For Choosing Multiples & Comparables, the Data Really Do Matter

***W.G. Anderson, et al. v. United States,* 2005 U.S. Dist. LEXIS 39573 (December 28, 2005)**

What do valuation analysts most like to hear from a court? How about: The expert made "an impressive witness," followed by the adoption, in large part, of that expert's analysis.

Of the four witnesses who appeared in this case, none impressed the Court to the others' exclusion. Name and credentials do count for a lot—the rebuttal witness was, after all, *BVU* emeritus Shannon Pratt, (Shannon Pratt Valuations, LLC, Portland). But most outstanding were the experts' selection, at different points in their analyses, of solid data and accurate comparables, as specific to the subject company as possible.

Discounts as certain as death, taxes

The 1997 death of Mrs. Gertrude Anderson generated over $14 million in estate and gift taxes. After an IRS audit, the Government assessed an additional $3 million-plus. The disputed difference related primarily to the fair market value of the Estate's minority interests in four LLCs, whose assets consisted largely of mineral and oil exploration rights.

All experts relied on the report of the same petroleum engineer to derive the baseline value of the mineral interests. In prior orders, the Court ruled that it would accept both the NAV and market approaches, but would give the former a 2:1 weight over the latter. In calculating the NAV, the parties would apply a minority discount of 10%, lack of marketability discount of 40%, and a 10% liquidation cost to the stipulated baseline value.

The Court also held the parties to a 40% marketability discount in their market approach analysis—which predictably became the only consistent element, due to the inherent difficulty in equating the value of public corporations with interests in a family-held oil and gas business. The experts also disagreed on the best method to calculate starting values for the LLCs, but neither had challenged the other's selections of comparable publicly-owned companies. The Court thus treated the comparables as "equally valid"—although not necessarily of equal weight.

Measures and multiples critical in market approach

In adjusting the comparables to reflect the economic realities of the subject LLCs, the Estate's expert, Charles Stryker (Trenwith Group, LLC, New York City) used two primary measures: price-to-pretax cash flow and price-to-appraised worth. John Thomson (Klaris Thomson Schroeder, Inc., Los Angeles), the Government's expert, used three: price-to-cash flow for the 12 months prior to valuation; price-to-cash flow for the prior fiscal year; and price-to-a-3-year cash flow average. While rebuttal expert Pratt found no significant difference in the start values that rose from the various measures, he agreed

with all experts that, at a minimum, price-to-cash flow is an acceptable measure of value for an oil and gas company. The Government argued that by including price-to-appraised worth, the Estate would be double-counting the value of LLC assets. But the Estate countered that appraised value simply provided another comparison point between the LLCs and the comparables—and the Court agreed, ordering the parties to use the Government's three measures, plus price-to-appraised worth.

Next, the experts used the financial measures to create a range of multiples, which they'd apply to the comparable companies to come up with the LLCs' value. "Perhaps more than any other determination," according to the court, "the selection of a range of multiples . . . is a judgment call by a qualified expert." Both Thomson and Stryker chose multiples below the statistical median of the range derived from the comparables, but varied significantly on how far below the median to go.

Based on the LLCs smaller size, lower operating margins, non-operator status, and other factors, Stryker felt that the lower range was more appropriate. Thomson agreed that the LLCs were both smaller and less diverse than the comparables, but their overall financial conditions—including lack of debt, history of distributions, and profit margins—suggested a higher range of multiplies. Thomson analyzed Mergerstat data on public- versus privately-held companies to derive his range—which at first blush appeared "sound," according to the court. However, the data did not provide sufficient detail to allow specific comparison to the acquisition values of the LLCs. As rebuttal witness, Pratt preferred the Estate's approach, suggesting that the Government's range would have been more reliable if it had used a larger downward adjustment from the median values.

The Court agreed, deeming the Estate's range of multiples to be the more accurate in the market approach. But because the LLCs were more likely to be liquidated than held for public sale, the Court adopted the Government's allocation of a 33.3% weighted market approach and 66.7% weighted net asset approach. And though the Court cited with approval Pratt's credentials—for some reason (and lest readers be confused) the opinion refers to him as "Carl," which just goes to show that in the end, the name doesn't count as much as the numbers.