent. What caused this significant increase? The answer: potential for increased local revenues due to an explosion in media rights fees.

METEORIC MEDIA RIGHTS FEE INCREASES

As mentioned earlier, recent media rights fees for local broadcasts of MLB teams have increased three to five times that of older contracts. These older contracts may have been ten years in length, but the new ones can be in force as long as twenty-five years.

Unlike the total revenues for NFL teams and, to a lesser extent, those of the NBA, local media rights fees make up the majority of revenues for MLB teams. In many markets, the content providers (cable and satellite companies) are vying for a unique live product that can differentiate them in the marketplace. This competition has caused bidding wars for TV and other media rights to MLB teams.

The largest current local MLB media contract was negotiated by the L.A. Dodgers, and was recently approved by MLB. In this contract, the L.A. Dodgers will reportedly receive $6 billion after a revenue-sharing split with MLB. This equates to an average of $240 million a year over twenty-five years. The old Dodgers contract was approximately $50 million dollars in its last year.

The next highest are the Texas Rangers and the Houston Astros at $80 million a year on average. In addition, the national TV MLB has jumped also—see Table 3.

3 Until recently, *Forbes* was the only public source of estimates for major league sports teams. They have been developing revenue, profit, and value estimates for over seventeen years. Numbers are as of Dec. 31, 2013.

4 Mike Ozanian, "Baseball Team Values 2014 Led by New York Yankees at $2.5 Billion," *Forbes Magazine*, March 26, 2014, http://www.forbes.com/sites/mikeozanian/2014/03/26/baseball-team-values-2014-led-by-new-york-yankees-at-2-5-billion/.

It should be noted that part of the massive increase in payments to the L.A. Dodgers by Time Warner Cable is covered by Time Warner's plan to pass the costs on to other pay TV providers, including Direct TV, Dish Network, Charter Communications, and Cox Communications.

Currently, Time Warner Cable and their providers are deadlocked on the price increases they will pay for airing the L.A. Dodger games. The providers contend that Time Warner's cable price for their L.A. Dodger sports channel is too high. How this negotiation is settled will affect prices other providers pay nationwide. For example, the Houston Astros RSN has not been picked up by many of the local providers and the RSN has been forced to file for bankruptcy.

TABLE 3: LARGEST RECENT DEALS FOR LOCAL MEDIA CONTRACTS[5]

Team	Average Annual Rights Fees	Dates
L.A. Dodgers	$240M	2014–2039
Philadelphia Phillies	$100M	2015–2040
Seattle Mariners	$100M	2012–2032
Houston Astros	$80M	2013–2033
Texas Rangers	$80M	2015–2035
L.A. Angels	$150M	2013–2030
San Diego Padres	$50M	2012–2032

"How this negotiation is settled will affect prices other providers pay nationwide."

TABLE 4: MLB NATIONAL TV DEALS CHART[6]

NETWORK	YEARS	CURRENT DEAL TOTAL	AVERAGE ANNUAL	YEARS	NEW DEAL TOTAL	AVERAGE ANNUAL
ESPN	2006–13	$2.37 billion	$296 million*	2014–21	$5.6 billion	$700 million
Fox	2007–13	$1.8 billion	$257 million	2014–21	$4.2 billion^	$525 million^
TBS	2007–13	$1.4 billion	$148.6 million	2014–21	$2.6 billion	$325 million

Table 4 shows the changes in the MLB National media contracts with the various networks. We note that the ESPN contracts increased from $296 million a year to $700 million a year. The Fox contract increased from $257 million a year to $525 million a year, etc. In short, the new national contracts increased by 120 percent from the other contract.

At the height of the recession, the San Diego Padres sold for $500 million in 2009. It resold in 2012 for $800 million due primarily to a major jump in a local media contract.

Are the teams making so much money that they warranted such a much higher price based on profits? The answer, surprisingly, is "no, not really."

5 Sources: Proprietary team sources.
6 Christina Settimi, "Baseball Scores 12 Billion in Baseball Deals," *Forbes Magazine*, October 2, 2012, www.forbes.com.

CASE STUDY: TEXAS RANGERS

The Texas Rangers sale in 2009 to the highest bidder out of bankruptcy court[7] is a good example. (Table 5.)

TABLE 5: TEXAS RANGERS FINANCIAL SUMMARY[8]

	2008	2009
Total Revenues	$149,462	$167,368
Operating Income	<356>	<7,452>

Note that these numbers were prior to any regional media contract increases now scheduled to begin with the 2015 season.

Also note that annual amounts shown in the both the local and national contracts are averages and the initial year of the contract is usually much less than the average price shown.

All teams are subject to a player salary cap, which come with significant penalties if violated. So conceptually, if your revenues go up $50 million in a particular year, that amount could fall to the bottom line. How much is $50 million of profit worth to buyers whose primary value driver is not cash flow? It could be $500 million. It could be $1 billion. Which then causes people to wonder how much profit do these teams actually make?

TABLE 6: TEXAS RANGERS PRICE HISTORY: 1974 TO PRESENT[9]

Purchaser	Date	Enterprise Price
Brad Corbett	1974	$11M
Eddie Chiles	April 1980	$30M
George W. Bush	1989	$80M
Tom Hicks	1998	$250M
Current Group	August 2010	$595M
Value Today	July 2014	?

The answer is that many lose money—some significant amounts. Many people ask why anyone would pay these amounts to buy teams if they do not make a reasonable profit. There are two main answers to that:

1. Every buyer has a different motivation.
2. Few of us can look at "investments" through the lens of a multi-billionaire to whom a $10 to $50 million annual loss is not significant to their financial well-being.

TEXAS RANGERS PRICE HISTORY

The Texas Rangers also provide a good example of transaction price changes in the MLB. Table 6 shows the transactions in the team since 1974.

Please note that in the $595 million 2010 transaction, the team was making very little money and with signing bonuses deducted, was not cash flow positive. What is the value of this team, considering such facts?

CONCLUSION

The intensity of local revenues for MLB has created a perfect storm for MLB teams as the media engages in a buying frenzy for live local sports entertainment.

Multiples of 4.0 times revenues are now becoming the new normal versus 2.0 times prior to 2006 driven by local revenue growth with media leading the way. Media contracts are increasing three to five times the annual amounts negotiated in the early to mid-2000s. The outlook for increased local media contracts will create new and higher MLB club transactions for years to come.

But what about value creation? In the case of the Dodgers, if their media revenue increases up hypothetically $200 million a year from the previous contract, how much increase in value will that create? Could it be an extra billion dollars or more? At the end of the day, these local media contract increases, coupled with the new increased national media contracts, generally tend to support the new much higher level of MLB prices.

Obviously, the smaller markets do not enjoy the same increases as the major markets like Los Angeles and New York, etc., but their new contracts will increase in multiples of older contracts i.e., from $15 to $20 million a year to $50 million plus as media providers compete for the exclusive content that live sports provides. VE

7 Bankruptcy Court For The Northern District Of Texas Fort Worth Division, *Texas Rangers Baseball Partners*, Chapter 11, Case No. 10-43400-DML.

8 Source: Proprietary

9 Source: Proprietary

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DOES ON-FIELD PERFORMANCE DRIVE HIGHER TRANSACTION PRICES OF MLB TEAMS?

To partially answer this question, let's look at the performance and ranking of two recent sales of MLB teams—the San Diego Padres and the Los Angeles Dodgers. As mentioned earlier, the Padres were sold in 2012 for sixty percent more than their price in 2009, yet their performance as shown in the chart below was average. The same is true of the Dodgers, which sold in 2012 for $2.15 billion dollars—the highest price in the history of the MLB.

	2009		2010		2011		2012	
	W/L%	NL Standings	W/L%	NL Standings	W/L%	NL Standings	W/L%	NL Standings
SD Padres	0.463	12th	0.556	5th	0.438	15th	0.469	11th
L.A. Dodgers	0.586	1st	4.0494	9th	0.509	7th	0.531	6th

I believe the answer is very little—the outlook for higher revenues is much more impactful on value of MLB teams. The reason: you can always change your general manager and player mix—both locale and the long term reputation of the trademark are more important.

VALUATION

A Case for the Cards: Using Value Inference Indicators as a Scorecard for MLB Executive Organizations

By Tony Wayne, CVA, CIRA, CFF, FCPA, CPA

Defining the subject entity and its business model is crucial to the process of developing any valuation, at any level of formality. Nowhere is this more dynamic and challenging than with Major League Baseball franchises and their closely related business operations. The "what business are we in" question is fascinating to ponder and essential to explore in understanding how to evaluate the relative worth of the 30 MLB franchises

Over the past 17 years, *Forbes Magazine* has undertaken an estimation of the enterprise values of the MLB franchises. More recently, *Bloomberg* has also joined the party and published their own valuation findings. Among other things, the findings of these two high-profile publishers of business information demonstrate the dramatic differences in value outcomes between bygone days and today. They vividly illustrate the effects on value of the rapidly changing world of sports entertainment via its delivery systems and technologies, major demographical shifts, and other changes in the marketplace that are profoundly shaping the future landscape of sports broadcasting.

But, how do *Forbes* and *Bloomberg* see and understand the MLB franchise business model and how does that affect their valuations of these franchises? What do these results tell us about analyzing and valuing executive organization performance? And, how might this affect the use by appraisers of their valuation estimates?

To answer such questions and offer some insights into this shifting landscape, we will critically examining the foundational assumptions of the *Forbes* "Business of Baseball" articles published March 26, 2014. We will discuss a stunning case example of the problem at hand—the St. Louis Cardinals (the Cards), the top-managed organization in professional sports, yet a virtual steal at $805-830 million as estimated by *Forbes.* We will then conclude with several takeaways for us as appraisers.

OUR RESEARCH PROCESS

In order to fully understand the *Forbes* and *Bloomberg* value estimates, we developed a comprehensive scorecard of various data, analytics, business performance indicators, fan demand metrics, and financial information.

We did not have access to comprehensive and detailed historical financial and operational information for the MLB teams, and thus had no opportunity to independently analyze critical financial, operating, and value-driver indicators. We simply worked with the value estimations developed by *Forbes* and the underlying detail provided in the various information sources. Our goal was to assess whether, on the surface, the *Forbes* assumptions and value inference estimations made sense and appeared consistent across the 30 teams.

In addition, we spoke with Michael Ozanian, executive editor of *Forbes* who co-authored "The Business of Baseball" articles. Mike's passion is taking lots and lots of numbers and turning them into proprietary concepts and multi-platform content. Three of his long-standing publishing creations include the valuations of sports teams, ranking actors, and movie studios on bang for the buck (usually referred to as return on investment—ROI) and the *Forbes* Fab 40 (the most valuable sports brands). As an executive editor at *Forbes,* he also serves as co-host and managing editor of the three-time New York Emmy award-winning *Forbes SportsMoney* on the YES Network.

We attempted to analyze everything from relative ticket prices, attendance vs. attendance potential, relative market population, number of television households per the Nielsen organization, 2011–2013 TV ratings summaries by market (where available), and annual television rights earnings. We also compared MLB averages for several of these metrics with NFL football—a

vastly different, more "forgiving" business model that encourages parity through revenue sharing, salary caps, the annual draft, and scheduling processes that encourage year by year competitiveness. Lastly we examined numerous other articles, position papers, and writings that are summarized and available at http://www.nacva.com/examiner/14-SO-Charts.asp.

From this process, we were able to extract considerable data that shed light on the value inferences estimated by *Forbes* as well as performance of the executive organizations on and off the field:

- *Forbes* value inference estimates for "sport," "stadium," "market," and "brand" values
- 2013 average ticket prices
- 2013 attendance vs. attendance "potential" based on seating capacities
- Annual ticket revenues
- Where available, 2013 and 2012 Nielsen local market television ratings and number of "TV households" per Nielsen
- Metro area population figures
- 2013 "sport" revenue as reported by *Forbes* along with operating profit
- Bloomberg-reported estimated enterprise asset values as of October 2013
- Annual television rights revenues, contract expiration dates, and regional sports network (RSN) equity stakes
- As of August 2013, NFL *Forbes* valuation estimates, debt to value ratios, sport revenues, and operating income data by team
- 1995-2013 post season results

THE ROLE OF ON-FIELD PERFORMANCE IN VALUE

At some level and to some degree, on-field performance for most teams correlates with and contributes to the four "asset" valuation estimates derived by *Forbes*. Perhaps this correlation and contribution might have been stronger in the days before cable television and the recent explosion in extraordinary cable deals. In particular, the correlation is likely most strongly seen with franchises in the post-expansion era and those in small markets.

