

About Value Added

This is the first issue of our newsletter, which is available both in hardcopy and by e-mail. Please feel free to forward this to your clients and associates.

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Power Points

(Recent Speaking Engagements and Publications by Our Staff)

- **Valuing Financial Planning Practices**
A presentation by Stan Feldman to the Guardian Life Insurance Elite Producers
- **Using the Experts**
A presentation by Stan Feldman at the IRS Town Meeting—Bentley College
- **The Business Transition Tidal Wave**
A presentation by Roger Winsby on the Barlow Research First Friday Webcast (October 2003)
- **The Business Transition Tidal Wave**
An article by Roger Winsby for the Association for Corporate Growth—Boston newsletter (August 2003)
- **Know the Value of Your Business**
A presentation by Matt O'Connor at the Nashua, NH Chamber of Commerce

Check the What's New and Valuation Library at www.axiomvaluation.com for links to most of these citations.

Value Added: Insights and Updates on Business Valuation

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Three Axioms in Choosing an Expert

Although the Supreme Court's *Daubert v. Merrell Dow Pharmaceuticals* decision defines who is an expert in the federal courts, your experts must dazzle the court and think on their feet. Otherwise, they're no expert.

In a recent divorce case in the Midwest, the husband and wife were far apart concerning the value of a business they had jointly built. The husband, who was now the 100% owner of the business, engaged a CPA from a well-known regional accounting firm who was a Certified Valuation Analyst ("CVA") to provide expert testimony on the value of the firm. The premise of this "expert's" opinion was that a business generating a pre-tax profit of over \$1 million dollars was worth only \$2.6 million.

The expert testified that the \$1 million was not sustainable, and adopted his client's pre-tax profit budget of \$550,000 claiming that, in his professional judg-

ment, this represented a "better number". This admission constituted the death knell for the expert's professed objectivity.

Axiom's founder, Dr. Stan Feldman, testified on behalf of the wife. Dr. Feldman walked the court through his valuation analysis using his report and a whiteboard. On rebuttal, using the other expert's numbers, Dr. Feldman demonstrated that by appropriately applying the opposition's valuation methodologies, the business was worth \$5.5 million rather than \$2.6 million as proffered by the husband's expert. After deliberation, the judge concluded that the business was worth \$5.2 million.

This case underscores the three axioms of choosing an expert.

1. The judge and the jury must believe that the expert is really THE EXPERT. An expert is one that is academically qualified and technically competent. The

expert must be knowledgeable of the latest academic research and current trends in their field and must be able to demonstrate this knowledge particularly when under cross examination.

2. An expert must be an excellent teacher. A courtroom is like a classroom with the jurors and judge assuming the role of students. They are learning technical material and need to be brought along carefully to enable them to comprehend the "real gist" of what the expert has concluded and why.

3. Finally, experts are most effective when perceived by the judge and jury as having reached their conclusions by conducting an impartial analysis that will stand up to scrutiny by any well trained third party. If jurors or a judge believe that the expert opinion offered is tainted, the expert's credibility is severely undermined.

FAS 141 & 142—Not Just for Public Firms

Most accountants are familiar with the recently enacted Financial Accounting Standards (FAS) that relate to purchase price allocation (FAS 141) and goodwill impairment testing (FAS 142) for acquisitions. These new standards have gotten the attention of the public markets, with many one-time high flyers, such as AOL Time Warner, having to take large charges against earnings related to decreased goodwill value for their acquisitions.

FAS 141 and 142 apply to private firms as well. A private firm that

complies with GAAP, either voluntarily or as a result of covenants contained in financing documents or at the insistence of equity investors, must comply with 141 and 142 when making an acquisition. Independence requirements prohibit this analysis from being handled by the firm's auditors.

The objective of these two standards is to make the balance sheets of public and private companies more reflective of the market value of the assets rather than the traditional book value paradigm.

Axiom's chairman, Dr. Stan Feldman, a member of the FASB Valuation Resources Group, notes that compliance with FAS 141 and 142 should be planned for **during the acquisition process**. This will save time and money in meeting the FAS 141 and 142 requirements; and should lead to better acquisition and divestiture decision-making. Using appropriate analytical techniques for valuing tangible and intangible assets provides an important check on discounted cash flow valuation results.

