

Portfolio Valuation Using Automation

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Business development companies, hedge funds, and other fund managers face intensive new scrutiny over periodic valuations of portfolio securities. From a funds management and compliance basis, it's critical to have reliable sources for this security valuation, especially for privately held holdings. For several reasons, business valuers who value these funds must value multiple securities at the same time quickly. To accomplish this valuation task may require employing new tools. Automating parts of the process may offer the ideal solution.

This is the second article in a two-part series. The first part (*The Value Examiner*, March/April 2008, page 13) gave a background on the growing rules, regulations, and protocols for portfolio valuation; the shift in focus from domestic to international applications; and the debate among regulators, portfolio managers, compliance personnel, and accountants about the proper procedures to use in portfolio valuation. This article discusses how technology could minimize analyst intervention, and solve the issues of valuing multiple securities within a rigid time constraint for compliance applications. Finding a solution is timely in light of mark-to-market concern expressed by the Federal Reserve chairman, the insurance industry, and others.¹ In this article we discuss marking-to-model.

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard 157 (effective for years beginning after November 15, 2007) on fair value, which defines what auditors must now evaluate to accept appraisals of securities in portfolios. The international community, through the International Accounting Standards

Board (IASB), accepts the FASB leadership on the fair value definition. The standard is consistent with accounting series releases from the SEC to fulfill its responsibility for supervision over the Investment Company Act of 1940. FASB has delayed some interpretations for financial assets; but appraisers, portfolio managers, and auditors can no longer use simple cost or rule of thumb to value securities in portfolios for audit and compliance purposes.

Conduct of Portfolio Valuations

Several significant issues will impact valuing securities in portfolios for compliance purposes. Appraisers must plan work or expect problems when reviewed by auditors. Such issues include the following:

- Business appraisers consider three approaches to value: the market approach, the asset-based approach, and the income approach. A robust appraisal should evaluate all three. But FASB defines a three-level hierarchy (see sidebar, page 19) in valuing securities, with each higher level—from “bucket 1” to “bucket 3”—needing more footnote disclosure and footnotes from auditors.
- Each higher level consumes more time, is more expensive, and is more vulnerable to rejection by an examiner. Since the appraiser and the auditor want greater certainty, appraisers will want to achieve values for private securities by using Level 2 methods, avoiding Level 3 when possible.
- FASB may reconsider whether publicly traded securities' prices should be reevaluated about size of blocks and trading

¹ See www.ft.com and other articles for discussion of Fed chairman Bernanke's Congressional testimony. See also “Liquidity and Leverage,” Tobias Adrian, Federal Reserve Bank New York, and Hyun Song Shiin, Princeton University, 2007, for argument that mark-to-market is procyclical and fails to give evidence of value.

volume. For now, however, appraisers will use a publicly traded price quote as the safest measure, despite the potential failure of the current price to reflect true value.

- The FASB and prior SEC accounting series releases stress prices quoted in public markets. This emphasis is consistent with the IRS, which has historically encouraged using the market approach while discouraging other methods.
- Using publicly traded securities to benchmark the values of private securities only amplifies the problem of the mark-to-market model, which fails to consider intrinsic value.
- The business appraisal community uses methods other than the market approach for much of its work. Appraisers have problems finding out what, if any, public companies are comparable; subjective, discretionary selection of guideline public companies occurs.
- Managers of private equity and those engaged in mergers and acquisitions use discounted cash flow analysis. Sophisticated computer software gives values that are transparent and easier to evaluate than before such software was available.
- Given the implied lower credibility for Level 3 analyses, investors may be less confident if “unobservable” data are used, such as discounted estimated future cash flows from analysts. Thus analysts may favor a method, even if the findings are less certain, because the conclusions have more support from the rule makers.
- A valuation engagement (AICPA definition of a complete valuation) may cost from \$8,000 to \$50,000 or more. For a fund with multiple securities, there will be a high cost to get defensible values.
- A valuation engagement may take

a month or more for *each* security analyzed. For multiple securities, there will be a significant delay between the effective date of a valuation and the delivery of findings. Given the use for compliance reporting, such delays fail to meet stated requirements.