Whatever the case, the profound changes brought upon by free agency [1], substantial expansion, cable television and the absence of revenue sharing arrangements, salary cap structures, scheduling, the draft and other NFL business-model attributes with parity as the over-riding goal, have muddied the critical importance of consistent on-field performance to enterprise value and created the problem of what the actual MLB franchise business model really is.

However, it still holds that consistency of performance is still important to the equation of enterprise value. As such, we developed a very simple "success metric" for the teams based on post-season results for the period 1995-2013 as follows:

- One point for a playoff appearance
- Two points for participating in the league championship series
- Three points for winning a league pennant
- Four points for winning the World Series

Looking at actual data regarding on-field performance and resulting fan interest, we believe this success metric provides a reasonable indicator.

OUR SCORECARD DATA ANALYSIS APPROACH

"Balanced scorecards" have been all the rage for the past fifteen years or so. With gigabytes of information at our fingertips, complete with metrics of all kinds, and the need to filter out the really relevant from the not so exciting, scorecards have the potential to filter out the clutter while pinpointing the critical drivers that may indeed provide insights to business performance. So, our intent was to develop a scorecard that would allow us to analyze the data we had compiled. We had to answer these questions:

1. Can we develop a simple, easy-to-understand success metric to evaluate and compare the business, operations, and financial performance of the teams to the recent historical results on the field?
2. If so, what other critical analytics might we closely examine with this success metric as indicators of sustainable brand, market, stadium, and sport value to visualize and project what the future might look like some two or three decades down the road?

We took the data we had plus the data we could find and we built our scorecard with selected comparatives which appears at http://www.nacva.com/examiner/14-SO-Charts.asp.

1 *Curt Flood v. Bowie Kuhn*, 407 U.S. 258 (1972)

TABLE 2: MLB EXECUTIVE GRADE REPORT

WGTS	0.8	1	1.2	1.4	1	1	1					
											FORBES	
	TV RIGHTS	TIC PRICE	ATT POT	ATT/ POP	SPORT REV	OC % REV % MED	SUCCESS MULT	WTD TOT	ADJ FOR POP	MGT RANK	EQUITY RANK	MGT-EQ RANK
St. Louis	23	6	2	2	5	2	3	39.6	33.66	1	14	(13)
Boston	8	1	3	14	2	11	2	45.6	45.6	2	3	(1)
San Fran	19	9	1	9	3	3	5	49	49	3	4	(1)
Detroit	14	14	4	10	8	14	9	75	75	4	17	(13)
Chicago Cubs	10	3	10	13	6	9	24	80.2	80.2	5	6	(1)
N.Y. Yankees	5	2	9	25	1	22	1	75.8	87.17	6	1	5
Minnesota	21	8	12	11	14	7	21	96.6	96.6	7	26	(19)
Milwaukee	26	17	13	1	23	13	26	116.8	99.28	8	15	(7)
San Diego	9	30	21	12	19	4	17	119.2	101.32	9	25	(16)
Philly	16	4	5	16	7	28	10	90.2	103.73	10	5	5
Pittsburgh	29	19	16	4	20	8	28	123	104.55	11	19	(8)
Cincy	18	23	14	3	18	26	25	127.4	108.29	12	13	(1)
Colorado	24	28	15	5	22	12	22	128.2	108.97	13	16	(3)
Baltimore	20	18	20	7	21	17	23	128.8	109.48	14	20	(6)
Cleveland	13	26	29	8	24	19	6	131.4	111.69	15	18	(3)
L.A. Angels	2	13	7	29	10	16	8	97.6	112.24	16	7	9
Texas	3	20	8	20	9	21	12	102	117.3	17	11	6
Atlanta	30	27	19	21	11	5	4	123.2	123.2	18	8	10
Seattle	4	12	30	17	16	15	19	125	125	19	9	10
Washington	22	5	11	22	12	10	27	115.6	132.94	20	27	(7)
Chi White Sox	11	15	26	18	17	20	16	133.2	133.2	21	10	11
L.A. Dodgers	1	21	6	30	4	30	13	118	135.7	22	2	20
Tampa Bay	27	24	24	15	30	29	7	161.4	137.19	23	28	(5)
Oakland	12	22	17	24	26	6	20	137.6	137.6	24	24	0
Royals	25	25	23	6	29	24	30	164	139.4	25	23	2
Houston	6	10	28	28	27	1	14	129.6	149.04	26	30	(4)
N.Y. Mets	7	16	22	27	13	18	15	131.8	151.57	27	21	6
Arizona	17	29	25	19	25	23	11	158.2	158.2	28	22	6
Toronto	15	7	18	23	15	27	29	143.8	165.37	29	12	17
Miami	28	11	27	26	28	25	18	173.2	199.18	30	29	1

EXECUTIVE GRADE CARD

Once we had compiled our data in the scorecard (shown on Table 2), we asked ourselves, "Is it possible to use the data we compiled to assess executive performance? If so, might this provide some possible indicators of over-/under-performing organizations, or perhaps over-valued and under-valued executive organizations as well? To what extent did *Forbes* consider this performance in their enterprise valuation estimates?"

To answer these questions, we undertook the following analysis:

- We selected, then ranked the following executive performance attributes:
  - Annual television revenue rights
  - Average ticket prices
  - Actual attendance as percentage of annual attendance potential
  - Actual attendance as a percentage of primary local market population base
  - Sport revenue as measured by *Forbes*
  - Operations profitability as reported by *Forbes*
  - On-field success multiple as defined/discussed above
- We compiled the various attribute rankings, weighting them as follows:
  - Television rights = .8
  - Attendance potential = 1.2
  - Attendance as a percentage of local base population = 1.4
  - All other attributes = 1.0

We then penalized the top ten population markets by .15, and added a .15 premium to the ten smallest markets. Our rationale was that the mega market teams have a significant advantage in sheer numbers and the ability to leverage them compared to the smallest markets.

Chart 1 shows that the results had some interesting trends. Looking at these results, we decided to dig deeper and focus on the Cards as an example of a possible misalignment of performance and value and potentially flawed analysis by *Forbes*.

CHART 1: MLB TOP PERFORMERS vs. MOST-AND LEAST-VALUED TEAMS

Top Five in Performance	Bottom Five in Performance	Most Under-Valued	Most Over-Valued
Cardinals	Astros	Twins	Braves
Boston	Mets	Padres	Mariners
Giants	Diamondbacks	Cardinals	White Sox
Tigers	Blue Jays	Tigers	Blue Jays
Cubs	Marlins	Pirates	Dodgers

ST. LOUIS CARDINALS CASE STUDY

In looking at the data we compiled and analyzed, we found the mega market teams' enterprise value is largely tied to television counts, as demonstrated on Chart 2.

Using the executive grade metric we described above, since 1994 the Cardinals have scored thirty-nine points, exceeded only by New York (seventy-nine points) and Boston (forty-nine points).

CHART 2: MLB FANS AND POPULATION vs. REVENUE AND PROFITABILITY

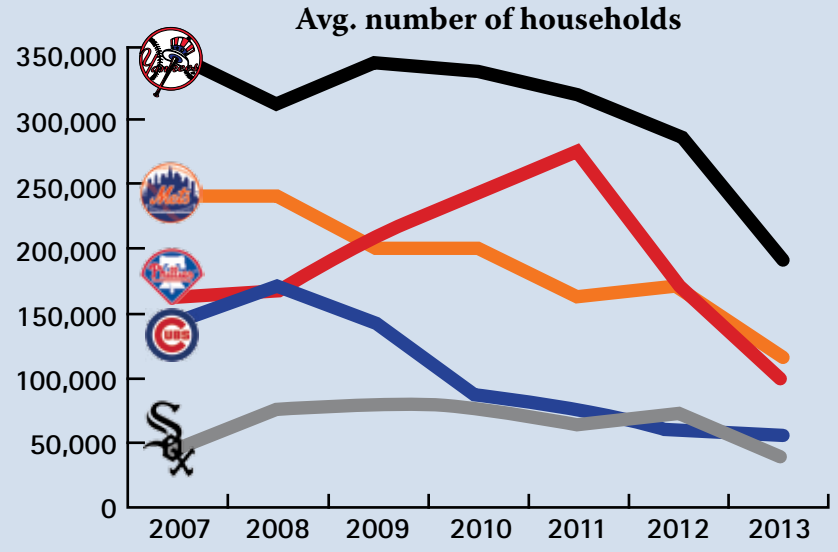
# of Fans (millions)		Population of Metro Area (millions)		Sport Revenue ($millions)		Profitability ($millions)	
Cards	Others	Cards	Others	Cards	Others	Cards	Others
3.4	Dodgers = 3.7	2.8	N.Y. = 20	283	N.Y. = 461	65	L.A. = – 81
			L.A. = 13		BOS = 357		PHIL = – 21
			CHI = 9.5		SF = 316		N.Y. = – 9
			DALLAS = 6.8		L.A. = 293		DALLAS = – 4.9
			PHIL = 6.0				
			BOS = 4.6				
			SF = 4.5				

CHART 3: SMALLEST MLB MARKETS SHOW RATINGS BOOST

Team	RSN	VG. RATING (CHANGE)
▲ TOP 5		
Detroit Tigers	FS Detriot	9.60 (+5.1%)
St. Louis Cardinals	FS Midwest	8.72 (+13.8%)
Pittsburgh Pirates	Root Sports Pittsburgh	7.99 (+22.5%)
Cincinnati Reds	FS Ohio	7.70 (.10.8%)
Boston Red Sox	NESN	7.30 (+14.2%)
▼ BOTTOM 5		
Miami Marlins	FS Florida	1.31 (.35.1%)
Oakland A's	CSN California	1.25 (.31%)
Los Angeles Angels	FS West	1.15 (+0.9%)
Chicago White Sox	CSN Chicago	1.14 (–45.2%)
Houston Astros	CSN Houston	0.40 (–59.6%)

CHART 3A: RATINGS DROP IN MLB'S BIGGEST MARKETS

Teams in three of MLB's biggest markets have seen sharp declines in local viewership of their games in recent years.



Source: *SportsBusiness Journal* analysis of Nielsen data

Source: John Ourand, "Smallest MLB Markets Show Ratings Boost," *SportsBusiness Journal*; September 30, 2013.

In contrast:

- Dodgers—thirteen points
- Rangers—fifteen points
- Cubs—six points
- Philly—seventeen points
- White Sox—twelve points
- Royals—zero points

Since it would appear that the mega market teams' enterprise value is largely tied to television counts, should we not then examine who is and is not tuning into the games? This examination provides further surprising results.

Chart 3 and 3A, reprinted from the September 30, 2013, John Ouran article in *SportsBusiness Journal*, demonstrate how the smallest MLB markets have the highest ratings boost.

We were struck by the Yankee Nielsen sharply downward trend line in relationship to the $1.3 billion market value estimation by *Forbes*, which is almost *four times* their estimate for St. Louis. A substantially greater market value makes sense, given the tremendous disparity in population base. Yet, given the local market size differential, the Cardinals drew more in attendance than the Yankees did in 2013, and their local Nielsen ratings were *3.4 times higher than the Yankees.*

At some point, population size and TV counts have to translate into revenues and cash flow, either on an annual basis or in the form of a terminal/exit payment. When we examine the following comparatives in Chart 3, we find further anomalies in the *Forbes* analysis:

CHART 4: COMPARISON OF MEDIA vs. STADIUM ATTENDANCE

2013 Estimated Regular Season, Local Market, Tuned-In Television Sets (thousands)		Annual Attendance as a % Of Primary Market Area Population	
Cards	Others	Cards	Others
110	N.Y. = 195	120%	BOS = 60%
	BOS = 178		Rangers = 60%
	Dodgers = 155		Yankees = 25%
	Rangers = 165		Dodgers = 20%

Yet, when we examine relative "stadium" value between the Dodgers and the Cards, we see that *Forbes* valued L.A. ($490 million) some *2.3 times higher* than they did the Cardinals. This is with roughly only ten percent greater attendance (+ 300k) and an average ticket price that is some *fifty percent lower* than the Cardinals ticket price. This fails the sniff test.

Moreover, when we consider the size and reach of the Cardinals' popularity across at least six states, in addition to their local market, and the fact that the Cardinal brand is one of the most iconic in sports history, this also calls into question a purported Dodger brand value of $280 million, some *2.2 times higher* than their Cardinal brand value estimate.

Finally, how can *Forbes* assert that the Royals have close to $100 million *more* in additional "sport" value over and above the Cardinals and place St. Louis near the bottom of the list for this component value given their long and consistent on-field and financial success over multiple decades? And, how can they indicate that the Yankees brand value is in excess of four times greater the brand value of the Cardinals, even though St. Louis outdrew them in attendance while generating an average of close to 110,000 TV viewers versus the Yankees viewership of around 195,000?

