

# AMERICAN BUSINESS APPRAISERS™

*Certified Business Valuations and Machinery / Equipment Appraisals*

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July 20, 20XX

ABC Insurance Agency  
123 Valley Road  
Phoenix, AZ 85XXX

Subject: Provide an estimate of the Fair Market Value of a 100% Equity Interest in an Arizona business known as ABC Insurance Agency, Inc.

Dear Mr. Smith:

At your request, American Business Appraisers, LLC was retained to provide an estimate of the fair market value<sup>1</sup> of a 100% equity interest in ABC Insurance Agency, Inc. (hereafter referred to as "Company" or "Subject"), as of December 31, 20XX. It is our understanding the valuation assignment results will be used solely for marital dissolution purposes.

This valuation appraisal assignment and accompanying written valuation report conforms to the Uniform Standards of Professional Appraisal Practice (USPAP) and meets the USPAP requirements for a Restricted Use Appraisal Report (*sometimes referred to as a Calculation Report*). This type of reporting format differs from an Appraisal Report. An Appraisal Report documents the information sufficiently so the client and intended users understand what steps the appraiser did or did not do and provides an unambiguous opinion of value of a business or ownership interest.

A Restricted Use Report is designed to be a matter of record rather than a complete documentation of the valuation engagement. In a restricted use engagement, the appraiser and the client agree on the valuation approaches and methods the appraiser will use and the extent of procedures the appraiser will perform in the process of calculating an approximate indication or range of value for the business or ownership interest.

A Restricted Use Appraisal Report saves time in preparing a written report. The client is WARNED that the appraiser's opinions and conclusion may not be understood properly without additional information contained in the appraiser's work file. Many regulatory agencies and third-party users of valuation reports do not rely on or accept restricted use/calculation reports. Therefore, this report is restricted to ABC Insurance Agency. Our work papers and file contain all of the necessary analysis and documentation to allow us to prepare a full narrative

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<sup>1</sup> Fair Market Value is defined as the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under any compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. Source: International Glossary of Business Valuation Terms

report, if requested. This Restricted Use Appraisal Report is otherwise in compliance with applicable USPAP standards.

The premise of value is going concern and is based on the amount a hypothetical willing buyer would pay and the amount a hypothetical willing seller would sell at. This premise assumes an ongoing business enterprise with management operating in a prudent manner with the objective of not diminishing value.

While the appraiser has been diligent in preparing this valuation, it is important to all concerned that this appraiser has relied heavily upon information given by others. For those persons who may review this valuation now and in the future, this appraiser has endeavored to clearly identify the information sources as follows;

- Federal tax returns for years ending December 31, 20XX thru 20XX.
- Information provided verbally by management of ABC Insurance Agency, Inc.
- The questionnaire completed by management.

**The reader is reminded all useful information has been changed. This is a sample report to give you an idea of our final work product (report). The figures have been distorted, as well as other financial information contained this sample report.**

Brokerages).

- U.S. Bureau of Labor Statistics – Occupational Outlook Handbook – Insurance Sales Agents.
- First Research industry data or SIC 6411 – Insurance Agencies.

Information for this report has been obtained from management, public information and other sources considered reliable and is of the type reasonably relied upon by experts in the field of business valuation. This appraiser has relied upon such information and no independent verification has been performed on any of the information received. This report is, therefore, dependent upon the information provided. A material change in critical information relied upon in this report would be cause for a reassessment in order to determine the effect, if any, on this appraiser's conclusion of value.

Based upon our understanding of this valuation assignment, it is the undersigned appraiser's independent opinion, using the valuation methods described herein and subject to certain assumptions and limiting conditions contained in this report dated July 20, 20XX, the "Fair Market Value" of a 100% equity interest, in this State of Arizona business known as, ABC Insurance Agency, Inc., as of December 31, 20XX, is best expressed as:

**\$560,000 (rounded)**  
**Five Hundred Sixty Thousand Dollars**

This transmittal letter and accompanying valuation report is to be distributed collectively and in its entirety.

