

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

European Goodwill Impairment Up 49% in 2020

According to a Kroll study, "[2021 European Goodwill Impairment Study](#)," total goodwill impairment recorded by European-listed companies in the STOXX® Europe 600 increased for the third consecutive year, rising 49%, to €54.1 billion (bn) in 2020. Spain had the highest aggregate amount of goodwill impairment in 2020, followed by the United Kingdom. Overall, the top three industries with the most significant increase in goodwill impairment amounts in 2020 are (in order of magnitude): financials and real estate, materials, and communications services.

Appeals Court OKs One Discount, Disallows Another in Divorce Matter

In a California divorce matter, *Harvey v. Harvey (In re Michael S.)*, 2021 Cal. App. Unpub. LEXIS 7867; 2021 WL 5934472, one side's expert applied two discounts to the valuation of the wife's one-half interest in his business: one discount for possible future taxes and one for a discount for lack of marketability (DLOM). The other side's expert did not apply either. The trial court ruled in favor of the husband's valuation (2 discounts). The appeals court upheld the DLOM, saying that it was supported by substantial evidence (using restricted stock studies) but concluded that the tax liability was erroneously accounted for and remanded the case.

Perils in Buy-Sell Agreements

The issue of valuation formulae in buy-sell agreements that are not updated (a frequent point of discussion by the valuation expert Chris Mercer) was important in the recent case of *Estate of Connie Collins v. Tabs Motors of Valley Stream Corp.*, 2021 NY Slip Op 32438(U). In that dispute a company's shareholder agreement included a

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

buyout provision with a price based on a fixed per-share value which was not updated. An ownership dispute ensued and the company exercised its buyout option at the fixed price, long outdated. Lawsuits were filed, and the court ruled that the shareholder agreement was enforceable and the fixed price was what should be paid. The fact pattern is not uncommon—many buy-sell agreements do not adequately address the issue of valuation when an owner exits the firm nor update the criteria.

In Discounted Cash Flow (DCF) Calculations Are Terminal Values Typically Too High, Too Low, Or Just Right?

The calculation to determine the value of the projected cash flows from future operations and from franchise fees and royalties using the Discounted Cash Flow (DCF) method follows three steps:

1. an estimation of net cash flows that will be generated over a projected period (generally 3-7 years);
2. computation of a terminal or residual value equal to the future value of the cash flows beyond the projection period (an exit multiple or Gordon Growth model generally); and
3. the application of a discount rate (estimated cost of capital) to reduce to present value the projected net cash flows and the estimated terminal or residual value.

Terminal values deserve substantial attention for the reason that that is often where (most of) the value is found. Some approaches to terminal value tend to result in higher values, whereas other approaches tend to result in lower values. [This recent article by Michael Vitti](#) provides some insight into the implied assumptions and relative biases of the approaches.

Discount Rate: Damodaran Posts His Data Update For 2022

Each year, Professor Aswath Damodaran (New York University Stern School of Business) generously posts a great amount of data on his website that include risk-free rates, equity risk premiums (ERPs), corporate default spreads, corporate tax rates, country risk premiums, and other data—all of which are free. A favorite topic of his is the ERP, and he uses a forward-looking method he calls the “implied” ERP as opposed to the “historical” ERP. He backs this number 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. He estimates the implied ERP to be 4.9% as of Jan. 1, 2022, and he reports the year-end estimates going back to 1960.

Intellectual Property Valuations

For a comprehensive series on the topic by the well-recognized Robert Reilly see the following:

[The Relief From Royalty Method - Part I of V](#)

[Elements of the Valuation Analysis - Part II of V](#)

[Application of the Relief From Royalty Method - Part III of V](#)

[Illustrative Example of the Relief From Royalty Method - Part IV of V](#)

[Analysis Caveats and Reporting Guidelines - Part V of V](#)

Damages

Attempt to Exclude Damages Expert Fails

In the recent patent case of *Xodus Med. v. Prime Med. (II)*, 2021 U.S. Dist. LEXIS 240473 defendants filed a motion to exclude the testimony of plaintiffs' damages expert. Among the arguments for exclusion was that the expert failed to offer reliable testimony to meet his "but for causality" burden for lost profits damages. They also challenged his reasonable royalty rate. The plaintiffs contended that the expert had a reliable foundation for his opinions and any issues the defendants had should be dealt with during cross-examination and not exclusion. The defendants' motion was denied.

Fraud

Gigi's Cupcakes Franchisees Can Pursue Fraud Claims Against Now-Defunct Franchisor

In *Sugarlips Bakery, LLC v. A&G Franchising, LLC*, January 24, 2022, Trauger, A., it was held that A&G Franchising—previously a franchisor of a chain of bakery shops doing business as "Gigi's Cupcakes"—could have violated Tennessee's and other states' laws by allegedly resorting to fraud and/or negligent misrepresentation in order to recruit potential franchisees/business partners. The consolidated claims of 17 former franchisees were neither untimely nor inadequately pled as a matter of law. Because the plaintiffs' claims for declaratory judgment were redundant but all their other claims remained pending, the defendants' motion to dismiss was granted in part and denied in part.

Quotations on Beginning a War

No plan survives first contact with the enemy. - Helmuth von Moltke the Elder

Everybody has a plan until they get punched in the mouth. - Mike Tyson

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