It is our conclusion that, across the entire spectrum of our balanced scorecard, the Cards rank as the most stable, predictable, and best-run team of MLB. If so, we also conclude the Cardinals are substantially undervalued. In fact, we suggest their enterprise valuation estimate should be closer to $1.2–$ 1.3 billion. We don't argue against the Yankee and Red Sox historical data. They're real; they have been demonstrated and validated. But, the demonstrated on-field and financial success of St. Louis reveals a very low-risk profile and an extraordinarily strong blue-sky value on the balance sheet. The strategic value component of the Cardinals is demonstrated, real, and substantial. And, in our opinion, it is a direct reflection of the top-performing executive organization in all of professional sports.

WHAT ABOUT *FORBES*?

According to *Forbes*, the top seven teams account for fifty percent of the total combined market equity value capitalization for all thirty teams combined. The Yankees, Dodgers, and Red Sox are close to one-third of this aggregate total. If indeed this is real, the implications are profound for MLB:

- This inherent inequity and disproportionate economic leverage poses a potentially serious, if not devastating, threat to the lower one-third of teams, in particular the small market ones. It raises the question of whether many are endangered species.
- Apparently, according to *Forbes* valuations, operating profits don't matter. As a multiple of revenues, the sport values are all over the map, and the extreme variance and dispersion of these multiples/values calls into question the underlying assumptions supporting them. In short, they make no sense.
- Why would anyone pay a multiple of 1.4 times sport revenues for the Royals who lost $7 million in 2013, but only .55 on the dollar for the Cardinals sport revenue stream that generated $65 million in operating profits? The short answer is no one would. These values fail the sniff test and reflect an apparent failure to sanity check the numbers amongst the teams.
- Moreover, the Dodgers bled operating cash at a rather alarming rate and the market rewards that performance with a sport value multiple in excess of two times that of the Cardinals? Absent compelling evidence to the contrary, we would suggest the

market doesn't value this stream at that rate. Perhaps this valuation is an effort to justify the $2.0 billion price paid by their investors rather than call into question the deal as an outlier, especially if the Dodgers continue to attract no more than 150,000 viewers per televised game.

SOME CAVEATS TO CONSIDER

There is a lot about the *Forbes* data that does not stand up under scrutiny for reasonableness. It appears to us the Dodger enterprise value estimate may be more of an exercise to rationalize and justify the $2 billion acquisition price than perform a thorough analysis of the underlying component value drivers. On the other hand, if the *Forbes* valuation is real and reasonably supported, it calls into question the valuation of the Cardinals, given our data gathering and analysis summarized above.

TELEVISED BASEBALL: IMPACT ON ESTIMATING FRANCHISE VALUE

To create value, people must watch the games, but the economics today are in opposition to this notion. We have pointed out the dangerous concentration of both revenues as well as market capitalization amongst the mega-market elite clubs. This concentration has dramatically accelerated over the past eight to ten years with the rapid growth in power held by RSNs, the introduction of franchise ownership stakes in their own networks (YES), the explosively controversial "Dodger-type" deals, and the power of ESPN and other programing sources to exert leverage on cable operators via exorbitant affiliate fees (which are passed on to the cable consumer at large through bundled-package programming). These bundled package fees have skyrocketed and may not be viable over the long-run, considering new and alternative entertainment delivery technologies.

Absent bundled programming to absorb and disperse these fees across non-sports programing, an a la carte, cafeteria programming and pricing structure would be cost-prohibitive and likely accelerate the steady decline in local MLB viewership trends.

Oddly, in the immediate-term, ESPN and others have been able to experience strong revenue growth from *declining* MLB local TV ratings and sharply declining ratings on national MLB programming. Fox's nationally televised "Game of the Week" saw their audiences shrink by 33 percent between 2004 and 2012. Across all national stations that broadcast MLB, ratings have been falling. In contrast to the explosion in revenues flowing from the cable consumer through the cable companies to the sports networks and the teams, baseball viewership on television has been in very steady decline. Ironically, several of the teams with the most current lucrative cable deals (Angels, Astros, White Sox, and A's) are at the very bottom in local ratings (see Chart 4):

CHART 4: CABLE DEALS FOR TEAMS WITH THE LOWEST RATINGS

Team	RSN	Record	Local TV Homes	Average Rating	Average Household Viewership
Miami Marlins	FS Florida	62–100	1,621,130	1.31	21,237
Oakland A's	CSN California	96–66	2,502,030	1.25	31,275
Los Angeles Angels	FW West	78–84	5,613,460	1.15	64,556
Chicago White Sox	CSN Chicago	63–99	3,484,300	1.14	39,721
Houston Astros	CSN Houston	51–111	2,215,650	.040	8,863

And cable TV overall? In the third quarter of 2012, the nation's fourth largest cable operator, Time Warner Cable, lost 306,000 TV subscribers. In 2013, we experienced the first ever annual decline in pay TV subscribers: 588,000. (Source: 2014 Strategy Analytics). With streaming services becoming more varied and more content available online, there are real alternatives to television. Please remember that this is the same TWC that guaranteed the Dodgers a base annual revenue stream of around $300 million, with huge guaranteed escalator provisions through 2038. As noted by Eric Bleeker in "How the Golden Age of Television and Baseball Ends:"[1]

While cable's reign might seem a given today, entrenched industries can fall fast to rapid external change. While it might be easy to look back and know newspapers died the day the web was born, in reality, the rapid decline of print advertising didn't begin in earnest until late 2006, and within three years, the industry was half its size. Give consumers a "good enough" alternative, and the speed at which they'll adopt it has surprised many once-thriving industries.

In addition to declining viewership on television, baseball's core demographic is aging and will soon be approaching the age when discretionary entertainment dollars feel the severe squeeze of fixed retirement incomes, spiraling healthcare costs, assisted living necessities and sadly, increased death rates. The baby boomer generation won't have the cash to subscribe and their kids appear to have other passions:

1 Eric Bleeker. "How the Golden Age of Television and Baseball Ends," The Motley Fool, www.fool.com/author/1689/index.aspx.

THE FLAVOR OF LOVE—HOW OUR QUEST BEGAN

By Tony Wayne, CVA, CIRA, CFF, FCPA, CPA

My dad gave me a very precious gift that would last a lifetime—a passionate love for our national sport. These were Dad's guys and he loved nothing more than a cold beverage in hand while relaxing on his screened-in porch and listening to Monte Moore's play-by-play accounts of his beloved Kansas City Athletics at venerable Municipal Stadium. Municipal Stadium was home to many a future legend and Hall of Famer—Buck O'Neill, Satchel Paige, Jackie Robinson, Ernie Banks, Elston Howard, Mickey Mantle, Phil Rizzuto, Roger Maris, and many others, including "Mr. October" himself, Reggie Jackson.

We even got to see Hank Bauer play and this World War II Marine hero made his home in Prairie Village and operated a small retail liquor store but just a few short blocks from my home. Hank adorned his walls with classic images of Billy, Mickey, Whitey, and himself. Hank was a tough, grizzled, but very soft-hearted giant who wore his high and tight proudly and was an institution in the village for years. Cardinals legends Tony La Russa and Whitey Herzog were ours as well back in the grand old early days of MLB in K.C.

Municipal Stadium and its surrounding area was also home to the greatest culinary delights the world has ever known. Gates' short-ends, Bryant's burnt ends, even Hayward got his start by the old ballpark. I can still smell the heavenly smoke as we would park our cars in front yards, back yards, side yards and made our way through the neighborhoods and into a place so grand, so beautiful and awesome that I can still feel the thrill of walking through those old turnstiles.

On the other side of the state, St. Louis is an old, old city initially discovered by the French, who rather than fight the Native Americans, decided to befriend and do business with them. European exploration of the area was actually recorded as far back as 1673, when French explorers Louis Jolliet and Jacques Marquette traveled through the Mississippi River valley. Five years later, La Salle claimed the region for France as part of La Louisiane. St. Louis was transferred to the Republic of France in 1800 and then sold to the United States in 1803 as part of the Louisiana Purchase.

Sometime very shortly thereafter, Harry Caray stepped up, grabbed the mic, popped the top on an ice cold Bud and the Cardinals radio network became the envy of all of professional sports with an astounding reach east, west as well as south from St. Louis.

- A recent ESPN.com poll showed that Major League Soccer is equally as popular with twelve to seventeen year-olds as MLB is. According to the poll, eighteen percent are "avid" MLS fans—the same figure as those claiming to be avid MLB fans.
- There are several highly popular soccer video games, but only one officially licensed alternative for baseball—"MLB: The Show."
- Other data points to declining baseball popularity amongst young people. The National Sporting Goods Association reported that in 2004, 15.9 million were playing baseball. By the end of 2009, that figure had fallen to 11.5 million. Other studies confirm this trend as well. Since the mid-1990s, Little League participation has fallen by almost twenty-five percent.
- The average World Series viewer is now almost fifty-five years old, up from 49.9 in 2009, according to Nielsen. The company's latest Year in Sports Media Report reveals that less than a quarter of all baseball fans are below the age of thirty-four, and a whopping fifty percent are at least fifty-five.

It is our opinion that considerations like these should be taken seriously when utilizing valuation data such as that provided by *Forbes*. If valuation is prospective, then the future of the MLB's most material revenue streams must be examined and adjusted for changing technologies and demographics.

WRAPPING UP

What business model is MLB pursuing currently? How do we adjust our franchise valuations to properly reflect this and other major changes taking place in America's favorite pastime? What about the future? Can we really depend on *Forbes* for reasonable, defensible valuation market data? We have provided our responses to these questions. And we have suggested a different and comprehensive approach to assembling and analyzing value inference indicators—all of which lead to what we believe to be a more grounded estimate of value. Our challenge to the reader is to try this approach out yourself. See if it fits the real world and yields solid conclusions. We rest our case for the Cards. VE

Tony Wayne, CVA, CIRA, CFF, FCPA, CPA, founded IronHorse, LLC, in 1998. IronHorse is a Kansas City, Missouri-based special-situation professional services firm with practice specialties in business valuation and appraisal, forensic services and litigation support, CFO services, due diligence, and complex financial and operations restructuring/turnaround consulting. In addition, Mr. Wayne is an adjunct professor of accounting at Rockhurst University and Johnson Community College. He serves on the Small Business Reorganization Committee as well as the Fraud Task Force with the American Institute of Bankruptcy. Mr. Wayne has extensive M&A experience on dozens of transactions, especially with financially distressed enterprises. E-mail: twayne@ihorsellc.com.

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VALUATION

$2 Billion for the Clippers—A Deal...or a Steal?*

By Michael Blake, CFA, ASA, ABAR, BCA

If you've turned on any media device in the last three months or so, you're at least vaguely aware of the fact that Donald Sterling, the owner of the Los Angeles Clippers, a National Basketball Association (NBA) franchise, was stripped of his ownership of the team he has owned since 1981, and after a court battle, the team was sold to ex-Microsoft CEO Steve Ballmer (he of Zune, Windows Vista, and SPOT watch fame; though to be fair, he did bring us the Xbox as well) for $2 billion. The circumstances of the team's sale are well-documented and won't be repeated here. A Google search for four minutes will get you up to speed on the particulars.

But out of the squabbling, noise, and on-again-off-again lawsuits and deals, comes the really interesting question: is $2 billion the right price? Did Ballmer overpay, get a great deal, or basically come out where he should have? Doing a little homework, we observe that no NBA team has ever been sold for more than $750 million, and now we have a $2 billion dollar sale. Now, a little bit of perspective here…In 2013, *Forbes* estimated the value of the Clippers at $430 million, and in 2014, *Forbes* hiked up that value $575 million. Yes, that is an increase of thirty-three percent in value, but Ballmer has offered a much more convincing value by putting his considerable money where his mouth is. You may be telling yourself that Ballmer is overpaying and that $2 billion is a ludicrous amount to pay for a sports team. However, the N.Y. Knicks were valued at $1.4 billion this year by *Forbes*. So, while $2 billion isn't that far-fetched when evaluating a NBA team, did Ballmer truly overpay for the L.A. Clippers?

A little team history is helpful background. Donald Sterling purchased the San Diego Clippers for about $12.5 million in 1981, and the team was consistently bad. In fact, the Clippers did not have a winning season until a decade later in the 1991–1992 season. The NBA effectively had to invent the draft lottery so that the Clippers wouldn't pick first in the draft every year. With the signing of superstars like Blake Griffin and Chris Paul in recent years, the L.A. Clippers have become a household name among NBA fans and have come a long way from their ridiculed days in the beginning of the Sterling era. The Clippers are a consistently competitive franchise in the NBA. Obviously Ballmer has some high hopes for the team—hopes worth $2 billion.