- The AICPA Statement of Standards for Valuation Services No. 1 lists two forms for appraisal services: a full valuation engagement and a valuation calculation. If only the market approach is used for portfolio securities, the work may technically be only a calculation and not reflect thorough due diligence. A valuation calculation has much less credibility to those who use the findings.
- Appraisers use capital market theory in an adjusted form for individual security risk build-up. Although the SEC and FASB prescribe approaches for valuing individual securities, SFAS 157 and the SEC do not address interacting securities within a portfolio for the combined securities’ affect on portfolio risk. Portfolio construction, however, has a proven affect on overall risk and the value of a portfolio.

Looking for Solutions

The time and cost for delivering valuations, coupled with the increased power of computers and availability of data, suggest using automated or semi-automated work flow. However, automation is antithetical to the hands-on analysis which now is the greatest strength of business valuers. Appraisers and rule makers should assess how to evaluate automation tools to conduct defensible work to comply with the new standards for multiple-securities valuations.

Several sellers offer software to value businesses, but the programs require a lot of subjective input by analysts for appraising non-public securities. Most soft-

3-Level Hierarchy For Fair Value

SFAS 157 set up a “fair value hierarchy” of three levels, which prioritizes valuation techniques for valuing portfolio securities, and aids in understanding what “good faith” should mean:

Level 1 uses quoted prices in active markets of the subject securities. FASB considers active markets those where transactions occur with enough frequency and volume to provide reliable pricing information.

Level 2 uses prices other than those quoted in Level 1 that are observable either directly or indirectly. This includes prices for similar investments in active markets, quoted prices for similar assets in markets that are not active, or drawn from or corroborated by observable market data.

Level 3 pricing considers unobservable inputs, also termed entity inputs. This includes projections used for discounted cash flow analyses.

ware solutions do cash flow projections and analyses, producing a discounted present value. Although discounted cash flow (DCF) evaluation gives intrinsic value estimates, thus marking-to-model rather than marking-to-market, a human analyst must estimate various inputs, including growth rate, capital structure, risk, and other factors. A few, such as the Automated Valuation Service of the National Association of Insurance Commissioners Securities Valuation Office, keep a computerized database for members only.² The database updates securities prices for insurance company portfolios, but only for traded bonds and preferred stocks, namely, securities that are filing-exempt.³

² See “Automated Valuation Service User’s Manual,” available at www.naic.org/documents/svo_AVS_user_guide.pdf.

³ The securities should be SEC-registered for reporting and have Committee on Uniform Securities Identification Procedures identification. The CUSIP

number identifies most securities, including stocks of all registered U.S. and Canadian companies and U.S. government and municipal bonds. CUSIP is owned by the American Bankers Association and operated by Standard & Poor’s to facilitate the clearing and settlement process of securities.

Analysts build their own inputs by using models that differ from analyst to analyst and incorporate personal bias. When analysts determine the inputs, they use a labor-intensive process of selecting certain data and models, which means slowing opinion delivery and increasing cost. More importantly, analyst intervention in this way means findings become more subject and thus Level 3 values, according to SFAS 157, and subject to the misgivings and costs associated with that reporting level. Maximizing automation to minimize analyst intervention would save time and cost and would be an ideal solution. Using publicly traded guideline companies to set parameters for cash flow projections of public companies to apply to a private company would combine the best attributes of the market approach and the DCF models, which use the income approach. Such automation may also shift findings from Level 3 to Level 2 if the conclusion is based on observable data and can be adequately back-tested and replicated.

