

**EFFECTIVE EXAMINATION  
OF VALUATION EXPERTS**

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**O'DELL & O'NEAL**  
**A T T O R N E Y S**

**SERVING CLIENTS AND COMMUNITY**



**Justin O'Dell** has been actively practicing law in Georgia since his admission to the bar in 2002. He founded O'Dell & O'Neal Attorneys in January 2013, based on a commitment to clients and community. Mr. O'Dell has litigated bench and jury cases in the U.S. District Court, Northern District of Georgia, and in the various Superior, State, Probate and Juvenile Courts of Metro Atlanta, Georgia. He has also appeared before local government Councils and Commissioners on various client matters.

Mr. O'Dell has a broad range of practice areas, including but not limited to business and civil litigation disputes, family law matters, probate litigation and property litigation. He has appeared in a variety of forums related to property title and use. Justin has also litigated consumer cases involving personal injury, wrongful foreclosure, wrongful eviction, breach of fiduciary duty and defective construction. He has also successfully represented residential and commercial property owners facing claims of eminent domain. Mr. O'Dell has successfully handled each of the last three election disputes in Cobb County.

Justin O'Dell was raised on a small family farm in Southern Idaho. He attended Furman University, graduating in 1999 with a degree in Political Science. He attended law school at the University of Georgia and completed his Juris Doctorate, cum laude, in 2002. In addition to working on a farm, Mr. O'Dell worked as a summer seasonal wild land firefighter for the U.S. Department of Interior, Bureau of Land Management.

Since coming to Marietta, Mr. O'Dell has become ingrained in the local community through civic and nonprofit service. He serves and has served on various civic and non-profit boards and recently completed a term as President of the Kiwanis Club of Marietta. Mr. O'Dell is an active member of the Cobb Chamber of Commerce and completed the Leadership Cobb program in 2007. Justin is active within the faith community as a member, Deacon and Sunday School Instruction at First Baptist Church of Marietta.

Mr. O'Dell's work has been recognized in a variety of ways. In 2010, he was named one of the 20 Rising Stars Under 40 in Cobb County, Georgia. Also in 2010, Justin was recognized by the State Bar of Georgia with the Robert Benham Award for Community Service. In 2012, Georgia Power awarded him their annual Citizen Wherever We Serve Award. Super Lawyers selected him for the past three years as a Georgia Rising Star. He has received recognition for outstanding service by the Marietta Kiwanis club and the Cobb Collaborative. In 2015, he was given the Chairman's Award by the Cobb Chamber of Commerce in recognition for his work in Co-Chairing the 2014 Countywide SPLOST referendum. He was also awarded the 2016 Next Generation Award by the Cobb Young Professionals division of the Cobb Chamber of Commerce.

### **REPORTED CASES:**

- *Vatacs Group, Inc. v. Homeside Lending, Inc.*, 281 Ga. 50, 635 S.E.2d 758 (2006);
- *In re Fennell*, 300 Ga. App. 878 (2009);
- *Wills v. Arnett*, 306 Ga. App. 503 (2010)
- *In Re: Kauffman*, 327 Ga. App. 900 (2014)
- *Amah v. Whitefield*, 331 Ga. App. 258 (2015)

### **NOTABLE JURY RESULTS:**

- *Buckner v. Complete Wrecker Service, Eviction Services, Inc., Morris, Schneider and Prior*, State Court of Dekalb County, (2007). Plaintiff's verdict for wrongful eviction in excess of \$200,000.00.
- *Burleigh v. Shackelford*, State Court of Cobb County (2006). Defendant verdict of only \$65,451.17 against a Plaintiff's request of in excess of \$800,000.00.
- *Weeks v. Huck*, Superior Court of Cobb County (2011). Plaintiff's verdict establishing a property line and award of \$20,000.00 attorney's fees.
- *Lincoln v. Beaumont Tax Service*, Superior Court of Cobb County (2011). Plaintiff's verdict in excess of \$150,000.00, plus award of punitive damages for breach of fiduciary duty and fraud and attorney's fees arising from negligent tax services.
- *Perry, Sexton v. Amah*, Superior Court of Cobb County (2015). Verdict in excess of \$140,000.00, including substantial attorney's fees, for claims arising from trespass and nuisance over disputed easement rights.

### **NOTABLE NON-JURY RESULTS:**

- *In RE: Mrs. B*, Probate Court of Gilmer County (2007). Successful defense and prosecution involving Guardianship and Conservatorship of incapacitated Mother.
- *Mr. B. v. Debt Collector*, Settlement for bad faith and harassment in violation of Fair Debt Collection Practices Act.
- *Church v. Board of Elections*, Superior Court of Cobb County (2008). Successfully obtained new election in race for Mayor of City of Kennesaw.
- *PMC v. CII Global*, Superior Court of Cobb County (2008). Defense of individual partner and prosecution of claims against other partners. Successful enforcement of settlement of dissolution of partnership in favor of client.
- *Godwin v. Pearlberg*, Superior Court of Cobb County (2009). Successful defense to a legal challenge to the eligibility of incumbent City Councilman for reelection before the County Board of Elections and appeal to the Superior Court.
- *Cardoza v. Wells Fargo, et. al.* Superior Court of Cobb County (2010). Successfully set aside foreclosure and returned home to homeowner. Confidential settlement.
- *Martin v. Board of Elections*, Superior Court of Cobb County (2012). Successfully set aside 2012 election referendum regarding Sunday Sales due to failure to comply with legislation and disenfranchisement of City voters.
- *Bejdic v. Smitherman*, Cobb County, Georgia (2013). Six figure settlement of automobile wreck involving compound fracture of spine against liability insurance and uninsured motorist insurance carriers.
- *Cobb County School District v. Crawford*, Cobb County, Georgia (2013). Successfully defended Principal against false allegation of failure to report. Following the case, the Head of

Professional Standards and Ethics was non-renewed and the Lead Investigator resigned. The Cobb County School Board later proposed revised standards for conducting investigations.