> 2013: Forbes values the Clippers at $430M
>
> 2014: Forbes values the Clippers at $575M
>
> June 2014: Ballmer offers $2B

When most people say, "the right price," they think of a valuation concept called fair value. Confusingly, fair value itself has many definitions, mostly varying state to state for marital dissolutions or shareholder breakups. But the financial statement audit world has a fairly universal definition called Accounting Standards Codification Topic 820 (or ASC 820). That definition is:

> The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Endemic to the ASC 820 definition is the concept that the seller and buyer are willing, that the asset for sale is not a liquidation, but rather intended to be a going concern, and that there are no synergistic elements. For example, if the

* This article originally appeared in Executive Decisions, Vol. 1, Issue 1, a Habif, Arogetti & Wynne, LLP, newsletter and is reprinted and updated with permission of the author.

Los Angeles Lakers had been allowed to buy the Clippers, they might have paid a hefty premium to remove their local competitor from the market. Also endemic to the discussion is the idea that buyer and seller have knowledge of all relevant facts required to make an informed transaction decision. Finally, fair value rests on the proposition that the motivators for an acquisition are financial in nature (we have to relax that for this analysis just a bit). Basically, in a fair value scenario, we don't assume transactions occur on the set of "Dallas" or "The Godfather."

> "It's not personal. It's just business." Don Corleone

Also, I feel compelled to address head-on the common argument that the value of an asset is what someone is willing to pay. That argument is specious; if I'm willing to pay $8 for the Clippers, then they are worth $8? Or if you really mean "what the highest bidder is willing to pay" then by definition, no one ever overpays? Just because Ballmer is paying $2 billion for the Clippers, that doesn't mean that's the team's fair value.

When valuation analysts look at appraising a company, they also look at similar companies for comparison purposes. Indeed, for ASC 820 this is the preferred method for determining fair value, and the Internal Revenue Service agrees in Revenue Ruling 59-60. The problem is that NBA teams are not publicly traded (although the Boston Celtics were in the 1990s), and they are not bought and sold frequently. It's not like looking up multiples for, say, marketing services firms. It's more like trying to find comparable deals in space travel firms. Purchases do happen from time to time, providing a bit of data to go on.

In 2012, the Toronto Raptors were purchased for $400 million compared with a *Forbes* valuation of $382 million. In 2013, the Sacramento Kings were purchased for $534 million compared with a *Forbes* valuation of $525 million. In 2014, the Milwaukee Bucks, a team that has lost more games than it has won in the last several seasons, were purchased for $550 million; *Forbes* valued them at $405 million. In the last three years, transaction prices of NBA teams have tracked Forbes' value estimates reasonably well. Yet the Clippers' offer completely eclipses the *Forbes* estimate as well as the prices paid for any NBA franchise purchase. The case could be made that the Los Angeles market (16 million[1]—or 8 million split between the two teams—the Clippers and the Lakers) is larger than those of Milwaukee, Sacramento, and Toronto combined. If you believe that team value is directly corrected to market size, then let's add up the three teams' purchase prices (see Table 1).

TABLE 1: TEAM VALUE vs. MARKET SIZE

MARKET (SIZE)	MARKET CAP
Milwaukee Bucks (regional pop 2.0 MM)	$550M
Sacramento Kings (regional pop 2.5 MM)	$534M
Toronto Raptors (city pop 2.5 MM)	$400M
Total (pop 7.0 MM)	$1.484B

It's a reasonable guess, but $1.48 billion doesn't get us to $2.0 billion. Other offers for the team reportedly fell in the range of $1.0–$1.6 billion, the latter made by a group that includes Larry Ellison and Oprah Winfrey. While all of these offers come close to what the "NBA market" indicates is the "fair value," Ballmer outbid the competition by $400 million. But, with only three transactions in the last three years, the NBA market is far from efficient. We need more information in order to enable us to draw a credible conclusion. To draw that credible conclusion, one will need to consider another approach to determine the fair value. That other approach is to use an income approach.

> The Clippers' local TV deal of $20M per season expires in 2016. The Lakers' TV deal is $200M a season.

So let's look at a cash flow analysis. As of this year, Forbes has estimated the revenue of the L.A. Clippers at $128 million. This is a $20 million increase from last year. The revenue stream is an accumulation of TV/media deals, gate sales, luxury suites, concessions, merchandising, and sponsors. The Clippers have TV deals of $51 million dollars, which includes both local and national. In terms of future revenue growth, this is the money maker and the value driver. The local deal of $20 million per season that the L.A. Clippers have in place right now is a very low-end deal. In comparison, the L.A. Lakers now have a TV deal worth nearly $200 million a season. Granted, the Lakers are much more popular than the Clippers, but the Clippers still have their following. In 2016, when the Clippers' local contract is up,

1 Including Los Angeles County, Orange County, and San Diego

they can expect a new deal of $75 million a season or a $55 million bump each season! In addition, the NBA's national television contracts with ESPN/ABC and TNT also end in 2016, and that's where the big money is. The new deal in place is expected to be nearly double the current contract to give each team in the league a boost of over $50 million a season. Overall, the new TV deals in 2016 should add up to nearly $130 million in revenue for the Clippers.

With ticket prices on the rise and stadiums being sold out, Ballmer likely anticipates that the Clippers can expect gate revenues to increase. In determining the future revenue stream, I decided to use a growth rate of six percent based on the past several years' average ticket prices for the Clippers in order to determine the future average price of a ticket. 2014 gate receipts were approximately $41 million, which is consistent with league-wide historical growth. If the Clippers continue their improved play, gate increases exceeding six percent is very plausible.

"One of the great features of owning a NBA franchise is that costs are relatively certain."

Luxury suites are an important profit center for sports teams, including the Clippers (which is why threatened corporate sponsor pullouts are material to the business). Luxury suites are often used by corporations to entertain and provide a good source of entertainment for their clients. Of course, a few suites are owned by high net worth individuals each year (especially in Los Angeles). In the Staples center, there are 150 of these suites with an average price tag of $350,000 per season, totaling $52.5 million a season.

One of the great features of owning a NBA franchise is that costs are relatively certain. The owners effectively broke the NBA Players Association in the 2011 lockout, and the salary cap equates to fifty percent of annual revenue (it was fifty-seven percent in 2010 and climbing). Accordingly, this reduces the risk of owning a team significantly. In this analysis, costs were increased by two percent annually.

An explanation of the salary growth assumption: a financially (not competitively) driven buyer would "normalize" the salary expense item to fall below the NBA salary cap. Over time, the players' share of revenue has declined as the NBA Players' Association has yet to mount a successful strike. The NBA Collective Bargaining Agreement includes a "soft cap," whereby teams can exceed a certain level of aggregate salary, and then pay a "luxury tax" for salaries paid above the cap. As of the writing of this article, the luxury tax threshold was $63 million and the hard cap level was $76.8 million.[2] The Clippers were over the luxury tax threshold by $5 million. Most teams do not manage their salary caps to be above the luxury tax threshold in the long term, and thus one would expect the Clippers to grow their salaries relatively slowly over time so as to allow the salary cap to catch up and exceed the Clipper's player salary expense.[3]

Further, while the salary cap might remain at fifty percent of revenues, not every team uses its full salary cap—and given the fact that so much of league revenues are shared and the fact that broadcast contracts are signed for ten plus years at a time, it's not clear that the financial incentives push teams to utilize their full caps. Indeed, the argument may be stronger that the financially prudent/profit maximizing course of action is to spend a minimal salary expense, except in the year or two prior to local broadcast rights renewal. As evidence of this, at least ten NBA teams were paying aggregate salaries that were less than the salary cap in 2014.[4]

The remaining team revenue streams are composed of sponsors, concessions, and merchandising. Concessions were calculated to provide around $10 million a season. Based on the Clippers' financials, the Clippers could expect to generate $144.5 million in annual revenue and make approximately $15 million in operating income in 2014, or $11.3 million after taxes (assuming some aggressive tax planning, given California's high state income tax rate). [5]

2 BasketballReference.com and NBA.com

3 If the reader remains unconvinced of the credibility of this assumption, sensitivity analysis revealed that, if all the other assumptions hold true, the $2 billion value is upheld even if costs increase by as much as seven percent/year. Seven percent is equal to the salary cap increase recently announced for the 2014-2015 season.

4 BasketballReference.com

5 The author acknowledges that a nominal corporate profit tax rate for a California-domiciled company would be in excess of forty percent. However, numerous studies (including by the General Accounting Office) indicate that many large corporations, through tax-optimization strategies, pay far less than the statutory rate. http://money.cnn.com/2013/07/01/news/economy/corporate-tax-rate/. As former CEO of Microsoft, Mr.

So, in light of the previous analysis, here are some financial forecasts for the Clippers: (Table 2)

TABLE 2: AUTHOR'S FINANCIAL FORECAST FOR THE LOS ANGELES CLIPPERS

(IN MILLIONS OF $)	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Revenue	154.1	165.5	168.9	250.9	254.8	258.9	263.2	267.8	272.6	277.8
TV Deal	51.0	51.0	51.0	129.3	129.3	129.3	129.3	129.3	129.3	129.3
Gate Sales	41.0	52.1	55.2	58.5	62.1	65.8	69.7	73.9	78.3	83.1
Suites	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5
Other	9.6	9.9	10.2	10.6	10.9	11.3	11.7	12.1	12.5	12.9
Costs	113.0	115.3	117.6	119.9	122.3	124.8	127.3	129.8	132.4	135.0
Operating Income [1]	41.1	50.2	51.3	131.0	132.5	134.1	135.9	138.0	140.2	142.8
After Tax Income	30.8	37.7	38.6	98.3	99.4	100.6	102.0	103.5	105.2	107.1

The Clippers ought to be a relatively low risk investment. No NBA team has shut down since the 1976 NBA/ABA merger. Costs are effectively fixed by collective bargaining and the sport is very popular. A large share of the franchise's revenue comes from national TV contracts, which don't change regardless of how well the Clippers play. And it is nearly inevitable that the Clippers' local TV contract will increase significantly by 2016, locking in revenue for years. In addition, the Clippers are in the second-largest market in the United States, even if they do share it with the Lakers. Bearing that in mind, what is the required return on owning the Clippers?

Perhaps the most useful market-based data point is Manchester United F.C., the U.K. soccer club that went public in 2012. Manchester United's cost of debt is 8.75 percent and they have roughly a 50/50 debt/equity capital structure. Cost of debt is the rate that a company pays on its current debt. *MANU's after-tax cost of debt is 6.56 percent.*[6] Their beta, the measure of risk as compared to the market as a whole, is 0.6 according to Yahoo! Finance. Invoking the Capital Asset Pricing Model (CAPM) model, and assuming a risk-free rate of four percent and an equity risk premium of six percent, MANU's cost of capital equity should be approximately 4% + .6*(6%) = 4% + 3.6% = 7.6%. With a 50/50 capital structure, that implies a cost of capital of around seven percent. It's reasonable to assume that MANU's cost of capital is roughly similar to that of the Clippers (surely no worse). [7]

In order to validate our discount rate, we measured the returns generated to the owners of the Bucks, Kings, and Raptors who have recently sold out (see Table 3). We analyzed the price appreciation of the Kings, Raptors, and Bucks between the times they were previously purchased and most recently sold. We performed a similar analysis of the Clippers, assuming the $2 billion sale is consummated.[8] In 1998, the Toronto Raptors were purchased for $180 million and sold for $400 million, indicating an annual rate of price appreciation of 5.87 percent. Also, in 1998, the Sacramento Kings were purchased for $156 million and sold for $534 million, which produced an annual rate of price appreciation of 8.6 percent. Lastly, in 1985, the Milwaukee Bucks were purchased for $18 million and sold for $550 million, a 19.7 percent annual rate of price appreciation. Sterling purchased the Clippers for $12.5 million in 1981, and is now being sold for $2 billion, which translates to a 16.6 percent annual rate of price appreciation. Note, this

Ballmer is likely familiar with such strategies. The author does not represent himself to be a tax expert, but sees no obvious reason why at least some of those strategies would not be available to the Clippers. The matter is, of course, complex, and resolving the issue of statutory vs. effective tax burden is beyond the scope of this article.