Appraiser's statement of certification as required by USPAP:

- The statement of facts, opinions and conclusions expressed are correct to the best of the appraiser's knowledge and belief.
- The report analysis, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and is this appraiser's personal, unbiased analysis, opinions and conclusions.
- The appraiser has no present or prospective interest in the property that is the Subject of this report, and the appraiser has no personal interest or bias with respect to the parties involved.
- The compensation paid is not contingent on an action or event resulting from the analysis, opinions, or conclusions in, or the use of this appraisal report.
- No one provided significant professional assistance to the person signing this report.
- The appraiser has performed no other services, as an appraiser or in any other capacity, regarding the Subject's property or business within the three-year period immediately preceding accepting this valuation assignment.
- This appraisal has been prepared and this report has been prepared in conformity with Institute of Business Appraisers' *Business Appraisal Standards*, Uniform Standards of Professional Appraisal Practice (USPAP), and American Society of Appraisers' *Business Valuation Standards*.

As indicated above, our report and conclusions are attached hereto and must be attached to this transmittal letter as an integral part of it. Authorized reports will carry the appraiser's original signature in blue ink. Copies, which do not have the appraiser's signature in blue ink, are unauthorized and incomplete.

If you have any questions regarding the reported results and analysis, contact our office.

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Appraiser One, CBA, CMEA, ASA  
*Certified Business Appraiser*  
*Certified Machinery & Equipment Appraiser*  
*Accredited Senior Appraiser*  
Principal, American Business Appraisers

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SAMPLE

## 1.1 Confidentiality and Privacy

American Business Appraisers, LLC will maintain the conformity and privacy of ABC Agency, Inc.'s information obtained in the course of this valuation assignment in compliance with the Institute of Business Appraisers' *Business Appraisal Standards*, American Society of Appraisers' *Business Valuation Standards*, USPAP and Title V of Gramm, Leach, Bliley Financial Modernization Act.

Information about this client or their business model will not be sold to others. American Business Appraisers' objective is to protect the security and any confidential information about personal and business related activities. Information is shared outside American Business Appraisers only when necessary to administer products or services provided when we have permission, or when required or permitted by law or the courts.

## 1.2 Effective Date of the Valuation (Appraisal Date)

The appraisal date for the ABC Agency, Inc. is December 31, 20XX (Appraisal Date), and that date alone. Our analysis will consider those facts and circumstances known or knowable as of that date. The opinion of value represented in this appraisal report would likely change if the effective date was modified. The opinion of value is based on the premise that ABC Agency, Inc. will continue as a going concern and the business will remain an operating and ongoing enterprise.

## 1.3 Ownership and Control

As of the effective date of this appraisal, ABC Agency, Inc. has one shareholder in the common shares of stock, the only class stock issued and outstanding. ABC owns 100% of ABC Agency, Inc.

## 1.4 Prior Ownership Transactions

Management states there have been no prior transactions in ABC Agency, Inc.

## 1.5 Assumptions & Limiting Conditions

The business valuation process requires certain assumptions and limiting conditions, many of which may have significant influence on the valuation conclusion (see Appendix C).

## 1.6 Overview - ABC Insurance Agency

ABC Agency, Inc. was founded in January 19XX at 1234 Edward Way Road, Phoenix Arizona. The business moved in May 20XX to 1234 Goodyear Valley Rd, Mesa Arizona. This location is approximately 1200 square feet with a monthly lease of \$2,096. The office is owned by ABC. The office is staffed with two part-time and one full-time customer service representatives (employees).

The business sells insurance products through an exclusive agreement with Good Hands Insurance. The Good Hands Agent Agreement, effective January 15, 19XX, specifically states ABC

is the agent and is bound by the agreement. The agreement clearly discusses policies (or products) sold by ABC are to remain the sole property of Good Hands Insurance. ABC receives a commission as a captive agent for products sold.

In the world of insurance professionals, there are generally two kinds of agents: captive agents and non-captive or independent agents. Captive agents work exclusively for one insurance carrier and are obligated to give business only to that company, such as is the case here.