- *Ms. H. v. Fitness International*, U.S. District Court, N.D. Georgia (2014). Successful settlement of claims involving sexual harassment.

#### **PRESENTATIONS & WRITING**

- Technology in the Law Office: Helping Small Firms Compete, Digital Strategies to Keep up with the Big Boys (Georgia Association of Paralegals, October 29, 2010)
- Election Challenges in Georgia (2011)
- The Court System & You: A Primer for Clergy, Non-Profit Organizations and Churches (February 22, 2011, Cobb County Clergy)
- Facebook Meets Voir Dire: The Good, The Bad & The Ugly of Mining the Internet During Litigation (National Association of Legal Secretaries, May 17, 2011; Cobb County Legal Secretaries Association, October 26, 2012; Cobb County Bar Association Family Law Section, December 14, 2012, National Association of Legal Secretaries, July 17, 2014)
- Ethics for Litigators, National Business Institute (July 25, 2012)
- Dirty Litigation Tactics: Ethics & Professional Conduct, National Business Institute (February 13, 2013)

## **INTRODUCTION**

The purpose of these materials is to provide a basic understanding of the direct and cross examination of valuation experts arising in various areas of litigation, primarily family law. The materials are designed to aid the litigator in the orderly and efficient presentation of evidence to the trial court and in drawing distinction between positions to allow for persuasive argument in support of one expert over the other. These materials commence with a general discussion concerning examination and then look at the actual application of the desired examination technique to each area of a typical valuation report.

### **A. EXAMINATION PREPARATION**

#### *1. Know Your Audience*

In preparing the testimony of an expert or the cross-examination of an expert, it is imperative that the counsel have a working understanding of the background of the trier of fact. A seasoned trial judge or one well-experienced in family law issues does not typically need to hear from the expert extensively on background and nature of the work performed. In fact, it is quite likely that the expert testifying has testified before that Judge on numerous occasions. Instead, the Judge is likely wanted to know the end result and valuation information as quickly as possible. On the other hand in a jury trial or in a presentation to a newly elected judge or judge with limited background in family law, the differentiation between the various methodologies and the basis for applying and discounting each could carry weight and credibility.

#### *2. Direct Examination*

On direct examination, it is important that the litigator efficiently deliver the information to the Court and avoid extraneous accusations and issues which undermine the credibility of counsel and the witness. Each valuation expert varies in the preparation and production of work product and reports. Some valuation experts prefer to hold back work product and worksheets until the last minute in order to avoid the adverse party (and expert) having the information to aid in cross-examination. Others are actually willing to meet with the adverse expert and party in order to compare notes in an attempt to reconcile differences of opinion. The inability of opposing counsel to receive information can, in the opinion of this writer, create an unnecessary distraction

and side issue for the Court. Better practice is to proceed with confidence concerning the position and valuation and the expert presenting the same. The presentation by the Court is made more credible on direct examination if Counsel is willing to state that their valuation work product has been made available to opposing counsel months in advance, opposing counsel was afforded the opportunity to depose and challenge the expert and the expert even went so far as to meet with the opposing valuation expert in an effort to reconsider their position.

It is also important to remember that communications between the attorney and the expert can be subject to discovery under O.C.G.A. §9-11-26. Any communication which suggests to the valuation expert a possible outcome (i.e. “We represent the Wife so we are looking to get her the most amount possible for her half of the business”) can be used to impeach or attack credibility, even if the overall effect of the communication had no bearing on the opinion of the expert.

The presentation of direct examination should be organized in such a way as to efficiently provide the necessary information to the Court in determining value. Many experts offer to provide Counsel with a list of scripted questions to ask in order to walk through the examination. This approach should be avoided. First, the communication providing the script could be subject to discovery and create credibility distraction. Second, the questions are being organized by a non-lawyer who may lack the overall perspectives of the other issues in the case. As a result, the testimony appears rehearsed and disconnected from the remainder of the case. Judges and juries instinctively tune out to testimony of this nature or fail to connect points established through other witnesses to the testimony provided by the expert. Throughout the remainder of these materials, each of the various points of adjustment for experts is discussed and analyzed. An effective presentation will take the expert witness through each of the various subjective adjustments made to the data provided, note any differences in objective data and then compare and contrast areas of agreement and disagreement between the expert and his/her opposing expert.

### *3. Cross Examination*

Cross examination of an opposing expert should be conducted carefully. More often than not, opposing counsel finds himself/herself locked in an argument with an expert that does nothing more than allow the expert to come across as even more authoritative.

The most effective cross-examination will accomplish the same as the direct examination: take the expert witness through each of the various subjective adjustments made to the data provided, note any differences in objective data and then compare and contrast areas of agreement and disagreement between the expert and his/her opposing expert.