6 8.75% x (1-25%) = 6.56%

7 The author believes that lenders would lend to a buyer of the Clippers at a lower nominal interest rate than 8.75 percent; the U.S. prime rate is 3.25 percent (and has been for some time). It is reasonable to speculate that the Clippers are a good source of collateral and that a buyer who is largely unleveraged coming into the deal could finance fifty percent of the purchase at an interest rate of 3.25 percent or 2.4375 percent after taxes (twenty-five percent rate). In this case, the weighted average cost of capital would be (50% x 7.6% + 50% x 2.4375% = 5%). Accordingly, the seven percent cost of capital/required rate of return can be reasonably considered to be conservative.

8 Editor's Note: The sale was finalized on August 12, 2014.

TABLE 3: RETURNS GENERATED TO TEAM

	PREVIOUS PURCHASE	RECENT PURCHASE	ANNUALIZED RETURN
Sacramento Kings	1998 – $156M	2013 – $534M	8.6%
Toronto Raptors	1998 – $180M	2012 – $400M	5.87%
Milwaukee Bucks	1985 – $18.0M	2014 – $550M	19.7%
L.A. Clippers	1981 – $12.5M	2014 – $2B	16.6%

is return just on the price appreciation—we are assuming annual cash flows were zero, so these returns are conservative.

So, what are the present value of future cash flows—do they justify a $2 billion purchase price applying a seven percent discount rate? The breakdown in cash flow discounting is summarized below. Table 4 assumes that the Clippers appreciate in value by seven percent a year for 10 years, resulting in a future sale value of $3.147 billion.[9] Hence, our exit price is $3.147 billion (future value) and, by definition, the present value is $1.6 billion.

Adding the present-valued annual cash flows of $560 million to the present value of the terminal value of $1.6 billion produces a total present value of *$2.16* billion.

What terminal value is required to achieve a $2 billion value? Applying the positive annual cash flows computed above, and assuming the fair value is $2 billion, the sale price of the Clippers in 2024 would have to be *$2.832 billion,* which is an annual price appreciation rate of 3.6 percent, well below the historical rate of price appreciation for the Clippers, as well as the Bucks, Kings, and even the Raptors. The forward/exit value of $2.8 billion is equal to a present value of $1.44 billion[10]—meaning that the true fair value would be that number—$1.44 billion, but even if Ballmer "overpaid" by $560 billion at a $2 billion price tag, he still comes out okay; the cash flows meet the required return of seven percent. However, that assumption of a $1.44 billion current value seems a bit punishing, as there were reports that at least one losing bid to buy the Clippers was $1.6 billion. Are we ready to argue that at least two buyers were prepared to overpay for the team? At some point, the "over payers" become the market.

Like many businesses, much of the value lies not so much in the annual cash flows, as it does in the terminal value. Accordingly, it's appropriate to stress-test the terminal value assumption—at least insofar as an event predicted to take place in a decade can be stress-tested. The bottom line is that this valuation analysis is highly sensitive to the terminal value assumption.

While the popular perception is that Ballmer wanted an NBA team and was willing to outbid all comers, the fact-based financial story is different. Ballmer astutely determined that the cash flows are relatively certain, and the core price appreciation story is modest, with a good deal of upside. Our analysis produces a fair value of approximately $2.16 billion, assuming that the Clippers' price appreciates at a rate seven percent per year. The $1.6 billion offer was a low-ball offer, whether by error or design.

Add the fact that Ballmer can probably borrow money at 3.25 percent (2.4 percent after taxes) and he's probably still making a huge profit, given the Clippers' likely cash flow. But Ballmer's financial capabilities aren't or shouldn't be considered in a fair value discussion. Investor-/buyer-/owner-specific circumstances are considered when the standard of value is investment value.

TABLE 5: CASH FLOW DISCOUNTING ($ MILLIONS)

	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10	Terminal
Net Income	30.8	37.7	38.6	98.3	99.4	100.6	102.0	103.5	105.2	107.1	3,147
Periods	.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	10
Disc Factor	.967	.903	.844	.789	.738	.689	.644	.602	.563	.526	.508
Disc CF	29.9	34.1	32.6	77.6	73.3	69.3	65.7	62.3	59.2	56.3	1,600
Pres. Value	$560 million (rounded)										$1,600

9 ($1.6 billion x $(1.07)^{10}$)
10 (1.439 billion/$(1.07)^{10}$)

It turns out that, even to make Vista and the Zune, you've still got to be pretty smart. Ballmer's folks figured out the financial engineering more quickly than Oprah's did, and he's got a deal that makes some sense and shows that *Forbes'* value on the Clippers was patently unrealistic. Based on market size alone, the Sterlings shouldn't have even taken a phone call with an offer under $1.4 billion. Of course, it bears admitting that our information comes from public sources—certainly with varying degrees of accuracy. Like any valuation model, garbage in produces garbage out, and it's entirely possible that the Clippers and their suitors were analyzing different, more accurate fact patterns.

However, if our facts are mostly accurate, then $2 billion probably winds up being fair—maybe even a little cheap, if the asset's value appreciates at exactly the same rate as the voverall required return. As a bonus, I hear the owner's seats are really good. VE

Michael Blake, CFA, ASA, ABAR, BCA, is director of Valuation Services for Habif, Arogeti & Wynne, LLP, in Atlanta, Georgia. Before entering the profession of business appraisal, Mr. Blake spent eight years in venture capital and investment banking. Mr. Blake is also a special instructor for business valuation in the Emory University/Georgia Institute of Technology TIGER program, and he frequently teaches the case study review for CVA recertification for the Atlanta NACVA chapter. Mr. Blake holds master of business administration degree from Georgetown University. E-mail: michael.blake@hawcpa.com.

VALUATION

Are You Ready for Some Football? Insights into NFL Team Valuations

Interview with Neil Beaton, CPA/ABV/CFF, CFA, ASA

Neil Beaton is a managing director with Alvarez & Marsal Valuation Services in Seattle, Washington. In his twenty-five year career he has had experience analyzing both closely and publicly held companies. Additionally he has valued a number of unique assets, including celebrity goodwill, domain names, patents, trademarks, movie rights, licenses, wireless spectrum, franchise rights, and non-compete agreements. Since the late 1990s, Neil has valued a variety of NFL and other professional athlete contracts. Mr. Beaton agreed to share some insights about his experience in valuing NFL contracts and economics related to the NFL.

> ***"The average NFL team is now worth $1.43 billion."***

VE: According to *Forbes*[1], the most valuable sports teams in the world come from the world of soccer: Real Madrid, said to be worth $3.44 billion, is ranked number one, Barcelona is number ranked number two with a current value of $3.2 billion, and Manchester United at number three with a value of $2.81 billion. The New York Yankees come in at number four, valued at $2.5 billion, and the Dallas Cowboys claim the number five spot at $2.3 billion. Why the valuation love for soccer teams as opposed to our boys of summer and fall, respectively?

NB: It really goes to the law of supply and demand. How many countries have soccer teams versus football teams? Soccer—or football as it is known throughout Europe, Asia, Africa, the Caribbean and Central America—is played around the world. Real Madrid, Barcelona, and Manchester United have a huge fan base and have each won major world titles. In the 2012–2013 season, Real Madrid revenues ($675 million) far exceeded all other teams in the world. Add to that real estate, retail, and media rights, you are looking at an extremely valuable entity.

Football is mainly a U.S. sport, but has gained some good traction with our neighbors to the north. But, despite soccer teams dominating the top of *Forbes*' "The World's 50 Most Valuable Sports Teams" list, American football teams occupy thirty of those slots. The Dallas Cowboys, arguably America's Team, have been the NFL's most valuable team for the past seven years. This is due in large part to the league's highest sponsorship and premium seating revenues. And, don't forget, Jerry Jones, the owner of the Cowboys, signed a naming rights deal with AT&T reportedly worth $500 million. I can't say for sure, but I suspect the other thirty teams on the list have, perhaps to a lesser degree than the Cowboys, a similar story.

VE: What does owner Jerry Jones know that other team owners don't?

NB: I can't say, since I am not familiar with Jerry Jones. What I do know is that he has been very influential in getting the league to change team sponsorship policy and that he has helped grow the team's popularity, influence, and wealth.

1 Kurt Badenhausen, "The Word's 50 Most Valuable Sports Teams," *Forbes Magazine*, July 16, 2014, www.forbes.com.

All kinds of people buy sports teams for all sorts of reasons. Some teams appeal to potential owners because they represent a sense of nostalgia. Some, like the New York Yankees or the Minnesota Vikings, have legendary histories. Whatever the reasons, it comes down to what teams are available, who has the money, and how much revenue will a team generate. The Dallas Cowboys are somewhat of an anomaly in that they are not strongly associated with a larger metropolitan area as some of the more valuable teams are. However, some of the richest people in the world live in Texas. A lot of money has gone into creating a state-of-the-art arena, and into "growing the pie."

VE: Is there a "bubble" in sports valuation as there is in the stock market or the real estate market. If so, is it likely to burst any time soon?

NB: Of course, what goes up must go down. However, the trick is to know when "down" is happening. The thing about "bubbles" is that most of us have no idea when it will burst. Only that it probably will at some point.

In sports valuation, every media outlet is looking for content. A short term spike in demand could inflate the bubble because there would be insufficient content to satisfy the demand. However, if that demand were to ebb—in terms of profits—that could burst a bubble. However, sports teams in almost any venue seem to find a fan base and, hence, content is always available. For example, when Starbucks founder and chairman Howard Schultz sold the Seattle Sonics in 2006, the NBA team had lost its owners $60 million over five years. New owner Clay Bennett renamed the team the Oklahoma City Thunder and has seen the team's fortunes increase. The Thunder's TV ratings have grown, ratings on the local Fox sports station jumped also. The team has seen a huge increase in attendance at games and has also seen an increase in season ticket holders. All of this goes to content. There was a vibrant market in Oklahoma City that was missing in Seattle. So, could the bubble burst? Yes, it could. But, there is pent-up demand in every city for sports teams. As long as that is true, it is hard to predict when the bubble will burst across the board.

But, back to the NFL. The average NFL team is now worth $1.43 billion. According to *Forbes*, that is the highest value in the seventeen years they have tracked professional football team finances. And that is a twenty-three percent higher valuation than last year. Which makes it the biggest year-over-year increase since 1999.[2] So, in terms of a bubble, as far as the NFL is concerned, things are looking good in terms of revenue being generated, operating income, and the importance of football to both cable and regular broadcast outlets.

VE: Who is on your fantasy Superbowl team?

NB: I am a West Coast guy. So it's more of a replay of last year's playoffs than a fantasy. Essentially, I want to see the Seattle Seahawks and the Denver Broncos—provided the real Broncos show up—play each other in Phoenix come February. Not to say the San Francisco 49ers are not a feisty team. But the Seahawks and the Broncos are the relatively new kids on the block, and it would be fun to see them battle for the top spot, again assuming the real Broncos show up. VE

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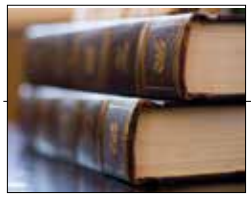
2 Mike Ozanian, "The NFL's Most Valuable Teams," *Forbes Magazine*, August 20, 2014.



BOOK REVIEW

Valuing Pass-Through Entities

By Eric J. Barr, CPA/ABV/CFF, CVA, CFE
John Wiley & Sons, 2014 (233 Pages)
Publication Date: Oct./Nov., 2014

Reviewed by John E. Barrett, Jr., MBA, CPA/ABV, CVA, CBA

Eric J. Barr is a founder and co-managing member of Fischer Barr & Wissinger, LLC, in Parsippany, New Jersey. Mr. Barr has more than forty years of public accounting experience, specializing in business valuation, litigation support, and traditional accounting services. Mr. Barr is a member of *The Value Examiner* Editorial Board. In this book, Eric brings his wealth of knowledge and understanding of business valuation to the challenging task of valuing pass-through entities. This book provides the reader with a fundamental review of the business valuation process and an effective approach to dealing with pass-through entity (PTE) issues.

OVERVIEW

Valuing Pass-Through Entities begins with a comprehensive review of the business valuation process. This includes an informative discussion of the various definitions of value. The book takes the reader through a historical and enlightening journey of the federal taxation of C corporations, pass-through entities, and of individuals. The reader is presented with a thorough and analytical approach (Modified Delaware MRI Model) to effectively value pass-through entities. The book concludes with interesting, useful, and practical case studies.

THE JOURNEY BEGINS

Eric Barr leads the journey through what he describes as the "PTE conundrum" with a fundamental review of the valuation process. Various standards of value are discussed. Chapter Five, in particular, presents a very readable and interesting chapter on the value to the holder standard of value. This concept will become increasingly important as various state family courts gravitate to this standard of value. The early chapters provide a rich history of the taxation of various entities and individuals over time. This history offers the reader a unique insight into the taxation and valuation issues surrounding pass-through entities.