Market and Income Approaches

When certified appraisers now value private companies, they are using a mark-to-model approach to valuation. They evaluate the market approach, of course, but also consider the income approach. The asset-based approach is usually used only for holding companies or companies with minimal value-added from management. Because the income approach employs so many assumptions that are not observable in the market, the conclusions using these methods are Level 3 inputs, requiring substantial documentation.

Designing an automated model with minimal analyst intervention for

business valuation first raises the question of what is state-of-the-art and how models have developed. Aswath Damodaran⁴ has stated that “the research into valuation models and metrics in finance is surprisingly spotty, with some aspects of valuation, such as risk assessment, being deeply analyzed and others, such as how best to estimate cash flows and reconciling different versions of models, not receiving the attention that they deserve.”⁵ Yet Damodaran argues DCF forms the basis for all other valuation.

Susan Mangiero, CFA, AVA, MBA, FRM, has said, “...model-related issues are relevant as never before. Anyone using a financial model must be prepared to defend it, warts and all. No one can afford to look at output alone. Valuation professionals will be under even more pressure to explain what goes into the black box, how it gets assembled, and whether the output makes sense.”⁶

An automated model must incorporate SEC, FASB, AICPA, USPAP, and valuation certifying body rules. Based on needs discussed, a model ideally would have the following features, for example:

- Use accurate and replicable data relevant to the effective date.
- Be sufficiently transparent so users can easily explain findings and support conclusions.
- Select comparable public guideline companies based on quantitative criteria without subjective input to avoid “cherry picking.”
- Gain a large enough “sample” of companies to lessen unique influence.
- Apply methods that are acceptable within the financial community, academic and practitioner, and can be accepted as a model within those communities.

- Focus on the market approach, using information from publicly traded companies to benchmark the value of private companies or those which are thinly traded because their quoted price may not be representative of value.
- Incorporate an income approach solution which can be applied to a subject company with minimal or no user intervention.
- Contain consideration of past inflation and future economic growth based on quantitative, non-subjective input.
- Discover risk based on quantitative reasons gained from the public market to lessen analyst judgment and bias.⁷
- Give a conclusion of value to reported equity (asset-based approach) for a reasonableness assessment and evaluation of intangible assets.
- Conduct back-testing or other means to estimate an error rate in findings.

The foregoing listing is not exhaustive, but describes minimum hurdles that must be overcome for any software solution. Addressing the list of criteria, the following should be goals for any automated solutions:

- Base identifying comparable guideline public companies on economics rather than arbitrary industry and size filters.⁸
- Companies may be comparable even though in different industries, while many within the same industry are not comparable, depending on capital structure and operating differences.
- Those using statistical methods and quantitative mathematics need understanding of the strengths and limits of these tools, including the

⁴Aswath Damodaran is a professor of finance at the Stern School of Business at New York University, where he teaches corporate finance and equity valuation. He is the author of several widely used academic texts on valuation, corporate finance, and investment management.

⁵“Valuation Approaches and Metrics: A Survey of the Theory and Evidence,” by Aswath Damodaran, Stern School of Business, November 2006.

⁶“Model Risk and Valuation,” by Susan M. Mangiero, Valuation Strategies, RIA Thompson, March/April 2003, page 37. Mangiero is president of

Business Valuation Analytics, LLC, and the author of *Risk Management for Pensions, Endowments, and Foundations* (John Wiley & Sons, NJ, 2005).

⁷Ibid. See discussion about using certainty equivalent cash flows versus a risk-adjusted discount rate, beginning page 6.

⁸This extends the concept of comparables as described in Gilbert E. Matthews’s presentation titled “Fairness Opinions,” April 2, 2001, the Estate of Gallo (Shannon Pratt), and Hallmark Cards.

amount of data needed and the distribution of data when developing value and confidence measures.⁹ The data may not be normally distributed, for example.¹⁰

- If an income approach method is developed, it should be based on information gained from the guideline public companies and applied to unique quantitative information relevant to the subject company. A measure of income should be determined, such as earnings, gross cash flow, net free cash flow, or cash economic return, which can be used across multiple industries.¹¹
- The software must enable analyses of financial statements to normalize companies so they can be adjusted to a common standard, such as making capital investment adjustments to normalize fixed assets and making excess cash adjustments.¹²
- The modeling measurement conclusions should be tested against the public guideline companies historically to find out how predictive the model is compared with historical pricing. These back-tests should enable the analyst to gain an error estimate for findings.