## **B. VALUATION METHODOLOGIES**

Typical valuation services provide testimony based upon the application of three, well-established methodologies or approaches: the income or capitalized earnings method, the market approach method, and the cost approach method. *Miller v. Miller*, 288 Ga. 274, 275, 705 S.E.2d 839, 842 (2010). Often, an expert will provide work product demonstrating each approach and then apply levels of weighting to each (which can include discounting or disregarding one approach entirely) and then use those weighted figures to determine an outcome. Although this frequently appears on the front page of the valuation report, these conclusions represent the result of a number of other calculations and adjustments. Thus, it is unwise to start the examination by focusing extensively on the methodologies and weighting. Instead, effective direct and cross examination would highlight the areas of agreement and disagreement between the expert and his/her opposing expert regarding methodologies and then “dive deeper” into the work product itself only to return to this discussion at the conclusion of the examination.

See Appendix – Example 1

### *1. Income/Capitalized Earnings Approach*

The income/capitalized earnings approach contains several areas which allow for subjective adjustments. Essentially, the goal of the methodology is to make a determination of an average or normalized income and then apply a capitalization or risk factor to the normalized earnings in order to determine value. The examination should focus heavily on the subjective adjustments being made as each can generate a dramatic difference in value.



a. Normalized Earnings Period

The first subjective area of review is determining the period over which to normalize the earnings and determining how to weight the relevant periods. Experts will often include or omit a period of time in which the earnings results of the corporation are aberrational (for example, during the divorce litigation). This decision can dramatically swing the determination of value. Depending on the position in the case, Counsel should be able to effectively establish whether or not the decision is prudent. Is the corporation likely to continue to suffer post-divorce or is it more likely to return to normal?

See Appendix – Example 2

b. Adjustments to Earnings

The second subjective areas of review in determining the normalized levels of income are the adjustments to income each year. It is not uncommon in a small business for expenses which are actually personal and not corporate to be paid by the business and deducted against earnings. In the process of determining value, these expenses should be fairly and accurately adjusted by reducing the expenses from the deductions and increasing the earnings and net profit of the business. In addition, a large adjustment is typically required for “adequate officer compensation.” Most small business owners do not pay themselves a market wage. For purposes of limiting payroll taxes and other withholding costs, many pay themselves a token salary (I.R.S. minimum is \$75,000/yr) and take the remainder of profits in the form of distributions. However, in determining value, an adjustment must be made in order to calculate the amount required to hire management level executives to replace the departing business owner. These salary costs would have the effect of reducing profitability and earnings and reducing the value of the company. In many instances, the adequate compensation analysis can cause the entirety of the profits to be swallowed. In this instance, the enterprise arguably has no inherent value and the owner essentially has a job and not a business.



There are important considerations to make in the presentation of the entire case when an expert has made adjustments to earnings. The domestic relations financial affidavit and child support worksheets should agree with all of the adjustments set forth by the expert. For example, if the party has typically paid their car payment through the business and the party's expert is adding back that payment to the business' profit, the expense should be reflected on the paying party's domestic relations financial affidavit and should not appear as an included item on the self-employment portion of the child support worksheets. The most important argument in this vein is the "double dip" argument discussed briefly in the matter of *Miller v. Miller*, 288 Ga. 274, 275, 705 S.E.2d 839, 842 (2010) which applies to the income of the spouse owning or employed by the corporation being valued. In that regard, an expert who provides for a reduction in corporate profitability by increasing the amount of adequate executive compensation would have to find fault with the presentation of a domestic relations financial affidavit or child support worksheet containing a number inconsistent with that same adjustment.

The adjustments to earnings may appear slight at times. However, each of these adjustments have fairly substantial effects in that the earnings are ultimately multiplied by a capitalization rate. For example, adjustments totaling just \$20,000 to EBITDA have an impact of \$100,000 in value when utilizing 20% discount rate.

See Appendix – Example 3

c. Working Capital/Capital Expenditures

Another important and subjective area of adjustment relates to the retention of adequate working capital and anticipated capital expenditures. The working capital adjustment seeks to exclude sufficient earnings from the corporation such that the corporation has sufficient cash on hand to operate on a regular basis. Many small business owners draw out corporate funds as they are available and, if necessary, are prepared to inject funds back into the business as needed (either as loans or capital) to meet expenses. The valuation process seeks to avoid this scenario by adjusting earnings such that the business retains adequate working capital. Adjustments for capital

expenditures anticipate and set aside cash on hand for irregular business expenses such as the repair or purchase of new equipment.

Credible testimony in these areas should establish that the adjustments are made based upon industry analysis and company history. If the expert notes that adjustments to working capital and capital expenditures are based upon information provided by the owner, the same should be subject to question on examination. During the pendency of litigation, the party has a motivation to claim the need for working capital or project upcoming capital expenditures in order to reduce value.

d. Discount/Capitalization Rate Selection

As discussed above, the discount or capitalization rate utilized by the valuation expert is the multiplier applied to the normalized earnings to generate value. The selection of the rate is therefore critical in providing a final valuation and a few percentage points in the rate can cause a value to swing significantly.

The capitalization rate seeks to quantify the “risk” of the company. The analysis starts with the risk free cost of capital; essentially the return an investor can receive on funds without risk. Added to that level of risk are the risks associated with the various markets (equities/stocks and bonds) and then the specific risk associated with the company being valued. The last determination is the portion of this analysis which is subject to variation. The capitalization rate is expressed in terms of a percentage. The valuation is determined by dividing the normalized earnings by the capitalization rate (or by dividing the capitalization rate by 100 to convert from a percentage to a whole number and then multiplying the whole number by the normalized earnings).

