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International Valuation Standards Council
41 Moorgate
London EC2R 6PP
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Re: Response to the Discounted Cash Flow Method Exposure Draft

Gentlemen:

This letter is in response to your request for comments in regards to the Discounted Cash Flow Method Exposure Draft promulgated by the International Valuation Standards Committee. I own a valuation firm that specializes in business valuation, real estate valuation, and M & E valuation. Having served for over 15 years on the Business Valuation Standards Subcommittee for the American Society of Appraisers' Business Valuation Committee, I am sensitive to new Standards, Codes of Ethics, and so called Technical Information Papers that impact the appraisal profession. In this regard, I submit the following comments to be considered in a final rendering of this proposed Technical Information Paper.

Questions:

1. I agree that the DCF Method, if property applied, can be used as a method to arrive at an indication of value be it Fair Market Value, Fair Value, Market Value, or Investment Value.

2 I agree that the DCF Method in concept can be applied equally to the valuation of real property and businesses, as well as machinery & equipment.

3 I do not agree that the Discount Rate is based solely on risk associated with the cash flows. In the development of the discount rate, factors such as marketability, liquidity, and company specific risks also impact the discount rate. While it is difficult to separate this issues from pure risk of the cash flows, they are equally important in the development of the discount rate.

4 I do agree that the most commonly adopted terminal value calculation is a constant growth model as you have defined it.

5 I do not agree with the proposed assumption. A discount rate is equal to the cost of capital and most often calculated net of inflation. It is then applied to projected cash flows that are also net of inflation. In the event the growth in cash flows do not exceed inflation, then the present value of future cash flows will become negative. The difference between discount rate and a capitalization rate is the anticipated growth rate of the specified industry or specific entity being valued. A procedure for developing a capitalization rate is first to develop the discount rate and then add the anticipated growth rate. A capitalization rate is not normally utilized in conjunction with DCF cash flows. Capitalization rates are more commonly applied to pre-tax or after tax income using other income approach methods.

6 I do agree that detailed examples tends to lead to cookie cutter procedures that are not always applicable in every situation.

The following are my recommendations for revisions to the proposed TIP:

Introduction:

Item 3 line 3 Suggest the insertion of the word “income” prior to the word “method”.

Item 4 Delete the entire last sentence. I don’t agree that the DDM may be a more applicable method to value a minority interest.. At best it may be a method. This last sentence adds nothing to the paragraph.

Definitions:

Discounted Cash Flow The definition of this method should include the concept of present value. I therefore suggest that following the word regarding in the first line, the following be added “the present value of”.

Free Cash Flow In describing the cash flow for real estate you state it is after expenses, but for business your did not mention expenses. I suggest you add “operating expenses” following For businesses this includes “operating expenses”, annual capital expenditure ….

Gross Present Value The difference between Gross Present Value and Net Present Value is existing or proposed debt. It has nothing to do with the difference between value and price.

Investment Value Suggest addition of “a specific owner or a specific prospect owner”.. Investment value is not a value to the general population.

Net Present Value See comment for Gross Present Value

The DCG Method – Overview:

Item 11 As per my comments in regard to Question 3, the development of the discount rate is not just based on risk of the cash flows. Liquidity and marketability are also components that adjust for specific company risks. This needs to be incorporated into item 11.

The DCF Method – Market Value

Item 16 The last line needs to be changed. The duration of the forecast period, components of the projected cash flow and specific items addressed will value “depending on the nature of the asset or business being valued and the development of the cash flows.”

Item 17 Businesses The word comparable is commonly used for real estate; because these properties can be observed and directly compared to the subject; however, in business valuation the more common term is Guideline Transaction. This is because no two businesses are exactly alike and all transaction information is not fully available to the appraiser and is sight unseen. Therefore, I suggest that you replace the work “Comparable” in the first line with the word “Guideline Transactions.” I suggest a change in the second line as follows: “When considering whether the guideline transactions are applicable, regard should …..”

I look forward to your response to my suggestions.

Respectfully,

Jeffrey D. Jones, ASA, CBA, CBI
President