Hot Links

(Websites of Interest to CPAs and Other Professional Advisors)

www.naicscodes.com
Free site for searching NAICS, SIC and IRS Business Activity Codes

www.cparunner.com
Free site with comprehensive web links for CPAs

Valuation Services Offered By Axiom

Business Value Estimates

Certified Business Valuations

FAS 141 (Purchase Price Allocation) & FAS 142 (Goodwill Impairment)

Litigation Support & Expert Testimony (Valuation/ Economic Damages)

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Advice for Advisors: The Perils of Business Owner Procrastination

As year-end nears, many of you are in the process of sitting down with business owner clients to devise different tax, financial and estate planning initiatives to put in place prior to December 31st and for the coming year. These conversations especially with those who are over 45 take on added significance because of the impending business transition tidal wave.

The number of established business owners wishing to retire between now and 2010 will grow by between **three and four times** the year 2000 levels, first as the Entrepreneurial Boomers and then the Baby Boomers hit their 60s. The vast majority of owners are woefully unprepared for the myriad of business transition issues they must face prior to retirement.

This lack of planning is all the more dangerous for owners who will seek to sell their businesses to third parties given that only about 25% of businesses put on the market ever sell. As the numbers of owners wanting to sell increases dramatically, there is a risk that many more businesses will go unsold.

As a trusted advisor, the importance of your role in encouraging this planning cannot be overstated. As part of this planning, having a current valuation of the business is essential. In order to provide reliable and defensible advice, you and the owner must understand where the business sits today in terms of value, and where it is projected to be in the future, as you devise strategies for dealing with estate tax liability, insurance planning, and, ultimately, how to tax-effectively transfer the business to a child, key employee or a third party purchaser.

CPAs, financial advisors, and lawyers in our affiliate network tell us that our Value Estimator service is a catalyst for getting owners to make and then update these crucial transition and risk management decisions. As one financial advisor put it, "We were able to move the owners forward on the planning we recommended as a direct result of Axiom helping them understand what the business was worth. I am incorporating Axiom's valuations as a standard part of my efforts with all clients who can benefit from a valuation". Brent Kvech, Lincoln Financial Advisors, Columbia, MD.

Recent Axiom Engagements

Key Employee Purchase: Axiom was recently engaged by a manager seeking to buy-out the owner/100% shareholder of a construction business with \$5M plus in sales. After determining an estimate of the fair market value of the firm, Axiom assisted the buyer to determine the firm's value after taking into consideration his anticipated operational changes as well as the new debt needed to finance the acquisition. We also assisted in identifying potential lenders for the transaction and in preparing the buyer for his lender meetings.

Co-Owner Buy Sell Agreement: Axiom recently valued a small chain of auto repair shops (\$3M plus annual sales) to enable the owners to put a buy-sell agreement in place that was funded by life insurance. In addition to using the valuation to determine the appropriate amount of insurance, the value estimate assisted the owners in their effort to determine the financial benefits of opening a new outlet.

Divorce Proceeding: Axiom recently advised, and testified on behalf of the non-employee spouse in a divorce case involving an special trade contracting firm (\$10M plus annual sales). We provided an initial estimate of value during divorce negotiations, prepared a full written expert report for trial, drafted direct and cross-examination testimony outlines, and served as an expert witness at trial. Axiom's opinion of value was adopted by the court.

Estate Planning: Axiom recently completed a valuation of a limited liability company set up for estate planning purposes, which held both real estate and public securities. Axiom prepared a certified valuation in compliance with IRS revenue ruling 59-60 and recent case law. The valuation incorporated all appropriate discounting to reflect minority interests being valued, the lack of marketability of the assets, and the restrictions placed on the assets by the LLC operating agreement.

Purchase Price Allocation: Axiom recently undertook a valuation of assets based on FAS 141 for a firm emerging from bankruptcy court. This manufacturing company with over \$100M in sales has multiple plants across the country and needed a current valuation of its extensive tangible and intangible assets. By drawing upon established microeconomic and financial approaches for this analysis, Axiom was able to deliver a timely and cost-effective report that passed the auditor's review with no problems. Our client commented that he found our valuation analysis for the company's brand name, patents, and non-compete agreements to be so insightful that in the future he plans to use these analytical approaches as part of the due diligence for acquisitions or divestitures.