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Cost-related approaches

Damages & Valuation

Module 1.4

Module outline

The Cost Approach

- What is the cost approach and when might we use it?
- Applying the cost approach in business valuation
- Applying the cost approach in asset valuations

Wasted Costs

- What are wasted costs?
- In what circumstances might damages be awarded based on wasted costs?
- Points to consider when assessing wasted costs

The cost approach

What is the "cost approach"?

- The **cost approach** is one of the three principal approaches to valuation (together with **market approach** and **income approach**)

- It provides an indication of **value** using the economic principle that "*a buyer will **pay** no more for an asset than the **cost** to obtain an asset of **equal utility**, whether by purchase or by construction, unless undue time, inconvenience, risk or other factors are involved*" (IVS105, 60.1)

- May be used to value assets and businesses in certain circumstances, or as a cross check to value derived using one of the other approaches

- Although called the "Cost Approach", objective is to determine the **market value** of the right to receive the future cash flows of the valued item or business.

Reminder: Market value = "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction"

When is it appropriate to use the cost approach?

- Valuing an **asset**, for example where:
    - the asset could be recreated quickly / without regulatory or legal restrictions
    - the asset is not directly income generating / is unique

- Valuing a **business**, when that business is:
    - an early stage / start up business
    - an investment or holding business, where value is derived from the value of its investments
    - not a going concern

  Important difference from income approach and market approach = **goodwill** will typically have zero value under the cost approach (i.e. the business is assumed to be worth the sum of its parts)

- Next up: **Interactive exercise!**

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Interactive Exercise 1

Applying the cost approach in business valuation

Step 1

Obtain a balance sheet as at the valuation date

Step 2

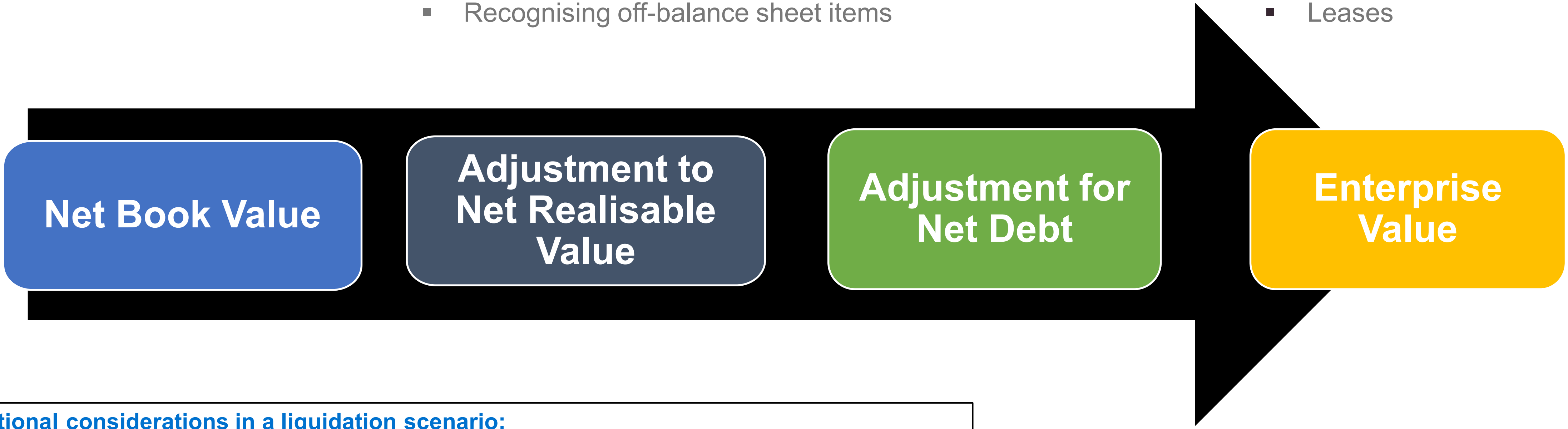
Adjust assets and liabilities to their Net Realisable Value. Adjustments can include the following:

- Restating property to Market Value
- Restating trade debtors to recoverable amounts
- Restating share investments to Market Value
- Recognising off-balance sheet items

Step 3

Adjust the calculation for net debt. Net debt items can include:

- Surplus Cash
- Loans/bonds
- Pensions
- Leases



Additional considerations in a liquidation scenario:

- Potential liquidation discounts (need to sell assets quickly)
- Assets that can’t be separated from business (goodwill, brand, relationships) will have nil value
- Need to note additional drags (such as redundancy costs, trading losses)

Cost approach methods in asset valuation

- **Replacement cost:** Amount of money a participant must pay so as to replicate the **utility** of the asset
  - For example, where machinery or equipment is outdated, value may be assessed as the cost of replacing it with smart technology

- **Reproduction cost**: Amount of money a participant must pay so as to replicate the **exact physical properties** of the asset
  - For example, asset valuations by insurance firms

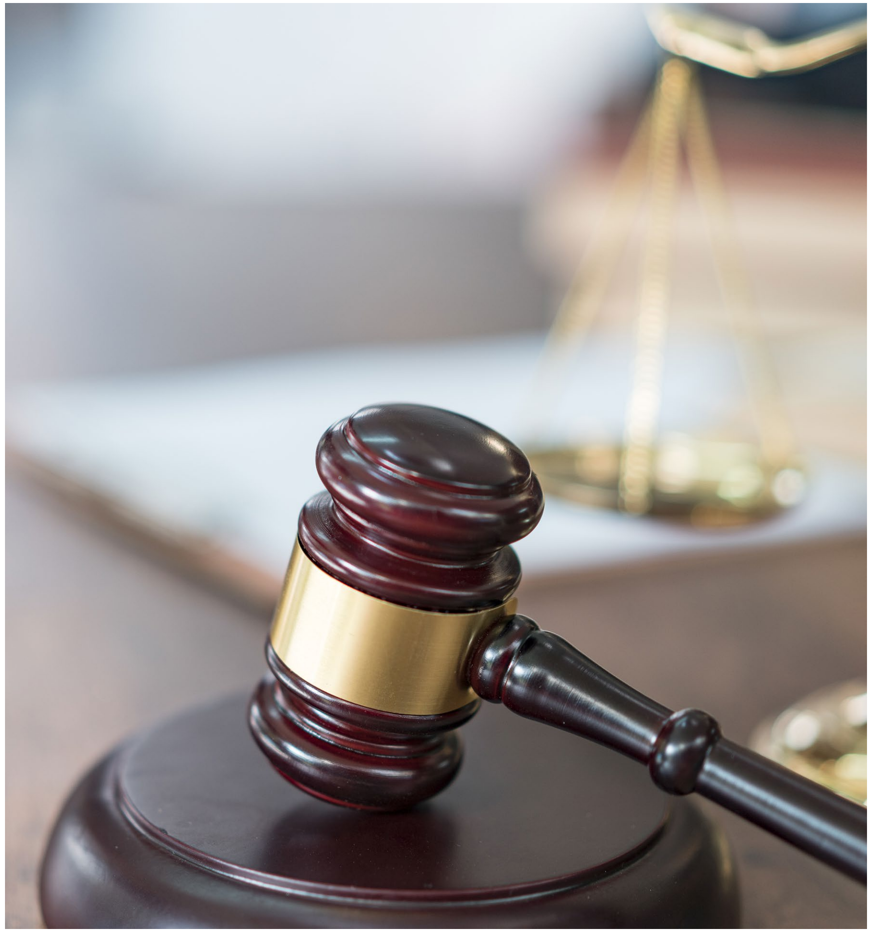
- Next up: **Interactive Exercise**!