In a working paper to be presented at the Financial Management Association conference in Texas in October, authors Robert J. Atra and Rawley Thomas¹³ describe a system for developing and evaluating an automated DCF model based on the fundamental measurement principles of robustness, accuracy, minimum bias, and predictability.

“Finding the ‘economic drivers’ is an essential result of developing a DCF model,” the authors write. A well-specified DCF model can avoid the criticisms of other models, including data mining. “Since the model of price level has a foundation of DCF at its base, there is a built-in economic explanation of why different inputs alter the intrinsic value. Theoreticians should be more comfortable with a process that begins with an economic model as opposed to one that is an artifact of massive statistical analysis.”¹⁴

To test existing computerized models of publicly traded common stock, Atra and Thomas used proven statistical techniques to assess whether models were robust, accurate, unbiased, and predictive. Basing the work on the assumption that market prices of publicly traded common stock represent errors around intrinsic values, the intrinsic values determined by the various models were then compared to actual market prices. Models that produce intrinsic values close to actual prices are deemed more accurate.

Atra and Thomas investigated several versions of dividend discount models for the study, as those models represented actual cash flows received by investors. The three particular models were the Gordon model, the GROW model, and the ROPE model. The Gordon Model is a “one-phase” model, not considering future changes in payout, while the GROW and ROPE models are “multi-phase,” where growth regresses toward a mean over time.

The results of their study show that models differ significantly in terms of accuracy. Model accuracy can be improved in a systematic fashion, however. For instance, the authors found that including firm-specific Betas actually created a bias in the models, reducing accuracy. Removing the bias by incorporating a uniform Beta actually improved the accuracy of the model. The more accurate models also demonstrated greater predictive capability in terms of future returns, in that securities that were found to be undervalued by the model provided greater returns than those determined to be overvalued.

The authors concluded that models can be built which are accurate and predictive, but that such models require developers to systematically remove bias due to particular inputs.

Data Sources

Business valuation professionals are fortunate to have high-quality publicly traded company information, both pricing and fundamental data. Unlike the experience of real estate professionals, the data available are not only high-quality but consistent across the nation as well.

There are several sellers that supply historical public company information, both pricing and financial. Four important vendors are: Hemscott Data,¹⁵ which has both fundamental and pricing data; the Center for Research in Security Prices (CRSP),¹⁶ which has

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⁹ See *Fat-Tailed and Skewed Asset Return Distributions, Implications for Risk Management, Portfolio Selection, and Option Pricing*, Svetlozar T. Rachev, Christian Menn, and Frank J. Fabozzi, Wiley Finance, NJ, 2005.

¹⁰ See discussion of Paretian versus Gaussian distributions in “Valuing Foreign Currency Options with the Paretian Stable Option Pricing Model,” by Stanley J. Hales, Price Waterhouse, LLP, October 3, 1997.

¹¹ See “Discounted Cash Flow Method, Using New Modeling to Test Reasonableness,” Randall Schostag and Rawley Thomas, *Valuation Strategies*, Thompson RIA, September/October 2006, pgs. 24–41.

¹² *Ibid*, page 37.

¹³ Robert J. Atra, PhD, is professor and chair of the Finance Department, Lewis University. Rawley Thomas is co-founder and president of Life Cycle Returns, Inc.

¹⁴ “The Fundamentals of Automated DCF Modeling,” Robert J. Atra, Rawley Thomas, March 16, 2008.