The Agreement goes into specific language in section I(2); *you represented the Company under this agreement for a period of at least ten years. That period begins on the effective date of this agreement and continues until termination of this agreement. That period will be interrupted from the effective date of any Advance Compensation Plan you sign until two years after the effective date of your plan or the termination date of your plan, whichever comes first.*

Furthermore, the Agreement discusses extended earnings based upon renewal service fees during the twelve months preceding termination would be 50%, if an agent has at least 10 years but less than 11 years. ABC signed the agreement on January 15, 1999, but elected to receive Advance Compensation, which delayed the beginning of the ten year term of service. Thus, January 15, 20XX, is the eligible date to receive the 50% commission on renewal service fees (*see Agreement for detailed explanation in Appendix B*). The valuation date selected is December 31, 20XX, so any claims for future compensation would be outside of the Agreement's time table.

The seller cannot transfer the policies or products (*future earnings potential*), as these are owned by Good Hands Insurance. A buyer would only be able to obtain or receive the underlying tangible assets and not the future earnings that might be available in the business, because of the restrictions placed on a captive agent by Good Hands Insurance. Hence, any valuation methods which rely upon the prospects of a buyer receiving future earnings would be invalid, based on the Agreement between Good Hands Insurance and ABC (agent). Later in this report, an asset based method is used to develop an opinion of value for ABC Agency, Inc.

## 1.7 Financial Analysis of the Subject Company

Detailed income statements and balance sheets were relied upon for this appraisal, and are contained in the appraiser's work papers. The balance sheet indicates the financial status of a business as of a certain date.

High points of the balance sheet analysis are as follows:

- Because the balance sheet is prepared on a cash basis, receivables and payables are not recorded.
- Total FF&E increased by \$6k in 20XX but no additional assets were purchased in 20XX.
- All assets have been depreciated by accounting methods, which is allowable by the tax regulations.
- Other liabilities are attributed to payroll taxes payable.

The income statement shows the financial activities of a business over a specific time period. This information is useful in determining costs associated with sales and selected operating line item expenses of ABC Agency, Inc.

High points of the income statement analysis are as follows:

- Sales peaked in 20XX and have declined the past two years. Management states growth in sales is expected to decline until the economy recovers.
- Operating expense (*as a percentage of sales*) on a five year basis averaged 60.9 percent. With the exception of 20XX (which is higher) the prior years have all fallen around the five year average percentage.
- Pre-tax income (as a percentage of sales) has been calculated at 39.1% for a five year average.
- A review of the selected operating line item expenses (as a % of sales) reveals nothing alarming.

We analyzed the historical income statements and made the following adjustments to present the Subject's results as they might have been under conditions similar to what a prudent owner would do to maximize profitability.

#### Exhibit 1-1

Income Statement Adjustments					
As of December 31,	20XX	20XX	20XX	20XX	20XX
<i>Months of Operations</i>	<i>12</i>	<i>12</i>	<i>12</i>	<i>12</i>	<i>12</i>
Historical Pre-Tax Income	109,460	109,684	123,346	118,230	94,712
Adjustments					
Excessive Owner's Compensation	29,500	15,230	12,598	22,741	46,485
Rent at Market Rates	<u>6,500</u>	<u>6,400</u>	<u>6,300</u>	<u>6,200</u>	<u>6,100</u>
Normalized Pre-Tax Income	145,460	131,314	142,244	147,171	147,297

**Excessive Owner's Compensation** was taken to reduce taxable income. We have estimated the owner received above market level compensation for duties performed. We used salary survey data to establish reasonable replacement compensation at market values for the same size (in revenues) of companies as our Subject.

**Rent at Market Rates** was adjusted to reflect the fair market value rent based on prevailing market rates. These rates were obtained from a local real estate appraiser for the general size and condition of the property which is leased by our Subject. In this case, the excess was added back to the pre-tax earnings stream for each year.

### 1.8 Methods Available to Estimate FMV

Estimating or arriving at a conclusion of fair market value for a business or an ownership interest begins with an analysis of the Company and its external forces that affect it. In this analysis the appraiser:

- Gains an understanding of the history of the business, its industry, products, facilities, suppliers, customers, organizational structure, marketing philosophy and management personnel;

- Performs a financial review of the business’ financial statements and performance ratios;
- Investigates outside forces affecting the business such as general and industry economic conditions, competitors, government regulations and technology;
- Forms an opinion about the business’ ability to effectively compete in its competitive environment.

