

BUSINESS VALUATION Notes



Minnesota Business Valuation Group, LLC
OLSEN THIELEN & CO., LTD.

January 2012

Minnesota Business Valuation Group, LLC, wholly-owned subsidiary of Olsen Thielen & Co., Ltd., CPAs & Consultants
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Happy New Year and our best wishes for 2012 from the Minnesota Business Valuation Group team:

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A Well-Defined Succession Plan Impacts Business Value

by Bryce Bowman

Management succession represents a key issue in the valuation of a business, and valuation professionals consider the impact of management succession in developing an opinion of value. An analysis of publicly-traded companies provides excellent insight into how investors price in the risk of management succession. For instance, we can analyze how the share price of Apple was impacted by the failing health of Steve Jobs, Apple's iconic Chief Executive Officer:

Between August 2004 and January 2011, Steve Jobs made three significant announcements regarding issues with his health. As a result, the shares in Apple declined, on average, about 7% lower in the three days following each of the three announcements.

However, when Mr. Jobs announced his resignation on August 24, 2011, the share price increased by 4%. So what happened? Coinciding with his resignation, Mr. Jobs announced that he had recommended that Tim Cook, Apple's chief operating officer, take over as CEO of the company. By announcing his successor, Mr. Jobs effectively reduced the management succession risk at Apple, and investors reacted favorably. When Mr. Jobs passed away on October 4, 2011, Apple's board had already hired Mr. Cook as the new CEO of Apple. Consequently, the stock was essentially unchanged by his death.

Succession Plan, continued on next page

Announcement	Percent Change
08/2004: Announced he was undergoing cancer surgery	-3.0%
01/2009: Announced a six month medical leave	-10.8%
01/2011: Began a medical leave of an indefinite time	-6.2%
08/2011: Resignation	+4.4%
10/2011: Steve Jobs passed away	+3.1%

Steve Jobs was one of the country's most iconic business managers, so it is little surprise that his medical leaves impacted the market value of Apple. However, the owners of small and mid-size businesses often possess just as much influence at their companies as Mr. Jobs did at Apple. Business owners may have personal relationships with customers, vendors, lenders, and employees of the business. Accordingly, the untimely departure of an owner could have significant repercussions for the entity for many years.

To ensure their departure does not adversely impact the business, owners should have a plan to transfer their

responsibilities in the event that they are prevented from fulfilling their duties. For instance, an effort should be made to introduce customers to some of the other key people involved in running the business. Additionally, key employees should be brought in on relationships with vendors, bankers, and any other outside entity with which the business has a significant relationship.

By preparing for an orderly transition, business owners can effectively increase the value of their business and ensure the business is ready to be passed on to the next generation.

Why You Should Revisit Your Buy-Sell Agreement – A Cautionary Tale

by Laurel Sorensen

When drawing up a buyout clause it is critical to specify, in no uncertain terms, the value to be applied to an owner's share. The case of the Estate of Cohen v. Booth Computers, July 13, 2011, is a good illustration of what can happen when the terms of a buy-sell agreement are not updated to reflect the current value of a company.

Claudia Cohen and her brother James were partners of Booth Computers, a family partnership set up by their father. A buyout provision was included in the partnership agreement, stating that upon the death of one of the partners the remaining partners could buy back the share at book value plus \$50,000. One of the assets owned by the partnership was an oceanfront estate in Palm Beach Florida that had increased in value from its original cost of \$760,000 in 1976 to \$45 million in 2007. The partnership paid Claudia's estate just over \$177,800 based on the "net book value" of the 50% interest as shown on the most recent balance sheet.

The executor of the estate appealed that the buyout was "unconscionable" based on the gross disparity between fair market value and net book value. The court determined that there was nothing "inherently offensive" in the buyout formula. Book value may be artificial but it is easily ascertainable. The estate appealed but the appellate court concluded that the language of the partnership agreement was plain and unambiguous. When a buy-sell provision is clear, the disparity between book value and fair market value alone is not sufficient to "shock the judicial conscience". The appeals court held and affirmed the buyout at book value.

The estate of Claudia L. Cohen is a "cautionary tale" for every business owner who has a buy-sell agreement with a formula or fixed price pricing mechanism. Formulas and fixed prices are not good pricing mechanisms for most buy-sell agreements as they may not reflect the current value of a company. To assure that the pricing mechanism in your buy-sell agreement will work as intended contact appropriate legal counsel and a business appraiser who is experienced valuing buy-sell agreements.

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