

## About Valuation Insights

Presented by Stout, Causey & Horning, P.A.

Welcome to the Valuation Insights Newsletter - a complimentary service presented quarterly to our friends in the legal and consulting professions. We hope that you will find the articles, insights, and court case abstracts both timely and informative.

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The firm's service lines include business valuation, litigation support, comprehensive accounting, tax, and business advisory services, and state and local tax services. We are one of three firms selected nationwide by Bowman's Accounting Report to the *Best of the Best* list of America's Top CPA firms for six consecutive years.

Please contact us if you would like additional information on any of these topics or to discuss ways we may be of assistance to you in your client matters.

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### COURT CASE ABSTRACT

#### *Buy-sell agreement's terms dismissed, effect discounted*

*Estate of HA True v. Commissioner*, 2004 U.S. App. LEXIS 24844 (10th Cir. December 2, 2004). *Judge Seymour*.

The issue in this tax case focused on the ability of the taxpayer's restrictive buy-sell agreement to reduce the value of the family business by its terms. The tax court ruled that it was unable to do so because the buy-sell agreements were not supported by full and adequate consideration and the agreements had testamentary inferences. However, the court held that the agreements were still enforceable and held that a marketability discount could be applied.

The True family conducted multiple businesses in the industries of oil, cattle and environmental clean-up. Although some of the enterprises were more successful than others, on average the True family was very successful. When the patriarch, H.A. True died, the buy-sell agreements were activated.

#### Buy-sell agreement

The court noted the terms of the buy-sell agreements:

The agreements dictated that an owner or partner could not transfer or encumber his or her interests in the business, and each owner or his or her spouse had to work in the business. Failure to work in the business, any attempt to transfer an interest in the business, death, and disability were each treated as if the holder of the interest had notified the other owners of his or her intent to withdraw from

ownership. Upon the occurrence of such an event, the other owners were required to purchase the departing owner's interests at a formula price listed in the buy-sell agreement.

In addition the True family used the tax book method of accounting and not GAAP. The Court of Appeals noted that although this was reasonable, it was not a proper method of valuing the business.

#### Holding and rationale

The IRS challenged the agreements at the tax court level and the court sided with the IRS. The Court of Appeals agreed, stating that:

[T]he transactions at issue here were neither conducted at arm's length nor without donative or testamentary intent. We noted the lack of arm's length negotiations between the True family members when entering into the various buy-sell agreements, as well as the inferences properly drawn from those agreements: they served, in part, to fulfill Dave and Jean True's overall testamentary plan to pass the family business on to their sons. The tax court did not clearly err in finding that these transactions could not aptly be construed as occurring within the ordinary course of business.



## COURT CASE ABSTRACT

### *Too many adjustments compromise Deloitte's valuation*

*In re Coram Healthcare Corp.*, 2004 Bankr. LEXIS 1516 (October 5, 2004). Judge Walrath

The relevant valuation issue in this bankruptcy matter, in which the court confirmed the trustee's modified plan, was the value of **Coram Healthcare Corp.** and **Coram, Inc.** (the "Debtors"), which would determine whether the trustee's plan was "fair and equitable."

#### Valuation evidence

Both parties provided expert testimony during trial and used the same methodologies: comparable public company analysis; comparable transaction analysis; and discounted cash flow analysis. However, as one might expect, their respective conclusions diverged substantially.

The court noted the key distinctions: "**Deloitte** [for equity committee] and **EB/SSG** [for trustee] included different assets in reaching their valuation conclusions, attached different weights to the three valuation methodologies, and took different positions regarding management's projections."

#### Did appraisers incorrectly rely on conservative, erroneous projections?

The equity committee argued that EB/SSG artificially deflated Debtors' value by relying on management's conservative projections. The equity committee argued that these projections were incorrect because they were not based on historical or industrial experience and the cash flow projections contained errors that resulted in a low discounted cash flow.

Additionally, EB/SSG did not conduct an independent review as to whether the projections were consistent with market projections or debtor's actual performance. EB/SSG's valuation was also criticized by the equity committee because their valuation methodologies varied from traditional methodologies as a result of their disregarding multiples that produced results that fell outside of their pre-conceived conclusions about the market. EB/SSG's valuation resulted in a going concern value of \$220 million.

#### Too many upward adjustments by Deloitte?

Deloitte's valuation utilized the "upside projections" prepared by EB/SSG. Deloitte adjusted EBITDA for charges that they did not consider to be regular. In addition to making adjust-

ments to EBITDA, Deloitte made significant adjustments to growth projections, cash flow projections and management's established reserves. Deloitte determined that higher multiples were proper because Debtors' value contained a "significant 'specialty pharmaceutical' component." Deloitte finally concluded that the going concern value of Debtors was \$279 million.

