BUSINESS VALUE v. ECONOMIC DAMAGES

Business Value

1. Enterprise value to stakeholders
   - Includes all assets
   - Present value of future benefits

2. Impacted by lost profits
   - Long-term effect on overall value
   - Short-term costs (e.g. costly debt for working capital)

Economic Damages

1. Reasons for lost profits
   - Diverted sales
   - Price erosion
   - Increased costs

2. Loss of past/future cash flow
   - Business
   - Individual

3. Analysis feeds business valuation
   - Lack of business cash flow
   - Loss of customers
   - Damaged reputation

4. Intellectual property (IP)
   - Established demand for IP
   - Capability to exploit the demand
   - Dearth of acceptable, non-infringing substitutes
   - Amount of profit expected (lost advantage)

Differences

There are substantial differences between the assignment to calculate lost profits and the valuation of a business as of a fixed date.

The fundamental objective of a business valuation is to determine the probable result of a negotiation between a hypothetical, probable willing seller and a hypothetical, willing buyer. We are calculating the value of an ownership interest on a specific date. To perform the business valuation, the analyst investigates information that would be known to transaction participants on the selected date and performs the valuation calculation that the transaction participants would perform. The analyst functions as an observer of the marketplace in which the stock interest would trade.

In the commercial damage assessment, the objective is to estimate if the plaintiff has been damaged by a potential breach of contract or tort, or fraud. In this engagement, there is no hypothetical buyer or seller, and no price negotiation. The analyst's work is to quantify any amount of economic damage.

The economic damage assessment is at a specific date. However, that "date" is a length of time rather than a fixed point, as in business valuation. The timeframe starts at the date of the wrongful act (or its impact) through a damage period; this is not a fixed point, but rather, a moving target. The analyst determines the length of the damages period, which is not stipulated. For this reason, among others, damages calculations can vary widely. Because the damages period many not have ended at the time of trial, the analyst must not only determine losses which have already occurred, but losses which will continue into the future. The court will also require evidence on the measures which could have been taken to mitigate losses, and may subtract the value of mitigation. <u>The loss of company value can be recognized in a business valuation as the company specific risk component of the build-up method in deriving a capitalization rate. Also, the subject company should be compared at a lower point of the data population in the application of a market approach. From a cash flow standpoint, reduced or lost profits will reflect in less business value.</u> Short term losses may, over a long term, reduce business value, though probably not much.

In the business valuation, the appraiser selects from methods under the asset, income and market approaches. In the economic damages assignment, the analyst has the income and the market approaches in a dialect form. The income analysis looks at the revenue stream of the company before the wrongful act and after the wrongful act has run its court, in terms of diminishing earnings. The analysis encompasses "what might have been" absent the impact.