After these analyses are completed, the appraiser forms opinions about the Company’s future prospects, its strengths and weaknesses; the appraiser selects valuation approaches and methods to be considered in forming an opinion of value. Valuation approaches are defined as “a general way of determining value using one or more specific valuation methods”.

### 1.9 Valuation Calculations

In order to determine the value of the Subject, we utilized the income and market approaches to valuation.

#### Income Approach

To determine a value under the income approach, we utilized the discounted future earnings method. Adjusted pre-tax income for the Subject has varied with revenues over the last five years. Revenues have increased steadily from 20XX to 20XX. Adjusted pre-tax income has followed a similar trend. We have prepared a forecast that is believed to be representative of what might reasonably occur in the future for ABC Insurance Agency. For this valuation, we have developed a four-year detailed forecast of pre-tax income for the period 20XX through 20XX.

Exhibit 1-2

<b>Forecasted Pre-Tax Income to Equity</b>					
<i>As of December 31st</i>	<i>Adjusted 20XX</i>	<i>Forecast 20XX</i>	<i>Forecast 20XX</i>	<i>Forecast 20XX</i>	<i>Forecast 20XX</i>
	<i>Growth Rate</i>	<i>8.0%</i>	<i>3.0%</i>	<i>5.0%</i>	<i>4.0%</i>
<b>Pre-Tax Income</b>	<b>147,297</b>	<b>159,081</b>	<b>163,853</b>	<b>172,046</b>	<b>178,928</b>

The fundamental premise underlying the selection of an equity rate of return is that the return required by an investor, in the Subject Company, is the sum of the rate required by investors in risk-free securities and a theoretically derived equity risk premium. The equity risk premium is indicative of the incremental rate of return demanded by investors in investments similar in risk to the subject. To develop an equity risk premium for the Subject, we used Duff & Phelps “20XX Risk Premium Report.”

We then added the risk-free rate of return and specific-company risk adjustment to the equity risk premium. Using these rates, we calculated a pre-tax equity discount rate of 26.5 percent as being appropriate for this engagement.

Although the forecasts run through 20XX, the Company has value beyond 20XX, since it is expected to continue to generate cash flow. Estimating a continuing value, and discounting that

continuing value to a present value, captures the present value of the expected future cash flows beyond 20XX. In this analysis we estimated the continuing value of the Subject at the end of the discrete forecast period by capitalizing 20XX's pre-tax income as an annuity in perpetuity. Our estimate of the Subject's continuing value is based on a 22.5 percent direct capitalization rate. This direct capitalization rate was derived from the equity discount rate less an expected long-term growth rate of four-percent.

The following table shows the discounted future earnings method calculation. The value of equity capital was determined by adding the present values of the pre-tax cash flows for the forecasted four future years and the continuing value. The resulting indicated value of equity is on a control, publicly traded marketable basis.

Exhibit 1-3				
Discounted Future Earnings Method				
Years Ending	Pre-Tax Income	Discount Factor	Capitalization Rate	Present Value
20XX	159,081	0.791		125,833
20XX	163,853	0.625		102,408
20XX	172,046	0.494		84,991
20XX	178,928	0.391		69,961
Continuing Value	186,085	0.391	0.225	323,374
Discounted Pre-Tax Earnings				706,566
Mid-Year Convention Adjustment Factor				1.107
Indication of Equity Value				\$ 782,169

### Market Approach

To determine a value under the market approach, we utilized the direct market data method ("DMDM"). This method utilizes sold transactional data, which represents the market as a whole.

