Lost Business Profits

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Universal Model & Basic Methodologies for Proving Lost Profits

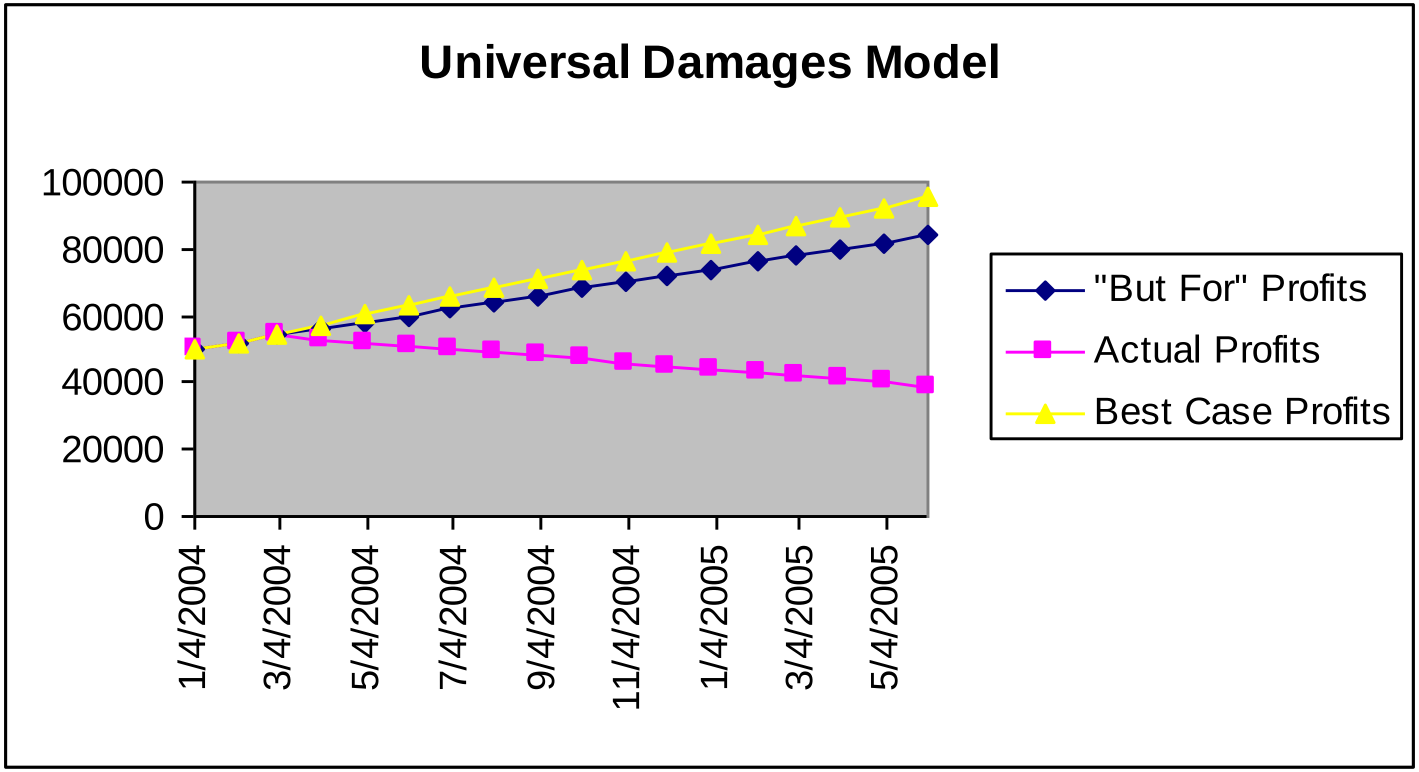
Universal "But For" Model

Only damages that would not have been incurred "but for" the actions of the defendant, are recoverable

Lost Profits =

"But For" Profits – Actual Profits

Universal "But For" Model



The Before and After Method

**Keys to employing the
Before and After Method include having:**

1) Sufficient historical data upon which to build a reliable forecast.
2) Similar economic and industry conditions during the before and after periods.
3) Data and information necessary to thoroughly analyze each period.