¹⁵ Hemscott databases offer historical financial data and stock price information on U.S., Canadian, and international publicly traded companies, 215 industry groups, and major equity markets. Most time series data in the database begins in the early 1970s. It was formed in 2003 from Media General Financial Services and was acquired by Morningstar in early 2008. Morningstar acquired Ibbotson Associates in 2006 and Standard & Poor’s fund data business in March 2007.

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pricing data; Compustat,¹⁷ which has fundamental data; a joint venture of CRSP and Computstat,¹⁸ which combines fundamental and pricing data; and EDGARonline, which has pricing and fundamental information.¹⁹

The SEC's EDGAR is a primary source of information. EDGARonline and other vendors use the reported information direct from EDGAR, while sellers such as Compustat adjust the reported information. EDGAR is available because the SEC requires reporting companies, including all exchange traded firms, to file financial statements in accordance with Regulation SX, an SEC rule that governs what the form and content of financial statements of publicly traded securities should look like.²⁰ Companies that report to the SEC have been required to use Regulation SX formatting since 1972.²¹ But many provisions of Regulation SX have been since modified by Regulation S-T, governing the preparation and submission of documents in electronic format. In turn, Regulation S-T is undergoing changes, with new and future provisions requiring significant new ways for companies to submit the data, thus making it easier to use the information.

Among those changes, in February 2008 the SEC launched the "Financial Explorer" on its website to help investors quickly and easily analyze the fi-

ancial results of public companies. With Financial Explorer, users can examine corporate performance with diagrams and charts, using financial information provided to the SEC as "interactive data" in eXtensible Business Reporting Language (XBRL).

Many expect the SEC's mandate for using XBRL for financial reporting will encourage more consistent charts of accounts and, therefore, consistency among reported financial statements. EDGARonline has been partnering with XBRL and has a database that is now consistent with the reporting (and downloading) of the new format.

Valuation Automation

Real estate appraisal has used automated valuation technology and gives some insight into problems and opportunities for business appraisal. Automated valuation models (AVMs) have been one answer for property assessors, insurance underwriters, and lenders to get timely and economical values. But acceptance of the models has met conflict.

After a history of more than 30 years, a regulator in late 2006 noted, "While AVM technology can augment the appraisal process, it is not a substitute for an appraisal or independent valuation." Later the regulator stated, "The appraisal rule contemplates the involvement of an experienced, disinterested individual who prepares the written estimate of value."²² In this case, the regulator subsequently backed away from the first tough stance. In early 2007

it wrote that AVM use is acceptable in "...conjunction with review by a loan officer or an individual with knowledge, training, and experience in the real estate market where the loan is being made."²³ The regulator referred to a legal opinion necessitating human involvement in the valuation work for tax assessment.²⁴

The correspondence does not concern FASB or the SEC. But it shows concern about automated models and insists on continuing professional oversight. The takeaway from this example is that even if automation is developed for securities analyses, there will be a continuing need for certified professionals to exercise oversight.

AVM technology is an outgrowth of multiple regression analysis.²⁵ Many econometric models use multiple regression analysis to identify statistically significant variables and, therefore, predictors.

In statistics, regression analysis is a method for explaining occurrences and predicting future events. Multivariate regression analysis uses many variables to predict some unknown variable, and produces a way to measure the correlation between variables and findings to assess confidence in findings. For real estate, the variables may include square footage, lot size, age, quality, and other measures.²⁶

After identifying statistically significant measures, such as square footage, lot size, etc., the real estate appraiser may use an adjustment grid to set forth the variables and then adjust for a specific subject property.²⁷ Or an analyst who

¹⁶ CRSP is an integral part of the University of Chicago's Graduate School of Business. With a grant of \$300,000 from Merrill Lynch, CRSP was established in 1960.