Transactional data was sorted by Standard Industry Classification (SIC) codes in the XYZ database. We identified 15 transactions grouped in SIC 81XX, which is defined as "Insurance Services". We reviewed these transactions for possible outliers or errors and found one duplicate transaction. We then performed statistical analysis by showing the mean, median, and coefficient of variation. The following sales price to gross revenue (P/S) multiples were derived:

Exhibit 1-4		
Private Transaction Data		
SIC 81XX	Mean	Median
<i>Number of Transactions</i>	14	14
Gross Sales	258,476	261,478
Price-to-Sales Multiple	2.10	2.81
Standard Deviation	0.32	n/a
Coefficient of Variation	0.49	n/a

We selected the price to gross sales as the preferred measure of the market due to the number of useable P/S transactions and a low coefficient of variation.

Our analysis of the Subject indicates the Company is less profitable, on average, than the companies shown above, which generally indicates a below-average valuation multiple is appropriate. However, the Company is forecast to grow at a significantly faster rate than the industry, which would indicate an above-average valuation market multiple is appropriate. We also considered the current economic climate, which suggests a smaller pool of buyers, which would imply a somewhat lower multiple. Based on this analysis, we believe a valuation multiple of 2.75, equal to the mean of the selected transactions is appropriate in this case.

Exhibit 1-5	
<b>Direct Market Data Method</b>	
Company's Financial Measurement	278,386
Selected Market Valuation Multiple	<u>2.10</u>
Initial Value	584,611
Adjustments	
Add: Cash	1,282
Deduct: Liabilities	<u>4,019</u>
Indication of Value	\$ 589,912

The DMDM's indicated value is on a controlling interest, closely held marketable basis.

#### 1.10 Adjustments to the Indicated Values

Before arriving at a final opinion of value, the appraiser must consider adjustments appropriate to this valuation assignment. The most common adjustments to values initially determine the differences between the level of control and/or marketability in the interest being appraised versus the level reflected in the value initially determined.

Although adjustments may be required for differing levels of lack of control and marketability, each are considered separately. Therefore, the issues related to level of control must first be considered and once correctly reflected, any adjustments necessary to properly reflect any lack of marketability will be determined. Adjustments may also be required for non-operating assets that were previously excluded from this analysis, but must be considered in determining the final opinion of value.

#### 1.11 Non-operating and Excess Assets

Discussions with management indicated that there were no non-operating assets or liabilities on the Company's balance sheet other than those which were discussed in this report. Therefore, the total non-operating and excess assets amount as of the valuation date are zero.

### 1.12 Adjustments for Lack of Control & Marketability Discount

The valuation assignment here was to estimate an opinion of value for a 100% controlling interest. In addition, the methods utilized in this report generated an estimate of value on a control basis therefore an adjustment for control issues are not necessary.

The discounted future earnings method requires an adjustment for lack of marketability as the estimate of value was obtained from publicly traded company information. The discounted future earnings method utilized management planning studies as a guide to selecting an appropriate discount. Applying the earnings discounts shown in the management planning studies indicates an appropriate discount would be in the range of 30 to 40 percent.

We selected a 30 percent discount as being appropriate in this case because of the Subject's anticipated future growth, niche market, and reputation within the insurance community. In addition, there are no restrictive covenants concerning the sale of an equity interest in the Company.

The direct market data method does not require an adjustment for lack of marketability as the transaction data already considers this issue in the selected market valuation multiple.

### 1.13 Indication of Value

As a result of our analysis, we have arrived at the following indications of value for ABC Insurance Agency, Inc.

Discount future earnings method	\$547,518
Direct market data method	\$589,912

Based on our review of the merits of each method, we assigned 70 percent of the weight to the discounted future earnings method and 30 percent to the direct market data.

### 1.14 Calculation Value Conclusion

Based on the foregoing, we have estimated the calculation value of a 100 percent ownership interest in ABC Insurance Agency Inc., as of December 31, 20XX, is approximately:

**\$560,000 (rounded)**  
**Five Hundred Sixty Thousand Dollars**

Our Contingent and Limiting Conditions and Professional Qualifications are attached to the report, and are an integral part of it.

## Appendix A - Professional Qualifications

*Omitted in this Sample Report*

## Appendix B – Assumptions & Limiting Conditions

The following are the assumptions and limiting conditions of this report.