UTILIZING THE MDMM

The middle chapters of this book take us through an effective and comprehensive approach to valuing pass-through entities. Barr's focus is on the Delaware MRI Model, with some refinements. He refers to his model as the *Modified Delaware MRI Model* (MDMM). The book includes numerous and understandable examples of applying the MDMM under several different scenarios. While the book presents a strong theoretical discussion regarding the valuation of PTEs, the examples are very practical and instructional. This book provides strong guidance on how to value PTEs in a rational and comprehensive manner. Interestingly, the author applies the MDMM to the market approach, as well as the income approach. Chapter 11 delves into the ramification of state tax issues and how valuation can change from one state to the next, depending on tax structure. The book also includes a detailed discussion of the various U.S. Tax Court cases involving pass-through entities.

APPLICATION TO CASE STUDIES

The last part of the book presents case studies that are both interesting and very informative. The case studies alone are an instructional read for both experienced and new business valuation professionals. The practicality of the cases is very helpful. Eric utilizes these practical case studies in a manner that is both educational and quite interesting for the reader. These case studies bring theory and constructive application together in a cohesive presentation.

RECOMMENDATION

Overall, the book provides valuable insight and advice on how to value pass-through entities. Tax-affecting issues that started in the U.S. Tax Courts (*Gross*, *Heck*, *Adams*, *Wall*, *Dallas*, and *Gallagher*) have now also become highly publicized at the shareholder dispute level (*Kessler-Delaware MRI*), and the family court level (*Bernier*, MA). This book provides the business appraiser with a comprehensive approach in dealing with the pass-through entity issues. I highly recommend this book to all business appraisers. VE

John E. Barrett, Jr., MBA, CPA/ABV, CVA, CBA, is a principal of Barrett Valuation Services, Inc., of Cranston, Rhode Island, and a director of Keystone Valuation Advisors, LLC, of Dedham, Massachusetts. He is a member of the editorial board of The Value Examiner. *E-mail: Jbarrettval@hotmail.com.*

The Value Examiner: Interview with Eric Barr

Eric Barr recently spoke with The Value Examiner about his background and how he came to write his book *Valuing Pass-Through Entities.*

VE: Tell us a bit about yourself. How did you get into this industry?

Eric: My father and my grandfather (who I always called Sam) were business partners while I was a boy growing up in Brooklyn. They operated a kosher food products, wholesale grocery business, and they were my heroes. The two of them would often talk about work after dinner and they would always let me listen in. As a boy, I grew up with an understanding of how important their business was to them, their commitment to success, and how challenging it was to manage a successful company. Their business was hard work, made more difficult by the people that they always talked about. From a boy's perspective, my dad and Sam always seemed to be surrounded by customers, employees, and colleagues who were trying to cheat them. Everyone that is, except Benny, their CPA.

Benny was the sole person who watched their back. He was their mentor and trusted advisor; he was respected and revered. Benny helped my father and Sam achieve their fullest potential as businessmen and made a profound difference in the success of my family's business. I was a beneficiary of Benny's contribution to my family. It was because of Benny that I viewed accounting as a helping profession. And it was because of Benny that I decided to become a CPA.

VE: What do you like best about this business?

Eric: In my role as CPA/advisor and business appraiser, I've been able to work with clients and help them anticipate and solve their business issues, thereby helping them achieve their fullest potential and effectively passing on to others what Benny did for me and my family. I find it deeply rewarding, and it's what I like best about my profession.

VE: In the Prologue to your book, *Valuing Pass-Through Entities*, you say that you have addressed many complex valuation and forensic issues over the years and have generally found a consensus within the industry or the literature regarding how to handle a dispute. The one exception to that observation is when valuing pass-through entities (PTEs). Why did you decide to take this issue on?

Eric: Most of the business ownership interests that I value involve PTEs, and it troubled me that so many professional business appraisers and the courts had such strong and seemingly conflicting points of view. None of the explanations that I heard satisfied me, and since my living depends on getting valuations right, I felt compelled to do something about it.

VE: The book contains worksheets and case studies in addition to chapters on various topics affecting PTEs. How do you envision this book being used by professionals?

Eric: I tried to create a book that would (a) be easy for a business appraiser to understand, apply, and explain to a client or court; (b) provide a flexible, yet simple model that was well grounded in valuation theory, court decisions and logic; and (c) offer illustrations, case studies, and a checklist that reinforce the text. My hope is that professionals and users of valuation reports welcome the book as a useful addition to our profession's body of knowledge and that it facilitates greater clarity and consensus regarding the valuation of PTEs.

VE: Are you thinking about your next book?

Eric: *Valuing Pass-Through Entities* called out to me as a topic that I needed to take on and writing the book was a logical way to express my findings. It was a remarkable self-actualizing learning experience. But just because I've completed the book, I don't view my involvement with the book's content as ending. Therefore, I'll hold off on pursuing my next book at this time (although I have a great topic in mind that I would like to address). VE

Eric Barr, CPA/ABV/CFF, CVA, CFE, is *the author of* Valuing Pass-Through Entities *(John Wiley & Sons, Englewood, New Jersey, October 2014) and a member of* The Value Examiner *Editorial Board.*

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ACADEMIC REVIEW

Contemporary Research in Valuation and Forensic Accounting

James A. DiGabriele, PhD, DPS, CPA/ABV/CFF, CVA

The purpose of this column is to provide the readers of *The Value Examiner* summaries of contemporary research in valuation and forensic accounting. The manuscripts covered are selected from numerous academic research outlets that include relevant topical coverage of valuation and related forensic accounting issues. The objective is to illustrate the core of this novel research while increasing awareness among the community of the subject matter.

As this column evolves, I encourage the readership to forward relevant manuscripts or working papers for consideration. Please send links and/or files to jim@dmcpa.com or digabrielej@mail.montclair.edu with Academic Research Briefs in the subject line.

EMPLOYEE TENURE AND ECONOMIC LOSSES

Author: Charles L. Baum II, Chair and Professor of Economics, Department of Economics and Finance, Middle Tennessee State University

Source: *Journal of Forensic Economics* 24(1), 2013, pp. 41-66

The calculation of lost earnings in wrongful employment termination cases should approximate the amount of time a terminated employee would have remained employed with the defendant employer. Forensic financial experts need to account for the probabilities of surviving, participating in the labor force, being employed, and remaining employed for that particular employer. The paper develops a model for the annual probability of remaining with a particular employer using *National Longitudinal Survey of Youth* data, which tracks the employment experiences of a nationally representative cohort of individuals over the 1979 through 2010 period. Short tenures are associated with a high probability of leaving an employer. After a point, somewhat longer tenures are associated with a higher probability of remaining with an employer an additional year.

Previous Literature Considered

Baum builds a hazard model (logistic regression) based on the lacuna from previous literature. Raymond (2005) argues wrongfully terminated workers face persistent losses (i.e., losses that persist after the expected tenure with a specific employer) due to reduced future employability, reputation damage, and psychological effects. Raymond cites studies showing persistent penalties from job displacement exist (Farber, 1997; Kletzer and Fairlie, 2003), termination leads to subsequent terminations (Hall, 1995), and laid-off workers are perceived to be of low ability (Gibbons and Katz, 1991). Raymond recommends allowing the jury to determine the extent of damage resulting from a wrongful employment termination rather than reducing this damage for the jury with attrition rates. Trout (1995) uses Current Population Survey (CPS) data from 1987 to estimate the probability of remaining employed with a particular company one additional year. Hughes (1997) estimates monthly transition rates using CPS data, and his model suggests average employment duration is short (1.87) years for women. Hughes suggests Trout's (1995) model overestimates employment durations because it does not include in the analysis durations of less than one year.

Digest of Findings

Employment spells still ongoing as of the thirteenth year have less than a ten percent chance of ending in any of the next eight years. In sum, this suggests that employment spells that survive the first couple of years have a relatively low probably of ending in subsequent years. The survivor rates are similar for males and females. The probability of separating increases with age. The employment hazard significantly decreases with education for males, but education has a statistically insignificant effect on

female employment spells. The hazard for employment ending significantly increases with the unemployment rate. A percentage-point increase the unemployment rate increases the separation hazard by 4.8 percent for males and 6.2 percent for females.

Conclusion and Implications

The results are particularly helpful in litigation when company-specific data on how long employees typically remain with an employer: (1) is not available at all, (2) is insufficient in size, or (3) is not sufficiently detailed. These results will allow forensic financial experts to approximate more accurately the time horizon over which to consider economic losses in wrongful employment termination cases by incorporating the probability of remaining with a particular employer. *This is a must read for an expert calculating economic damages.*

IN SEARCH OF VALUE: GUIDELINE PUBLIC COMPANY METHOD

Author: John D. Finnerty Professor of Finance, Fordham University

Source: http://www.fma.org/Nashville/Papers/In_Search_of_Value.pdf

The Guideline Public Company Method infers firm value from the prices at which comparable public firm shares trade in the capital market using selected valuation multiples. Fair market value is typically benchmarked by subjectively choosing a value for each multiple, or more simply, using the mean or median multiple from the range of multiples for a set of comparable firms. This paper develops a more reliable multiple regression method for determining values for guideline public company multiples and illustrates that it reduces the average absolute estimation error and the standard deviation of the estimation errors as compared to the common practice of simply selecting the mean or median multiple.

Motivation for Study

Valuation analysts select the subject firm multiple either by comparing the characteristics of the subject firm to those of the comparable firms and making a subjective choice, or more simply, by selecting the mean or median of the calculated range of comparable firm multiples (Pratt and Niculita, 2008). While some valuation books recommend using regression analysis to choose the multiple based on the firm characteristics relevant to firm valuation, they leave it to the appraiser to choose the set of variables and the mathematical form of the model (Damodaran, 2012; Trugman, 2008).

This paper proffers a model grounded in valuation theory for developing multiple regression models for guideline public company valuation multiples. It illustrates this procedure by developing and empirically testing multiple regression models for three widely used guideline public company valuation multiples: enterprise value (EV) to earnings before interest, taxes, depreciation, and amortization (EBITDA), enterprise value to earnings before interest and taxes (EBIT), and enterprise value to revenue (Damodaran, 2012; Pratt and Niculita, 2008; and Trugman, 2008). The paper quantifies the reduction in the average absolute estimation error and in the standard deviation of the estimation errors as compared to the common practice of simply choosing the mean or median multiple for a sample of comparable firms. The procedure developed is easy to implement and improves upon earlier regression approaches (Damodaran, 2012) in that it adjusts the industry median valuation multiple to account for the differences between the valuation factors for the subject firm and the comparable firms to obtain the subject firm valuation multiple.

Digest of Findings

Adjusted R2 values for the EV/EBIT (0.1827) and EV/EBITDA (0.1384) regressions are lower, which is reasonable considering the inherent noisiness of stock price data. The adjusted R2 value for the EV/R regression is much higher at 0.4674, suggesting a better overall fit. The very low p-values of the F-statistics indicate that the models are highly statistically significant. Valuation analysts often choose the mean or the median of the range of valuation multiples for the comparable companies. The author refers to this practice as a "naïve technique [that] is easy to apply but is prone to error." The regression modeling approach reduces the standard deviation of the estimation errors for all three valuation multiples.

Conclusion and Implications

Finnerty finds that the regression modeling approach reduces the average absolute error for each valuation multiple considered in the paper, especially for the enterprise value to revenue multiple; reduces the standard deviation of the estimation errors, especially for the enterprise value to revenue multiple; and reduces the skewness of the distribution of standard errors, especially for the enterprise value to EBIT multiple. The reduction in average absolute error for the EV to revenue multiple is approximately one-third when the median of the range of comparable firm multiples is selected for the subject firm.

VALUING HOUSEHOLD SERVICES: A NEW LOOK

Author: Matthew J. Cushing, Professor of Economics, University of Nebraska, David I. Rosenbaum, Professor of Economics, University of Nebraska.

Source: *Journal of Legal Economics* 19(1) (2012) pp. 37–60.

Forensic experts are called upon to assess the loss of household services in personal injury and wrongful death cases. A frequently used method for doing this is to value the labor hours spent on household services at market wage rates. A less often used alternative values the actual services produced at retail market prices. This paper develops a new technique for valuing services at retail prices. It then investigates the relative divergence between the wage rate and retail price approaches. The analysis indicates that valuing the actual retail services produced generates estimates significantly larger than those generated by valuing labor hours.

