



# Valuation Perspectives

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### Don't Just Guess

By: Hillary Stilwell

Recently WHM Capital Advisors, President and Chief Investment Officer, Bill McAfee, Jr. published research on company specific premiums in the January/February 2008 Issue of *The Value Examiner*, an international publication on business valuation. When asked about the basis for writing this article he responded, "I have been concerned for some time that expert valuation opinions are at risk in tax and litigation arenas due to unsubstantiated risk premiums."

McAfee's recent article discusses the quantification of risk in private companies. The basis of the article is to find a way to more accurately value risk premiums in order to find a more precise valuation of private companies. Public companies are measured by their rate of return to shareholders relative to the risk taken by investors, but market risk does not apply to private companies. There is more than one way to value private companies, and all are highly debated as to their accuracy, precision, and formulation.

Analysts typically use data from Ibbotson and Associates or Duff and Phelps to "build up" rate of return or use a capital asset pricing model (CAPM) to try to measure the risk taken by the private companies. McAfee states in his article that these "models use an empirically derived risk-free rate and equity risk premium, then add additional premia for size and industry." McAfee continues, "The most difficult piece of the discount rate has been how to determine the company-specific risk premium (CSRP)... the CSRP has been largely defined by the subjective judgment of the valuation analyst."

Recently there have been several articles published regarding the use of market derived methods to determine risk and discount rates of private companies. McAfee states, "Beta <market risk> is the risk of being in a system associated with the stock market, regardless of how diversified the portfolio of assets. It becomes apparent that Beta is most relevant in measuring the risk of publicly traded companies." Publicly traded companies offer a multitude of ways to find their Beta, however, "The risks represented by a Beta derived from public company data does not necessarily equate to the risks of a single private company."

WHM Capital Advisors' valuation process focuses on the risk variables of each individual private company. In his article, McAfee wrote, "Over the last five years, our firm has worked with standard deviation of ROE as the CSRP determinant. The methodology has shown itself to be consistent in determining relevant and realistic CSRP conclusions. Furthermore, we have presented trends in value over time using our CSRP derivation as a consistent cost of equity component over the years measured. ... This has led to ongoing discussions with management of these companies similar to the discussion public management has had with its analysts in addressing the question, 'Is management creating shareholder value?'" McAfee has developed a proprietary software, A.Q.U.A.®

McAfee believes that using internal variables to determine risk premiums leads to more justifiable business valuations in tax and litigation settings where experts are called upon to defend their conclusions in an adversarial setting.

For more information or to view the complete article, please go to our [website](http://www.whmca.com) (www.whmca.com).

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### Sidebar—In Our Court

By: John Barnes

In *Albert Gottesman, as Executor of the Estate of James M Henson, v. United States*, 2007-1 U.S. Tax Cas., the U.S. District Court for the Southern District of New York had to determine whether the estate could use a deduction from FMV of company stock based on the amount allegedly due under a marital separation agreement. Judge Jones ruled that the requirement for using the discount for FMV was not met. Jim Henson had bequeathed interest in his company to his children, and the children made subsequent payment to Jane, his estranged wife to comply with the separation agreement. Judge Jones ruled that property interest had "passed to the surviving spouse" according to IRC sec. 2056(a) therefore, no deduction was entitled to the estate of Jim Henson on the payments to Jane from the liquidation of company stock. The Estate's motion to grant a refund of estate taxes paid was not granted.

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WHM Capital Advisors, LLC is a financial advisory and wealth strategies firm headquartered in Columbia, South Carolina, which specializes in valuing companies, designing exit strategies and managing portfolios for business owners.