



Divorce Roundup: the Challenges of Valuing 'Main Street' Businesses

A summary of recent divorce cases shows courts still concerned with inputs, assumptions, and discounts in the valuation of small to midsize private businesses:

In **Kapadia v. Kapadia, 2011WL 1849407 (Ohio App. 8 Dist.)(May 12, 2011)**, the wife owned 47.2% in a local chain of 13 sandwich shops. At trial, the husband's expert valued her interest at \$1.6 million, compared to the wife's expert, who said it was worth \$1.0 million. The difference: The wife's expert characterized the business as a "grilled sub sandwich" business akin to those in mall and airport food courts, but the husband's expert compared it to a national franchise such as Subway or Quiznos. The trial court rejected this "artificially high" earnings analogy, however, finding that "you could not compare a nationally based franchise, with the revenue it generates and the advertising budget it expends, with a smaller regional sandwich shop. It adopted the value by the wife's expert, and the husband appealed. *Held:* The trial court's decision was supported by "competent, credible" expert evidence and the appellate court confirmed the same.

In **McRae v. McRae, 2011 WL 1991725 (Conn. App.)(May 31, 2011)**, the husband owned a company that created software programs for healthcare providers. The wife's expert estimated its fair market value at roughly \$377,000 compared to the husband's appraisal at \$56,000. The trial court accepted the latter, adding an \$88,000 undeposited check from one of the company's customers for a total value of \$144,000.

The husband appealed, claiming that the check was for future services. Even so, he said, his expert had already included the check in his final value without factoring in related costs. *Held:* The appellate found sufficient evidence in the record, including testimony from the customer's accounts payable personnel, that the business had earned the check. Moreover, the husband's appraiser testified that he treated the check as both an account receivable (an asset) and a deferred revenue (liability), for a full offset (no added value); and that he also factored in approximately \$37,000 in

costs related to the business's future jobs. Thus the trial court correctly added the check to its ultimate valuation, and the appellate court confirmed the same.

In *In re Marriage of Price and Turkanis*, 2011 WL 1783096 (Cal. App. 2 Dist.)(May 11, 2011)(unpub.), the husband sold his medical software company three years into the marriage for \$9.45 million. At trial, the parties' experts disputed the value of the business at the beginning of the marriage: the wife's expert said it was worth nothing while the husband's said it was worth \$6.25 million, based on comparable transactions that post-dated the valuation. The trial court continued the hearing to take additional evidence on comparable transactions, but the husband's new expert could still find only one similar, contemporaneous sale. He did find six transactions within a year of the marriage, including the sale of a direct competitor, which led him to value the husband's company at \$6.25 million as of the marriage. After the trial court adopted this value the wife appealed. *Held*: The court of appeals affirmed, finding the use of subsequent comparable data appropriate in this case

In *Wright v. Wright*, 2011 WL 1832801 (Cal. App. 4 Dist.) (unpub.)(May 11, 2011), the husband owned an accounting firm. Both of the parties' experts used an adjusted revenue/earnings method, reaching values that were only \$7,000 apart (\$330,000 for the husband's expert vs. \$337,000 for the wife's). The trial court accepted the lower value, and then applied a 20% discount due to the attrition of the business. The wife appealed the application of *any* discount; she also argued that the \$330,000 value already included a 20% discount. *Held*: The appellate court affirmed the application of the "attrition" discount, citing precedent that permitted a valuation to include the expected continuity of the business. Notably, both experts agreed that the firm was losing customers due to attrition, and this "was not a speculative event," the appellate court found. Further, there was no evidence that the appraisers (or the trial court) included an additional discount in the ultimate valuations.

Compare *Keil v. Keil*, 2011 WL 2150009 (N.Y.A.D. 3 Dept.)(June 2, 2011), in which the husband owned a pool servicing business. The husband declined to present an expert appraiser, and the trial court accepted the \$437,000 value by the wife's expert, based on various methods and assumptions. The trial court discounted the value by 20% due to the husband's age (67) and the uncertainty that he could continue to run the business. The wife appealed, claiming her expert had already factored in a "key man" discount to his valuation as well as the effects of the economic downturn. *Held*: The appellate court found no explanation in the record as to how the husband's age or health would negatively impact the market value of the business as of the divorce date, and reversed the 20% discount.

In *K.B.R. v. E.P.R.* 2011 WL 2183858 (Mass. App. Ct.)(unpub.)(June 7, 2011), the husband owned a "lender of last resort" for companies and individuals, charging high interest rates for primarily real estate investments. At the time of the divorce, the firm held \$1.4 million in outstanding loans. The husband's expert assumed a sale of the entire portfolio to a third party for a fair market value of only \$175,000.

In contrast, the wife's expert couldn't offer a "precise" value, but assessed a "weighted average collectability" for the loans of 70%; that is, in his opinion, the business would recover at least 70% of the \$1.4 million in outstanding loans.

The trial court found the husband's expert value lacked credibility, but also found the wife's expert approach was "too optimistic given the economic realities of 2008, the bankruptcy of some of the borrowers, and . . . that all of the loans . . . were in default of some sort." Instead, it adopted a more "reasonable value" of \$840,000 (or roughly 60% of the loan portfolio) due to the husband's past experience and the business's successful track record in collections, and the husband appealed. *Held*: The trial court's rationale was clear and there was no error in its valuation of the corporation.

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Capital Endeavors, Inc.

P.O. Box 895, 232 Crogan Street, Lawrenceville, Georgia 30046

Web: www.capitalendeavors.com Email: davidstill@capitalendeavors.com

Phone: 770-962-8399 FAX: 770-962-8640