Literature Considered in Study

Current efforts to value household activities use imputation methods to value the time spent in non-market production (Zick and Bryant, 1990; Bryant et al., 1992; Landefeld and McCulla, 2000; Trewin, 2000; Ironmonger, 2001; Hamdad, 2003; Folbre, 2008). Time devoted to household production is the salient unmeasured quantitative term, and time-use surveys are the most popular method for recording the number of hours devoted to household production (Expectancy Data, 2011; Chadeau, 1992; Abraham and Mackie, 2005; Pratt, 2009; Folbre et al., 2005). There are two widely applied imputation methods: the Opportunity Cost Method and the Replacement Wage Method. The Opportunity Cost Method values time devoted to household production at the rate an individual could earn in the market (Becker, 1965; James, Jr., 1996; Abraham and Mackie, 2005; Pratt, 2009). The Replacement Wage Method values household production time at the wage of a hired worker who performs the work (Expectancy Data, 2011; James, Jr., 1996; Abraham and Mackie, 2005). This paper offers a new approach to valuing household production at retail prices. Rather than start with output, start with the hours spent on household services.

Digest of Findings

The new methodology starts with hours spent on household services, rather than the amount of output produced. This is the same starting point as the Labor Value Approach to valuing household services. A series is developed of hourly retail prices that consumers would pay if they were to purchase equivalent services on a retail market. Two adjustments are then made to the price series: 1) prices for some services are adjusted downward to account for inputs no longer used in personal production of household services; and 2) the series is adjusted to account for relative productivity differences between individuals and retail service providers.

Conclusion and Implications

Results using the new approach are compared to the value of household services developed using the typical Labor Value Approach. Results show that the direct output estimates are at least twice as large as the labor value estimates. This divergence suggests that in forensic applications, the more commonly used Labor Value Approach may produce a fairly conservative estimate of the loss related to provision of household services. VE

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LITIGATION CONSULTING

Court Corner

By Peter Agrapides, MBA, CVA

ESTATE TAX

Estate of Kessel v. Commissioner

T.C. Memo 2014-97; May 21, 2014

U.S. Tax Court, Judge Kroupa

This case involved a motion for summary judgment brought by the IRS concerning reasonably foreseeable future events, as they relate to the fair market value standard of value. At the date of the decedent's death on July 16, 2006, he held a $4.8 million investment account with Bernie Madoff. The estate timely filed a Form 706 and paid all related estate taxes. Upon discovery that the Madoff investments were in fact a Ponzi scheme, the estate filed a revised Form 706 claiming a refund on the estate tax paid (for the estate tax related to the investment account).

The revised Form 706 reported a value of zero for the Madoff investments. The IRS filed a motion for summary judgment taking the position that under the fair market value standard, the hypothetical willing buyer and willing seller "would not reasonably know or foresee that Mr. Madoff was operating a Ponzi scheme at the time Decedent died."

The court denied the IRS's motion for summary judgment, stating that some in the investment community had suspected Madoff's investments and their consistently high returns. The court further stated, "Whether a hypothetical willing buyer and willing seller would have access to this information and to what degree this information would affect the fair market value of the Madoff account or the assets purportedly held in the Madoff account on the date Decedent died are disputed material facts."

It should be noted that the Madoff bankruptcy trustee classifies the estate as a "net winner," as they withdrew a total of over $5.5 million, while only depositing approximately $2.8 million in the Madoff investment account. Further, the Madoff trustee has brought an adversarial proceeding against the estate seeking to recover "fictitious profits."

MARITAL PROPERTY

Berg v. Berg

2014 Tenn. App. LEXIS 373; June 25, 2014

Court of Appeals of Tennessee, Judge Clement, Jr.

HOLDINGS: [1] The court properly classified property under Tenn. Code Ann. §36-4-121 as the husband's separate property because he presented testimony of an oil and gas expert, a forensic accountant, and the entities' bookkeepers and employees; the wife presented no expert testimony, relying on her own estimates for valuation; [2] Division of the marital estate under §36-4-121 was proper because the husband's poor business practices—not dissipation—resulted in the decrease in the marital estate, the wife's refusal to sign tax returns increased the tax liability by $90,000, and a debt owed to the husband's brother was a valid marital debt, which was assigned to the husband; [3] The wife's alimony of $8,000 per month was proper under §36-5-121 because she misrepresented her monthly expenses and accepted no blame for the demise of the marriage.

PRICING

Paramount Petroleum Corp. v. Superior Court

227 Cal. App. 4th 226; June 20, 2014

Court of Appeal of California, Judge Croskey

The plaintiff, a manufacturer of roof shingles, sued the defendant, a supplier of asphalt coating, alleging that the supplier stopped performing after the price of oil (on which the pricing formula was based) fell, while the price of the oil used in the shingle coating remained constant. The Superior Court of Los Angeles County, California, granted summary adjudication for the manufacturer as to liability and a defense. The supplier sought writ review.

The court of appeal held that plaintiffs may, despite the confusing language of Code Civ. Proc., §437c, subd. (f)(1), move for summary adjudication of a cause of action if the plaintiff asserts there is "no defense" to that cause of action. Further, the plaintiff must prove each element on that cause of action.

In the current case, it was deemed improper to grant summary adjudication as to the supplier's liability for breach of contract with the specific understanding that damages would be determined at trial, because damages are an element of a breach of contract cause of action. Therefore, a plaintiff cannot obtain judgment on a breach of contract cause of action in an amount of damages to be determined later. However, summary adjudication was proper as to mistake of fact under Civ. Code, §1577, because the mistake was one of judgment, not fact.

The supplier was mistaken as to whether the correlation in price between the two types of oil would continue, but not as to the value of the price-formula oil at the time of the contract. The supplier could have protected itself by providing that the continued use of the formula pricing depended on the continuation of the price relationship, but it failed to do so.

The court of appeal granted writ relief as to summary adjudication on liability and denied relief as to summary adjudication on the defense of mutual mistake.

SECURITIES

Dent v. Ramtron International Corp.

2014 Del. Ch. LEXIS 110; June 30, 2014

Court of Chancery of Delaware, Judge Parsons

HOLDINGS: [1]-A breach of fiduciary duty claim under Revlon by a former stockholder (FSH) of a company against the company's board of directors, arising from the company's acquisition by a strategic buyer, did not survive chal-

lenge by a motion to dismiss because the company charter contained an exculpatory provision under Del. Code Ann. tit. 8, § 102(b)(7), and there was no reasonable inference of a breach of their duty of loyalty or that they acted in bad faith; [2]-The claim that the individual directors breached their duty of candor also did not survive challenge because the FSH did not establish that there were material omissions or a lack of completeness as to the disclosures in the proxy that were material. The Delaware Court of Chancery granted the dismissal motion.

Finnerty v. Stiefel Labs, Inc.

2014 U.S. App. LEXIS 12237; June 30, 2014
U.S. Court of Appeals for the Eleventh Circuit, Judge Anderson

HOLDINGS: [1] In a securities fraud case under §10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. §78j(b), the evidence supported a finding that prior statements that a corporation would continue to be privately held gave rise to a duty to update when the corporation considered itself to be a serious acquisition target; [2] The corporation only had a duty to disclose facts that were necessary to make its prior statements non misleading, and it had a duty to update a shareholder before repurchasing shares of its own stock from him; [3] Merger talks were sufficiently advanced by the date when the shareholder exercised a "put" option for a jury to have found the talks material; [4] The corporation was not entitled to an instruction that it was required to purchase the shareholder's stock as soon as he exercised his "put" option, as the jury was not misled as to that issue. The lower court's judgment was affirmed.

Laidler v. Hesco Basticon Environmental, Inc.

2014 Del. Ch. LEXIS 105; June 25, 2014
Delaware Court of Chancery, Judge Glasscock III

HOLDINGS: [1] In an appraisal action, petitioner's submission of "proposed computational corrections" was adopted by the court with respect to the fair share value because the court had failed to consider applying a mid-year convention to the direct capitalization of cash flow method of calculating the value, and it was applicable due to the random nature of the product sales; [2] Although petitioner did not file a motion for re-argument pursuant to Del. Ch. Ct. R. 59(f), the matter was within the scope of the computational errors that the court requested commentary about, such that it was properly considered. The Delaware Court of Chancery corrected the share value. VE

Peter H. Agrapides, MBA, CVA, is a principal with Western Valuation Advisors, where his practice focuses primarily on valuation for gift and estate tax reporting, ligation support, financial reporting, and buy-sell engagements. These engagements have ranged from the valuation of small family-owned businesses to companies with over $1 billion in revenue. Agrapides served on NACVA's Valuation Credentialing Board in 2010, and is a member of the Current Update in Valuations instructor team. E-mail: peter@westernva.com.

PRACTICE MANAGEMENT

Practicing Solo

"Practicing Solo" features interviews with our industry's seasoned sole practitioners. If you are itching to join the solo ranks, or striving to be more efficient and effective in your established one-person firm, this column offers you practical advice, steeped in experience from the trenches, that can move you forward.

By Rod P. Burkert, CPA/ABV, CVA

INTERVIEW: KAREN FINE

I hope you enjoyed last issue's interview with Greg Crumling. Our interview series continues, with this issue featuring Karen Fine, CPA, CVA, CDFA. Karen is located in Charleston, South Carolina, a bastion of Southern manners and hospitality.

Karen has been on her own since 2011, practicing as Fine Accountess, LLC (fineaccountess.com). Her practice sweet spot is litigation support, with most of her engagements being matrimonial-related, and all of her clients are attorneys. She also has completed a substantial number of economic damage engagements and recently accepted her first criminal defense engagement.

Karen Fine

Rod: What was your first year like, and what would have made it better?

Karen: My first year was exciting, in the sense that it was a start-up enterprise, and I felt eager and optimistic. At the same time, I had genuine concerns, as there was no guarantee of professional or financial success.

During my thirty-year professional career, I had a great deal of experience in accounting as well as financial planning and analysis. However, I also had other areas of interest and work experience that are not included in the typical background of most accounting professionals. Those non-traditional years and careers turned out to be critical to the success of my practice in that first year because they provided me with a healthy dose of confidence, optimism, resilience, endurance, and personal discernment.

Rod: Did you have a formal (or even semi-formal) business plan?

Karen: Not really. Fortunately, I had a very non-traditional career path, and the positions I worked in enabled me to assess the risks and strategize the most likely courses for success. I also received wise counsel from several prominent attorneys in my local community who strongly advised that there was demand for additional providers of litigation support services.

I continually refined my business and marketing plan to align my expertise and interests with the needs of the local market. For example, I learned that Charleston is not a big mergers-and-acquisitions market, so there was no sense going down that road. I also discovered that many of the matrimonial clients I was likely to encounter were small business owners, so I would need to be accredited to perform business valuations.

Rod: How did you first attract clients, and how did that strategy evolve over time?

Karen: I've gained clients exclusively through individual referrals, primarily from other attorneys. Most attorneys don't want to be the first attorney to use an expert, and will only hire an expert that has been used by another attorney they personally know and trust.

So as soon as I began thinking about starting my practice, I alerted all the attorneys that I knew about my plans and asked for their opinion of my vision. When I started practicing, I re-contacted those same attorneys, took them out for a bite to eat,

Karen's office looks out on a quaint street in Charleston, SC.

and asked them for work or suggestions of other attorneys to contact. Then, I cold-called those attorneys with an introduction from the referring attorney, asking them about their practice and offering to take them to lunch.

I also sent introductory letters with my CV to selected local attorneys from the county bar association, telling them about my services. This was probably a waste of time, paper, and postage, as it generated little response that I am aware of. But, it kept me busy and hopeful in the early days as I walked each batch of mail down to the post office week after week.

I obtained attorney e-mail addresses from the county bar association and sent out periodic newsletters, using Constant Contact. Constant Contact tracks which recipients open the e-mails, so I was able to gauge the number of responses and unsubscribes. I received two great phone calls from attorneys who read my newsletter. I immediately suggested a lunch and have now done work for both of them and received referrals to other attorneys. I know two people don't sound like a lot of success, but the compounding effect was tremendous. I can trace at least 30 new clients over the past three years back to those two attorneys who read my initial Constant Contact newsletter.

I attended a state bar convention and introduced myself to every attorney and judge I met. I deliberately did not exhibit at a booth in the vendor section. I did not want to stand around all day, smiling as people walked by, and hand out promotional items. Instead, I attended the educational sessions and conversed one-on-one with attorneys and judges.