Low risk companies (those with large contractual based clients or those in stable industries) have a capitalization rates which are nearer to the risk free rate. Since the capitalization rate is divided by normalized earnings or inverted to a whole number and multiplied by earnings, a low capitalization rate increases value. High risk companies have a capitalization rate expressed as a high percentage which has the effect of decreasing value.

See Appendix – Example 4.

### **C. MARKET APPROACH**

If performed correctly, the market approach can be the most accurate means to test the valuation of a company. The approach is highly similar to the approach utilized to appraise real property. The valuation expert attempts to locate comparable sales, adjust those sales to apply to the company at issue and then determine a value under similar conditions. The difficulties in the market approach are the assimilation of accurate and complete data and the determination and subjective application of those adjustments to the subject company.

In attempting to locate comparable sales transactions of other companies, valuation experts examine reported company sales from sources such as Pratt's Stats, BizComps and IBA. The sales are then analyzed in terms of the company revenue and earnings to determine an average sales discount or capitalization rate. However, for sales of companies which are small to medium in size (like those generally at issue in a litigation matter), the data reported is limited, at best. In addition, it is not uncommon for small business sales to adapt the sales price and proceeds to the unique circumstances of the buyer and seller. For example, a buyer who is acquiring a company from a seller for an agreed upon purchase price of \$5 million may not have the ability to borrow the total funds required at closing. Likewise, the seller may be motivated to defer some of the sales proceeds (reportable as capital gains income taxes) over time. Thus, the sale could be structured whereby the buyer is only paying \$3 million for the purchase of the company at closing and then agrees to retain the seller as a 1099 consultant for \$500,000 per year over four years. The reporting of the transaction to the databases mentioned above may or may not catch the entirety of the negotiation and skew the sales figures.

It is also difficult for valuation experts to locate comparable sales within a specific industry. In order to obtain sufficient, relevant sales data the expert is forced to broaden his or her net. Valuation experts often begin by looking for sales within an North American Industry Classification System (NAICS) code. This code (located on the

top of each tax return) is based on production (not product). A company code can be located here: <https://www.census.gov/eos/www/naics/>. Law offices, for example, are coded 541110. Each digit in the code is part of a series of progressively narrower categories, and the more digits in the code signify greater classification detail. The first two digits designate the economic sector, the third digit designates the subsector, the fourth digit designates the industry group, the fifth digit designates the NAICS industry, and the sixth digit designates the national industry. The 5-digit NAICS code is the level at which there is comparability in code and definitions for most of the NAICS sectors across the three countries participating in NAICS (the United States, Canada, and Mexico). The 6-digit level allows for the United States, Canada, and Mexico each to have country-specific detail. A complete and valid NAICS code contains six digits. Some industries have completely different codes for wholesale, manufacturing and retail. Also, some companies are engaged in multiple revenue streams and may provide both wholesale, manufacturing and retail services.

See Appendix – Example 5.

Often times an expert will be forced to pull sales data based only upon the first four digits in order to get a sufficient number of sales to analyze. It is also not uncommon for a company to have obtained an NAICS code based on the production at the time of establishment, but over time the company has pivoted the production into another area. The NAICS code is almost never updated. Some companies select the wrong code from the outset and never correct it. A valuation expert who relies solely on the NAICS code provided on the tax return opens up a host of questioning. Beyond the proper NAICS coding, an expert should also factor into the analysis the Small Business Administration guide for company sizes: <https://www.sba.gov/sites/default/files/files/Size Standards Table 2017.pdf>. This guide provides industry by industry determinations for the definition of a “small” business. While most businesses being valued in litigation matters are within the definition of “small”, the NAICS code is not discriminating. Thus, sales transactions that are within the entirety of the six digit NAICS code may arguably be excluded or

should be disregarded because the sales comparable involves a “small” business vs. a large one.

At a minimum, any expert relying on the market approach at all should be examined extensively on the breadth of the search for comparable sales.

See Appendix – Example 6.

#### **D. COST APPROACH**

The cost approach is seldom granted any weight or credibility in a business valuation. The cost approach essentially looks at the balance sheet of the corporation and determines a value in a liquidation situation. In simplest form, the company is worth the amount by which its assets (receivables, furniture, equipment etc...) exceed its liabilities (payables). The analysis is not highly subjective and would only be proper under the circumstances in which a fact scenario presented that the owning party planned to close up the doors and walk away.

#### **E. THE GOODWILL FACTOR**

Goodwill is a frequently misunderstood and over analyzed concept in the valuation process. However, experts have created a highly subjective means to affect a final valuation number through the use of goodwill and an “assumption” in the valuation process. There are two components to “goodwill” – corporate goodwill and personal goodwill. Corporate goodwill is the value of the brand of the company. This form of goodwill is included in the value of the company. Personal goodwill is the portion of the company value which is attributable to the owner or principal. Under the holding of *Miller v. Miller*, 288 Ga. 274, 275, 705 S.E.2d 839, 842 (2010), the testifying expert must account for the discount in value associated with personal goodwill in some fashion. Some experts choose to make the allocation in determining a capitalization rate (the company has higher risk due to the personal goodwill of the owner), some experts make the adjustment through the market approach (assuming comparable sales also dealt with the goodwill issue) and others make a generalized discount for goodwill from the final value.

The discussion of a goodwill discount often dovetails with a discussion about the execution of a covenant not to compete by the selling party. In theory, the entry of a covenant not to compete causes the concern/risk associated with personal goodwill to mitigate to some degree since the selling party will not have the opportunity to take business from his former company. Personal goodwill discounts could still apply (particularly in personal service industries – doctors, dentists, etc...) on the theory that some customers may choose to go elsewhere anyway. When an expert elects not to make an overt discount for personal goodwill (thus increasing the value of the corporation), the typical rationale provided is that the assumption is made that the selling person would execute a reasonable non-compete on the grounds that the valuation standards assume a “willing seller” and a “willing buyer.”

