BANISTER FINANCIAL, INC.
Business Valuation Specialists
www.businessvalue.com

1338 HARDING PLACE • SUITE 200
CHARLOTTE, NORTH CAROLINA 28204
PHONE: 704-334-4932 FAX: 704-334-5770
Contact: George B. Hawkins, ASA, CFA, President

FAIR VALUE™

Reprinted from the Winter/Spring 2003 Issue

LICENSE VALUATION REVISITED

By: Michael A. Paschall, ASA, CFA
Managing Director

Introduction. In the Spring 2000 issue of *Fair Value*, George Hawkins presented a clear, rational, and point-by-point case for why the idea of professional license valuation that is put forth by some attorneys and business valuation "experts" is valuation voodoo. In his article (available at www.businessvalue.com), Hawkins notes a number of reasons why such license valuation is nonsense, including the fact that it is a person's intelligence and ambition that largely determines his or her future earnings, not the holding of a professional license (the richest man in the world, Bill Gates, doesn't even have a college degree, much less a professional license). Fortunately, nearly every state in the country (including North and South Carolina) has not accepted this idea of professional license valuation. Most of the instances in which we have seen attempts at professional license valuation in the equitable distribution context have involved traditional professional licenses such as medical licenses or law licenses. A recent development, however, has cast a whole new light on license valuation and we at Banister Financial are compelled to address it as it no doubt will impact business valuations for years to come.

Michael Paschall

Gentlemen, Start Your Engines. Living in the buckle on the NASCAR belt, it was impossible not to notice a significant event that occurred within the past year. On March 15, 2002, Brooke Gordon sued for divorce from her husband of eight years, four-time Winston Cup Champion driver Jeff Gordon. Although Jeff Gordon holds neither a college degree nor the kind of professional license that has traditionally been the issue in equitable distribution cases, he nonetheless does hold a professional license that has resulted in significant personal wealth and the promise of even greater future wealth. Like a medical or law license, the professional license owned by Mr. Gordon required an investment of time, effort, and money. Although Mr. Gordon obtained his professional license prior to the marriage, the fact that Mr. Gordon has enjoyed the fruits of this license during the marriage (and will continue to enjoy them after the marriage) demands that this license be valued and divided as a part of the marital estate. Of course, the professional license we are referring to is Mr. Gordon's driver's license.

It is an uncontroverted fact that, without his driver's license, Mr. Gordon would not have been able to achieve the success and riches that he enjoys today. The logic is unassailable. Mr. Gordon makes his living by driving a car. You need a driver's license to legally drive a car. Without his driver's license, Mr. Gordon couldn't legally drive a car. If Mr. Gordon couldn't drive a car, he wouldn't have won over 60 Winston Cup races, four Winston Cup Championships, almost $50 million in prize money, and millions more in endorsement earnings. Mr. Gordon's ability to drive a car is critical to his livelihood – in fact, there is no other single issue as important to him. Mr. Gordon's driver's license is undoubtedly the most valuable asset he owns and therefore must be valued and divided as a part of the marital estate.

LICENSE VALUATION (continued)

The Green Flag. In order to compute the value of Mr. Gordon's driver's license, it is first necessary to project what Mr. Gordon's earnings will be over the rest of his professional life. For simplicity purposes, our license valuation will commence at the date of separation, which we will assume is January 1, 2002. Through January 1, 2002, Mr. Gordon had won almost $50 million in Winston Cup prize money, the most of any driver in history. Mr. Gordon's prize winnings, however, are but a fraction of his actual total compensation. According to data on Forbes.com, Mr. Gordon earned total compensation of $14 million in 1998, $17 million in 1999, and $20 million in 2001 (data for 2000 was unavailable).

For purposes of this calculation, let's assume Mr. Gordon earns $20 million again in 2002 and increases his earnings by 5% each year thereafter. Also assume Mr. Gordon (who was 30 years old on January 1, 2002) has 15 more years of competitive racing. Upon turning 45, Mr. Gordon will have accumulated such personal wealth as to be able to own several racing teams. Without Mr. Gordon's success as a driver (which was due to his ownership of a driver's license), he would not have been able to accumulate the wealth, knowledge, and contacts to enable him to own these several racing teams. Therefore, Mr. Gordon's driver's license is not only the reason he is able to make a living from driving a race car, it is also the catalyst that will allow him to enjoy these future benefits from his racing teams. Assume Mr. Gordon's ownership of those teams earns him $10 million per year beginning at age 45 and assume those earnings also increase at 5% per year. Finally, assume Mr. Gordon enjoys his income from those racing teams until his retirement at 65.

Get in the Zone. The second key factor in the calculation of Mr. Gordon's license valuation is determining what Mr. Gordon's lifetime earnings would have been *without* his owning a driver's license. Given his current occupation, Mr. Gordon must have some interest in and inclination towards automobiles and their inner workings. Therefore, let's assume that "Walkin' Jeff" (Mr. Gordon's life as if he did not own a driver's license) would be working as sales clerk at AutoZone. Of course, this AutoZone would have to be either within walking distance of Mr. Gordon's house or along the bus line as Walkin' Jeff does not own a driver's license and therefore cannot legally drive himself to and from work. Assume that Walkin' Jeff would begin by earning $30,000 per year as a sales clerk with an expectation of a 3% raise each year. Also assume that Walkin' Jeff would hold this