I continue to specifically ask attorneys I know for new business, letting them know of my availability. A key factor seems to be that the attorneys feel comfortable working with me on a professional and personal basis, particularly if their client is difficult. The attorney has to know that they can speak quickly, efficiently, and comfortably to me—in addition to knowing that I will produce a quality work product.

Rod: What kinds of engagements did you start with?

Karen: My very first three clients were a shareholder dispute, followed by a matrimonial matter, and then a business valuation engagement. I enjoyed all three cases and found the work to be genuinely interesting.

During the course of my early engagements, I made a point to contact and meet with many of my colleagues and competitors. I found that, without exception, people were friendly and helpful, and wished me well in the start-up of my practice. Several of those relationships have continued through today. We often meet for lunch to share advice or tips on technical matters, local news, or market conditions.

Rod: Do you practice in a specialized niche today?

Karen: Yes. The focus of my practice has evolved into two primary areas: matrimonial (support and equitable division calculations) and economic damage calculations. This is not something I have sought out, but rather those are the types of engagements that are practiced by the attorneys with whom I have naturally formed relationships over the years.

Rod: What has been your best marketing tactic?

Karen: Building personal relationships with attorneys—no high-pressure sales tactics, just genuine friendships. I practice in a relatively small geographic area, and people with shared interests frequently find themselves in communication and attendance at public events. It just builds from there.

LinkedIn has proven very useful, not so much for marketing or contacts, but for being vetted by potential clients. I've found that everyone views my LinkedIn page prior to retaining me, as do opposing parties. I intentionally do not have a Facebook page. There's just too much possible downside to unpredictable posts and comments by "friends."

Rod: How do you price work?

Karen: I like to believe that I price my work competitively. Earning a large income is not my primary professional goal. I am also mindful of the expense to my clients at what is likely a very difficult time in their lives.

There are very few cases I will perform for a flat fee, just an occasional small job for a few select attorneys. My hourly rates are generally less than the attorneys' rates with whom I work. However, I am not perceived as someone that will work cheaply. I am very thorough in my approach, which by definition can be time-consuming and, thus, expensive.

Rod: How do you differentiate yourself from larger firms?

Karen: Fairly easily. I answer my own phone because there's only me. I am known for my responsiveness and high-quality service. Some attorneys have said they like to refer clients to me that need a lot of handholding and diplomacy. They know I will work closely with them and be patient and sensitive to their entire situation.

Rod: Do you work from a home office or an office-office?

Karen: An office-office is a must for me. I initially started in a home office and found it to be unworkable in terms of an appropriate place for meeting clients. And the view out my home office window is highly distracting. I live on a beautiful marsh that spills out into the Charleston harbor, where local lore says the Ashley and Cooper Rivers come together to form the Atlantic Ocean. [*Editor's Note: Does anyone beside me believe this is unusual! The view is too beautiful?!*]

I am fortunate to sub-lease my current office from a wonderful CPA firm, which specializes in tax. My monthly rent includes an office, conference room, kitchen, receptionist, Internet, fax, and great camaraderie throughout the day—all in beautiful downtown Charleston.

I continue to use my home office in evenings and on weekends. I have it set up to mirror my office so I'm not hauling computers or peripherals back and forth. All of my files are stored on the cloud, so everything is accessible.

Rod: What is your current mobile device?

Karen: I rely on an iPhone and an iPad. I carry both devices with me at all times. I have chargers in every place I'm likely to be for more than an hour at any time throughout the week. I don't have a landline in my office (or home, for that matter).

Rod: Describe your current computer workstation set up.

Karen: I have a single desk with a great chair, a bookcase, and one visitor chair. On my desk are a laptop, large-screen monitor, and scanner/printer. On my walls I have every diploma and certificate I've ever earned as an adult.

All files and documents are stored in the cloud, so I don't have file cabinets. Often, an opposing counsel will provide requested documents in paper format, which I then scan and store. When I can afford to make another capital purchase, I plan to buy a high-speed scanner.

Rod: Besides your phone and computer, any office hardware or software that you just couldn't live without?

Karen: I really like my Adobe Reader XI, Excel 2013, and Microsoft Outlook. I designed my own website using GoDaddy and use their exchange server to host my e-mail and website. I've been very pleased with the GoDaddy customer support, but find the Adobe and Microsoft support to be practically non-existent.

Rod: What do you listen to while you work?

Karen: Nothing. I would find music too distracting to me and too disruptive to my office mates.

Rod: What tool(s) do you use to manage your to-do list?

Karen: I manage my to-do list with the Notes feature in my iPhone or iPad, or on brightly colored scraps of paper that I transfer to my Outlook calendar on a daily basis. At the end of each day, I recopy my to-do list and stick it on the front of my monitor, ready for the next day.

Rod: What are your best-cost saving ideas?

Karen: Do not spend any money until absolutely necessary. Don't buy a database subscription because you think you're going to get a client. Buy used furniture. I do everything I can for myself and understand up front that I'm going to put in a lot of hours. Sometimes it's not easy, and there are a lot of late nights, but it just has to be done that way during the start-up period.

I also request a healthy retainer from new clients and bill on a regular basis. I often invoice upon the completion of a task or a milestone of an engagement rather than waiting until the end of a month. When a retainer has been substantially depleted, I request that the client replenish it.

Rod: How about your favorite productivity tip that saves you lots of time?

Karen: I complete all pressing tasks before leaving the office each day and prepare a prioritized list of work for the next day. This frees my mind to think about other things in the evening, even if they are work-related, which is far more productive than worrying about what needs to get done the next day.

My other tip is to handle all work and personal items electronically wherever possible. I know that might horrify some people—they want to touch the paper and fill three-ring binders. All of my document management is digital. Most of my communications are electronic, other than sensitive phone calls and strategy sessions with clients. I rarely write anything down on paper and don't even own a ten-key calculator with a spool of tape.

Rod: What method/system/tool do you use to stay organized?

Karen: Staying organized is a matter of self-discipline and perhaps some pre-disposition to obsessive-compulsive behavior. I like to organize and address tasks ASAP. I don't go home at night until the matters of the day are in order and

ready for the next day. I check the calendar on my phone each night to be sure I haven't forgotten anything and can plan just how professional or casual I need to dress the next day. I'm also good at multi-tasking and can change direction on a dime. I can be very responsive to what is pressing at any hour of the day, depending upon my clients' needs.

Rod: Early bird or night owl—what's your sleep routine?

Karen: Night owl. It's quiet—no phone or emails or text to distract me. Most of the attorneys I work with tend to contact me later in the day and rarely set meetings prior to 10:00 a.m.

Rod: Do you have liability insurance?

Karen: Yes, I have insurance through the AICPA. Having this coverage allows me to sleep better at night.

Rod: Do you have any office staff?

Karen: I am able to use the services of the wonderful receptionist provided by my landlord and shared with the entire office. She is very professional and friendly, and it's always refreshing to walk in the office and be greeted by her.

Rod: Do you have a support group to call on?

Karen: Yes—many colleagues, office mates, friends, and family members have been very supportive. I have found support in unexpected places. A local accounting recruiter introduced me to a friend of his, with whom I share professional interests, and he has always been willing to share his perspective and encouragement for the price of lunch. Personal friends, who are not the least bit interested in my profession, are very interested in my experiences, and encourage me to continue in my work as a vehicle to assist others. Through my volunteer experiences, I have become acquainted with several attorneys who often refer me to their colleagues.

Rod: Who reviews your work?

Karen: I contract by the job with experienced and appropriately specialized colleagues to review my work. I maintain good relationships by staying in regular communication and taking them out for occasional lunches so a good foundation is in place if I ever need something in a hurry.

Rod: How do you stay technically current with changes in the profession?

Karen: I invest in high–quality, live CPE. It's also a great opportunity to network and market my services. I've met some great folks at seminars who have served as both role models and inspirations. And people always want to ask me questions about Charleston, since it's such a great place to visit.

Rod: What's your work-life balance like?

Karen: My work-life balance is good. I have a very supportive husband and having his income and medical benefits were key factors in starting my solo practice. He is also a great sounding board and honest critic. He can pretty much read my mind and knows when I have a troubling case and need to reflect, or when I just need to vent. And he understands that my turmoil (anger) has nothing to do with anything he's done. He's pretty special.

In terms of managing the stress of being self-employed, it's vital to have a sense of perspective—my work is what I do, it's not who I am. And keeping a sense of humor really helps provide that outlook in tough times.

Rod: What practice areas do you think offer the most promise to someone going solo now?

Karen: As the economy continues to improve, I think there will be more opportunities for solo practitioners in litigation support.

Rod: Finish this sentence: If I knew then what I know now, I would…

Karen: …spend more time on disciplined and methodical marketing every week, and be less self-critical.

That's a wrap! Do you have a question you would like me to ask in an interview? Got an idea for someone you would like me to interview? Or a question you'd like to ask me? E-mail me at rod.burkert@burkertvaluation.com, and I'll see what I can do. VE

Rod P. Burkert, CPA/ABV, CVA, is president of Burkert Valuation Advisors, LLC (burkertvaluation.com). His engagements focus on income/gift/estate situations, divorce proceedings, partner/shareholder disputes, and commercial damage/economic loss matters. He also provides independent report review and project consulting services to assist fellow practitioners with their assignments. He recently co-founded Practice Builder Academy (practicebuilderacademy.com), a twelve-month mentoring program that teaches strategies to BVFLS professionals who want to build their practices and redesign their lives. Rod is a long-time instructor for NACVA's Consultants' Training Institute and was recently re-elected to NACVA's Executive Advisory Board. He is also a member of The Value Examiner *Editorial Board.*

PRACTICE MANAGEMENT

Chronicles of a Startup

Glenn Spinello Discusses His Areas of Focus

By Rod P. Burkert, CPA/ABV, CVA

As detailed in the July/August issue, back in April I received an e-mail from Glenn Spinello, CPA/ABV, CVA. He was writing to announce that he was going solo. My first thought was to catch up with him in a year, when he would have actual experiences to recount and conduct his interview in 2015.

Then I thought, why not interview this person in real time and let readers vicariously share his roller coaster ride of entrepreneurship?! So that's what I'm doing. Welcome to "Chronicles of a Startup." For the next several issues, my "regular" Practicing Solo column will feature this brief postscript. Here is Glenn's second installment…

Glenn Spinello

It has now been just over three months since I formed Spinello Business Valuation, LLC. In short, life is good! I am thoroughly enjoying myself, and I remain positive about my prospects. I'm happy to say that I have some BV reports going out and some cash coming in. I am recently "in the black" despite having paid significant upfront expenses (see below for some details). And in fairness and to those of you who might be wondering, this profit is *before* a normalization adjustment to my compensation. Nevertheless, the experience feels great!

Most importantly, the pipeline of received and potential engagements is growing steadily. I am not concerned about survival as an entrepreneur so much as I am with managing the myriad of practice opportunities and juggling that with the burden of being a one-man startup. Fortunately, I have a highly supportive wife, who recently rejoined the workforce, and older kids. Aside from upcoming tuition bills for two college educations, we live modestly.

In the first three months of operations I focused on 1) business development and production, and 2) initial infrastructure. Here is a breakdown of how those areas worked out:

BUSINESS DEVELOPMENT AND PRODUCTION

In addition to the backbone activities of "bringing in and doing the work," I focused hard on implementing a contact management system (I'm currently using Salesforce, but am re-evaluating that decision); getting out an initial e-mail and LinkedIn blast to let people know what I'm doing now; and following up with phone calls, coffee and meal invites, other networking events, etc. I am fortunate to have a large network of folks to call on, having performed BV work exclusively for over seventeen years before going solo. But I am also well aware that I need to continue managing and growing my network.

INITIAL INFRASTRUCTURE

Sharing importance with business development and production activities was implementing needed infrastructure. Fortunately, my virtual firm needs are fairly basic. That said, there was much to do—summarized as follows:

- Organize my business as a limited liability company.
- Obtain insurance (from Continental Casualty Company, a CNA member company, through the AICPA).
- Buy a computer, monitors, printer, and cell phone.
- Create a logo and then purchase business cards, letterhead, etc.
- Identify and subscribe to various valuation databases and resources.
- Implement a cloud-based backup system for my files.
- Design and install Excel-based management software. The metrics I track include billable time, engagement progress and profitability, work in progress, and accounts receivable
- Update my LinkedIn profile.
- Develop a website—a weak spot for me, and it's taking some time. I started the process; now I just need to finish it.

In addition to the above areas of initial focus, I have been trying to look forward and identify areas for improvement and growth. I have a constantly evolving list of projects—ranging from implementing a more-focused business development effort, to developing new markets, to building templates and other practice tools, to updating my information technology. I will discuss some of these items in my next update. VE


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