The trustee criticized Deloitte's valuation for numerous adjustments to management's projections and the utilization of inflated multiples. In addition, the trustee argued that Deloitte's characterization of the company as a specialty pharmaceutical company was inaccurate and that Deloitte's inflated projections did not take into account the "price pressures" inherent in the industry. The trustee also argued that the increase of the EBITDA by 40%, due to the multiple adjustments made by Deloitte, was improper.

#### Holding and rationale

The Bankruptcy Court discussed the motivation for the difference in valuations, "[W]e recognize each side's incentives to either overvalue or undervalue the Debtors." However, the court noted there are limits, "Although valuations are subjective, there are proper and improper methods of performing a valuation."

The court held, "After our review of the evidence, we cannot conclude that EB/SSG strayed from generally accepted valuation methodologies. While we agree that their numerical inputs ... may have been conservative, the evidence does not establish that EB/SSG made inappropriate downward adjustments ... Accordingly, we do not find that the EB/SSG valuation is improper."

"After considering the competing valuations, the competing incentives of the parties, and the divergent evidence offered in support of the valuations we conclude that the value of the Debtors is less than \$ 317 million." In a footnote, the court noted that "This figure is calculated by adding the going concern value of \$ 220 million determined by EB/SSG, the \$ 31.2 million in cash on hand, the \$ 10 million in present value of the NOLs, and the value of the claims being released (less than \$ 56 million)."

In addition, the Bankruptcy Court noted why Deloitte's valuation was not adopted: "Deloitte took aggressive and optimistic views regarding the valuation and strength of the Debtors. Therefore, we do not find that the Deloitte valua-



tion is an accurate reflection of the Debtors' value." The court adopted the valuation of EB/SSG and valued the debtor at \$220 million.

## COURT CASE ABSTRACT

### *Good experts on both sides make appeal difficult*

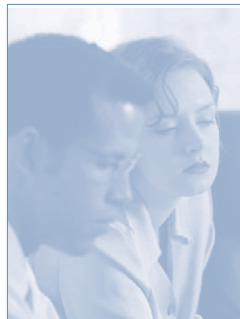
*Frick v. Frick, 2004 Ohio App. LEXIS 6482 (December 17, 2004). Judge Singer.*

The issue in this marital dissolution was the value of the couple's interest in multiple restaurants. While the court did not discuss the valuations in depth, it noted that:

Both [experts] come with impeccable credentials and experience. Indeed each was highly differential to the work of the other. Each utilized essentially the same formulas applied to the same data. Each offered a range of values resulting from the application of a variety of commonly utilized valuation techniques. Each explained in detail the reliability of the techniques employed and the reasons the expert elected to employ one valuation over another.

Because of the qualifications of both experts, the court of appeals was not compelled to overturn the trial court's ruling:

[E]ach of the values advanced by both parties' experts were well reasoned and well supported, so the estimates of the value themselves were neither arbitrary nor unreasonable. The reason the court gave for selecting appellant's valuation was that, "... this valuation approach is fair to both parties . . ." Fairness is, by definition, the purpose of equity."



(defendant) relating to the development, ownership and licensing of computer software. The breach, which was characterized as a failure to deliver source code, resulted in the complete destruction of the business. When a business is destroyed, the business damages equal the market value of the business, which, in this case, the jury valued at \$2,909,562.50.

### **Valuation evidence**

Athle-Tec proffered the testimony of **Steven Oscher**. Oscher testified that if one would use the "guideline company" approach, the 8.9 million net dollar offer to buy a related company would be a good indication as to the value of Athle-Tec. However it was brought out during his testimony that Oscher had not conducted a valuation of Athle-Tec because he was never engaged to do so.



Oscher then admitted on cross-examination that he was not expressing an opinion that the loss value of Athle-Tec was 8.9 million. It was noted in the court of appeals opinion that, "Oscher's testimony on the question of value was limited to identifying a comparable indicator of value. Oscher did not perform the remainder of the extensive analysis that would have been necessary to arrive at an appraisal of the value of Athle-Tech's business at the time it was destroyed." The defense did not offer any evidence as to the value of the business.

### **Holding and rationale**

The court of appeals reversed the trial court and remanded the case because Athle-Tech failed to provide legally sufficient proof of the business damages awarded by the jury. The court of appeals noted that, "Athle-Tech did not offer any other evidence directed to the value of its business, and the Defendants did not offer any evidence on this issue.

Because neither Oscher nor any other witness testified to the value of Athle-Tech's business on the date of its destruction, Athle-Tech's proof at trial was insufficient to establish the amount of the loss it sustained on account of the destruction of its business."

## COURT CASE ABSTRACT

### *Unopposed but incomplete evidence of value is not enough to support verdict*

*Montage v. Athle-Tech, 2004 Fla. App. LEXIS 14973 (October 13, 2004). Judge Wallace.*

The issue in this damages case arose out of the breach of an agreement between **Athle-Tec** (plaintiff) and **Montage**

## *In This Issue of Valuation Insights...*

*Effect of Too Many Adjustments on a Valuation; Incomplete But Unopposed Evidence; Restrictive Buy-Sell Agreements*

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