However, effective examination cannot overlook that if an expert has set aside reasonable compensation for the selling party in adjusting for normalized income and correctly utilized that income for child support and budgetary purposes, it is intellectually inconsistent to factor in the existence of a non-compete agreement for the selling party. In other words, if the reasonable salary for the selling party is listed as \$300,000 per year (leaving the remainder of the corporate earnings as normalized income for valuation), but the selling party is assumed to be subjected to a non-compete, how is the selling party expected to earn \$300,000.00 per year? He/She is no longer able to work in the industry, region or utilize their network for a period of several years.

#### **F. SANITY CHECKS & TRAPS**

Experts often become locked into their methodologies and math and can easily lose the forest for the trees. Sometime the methodology, applied too rigidly, creates a result that is patently nonsensical. valuation experts who are pushing the envelope in the subjective areas may attempt to load their report with a litany of unnecessary material designed to make the valuation look more substantial. Alternatively, an expert may hold back on the worksheets and refrain from “showing their work” lest the same be subjected to scrutiny and analysis prior to examination.

One of the simplest sanity checks is to determine whether the valuation provided is less than the book value of the enterprise. Essentially, if a purchaser could acquire the company for the value indicated, collect the receivables, pay the payables, close the company and turn a profit, the valuation likely lacks credibility.

If an expert has produced a report and feels compelled to load the report with charts, graphs, articles printed from the internet and the like, it should be noted on examination. Although an expert is allowed to incorporate hearsay materials into their work product, the Court should be made aware of the degree to which the expert has actually produced and provided work product and the degree to which the expert has attached a bunch of filler. If the opposite is true and the expert has elected to hide their work and not reveal their adjustments and calculations, it should be brought to the attention of the trier of fact.

Finally, the most effective check on valuation is to ask the opposing party if he/she would be willing to acquire the business at their expert's value. If the opposite spouse (not expected to have the company) immediately recoils and replies that it would be absurd because they could not run the business and all the customers would leave, issues such as goodwill and capitalization factors associated with risk become very concrete. Likewise, if the opposite spouse (expected to be in possession of the company) is unwilling to sell it to his spouse at the price his/her expert has determined, it is likely obvious that the possession of the company is worth far, far more.



## Example 1 Valuation Methods

### Summary sheet Expert 1:

Valuation Methodology	<u>Indicated Value</u>	<u>Incr. Val of Tax-Pass-Thru</u>	<u>Subtotal</u>	<u>Weight (2)</u>	<u>Weighted Value</u>
<u>Income Approach</u>					
Discounted Cash Flow - Equity	\$1,260,000	\$8,960	\$1,268,960	25.0%	317,240
Capitalization of Cash Flow	\$1,320,000	\$8,960	\$1,328,960	25.0%	332,240
<u>Market Approach</u>					
Guideline Transaction Comparison					
Small Transactions	\$1,350,000	n/a	\$1,350,000	50.0%	675,000
Indicated Value				100.0%	\$1,324,480

### Summary sheet Expert 2:

	<u>Value Indicator</u>	<u>Weight</u>	<u>Value</u>
Asset Approach	(530,000)	0.0%	-
Market Approach	-	0.0%	-
Income Approach	890,000	100.0%	890,000
Total			<u>890,000</u>
Indicated value of a 100% interest in [REDACTED] on a controlling, non marketable basis			<u>890,000</u>
Less:			
Payroll Taxes Payable			(406,984)
Credit Card Payable			(42,229)
Due to [REDACTED]			(90,129)
Conclusion of Value of 100% interest in [REDACTED] Inc. on a controlling, non marketable basis (rounded)			<u>350,000</u>

Effective direct and cross examination should establish the following:

- 1) Both experts have declined to use or assign any weight to an asset or cost approach.
- 2) Expert 1 is weighting the income and market approaches equally while Expert 2 is weighting the market approach 100%.
- 3) Expert 2 is utilizing the income approach, but then making specific deductions for payables (more typical of the asset/cost approach).

### Example 2 Normalized Earnings Period

	2014	2013	2012	2011	2010	2009
<b>Revenue</b>	1,828,176	1,479,533	2,635,013	2,907,721	2,982,434	1,962,230
<b>Cost of Goods Sold</b>	868,794	627,700	1,315,502	1,252,506	1,741,953	1,161,148
<b>Gross Profit</b>	<u>959,382</u>	<u>851,833</u>	<u>1,319,511</u>	<u>1,655,215</u>	<u>1,240,481</u>	<u>801,082</u>
<b>Adjusted Pre-Tax Income</b>	195,272	35,670	264,858	340,096	309,227	163,892
<b>Add: Depreciation and amortization</b>	-	1,418	1,419	36,268	9,803	3,957
<b>EBITDA</b>	<u>195,272</u>	<u>37,088</u>	<u>266,277</u>	<u>376,364</u>	<u>319,030</u>	<u>167,849</u>

Effective direct & cross examination should establish the following:

- 1) Periods 2013 and 2014 are aberrational. Their inclusion creates a normalized EBITDA of \$226,980. Their exclusion creates a normalized EBITDA of \$282,380. Although the difference seems smallish (\$60k), the effect when applied to the capitalization rate utilized by this expert results in a difference from \$1,134,900 to \$1,411,900 in final value.
- 2) Period 2014 shows a recovery as a temporary order went into effect and things returned to normal. This would reinforce the argument that the business should be able to recover post-divorce to pre-2013 levels.

