

# The Franchise Valuations Reporter



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## Our Expertise



Within the franchise, distribution and dealership context, we are experts in:

- Valuations
- Damages
- Expert Testimony
- Finance, Accounting & Tax

## Have a Question About Succession Planning for Franchise Owners?

Call us for a free, confidential consultation. And we're always interested in your comments about the newsletter.

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## We Write the Book

**Franchise Regulation and Damages**, the only treatise that covers valuations and damages in franchise disputes, is updated 3 times a year.

For more details, to see a Table of Contents or to place an order,

## Valuation

### *Discount Rate: Damodaran Updates His Implied Equity Risk Premium In Wake of Ukraine Invasion*

Professor Aswath Damodaran (New York University Stern School of Business) updated his implied equity risk premium to 4.73% as of March 16, up from 4.24% at the start of 2022. To that he adds the risk-free rate (2.19%, the 10-year T-bond rate on March 16) to get the long-term annual expected return on equity of 6.92%, which is “still lower than historical norms, but closer to the numbers that we have seen in the last decade,” he wrote, saying that “equities were already under pressure in the weeks before the invasion, as inflation fears surfaced again, and then hostilities have put further pressure on them.” Damodaran’s implied ERP is a forward-looking method, calculated by backing it out from the current market prices and expected future cash flows, which gives an internal rate of return for equities that is analogous to the yield to maturity on a bond.

### *Kroll (formerly Duff & Phelps) Increased Normalized Risk-Free Rate From 2.5% to 3% Effective April 7, 2022*

As an additional data point for discount rate calculations, following the same economic data Kroll raised its risk-free rate which may cumulatively impact valuers' (or damages experts') discount rate calculations.

### *4Q 2021 EBITDA Multiples Fall To 3.9X*

According to Business Valuation Resources, growing concerns over rising inflationary pressures coupled with the spread of the omicron variant weakened the outlook of continued economic growth, resulting in EBITDA multiples falling to 3.9x in the fourth quarter of 2021, ending the string of increases seen in the prior two quarters. While a weakened economic outlook dimmed prospects of

go to the [Wolters Kluwer Law & Business web page here.](#)

continued economic growth, the decline in the fourth quarter continued the cyclical trend of a decline in the EBITDA multiple in the fourth quarter, dating back to 2017. Prior to its decline, the EBITDA multiple rose to 5.0x in the third quarter of 2021, the highest multiple since the start of the pandemic.

### ***EBITDA Margins Remain At 12% In 4Q21***

Also, according to Business Valuation Resources EBITDA, as a percentage of net sales, remained at 12% in the fourth quarter of 2021, a decline from the 13% margin seen in the first two quarters of 2021. From the first quarter of 2019 through all of 2020, EBITDA multiples saw little movement, changing from 11% to 12%. It appears as though companies have improved operating costs by decreasing capital expenditures and operating under a more restrictive budgetary policies, in addition to a decrease in employment expenses as well as lower interest payments on loans as a result of low interest rates on borrowing, which resulted in EBITDA margins rising to 13% through the first half of 2021.

### ***Purchase Price Equals Value of Business Caught Up in Divorce***

In *Dettloff-Meyer v. Meyer*, 2022 Wisc. App. LEXIS 205, a Wisconsin divorce case, the valuations of two experts were both deemed not credible for a business caught up in a marital dissolution. The enterprise was Dr. Paul's brand of herbal products for treating livestock. The wife had bought the business from her parents one year prior to the divorce filing (no gift involved). The purchase price was \$500,000 (100% financed by a note from the parents), and she also borrowed \$57,920 from them shortly after for working capital.

The circuit court rejected the experts on both sides and found that the best measure of value was the purchase price/loan plus the working capital loan less any remaining principal at the time of trial, for a net value of \$45,230. The husband argued that the purchase price was not fair market value because it was not at arm's length. While the court agreed the transaction was not arm's length, still the tribunal felt it was the best indicator of value especially since neither expert's valuation of the business made "logical sense." The husband appealed, but the appellate court upheld the circuit court's decision.

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## Goodwill

### *It's Not Just for Divorce Anymore*

Personal and enterprise goodwill are not just relevant in marital dissolution cases; they are important considerations in bankruptcy, tax, business succession planning, execution of buy-sell agreements, and transactional matters. Furthermore, it comes up in disputes over franchise agreement reservations of goodwill to the franchisor.

### *Goodwill Impairments in U.S. Doubled in 2020: Kroll Study*

Total goodwill impairment in U.S. public companies was \$142.5 billion in 2020, more than double the \$71 billion recorded in 2019, according to the “[2021 U.S. Goodwill Impairment Study](#)” by Kroll. Even so, the level of impairments still fell short of the amount recorded at the onset of the 2008 financial crisis, which was \$188.4 billion. The study examines general and industry goodwill impairment (GWI) trends of more than 8,900 U.S. publicly traded companies through December 2020. The top three industries with the largest increase in GWI in 2020 were energy, financials and real estate, and industrials.

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## 2023 Tax Proposals

### *A Summary*

The top shelf Anchin accounting firm has put together a synopsis on the Biden Administration tax proposals in general terms. I've been following tax legislation for decades and have generally found that paying too much attention to the early proposals is a waste of time. Nonetheless [the Anchin article](#) is very worthwhile.

#### Proposed Tax Changes:

1. Increase of the preferred long-term capital gains and qualified dividends rates to the ordinary income rates for taxpayers with taxable income of more than \$1 million.
2. Creation of a so-called “billionaire’s income tax” beginning with the 2023 tax year which would impose a 20% minimum tax rate on those individuals with assets exceeding \$100 million inclusive of unrealized capital gains.
3. Returning the top individual marginal tax rate to 39.6%.
4. Raising the corporate tax rate to 28% up from 21%.
5. Addition of certain tax incentives for companies that keep jobs in the U.S., such as a 10% credit with regard to eligible expenses incurred in connection with the on-shoring of a US business, and the removal of certain deductions when domestic jobs are moved abroad.
6. Creation of a new “undertaxed profits rule” targeting multinational organizations which would replace the current base erosion anti-abuse tax (BEAT) regime.
7. Modifications to estate and gift taxes, including limiting the exemption for generation-skipping transfer (GST) taxes and changing the rules for certain grantor trusts.
8. Taxing carried interest fees earned by hedge fund managers for providing services to a partnership would be taxed as ordinary income rather than capital gains.
9. Imposition of a limit on the deferral of gains from like-kind exchanges of real property to \$500,000 for each taxpayer (\$1 million for married individuals filing a joint) per tax year.
10. Provide the IRS with \$14.1 billion in funding of which \$798 million will be directed toward improving taxpayer service and \$310 million for digital modernization of systems.

## Expert Testimony

### *Proposed Rule Change Will Attempt To Crack Down On Testifying Experts*

It has been argued by many that too many experts who are not qualified are being allowed to testify in court. Thus, there have been proposed changes to strengthen Rule 702 of the FRCP, which is the federal rule of evidence regarding testifying experts. If adopted, the changes will result in more experts being excluded from testifying.

## Quotations From Eleanor Roosevelt

***“No one can make you feel inferior without your consent.”***

***“Do one thing every day that scares you.”***

***“Do what you feel in your heart to be right – for you’ll be criticized anyway.”***