1. The valuation process is not a finding of fact, but is a good faith finding of opinion. The opinion is supported by a reasonable amount of research and analysis, but is ultimately only the appraiser's personal, unbiased professional judgment.
2. This appraisal report is designed to provide an opinion of value. It is not an accounting report and should not be relied upon to disclose hidden assets or to verify financial reporting.
3. The valuation report is based upon facts and conditions existing as of the date of valuation. This appraiser has not considered subsequent events. Unless specifically requested by the client and agreed upon by me, I have no obligation to update this valuation report for such events and conditions.
4. The estimate of value included in this report assumes the existing business will maintain the character and integrity of the business through any sale, reorganization or reduction of any owner's/manager's participation in the existing activities of the business.
5. The ultimate price paid in any actual transaction is a function of negotiations between a specific buyer and seller, and those negotiations may be affected by individual interests not contemplated in our analysis. The timing of and conditions surrounding such a negotiation would differ from the effective date of our valuation. Therefore, we are not responsible for any buyer's or seller's ability or inability to consummate a transaction at the value developed herein.
6. This appraiser relied upon representations made by ABC Agency, Inc. regarding the background and history of the business. Management has acknowledged information provided was complete and accurate. However, this appraiser assumes no responsibility for the accuracy of the information provided to this appraiser by ABC Agency, Inc.'s representatives.
7. Subject's assets, properties, or business interests are appraised free and clear of any or all liens or encumbrances unless otherwise stated.
8. This report is based on financial information provided by management of ABC Agency, Inc. and other third parties. This appraiser has not audited the underlying financial data. Accordingly, this appraiser takes no responsibility for the underlying financial data presented in this report and users of this valuation report should be aware that valuations may be based on future earnings potential that may or may not materialize. Therefore, the actual results achieved may vary from the information utilized in this valuation and the variations may be material.
9. American Business Appraisers accepted the financial statements of ABC Agency, Inc. without testing their accuracy. The financial statements consist of balance sheets and income statements. The accuracy of the financial statements is the sole responsibility of ABC Agency, Inc.'s management.
10. This appraiser is not aware of any information that was knowingly withheld. However, this appraiser makes no guarantee that ABC Agency, Inc. or others have disclosed all relevant information to this appraiser. The information furnished by others is believed

- to be reliable. However, American Business Appraisers issues no warranty or other form of assurance regarding its accuracy.
11. This appraiser assumes there are no hidden or unapparent conditions regarding the Subject's assets, properties, or business interests. The Subject is assumed to be in full compliance with all applicable federal, state, and local regulations and laws unless the lack of compliance is stated, defined, and considered in the appraisal report.
  12. American Business Appraisers assumes that all required licenses, certificates of occupancy, consents, or legislative or administrative authority from any local, state, or national government, or private entity or organization have been or can be obtained or reviewed for any use on which the opinion contained in this report is based.
  13. Unless otherwise stated in this report, this appraiser did not observe and has no knowledge of, the existence of hazardous materials with regard to the Subject's assets, properties, or business interests. However, this appraiser is not qualified to detect such substances and accepts no responsibility for such conditions or for any expertise required to discover them.
  14. Possession of this report, or a copy thereof, does not carry with it the right of publication of all or part of it, nor may it be used for any purpose without our previous written consent, and in any event only with proper authorization. Authorized copies of this report will be signed in blue ink by the appraiser of American Business Appraisers. Unsigned copies, or copies not signed in blue ink, should be considered to be incomplete.
  15. American Business Appraisers are not licensed attorneys. Any comments, discussions, or analyses of Company documents or any other federal or state law, provision, or regulation are not to be considered legal opinions. The appraiser's focus is to consider all relevant factors that might impact value and estimate the extent of the impact of such factors.
  16. The analyses, opinions, and conclusions presented in this report apply to this engagement only and may not be used out of the context presented herein. This report is valid for the effective date specified herein and only for the purpose specified herein.
  17. The analyses, conclusions and opinions are based on information and data provided as of the date of valuation and could change, based on obtaining additional information and having additional time to analyze such additional data. This appraiser, therefore, reserves the right to amend this report based on additional analysis and data. Further, in the case of testimony, this appraiser reserves the right to offer rebuttal testimony.