## Example 3 Adjustments to Earnings

### Expert 1 Adjustments & Comments:

	FYE December 31,					TTM
	2009	2010	2011	2012	2013	Dec 31, 2014
<i>Operating Expenses:</i>						
Adjusted revenue						\$1,828,176
Est. of market compensation as % of revenue						<u>6,5%</u>
Est. of market officer compensation						\$118,831
Less: reported compensation						-
Officers Compensation	-	-	-	-	-	118,831
Remove to separate Officer Compensation from other wages						(72,000)
Other Compensation	-	-	-	-	-	(72,000)
Additional payroll						46,831
Company cost	8.00%					3,747
Payroll Tax	-	-	-	-	-	3,747
Adjust to est. normalized amount						(58,733)
Legal & Accounting	-	-	-	-	-	(58,733)
Reduce Insurance Expense for personal items (see GL detail)						(2,144)
Insurance	-	-	-	-	-	(2,144)
Reduce Auto Expense for personal items (see GL detail)						(5,935)
Other	-	-	-	-	-	(5,935)
Removed; not considered a recurring, operating element	51,318	96,527	87,320	32,403	-	-
Contributions	51,318	96,527	87,320	32,403	-	-

### Expert 2 Adjustments & Comments:

	2014	2013	2012	2011	2010	2009
Officers' Compensation	65,750	72,000	66,000	72,000	12,000	3,457
Normalized Salaries	112,475	110,000	107,892	105,875	103,767	101,750
Compensation Adjustment	<u>(46,725)</u>	<u>(38,000)</u>	<u>(41,892)</u>	<u>(33,875)</u>	<u>(91,767)</u>	<u>(98,293)</u>
Payroll Taxes	(3,574)	(2,907)	(3,205)	(2,591)	(7,020)	(7,519)
Total Compensation Related Adjustment	<u>(50,299)</u>	<u>(40,907)</u>	<u>(45,097)</u>	<u>(36,466)</u>	<u>(98,787)</u>	<u>(105,812)</u>

<b>Adjustments</b>						
Compensation Adjustment	(50,299)	(40,907)	(45,097)	(36,466)	(98,787)	(105,812)
Interest Expense	2,349	-	22,817	-	-	-
Contributions	-	50	32,403	87,320	96,527	51,318
Flowers & Gifts	-	103	-	2,986	-	-
Car Payments (1)	8,333	5,474	-	-	-	-
Automobile Expense (1)	5,434	4,687	5,068	8,061	7,452	4,502
Insurance (2)	9,216	9,428	-	-	-	-
Legal & Professional (3)	40,543	12,400	19,000	-	-	-
Telephone (4)	3,258	1,313	-	-	-	-
Utilities (4)	8,535	7,086	-	-	-	-
Meals & Entertainment	-	-	16,147	17,796	-	-
Travel	-	-	19,912	45,947	-	-
Income Tax	10	-	-	-	-	-

Effective direct and cross examination would establish the following:

- 1) In this case, the parties operated the business together at a combined salary of \$72,000, each functioning as an executive. The adequate salary of an executive in this company is not an area of large dispute (\$112 - \$118,000). Each should be reporting the approximate income on other relevant court documents.
- 2) Both experts are removing auto, insurance and mortgage expenses paid through the business from earnings. All of these items should also be reflected on the parties' domestic relations financial affidavits.
- 3) Both experts have adjusted for payroll tax to a newly hired executive at full salary. Although a small adjustment, this demonstrates a thorough approach. Failure to make this adjustment can lead to a readily confessed error by an expert which affects credibility.

## Example 4 Capitalization Rate

### Expert 1:

Normalized Cash Flow - Mid-Point Convention		\$239,492
Capitalization Rate		
Weighted Average Cost of Capital	22.20%	
Long-Term Growth Rate	4.0%	
Capitalization Rate		<u>18.20%</u>
Indicated Value - Invested Capital		\$1,315,892

### Expert 2:

Ongoing Net Cash Flow	184,988
Capitalization Rate	<u>20.7%</u>
Operating Value	<u><u>893,662</u></u>
Indication of Value	<u><u>890,000</u></u>

Effective direct and cross examination would establish the following:

- 1) The two capitalization rates are fairly close. Both perceive the company as having relatively high risk .
- 2) Each expert should be called to concede the other expert's capitalization rate, applied to his/her earnings. For example, if Expert 2 accepted the capitalization rate of Expert 1, the value would increase to \$1,016,417 ( $\$184,988 / .182$ ). Likewise, if Expert 1 accepted the capitalization rate of Expert 2, the valuation would drop to \$1,156,966 ( $\$239,492 / .207$ ).
- 3) Any other concessions made on adjustments to income or normalized earnings should be reapplied to each capitalization rate.

- 4) Based on the perceived strengths and weaknesses of the case, each expert could be asked to compromise. The average of the normalized earnings is \$212,240.00. The average capitalization rate is 19.45%. This generates a value of \$1,091,208.20. This may or may not present a middle ground that a client could live with a Judge determining.

### Example 5 – NAICS Codes

The corporation analyzed by the valuation experts throughout this appendix takes powders from herbs and other vitamins and minerals. Some of those are packaged and sold entirely (i.e. ginseng). Others are mixed with different powders to create a customized product tablet (i.e. energy booster). The products are sold to retail establishments (gas stations and grocery stores) and also to direct end users online. Which NAICS code is appropriate?