¹⁷ Standard & Poor's started Compustat in 1962. Compustat provides unmatched company history back to 1950, providing key restated and unrestated data for back-testing. S&P's Compustat data are standardized to ensure comparability among similar types of data items, as well as financial results in current and prior time frames. Compustat notes that there is much latitude among companies and industries regarding reporting, presentation, and disclosure methods and claim that its manual adjustments present better data for modeling.

¹⁸ See www.crsp.com/products/ccm.htm.

¹⁹ EDGAR Online, Inc., makes its information and a variety of analytical tools available via online subscriptions and licensing agreements (www.edgaronline.com/company/about.aspx).

²⁰ All companies, foreign and domestic, are required to file registration statements, periodic reports, and other forms electronically through EDGAR.

²¹ See www.law.uc.edu/CCL/regS-X/SX1-01.html#history.

²² Letter dated October 31, 2006, to Infinity Federal Credit Union, Westbrook, Maine, from National Credit Union Administration associate general counsel Sheila Albin, regarding use of automated valuation models. NCUA is the federal agency that charters and supervises federal credit unions and insures savings in federal and most state-chartered credit unions.

²³ Letter dated January 19, 2007, to Infinity Federal Credit Union from NCUA, regarding "Additional Guidance on Using Automated Valuation Methods."

²⁴ NCUA Office of General Counsel Opinion 94-0909 (October 7, 1994).

²⁵ "Automated Valuation Models—Threat and Opportunity," *Appraisal Today*, 1998, Ann O'Rourke. Available at www.appraisaltoday.com/avms.htm.

²⁶ O'Rourke, *ibid*.

feels that growth rate, debt to equity, or yield of a stock might be useful in predicting a price-earnings ratio may use multiple linear regression and produce a range of possible price-earnings ratios.²⁸ Business appraisers also use grids, often for assessing “factors,” when comparing a subject company to public guideline companies or private transactions.

Access to a reliable database is essential to AVM for producing real estate values. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, for example, use their proprietary, internal databases for pricing.²⁹ Vendors that build databases rely chiefly on public records from states that disclose the information. If unavailable, tax assessment information (adjusted for percent of market value considered in locations) and Multiple Listing Service data may also be used for benchmarking.

Many vendors use multiple sources and methods for confirmation. However, some states, for example, do not make tax assessment information available, and in many rural areas no data is available. When such information is not available, the real estate appraiser is unable to use AVM.

Lessons from AVM

The Uniform Standards of Professional Appraisal Practice (USPAP)³⁰ lists five critical questions to which the real estate appraiser should answer yes before using AVM in an engagement for valuing real estate.³¹ Appraisers who can give positive answers to the following questions are likely competent to perform an appraisal using AVM:

1. Does the appraiser have a basic understanding of how the AVM works?
2. Can the appraiser use the AVM

properly?

3. Are the AVM and the data it uses suitable given the intended use of assignment results?
4. Is the AVM output credible?
5. Is the AVM output sufficiently reliable for use in the assignment?

Further, the appraiser must specify if the scope of work is to perform an appraisal, appraisal review, appraisal consulting service, or solely AVM findings, according to the USPAP advisory opinion. This real estate appraisal criterion is consistent with the AICPA Statement of Standards for Valuation Services No. 1 (effective January 1, 2008) for business appraisal to define if the work is a valuation engagement or a valuation calculation.

Up to this point, we have learned that the appraiser will want to use the market approach. The SEC, FASB, and IRS favor it. The analyst should search to see if there is an automated solution to speed up the valuation and reduce cost. And the appraiser will try to either find or develop an automated solution. Finally, the appraiser must learn the model intimately to assure reliable, defensible determinations.

