

Marital Court Offers ‘Well-Reasoned’ Resolution Of Conflicting S Corp Valuations

Nowels v. Nowels, 2005 Ind. App. LEXIS 2039 (November 3, 2005) Judge Bailey.

The expert for the husband valued his 50% interest in an S corporation at \$818,000. The wife’s expert valued the same interest at \$3.55 million—for a difference of more than \$2.7 million. Did the trial court do what even Solomon couldn’t (but so many marital judges seem to manage) and split the business “baby”?

Court carefully considers facts

The trial court made extensive factual findings regarding the financial condition of the subject company, Wible Lumber, including its lack of succession planning and management depth, and its lack of marketability as a closely-held company. Each of the principals was critical to the company’s continued success—and each handled entirely different aspects of the business; “significant” corporate action required 100% shareholder agreement. The husband had executed promissory notes to pay for his 50% portion of stock, and personally guaranteed the company’s debts. The company’s land lease ran through 2083 and it held other significant, capital asset leases; relocation would cost \$5 million. Finally, despite nearby competitors, the company had experienced “unprecedented” growth in recent years, operating at 20% over capacity. The growth could reasonably be expected to “level off,” as the capital-intensive business was about to lose one of its top customers while another was “at risk.”

To reach the \$818,000 value for the husband’s interest, his expert, Jean Tipton, CPA/ABV, ASA (Baden, Gage & Schroeder, LLC; Fort Wayne, IN), used the income approach (capitalized cash flow method) and the market approach (industry comparables method), weighting the former at 60% and the latter at 40%. Both her appraisal and her testimony emphasized the inherent risks of a closely-held business—but her valuation did not include the company’s latest and most profitable year. She also applied a 19% discount rate to the husband’s half-interest (and neither the lower nor the appeals court allocated the rate between specific discounts).

To reach a fair market value of \$3.55 million for the husband’s interest, the wife’s expert, Professor William Lewellen (Purdue University, Krannert Graduate School of Management), also relied on the income approach (capital asset pricing model). The trial court noted, however, that Lewellen had not conducted a site visit or talked to the principals about the business’ operations, its leases, the geographic area of sales, or other specific company issues which might have affected its valuation—and which is “generally recommended” by “recognized business valuation experts.”

Wife’s expert did review the company’s financial data—but did not look at (or was unaware of) its stock purchase agreements, asset lease issues, “key man” life insurance, and shareholders’ agreement until right before trial. Lewellen did opine that the husband’s 50% interest equated to a control position, as he could block “significant

action” by the other 50% principal, thereby supporting a discount rate of 12%. Lewellen played down the risks of the successful family business, emphasizing instead its recent profits and its assets worth \$3.8 million, excluding goodwill.

Neither expert is entirely persuasive

Given the company’s “consistent” profitability over many years and its “record” revenues in the most recent, the husband’s \$818,000 valuation of his interest was “completely unrealistic,” according to the court. At the same time, it considered the wife’s valuation “too high,” given that her expert was “not aware of all...relevant facts about the business, and that a less-than-control interest in a closely-held family corporation has diminished marketability.” The husband’s opinion that his interest amounts to a control position because he can block significant corporate action was neither “supportable [nor] tenable,” the court added, as “it is the fair market value of [his] 50% interest...which is at issue, not the value of [the company] as an entity, or the value of [the company] to the owners as a going concern.”

In the end, the lower court set the fair market value of the husband’s interest at \$2.5 million—and the appeals court upheld the valuation as “well-reasoned resolution of conflicting evidence,” supported by a comprehensive factual record.

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