<a href="#">325411</a> Dietary <b>supplements</b> , uncompounded, manufacturing
<a href="#">325411</a> Herbal <b>supplements</b> , uncompounded, manufacturing
<a href="#">325412</a> Herbal <b>supplements</b> , compounded, manufacturing
<a href="#">325412</a> Dietary <b>supplements</b> , compounded, manufacturing
<a href="#">424210</a> Herbal <b>supplements</b> merchant wholesalers
<a href="#">424210</a> Dietary <b>supplements</b> merchant wholesalers
<a href="#">424910</a> Mineral <b>supplements</b> , animal, merchant wholesalers
<a href="#">446191</a> Nutrition (i.e., food <b>supplement</b> ) stores
<a href="#">446191</a> Herbal <b>supplement</b> stores
<a href="#">446191</a> Food (i.e., health) <b>supplement</b> stores

# Example 6 – Comparable Sales (Breadth of Pool)

Transaction Date	Seller	Buyer	Co. Type	Transaction Type	Transaction Value	Market Metrics		Financial Ratios		Valuation Metrics		Additional Metrics										
						TTM Revenue	TTM EBITDA	EBITDA / Revenue	EBITDA / EBITDA	MWIC / Revenue	MWIC / EBITDA	MWIC / Revenue	MWIC / EBITDA									
10/13/2011	Termination Date Seller	Buyer	Co. Type	Asset	\$941	\$709	\$22	\$110	\$29	1.0	12.8%	12.0%	25.0%	0.87	7.7	21	39	1.00	0.70	8.4	4.8	
May-13	Global Sale of Nutritional Supplements	Global Sale of Nutritional Supplements	S Corporation	Asset	\$135	\$166	\$32	\$22	\$22	2.4	6.8%	6.8%	15.3%	0.12	4.2	6.2	2.3	0.13	0.51	6.5	2.8	
Apr-12	Andi Health, Inc.	Manufacturer and Seller of Nutritional Products	S Corporation	Stock	\$551,200	\$108,100	\$0	\$56,700	\$0	2.1	n/a	23.8%	n/a	3.20	n/a	14.3	n/a	1.50	n/a	20.0	n/a	
Dec-12	n/a	Manufacturer of Nutritional Supplements and Cosmetics	S Corporation	Asset	\$2,215	\$1,481	\$308	\$338	\$342	1.2	10.0%	10.0%	13.3%	0.38	8.3	8.3	6.4	0.81	0.1	8.1	6.3	
Jul-12	n/a	Nutrition Shop	S Corporation	Asset	\$100	\$160	\$0	\$52	\$0	n/a	n/a	20.2%	n/a	0.58	n/a	5.3	n/a	0.68	n/a	3.4	n/a	
Dec-11	Alan Wayne Sports Nutrition	Sports Nutrition Retail	S Corporation	Asset	\$100	\$207	\$27	\$27	\$27	3.0	9.3%	9.3%	8.2%	0.34	3.6	3.7	3.5	0.35	3.8	3.8	1.9	
Aug-10	BodyForm Holdings, Ltd.	Manufacturer of Health and Fitness Products, Protein and Bodybuilding Nutrition Products	S Corporation	Asset	\$62,738	\$14,112	\$5,320	\$6,439	\$0	2.0	n/a	n/a	n/a	4.35	n/a	n/a	n/a	3.05	n/a	n/a	n/a	
Aug-07	n/a	Manufacturer of Nutritional Supplements and Vitamins	S Corporation	Asset	\$123	\$0	\$0	\$24	\$4	20	13.8%	6.0%	n/a	0.28	5.3	5.5	n/a	0.67	5.7	10.7	n/a	
Jan-07	n/a	Nutrition and Health Store with Sports Supplements	S Corporation	Asset	\$122	\$0	\$180	\$18	\$29	55	n/a	10.0%	7.7%	14.3%	0.60	6.0	7.7	4.2	0.61	6.4	8.4	4.2
Jul-06	n/a	Nutrition and Health Store with Sports Supplements	S Corporation	Asset	\$110	\$0	\$40	\$9	\$4	19	n/a	3.8%	0.94	0.45	23.5	46.9	11.0	0.41	28.5	7.3	11.7	
Dec-05	NVI Protein Inc.	Manufacturer and Seller of Health and Nutrition Products on the Internet	S Corporation	Asset	\$50,415	\$18,325	\$10,210	\$13,143	\$0	1.8	17.5%	17.5%	n/a	1.38	7.9	8.0	n/a	1.32	6.7	8.3	n/a	
Aug-05	Health's Laboratories, Inc.	Sports Nutrition Supplements and Other Vitamins	S Corporation	Asset	\$8,847	\$2,212	\$9,955	\$9,910	\$9,991	50	4.3	n/a	n/a	0.17	n/a	n/a	n/a	0.81	n/a	n/a	n/a	
Mar-05	Optimal Marketing, Inc.	Wholesaling and Distribution of Dietary Supplements and Nutritional Products	S Corporation	Asset	\$487	\$0	\$445	\$0	\$60	50	n/a	1.5%	n/a	0.13	n/a	1.9	n/a	0.31	n/a	1.0	n/a	
Oct-04	3rd Party Health Food Distributor Co., Inc.	Sales and Distribution of a Prescription Dietary Supplement, Vitamin, Health Food and Nutritional	S Corporation	Stock	\$5,203	\$3,290	\$2,702	\$0	\$10	50	7.8	n/a	2.4%	n/a	0.19	n/a	8.1	n/a	0.19	n/a	1.1	n/a
Aug-04	Warburton Investments, Inc.	Formulating and Distributing Whole Food Protein Health and Nutrition Supplements	Stock	\$12,244	\$5,201	\$4,057	\$400	\$497	\$0	2.2	4.3%	3.1%	n/a	0.88	20.7	22.2	n/a	0.81	18.2	20.1	n/a	
