

A Note from Ron Scott on the Evolution of Business Valuations

Ron Scott has been active in the Business Valuations group at Ernst & Young since the early 1970's. He joined the group out of the Accounting Standards department of the firm and initially divided his time between valuations and providing expert accounting and financial evidence in public utility regulatory proceedings. Ron's participation in the evolution of the discipline in Canada has seen significant change in the what and how of the way valuations have been done over these years and where the profession has delivered value (in the sense of improved bases for decision making) to participants in the economy.



- In its initial implementations the discipline was very much a matter of "P/E multiples times normalized earnings" applied to estimate things like V-Day values.
- Then in response to the leveraged acquisitions era of the late 1970's to early 1990's the perspective on value moved to capital structure independent estimation - enshrining the notions of EBITDA/EBIT into the lexicon of key valuation reference points.
- While that move up the income statement was progressing, the facilitative function of computer spreadsheet business model and projection techniques moved the art seriously in the direction of DCF valuation techniques and the potential to do complex analytical modelling of business interests and securities as claims on business entities.
- Supporting that development were moves into the estimation of Cost of Capital for solving the pricing dimension of the valuation challenge to supplement the long established "reasoning by analogy" process involved in comparable company based estimates with the result that concepts such as CAPM and WACC entered the regular vocabulary of the discipline from the realm of theoretical finance.
- And situations in which valuation expertise had a bearing on the working of financial markets expanded as well with valuations and fairness opinions being accepted evidentiary inputs to things like going private transactions, acquisition price justifications and dispute resolution requirements in numerous public and private areas.
- Around the turn of the century practitioners of the valuations arts encountered various needs to deal with inferences from "soft information" as capital markets effectively priced "pure opportunities in Internet concept businesses" and valuation reference points briefly involved things like revenues regardless of losses, eyeball counts attracting capital, and hockey stick models of possible futures - until the "tech wreck" arrived and brought a return to more normal reference points for value.
- The next major change was for the valuations discipline to become more and more relevant to the financial accounting and reporting process as fair value concepts and asset impairment testing - particularly in the realm of goodwill and intangible assets - became a pervasive need in the preparation of financial statements.
- And in recent years as the financial reporting process responded to the development of ever more sophisticated financial instruments in the period leading up to and consequent upon the 2007/09 "credit wreck", valuations practitioners had to deal more and more with measurement of instruments impounding optionality and other contingent payoffs leading in the direction of more uses of sophisticated mathematical modeling to estimate values for financial reporting and other purposes.

As the saying goes, Ron's career has involved working in interesting times. Over the past 35 odd years he has observed and participated as a journeyman valuator in the dynamics of a profession that has become systematically more important to the way the worlds of finance and economics work. And Ron's career has involved working with (and, at times, against!) a veritable pantheon of interesting Canadian valuation professionals both within Ernst & Young and in the broader reaches of the profession. Interesting / Challenging / Relevant - Ron sees all of these in the future prospects for the profession and its practitioners.