BV Software

For non-real estate appraisal solutions, software developers who create software to discover the intrinsic value of publicly traded companies for investor buy/sell decisions should be one source of possible programs. Doing an Internet search of “business valuation software,” we found the following companies: Business ValuExpress,³² Business Valuation Manager Pro from the National Association of Certified

Valuation Analysts (NACVA, publisher of *The Value Examiner*), Business Valuation Model from BizPrep, ValuSource Pro from MBAAware, BizPricer from Business Book Express, DealSense Plus from MoneySoft, Business Valuation Specialist from Thompson, Business Valuation from Ball Park, VALUware from Deal Maker’s Resource Center; business valuation software from several vendors including PriceYourBusiness.com, Value Adder, Business Valuer, Urgent Business Forms; and numerous programs to run on Excel available as shareware or freeware.

In the institutional investor market, there are more products that approach the criteria for minimal analyst intervention. These include Stock Screener by Credit Suisse, which includes analysis by sector, market, momentum, price to earnings, return on equity, price to book, dividend yield, and other measures; a series of Value Line Investment Survey products; and programs from Zachs, Schaeffer’s Research, StockTrak, Hagen Custom Financial Systems, and DeMarche Associates ranking system.

There are many other valuation software sellers; the names are not important. The software from all includes a common problem: The user must make many subject decisions about what to input. User judgments include growth and margin forecasts for expected future performance using the income approach. The few software packages that include the market approach call for screening and selecting public guideline companies by analysts for market comparables. None of the various models now available have back-testing to supply confidence measures for an analyst, and none of these models applies the findings for use

²⁷ “Appraisers, Buyers and Adjustment Grids,” William Gordon, www.aicanada.ca/e/articles/appraisal_principles_related_to_market_value_and_injurious_affection.cfm

²⁸ “Multiple Linear Regression,” www.trade10.com/Linear_Regression.html.

²⁹ See Econbrowser, www.econbrowser.com/archives/2007/03/fannie_fred-die.html, for discussion of Freddie Mac and Fannie Mae business of holding large mortgage portfolios.

³⁰ USPAP, 2008-2009 Edition, effective January 1, 2008 through December

31, 2009, Appraisal Standards Board, The Appraisal Foundation. See Advisory Opinion 18 (AO -18), p. A-45.

³¹ This discussion does not pertain to “mass appraisal” but to the appraisal of a specific real property. Mass appraisal generally describes a procedure which defines a group of properties with characteristics sufficiently similar so that one model may be applied to all.

³² Business ValuExpress is owned by Mike Adhikari, a principal of the Minnesota Business Valuation Group, LLC.

against private securities for an enhanced market approach method.

Software can be designed to follow accepted valuation methods for: fitting standards, cutting out mathematical errors, avoiding information after the valuation effective date, objectively finding out capitalization rates and long-term growth capacity, avoiding subjective use of comparable company data, and giving consistent analyses across different companies and industries.

This kind of solution remains weak, however, relying on numbers only and not including company visits. Those weaknesses must be fully disclosed and the procedures must contain enough information so the conclusion of value can rise above the weaknesses. Any reporting must contain enough information so results can be reproduced by another analyst, and a certified appraiser must remain responsible for a review and sign the conclusion. Output and reporting with an automated model implies peers within the professional community should be able to test and accept a model. Certifying organizations such as NACVA should develop a certification program for appraisers.

Opportunities for Portfolio Valuation

The growing concern by the SEC, FASB, IASB, and domestic and international private equity groups for consistent, independent valuation of portfolio securities has created opportunities within the business valuation community. Strict

new rules necessitate increased appraisal quality for financial and regulatory reporting.

Historically, valuing companies has evolved from mostly an art to the increasing use of science. The introduction of powerful personal computers and sophisticated software, and increased availability of digital information about publicly traded companies, makes research and analysis much more cost-effective. The problems associated with marking-to-market should be overcome today with sophisticated programs to mark-to-model.

Software programs now exist to value public securities for assisting investors in choosing publicly traded common stocks to buy and sell. Logic dictates the base has been laid to extend use of such programs into sophisticated models for a market approach which can minimize analyst intervention and produce robust values for privately held common stock based on empirical data. **VE**



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