May-04	Anda Nutrition Group, Inc.	Manufacturing Nutritional Supplements	S Corporation	Stock	\$129	\$108	\$438	\$430	\$0	2.1	n/a	n/a	n/a	0.45	n/a	n/a	n/a	0.47	n/a	n/a	n/a	
Jan-04	Let's Get Healthy, Inc.	Manufacturer of Vitamins and Nutrition Supplements	S Corporation	Asset	\$120,000	\$118	\$2,072	\$18	\$1.76	50	5.2	6.8%	6.8%	n/a	56.12	88.4	84.5	n/a	27.82	207.5	281.1	n/a
Dec-03	n/a	Health and Nutrition Store	S Corporation	Asset	\$10	\$0	\$0	\$10	\$0	n/a	n/a	n/a	0.09	n/a	n/a	n/a	n/a	0.03	n/a	n/a	n/a	
Feb-03	AAA Health Products, Inc.	Manufacturer and Importer of Health and Nutrition Store	S Corporation	Asset	\$1,010	\$1,281	\$1,238	\$801	\$246	1.7	6.3%	3.8%	n/a	6.07	1.1	1.9	n/a	0.07	1.1	1.8	n/a	
Sept-02	n/a	Health and Nutrition Store	Asset	\$70	\$0	\$143	\$0	\$0	50	n/a	n/a	3.3%	n/a	0.60	n/a	14.8	n/a	0.52	n/a	28.5	n/a	
Nov-99	Biotech Pharmaceuticals, Inc.	Manufacturer of Nutritional Supplements	S Corporation	Asset	\$7,510	\$7,584	\$1,107	\$3,038	\$0	1.8	15.6%	14.5%	n/a	1.06	7.0	7.3	n/a	0.89	8.6	6.8	n/a	
Nov-98	Innate Natural, Inc.	Manufacturer of Nutritional Supplements	S Corporation	Asset	\$12,300	\$4,239	\$880	\$318	\$0	4.0	7.5%	7.7%	n/a	3.34	84.9	35.4	n/a	3.49	28.5	30.0	n/a	
Feb-99	Health & Vitamin Distrib.	Online Retailer of Nutritional Supplements	S Corporation	Stock	\$2,844	\$56	\$662	\$380	\$381	50	13.7	n/a	n/a	n/a	4.39	n/a	n/a	5.62	n/a	n/a	n/a	
Jan-99	Optimal Marketing, Inc.	Wholesaling and Distributing of Dietary Supplements and Nutritional Products	S Corporation	Asset	\$7,441	\$191	\$7,528	\$9,016	\$8,009	50	10.2	40.1%	40.7%	n/a	6.09	2.5	2.5	n/a	0.43	7.4	2.4	n/a
Apr-98	Multi-Special Nutrition	Vitamins and Nutritional Supplements	S Corporation	Asset	\$51,000	\$12,258	\$21,208	\$30,243	\$4,265	50	3.4	20.7%	20.9%	n/a	2.71	5.2	5.8	n/a	1.39	4.8	5.2	n/a
Timeline Mean @ 27%					\$6,124		\$6,124		\$6,124	3.0	8.8%	10.3%	11.3%	0.65	11.4	10.6	5.3	0.84	10.9	8.8	5.7	
Median					\$2,881		\$2,881		\$2,881	2.2	6.0%	6.4%	10.6%	0.65	7.4	8.1	4.0	0.68	7.4	6.1	4.2	
20th Percentile					\$441		\$441		\$441	1.8	6.3%	3.7%	8.2%	0.43	3.2	3.6	3.5	0.45	4.8	3.7	3.3	
80th Percentile					\$14,208		\$14,208		\$14,208	4.8	15.0%	17.8%	15.7%	1.85	28.5	17.3	6.4	1.33	28.5	28.5	16.3	



In the particular case, the company had obvious and inherent value based on the historical earnings and performance. However, the industry was highly diverse and difficult to narrow down in a way to create meaningful comparisons. Expert 2 in the case disregarded the market approach entirely due to a lack of accurate data. Expert 1 weighted the approach at 50% which had the net effect of increasing value.

However, on examination the market approach data included the sale of GNC stores in 2005 as well as a host of other pre-recession (and even pre-21<sup>st</sup> century transactions). Also included were a number of C-corporations and corporations with assets in the hundreds of millions. Although the market approach allows for the adjustment and factoring of these differences (since what is really being sought is the average earnings multiplier), highlighting these distinctions draws the credibility of the analysis into question even if the effect on the ultimate valuation is negligible.

The analogy is readily understandable when applied to appraising houses. If an appraiser valuing a 4 bedroom, 2 bathroom, 4000 square foot home in Canton, Georgia in 2017 pulls a home sale from Vinings involving a 8 bedroom, 5 bathroom, 8000 square foot residence in 2001, would anyone consider those comparable simply because they were both “single family residential?” Even if adjustments can be made to determine the price “per bedroom, per bathroom, per foot, etc...” at some point, the analysis comes off incredible.