The Yardstick Approach

- With the Yardstick Approach, the damages expert attempts to measure damages by comparing the performance of the impacted business after an event to the performance of a comparable business during the same period
- Factors to consider can include size, location, customer base, market share, and product differences.

Framework for Assessing Lost Profits

1) **Establishment of Loss Period**
2) **Analysis of Macroeconomic Conditions**
3) **Analysis of Industry Conditions**
4) **Analysis of the Specific Entity**
   a. Revenue Forecasting
   b. Cost Analysis
   c. Analysis of Performance vs. Budgets/Forecasts
   d. Analysis of Contractual Relationships with Key Customers and Management
   e. Financial Analysis
5) **Measurement of Lost Profits**
6) **Adjustment for Present Value**

Establishing the Loss Period

Depending on the situation, a loss period can be closed, open or infinite.

Analysis of Macroeconomic Conditions

- A macroeconomic analysis considers the general economy and compares the plaintiff's performance relative to it
- Purpose of the macroeconomic analysis is to determine if there were general economic conditions which may have contributed to the plaintiff's losses

Industry Analysis

- More refined than general or even regional economic data, industry analysis provides data specifically relevant to businesses in that particular industry
- Purpose of industry analysis is to determine if the factors that contributed to the plaintiff's losses are specific to the plaintiff or are part of an industry wide trend

Industry Analysis

Potential Pitfalls in Plaintiff/Industry Comparisons

- Defining the industry too broadly
- Failing to consider life cycles.
- Failure to Consider Industry Volatility
- Using Unreliable Data

Entity Specific Analysis

The entity specific analysis can be broken down into the following phases:

- Revenue Forecasting
- Cost Analysis & Estimating
- Analysis of Performance vs. Budgets/Forecasts
- Analysis of Contractual Relationships with Key Customers and Management
- Financial Analysis

Entity Specific Analysis

Revenue Forecasting

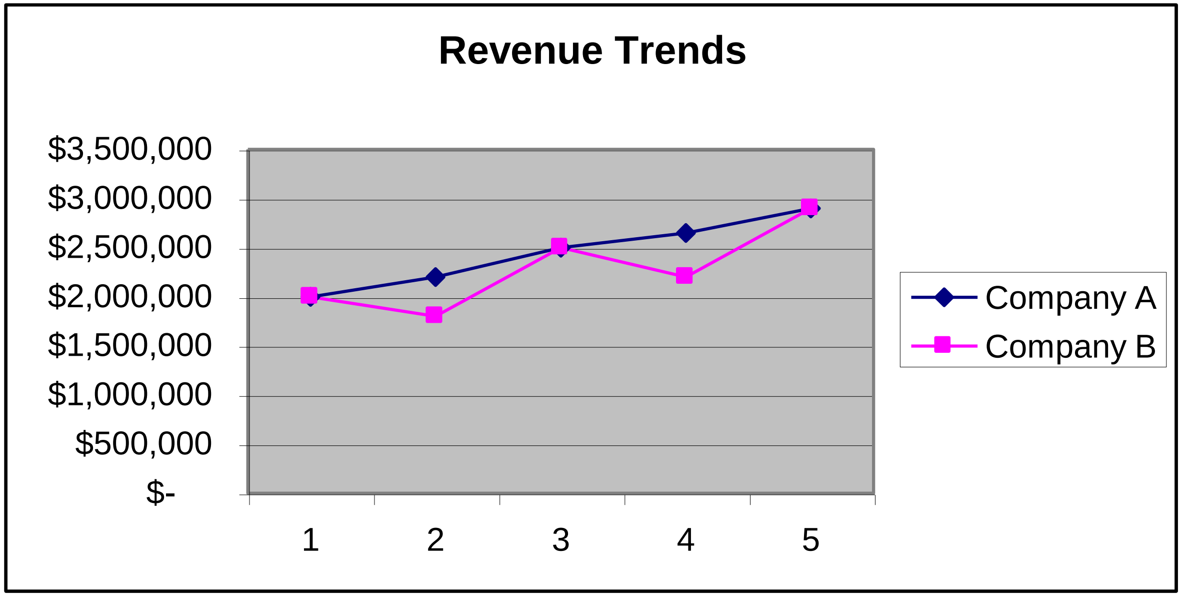
The most common method of forecasting revenue is to simply apply a projected growth rate extrapolated from the entity's historical revenue growth to an appropriate revenue base.