Interactive Exercise 2

Wasted costs

Wasted costs

- Type of compensatory relief in breach of contract and investor state matters – sometimes referred to as **Reliance Damages**
- Aim = to put the Claimant back in the position they would have been in if the **contract had not been entered into** or the **investment had not been made**
- Damages are assessed referring to the **cost wasted by the Claimant** in reliance on the contract
- “Backward-looking” methodology vs “forward-looking” methodology



When might damages be awarded based on wasted costs? Examples

Claimant cannot provide a well-supported assessment of Expectation Damages:

Past track record of the project or business	Stability or predictability of future revenues and costs
Availability and / or reliability of evidence to support projections	Ability to keep operating / to operate profitably over the duration of the projections

Points to consider when assessing wasted costs

Possibility of isolating wasted costs	Evidence
Reasonableness	Deduction for any benefits received

- Next up: **Interactive exercise!**

Interactive Exercise 3

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About us

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Our Global Firm

€2.1bn*
Global revenues

44,000+
People

1
Integrated partnership

90+
Countries

1,000+
Partners

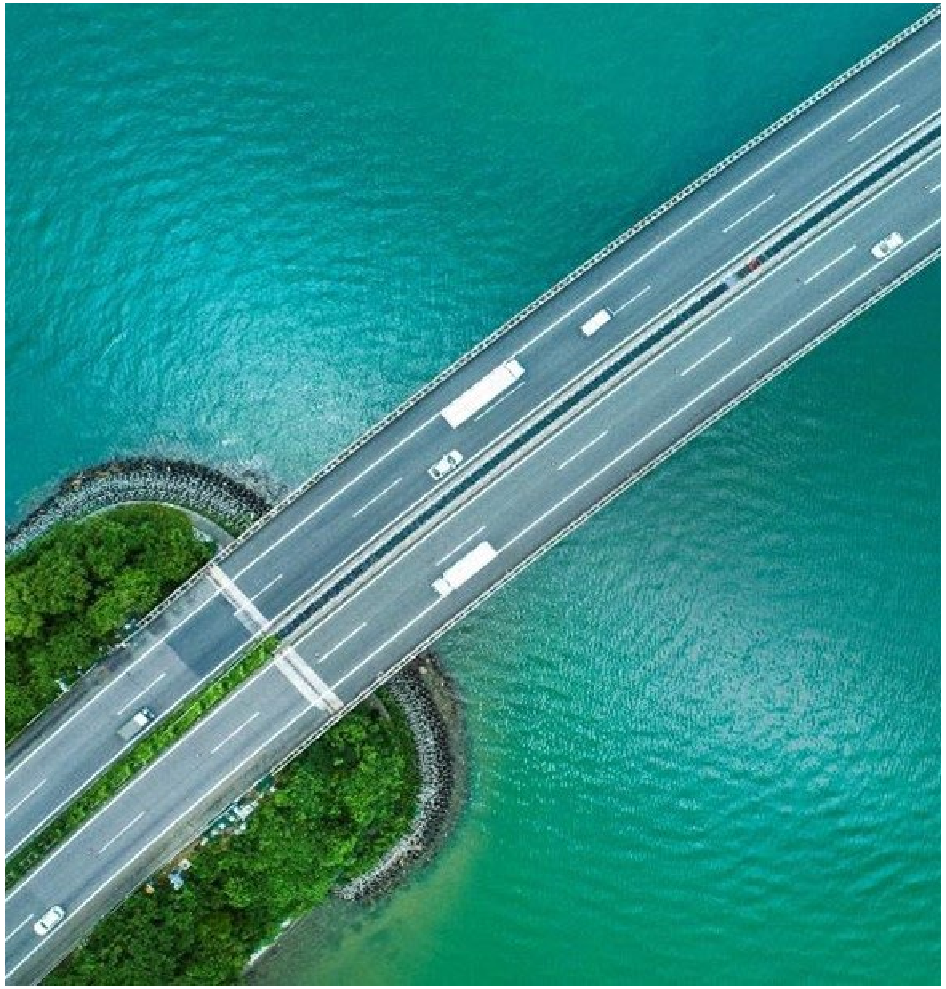
300+
Offices

+12.3%*
Revenue growth

54%
Female workforce

87%
of our team contributed to a charitable cause

*As at January 2022, vs. 2019/2020 financial year



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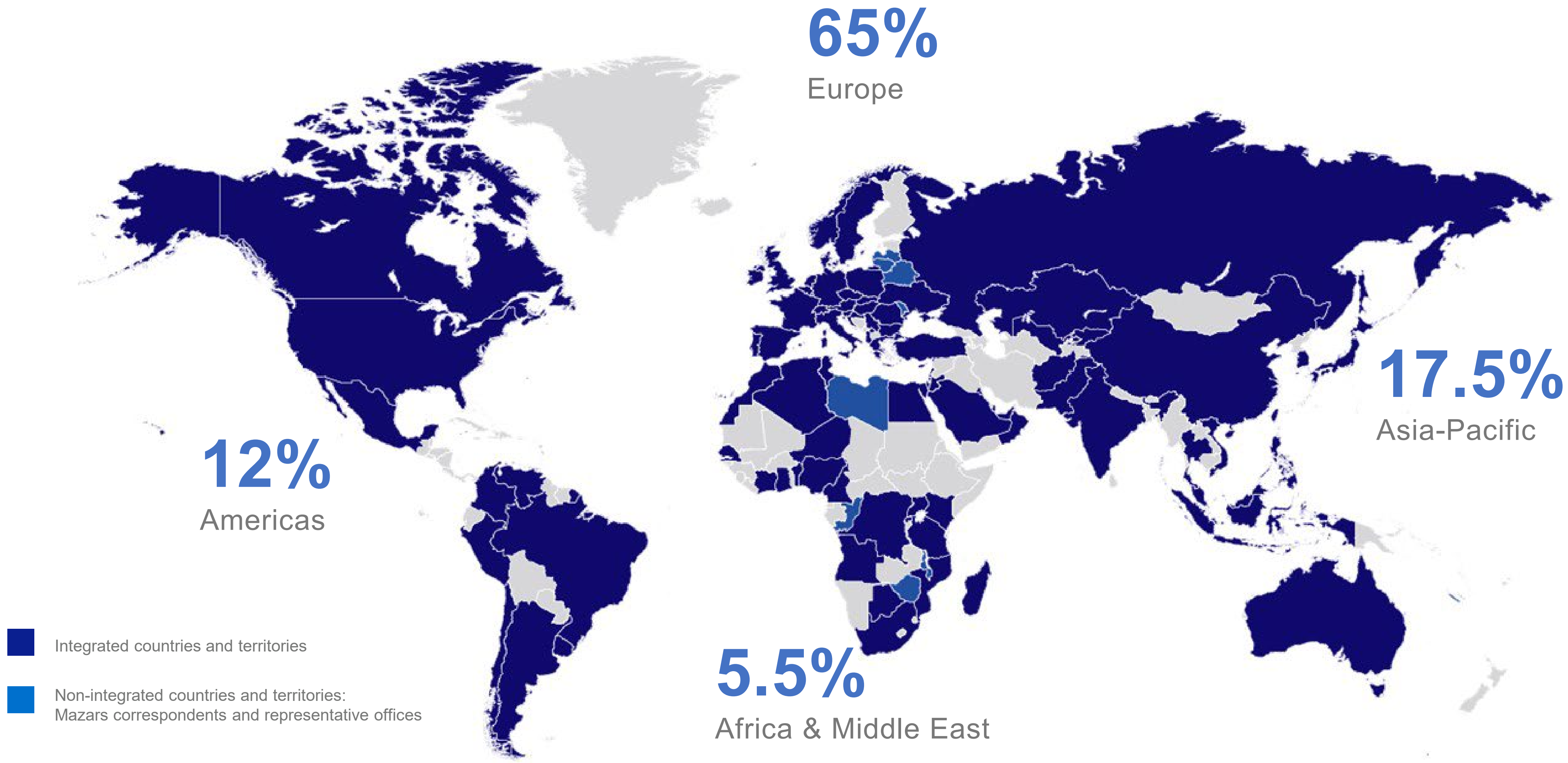
Our Geographical Coverage



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