Table 1
Calculation of the Present Value of Jeff Gordon's Driver's License

Jeff's Age	Drivin' Jeff's Earnings	Less: Walkin' Jeff's Earnings	Equals: Net Difference	Times: 7.5% Present Value Factor	Equals: Present Value
31	$20,000,000	$30,000	$19,970,000	0.9645	$19,261,065
32	$21,000,000	$30,900	$20,969,100	0.8972	$18,813,477
33	$22,050,000	$31,827	$22,018,173	0.8346	$18,376,367
34	$23,152,500	$32,782	$23,119,718	0.7764	$17,950,149
35	$24,310,125	$33,765	$24,276,360	0.7222	$17,532,387
36	$25,525,631	$34,778	$25,490,853	0.6718	$17,124,755
37	$26,801,913	$35,821	$26,766,092	0.6249	$16,726,131
38	$28,142,009	$36,896	$28,105,113	0.5813	$16,337,502
39	$29,549,109	$38,003	$29,511,106	0.5408	$15,959,606
40	$31,026,564	$39,143	$30,987,421	0.5031	$15,589,772
41	$32,577,892	$40,317	$32,537,575	0.4680	$15,227,585
42	$34,206,787	$41,527	$34,165,260	0.4353	$14,872,138
43	$35,917,126	$42,773	$35,874,353	0.4049	$14,525,526
44	$37,712,982	$44,056	$37,668,926	0.3767	$14,189,884
45	$39,598,631	$45,378	$39,553,253	0.3504	$13,859,460
46	$10,000,000	$46,739	$9,953,261	0.3260	$3,244,763
47	$10,500,000	$48,141	$10,451,859	0.3032	$3,169,004
48	$11,025,000	$49,585	$10,975,415	0.2821	$3,096,165
49	$11,576,250	$51,073	$11,525,177	0.2624	$3,024,206
50	$12,155,063	$52,605	$12,102,458	0.2441	$2,954,210
51	$12,762,816	$54,183	$12,708,633	0.2271	$2,886,131
52	$13,400,957	$55,808	$13,345,149	0.2112	$2,818,495
53	$14,071,005	$57,482	$14,013,523	0.1965	$2,753,657
54	$14,774,555	$59,206	$14,715,349	0.1828	$2,689,966
55	$15,513,283	$60,982	$15,452,301	0.1700	$2,626,891
56	$16,288,947	$62,811	$16,226,136	0.1582	$2,566,975
57	$17,103,394	$64,695	$17,038,699	0.1471	$2,506,393
58	$17,958,564	$66,636	$17,891,928	0.1369	$2,449,405
59	$18,856,492	$68,635	$18,787,857	0.1273	$2,391,694
60	$19,799,317	$70,694	$19,728,623	0.1184	$2,335,869
61	$20,789,283	$72,815	$20,716,468	0.1102	$2,282,955
62	$21,828,747	$74,999	$21,753,748	0.1025	$2,229,759
63	$22,920,184	$77,249	$22,842,935	0.0953	$2,176,932
64	$24,066,193	$79,566	$23,986,627	0.0887	$2,127,614
65	$25,269,503	$81,953	$25,187,550	0.0825	$2,077,973
				Total Present Value	**$298,754,861**

LICENSE VALUATION (continued)

position until his retirement at 65.

The final piece of the puzzle needed is estimating the rate at which to discount the differences in earnings between "Drivin' Jeff" (Mr. Gordon as he exists today, holding a driver's license) and Walkin' Jeff. Some proponents of professional license valuation believe a risk free U.S. Government rate plus some slight risk premium is the appropriate rate at which to discount these differences in earnings. On January 1, 2002, the long-term risk free rate on U.S. Government securities was about 5.5%. Assuming a 2% risk premium on that rate, the selected discount rate for our calculation is 7.5%.

Given all these elements, it is now simple to calculate the present value of Mr. Gordon's driver's license as shown in **Table 1**.

Victory Lane. In Brooke Gordon's Petition for Dissolution of Marriage, she asks for the exclusive possession of various assets, including a Porsche, a Mercedes, and a $9 million Florida beach house (including the evening and daytime housekeepers, maintenance workers, and chef). Mrs. Gordon also asks for temporary and periodic use of various boats and an airplane.

Personally, I think Mrs. Gordon is selling herself *way* short in her Petition. As clearly proven above, the present value of Mr. Gordon's driver's license is almost $300 million. One half of that amount is $150 million, which could buy Mrs. Gordon $9 million beach houses in sixteen different states, a Porsche and a Mercedes at each house, plus money left over for her own airplane and boat. My advice is that Mrs. Gordon and her attorneys forget about the obvious assets and shift their focus to that little piece of plastic Jeff carries in his wallet. *That's* where the real value is.

Conclusion. If the preceding license valuation calculation makes sense to you, please seek professional help (or move to New York, one of only a handful of states where you might have a shot of getting such nonsense past a judge). The above illustration is a joke. Sadly, though, the preceding illustration is *identical* to what some attorneys and business valuation "experts" advocate as a reasonable valuation technique for professional licenses. Banister Financial's position on license valuation is clear. While we believe there needs to be some policy of fairly dividing the marital estate and compensating the non-professional spouse, license valuation is *not* the answer. As illustrated by this ridiculous hypothetical and as clearly outlined in the "Valuation Voodoo" article by George Hawkins, the continued practice of license valuation is nothing more than a smoke-and-mirrors approach to the issue that results in unsupportable conclusions of value and irrational settlements in equitable distribution matters. ♦

Michael A. Paschall is co-author of the *CCH Business Valuation Guide* and a Managing Director of Banister Financial, Inc., a business valuation firm in Charlotte, North Carolina. He can be reached at mpaschall@businessvalue.com or 704-334-4932.