Two Steps:

(1) Determine an appropriate revenue base

(2) Extrapolate the historic growth rate

Year	Company A	Company B
2001	$ 2,000,000	$ 2,000,000
2002	$ 2,200,000	$ 1,800,000
2003	$ 2,500,000	$ 2,500,000
2004	$ 2,650,000	$ 2,200,000
2005	$ 2,900,000	$ 2,900,000



Entity Specific Analysis

The second component of the extrapolation method is the revenue growth rate

Methods:

- Can include the use of sophisticated regression analysis and econometric modeling
- More common to use simple projections based on historical growth rates
- Consideration should be given to the relevancy of remote results.

Growth Rates

Year	Company A		Company B	
2001	$ 2,000,000		$ 2,000,000	
2002	$ 2,200,000	10.0%	$ 1,800,000	-10.0%
2003	$ 2,500,000	13.6%	$ 2,500,000	38.9%
2004	$ 2,650,000	6.0%	$ 2,200,000	-12.0%
2005	$ 2,900,000	9.4%	$ 2,900,000	31.8%
	Average	9.8%		12.2%
	Weighted Avg	9.3%		15.9%

Entity Specific Analysis

Cost Analysis & Estimating

It is critical that the damages analyst thoroughly examine the plaintiff's cost structure to determine which costs are incremental in relation to the lost revenue

Entity Specific Analysis

The fundamental question when analyzing a particular cost is:

"In order to generate the lost "but for" revenue, would the plaintiff need to incur more of this cost?"

Analysis of Performance vs. Budgets/Forecasts

- If it can be shown that a company's budgets and forecasts are reliable indicators of what would have happened but for the wrongful action, then they can be useful in proving damages incurred.
- A persuasive means of establishing such reliability is to show that the company has a favorable history of preparing accurate budgets and forecasts.

Analysis of Contractual Relationships with Key Customers and Management

- Analysis of customer contracts may provide critical information concerning what would have happened but for the wrongful actions of the defendant.
- Analysis of customer contracts may help the financial analyst:
  - Establish demand for the plaintiff's product or services
  - Bolster estimates of but for revenue
  - Support estimates of projected costs
- Showing that key personnel who have been materially responsibly for the plaintiff's pre-disruption performance are under contract for the duration of a projected loss period will help support estimates of revenue and costs based on past performance.

Financial Analysis

Common performance ratios include:

• Return on Assets	(Profit before taxes / Total Assets) x 100
• Return on Equity	(Profit before taxes / Net Worth) x 100

Common liquidity ratios include:

• Current Ratio	Current Assets / Current Liabilities
• Quick Ratio	(Cash + AR + Cash Equivalents) / (AP + Other Short Term Liab)

Common Leverage Ratios include

• Debt to Equity	Total Liabilities / Total Equity
• Debt Coverage	Profits B-4 Depreciation & Amortization / Current LT Debt
• Interest Coverage	EBIT / Interest Expense

Common Activity ratios include:

• Inventory Turnover	Annualized COGS / Average Inventory
• Fixed Asset Turnover	Net Sales / Average Fixed Assets

Adjusting for Present Value

- Damage calculation may quantify losses that have occurred in the past or will occur in the future
- Expert must typically adjust the damage calculation to present value
- Most courts typically hold that damages should be awarded based on their present value as of the date of judgment
- Some states exclude prejudgment interest on certain types of cases

Questions?

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