

Business Valuation Notes

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Important Financial Tool...

VALUATION FOR STOCK PICKS

MBVG Will Use for Portfolio Valuation ...

Michael Choniski, Minnesota Business Valuation Group Principal, has announced that a



new fundamental equity valuation platform is now available for use in a range of financial product and service offerings for both individual and institutional investors. Designed to improve returns and reduce risk, it is the result of several years of development and testing by the principal architect of the HOLT Valuation Platform now owned by Credit Suisse. A simplified product, ValuFocus, is available through MBVG for easy use and adaptation to whatever system is currently used.

The new valuation platform by LifeCycle Returns, Inc. (LCRT) is up and running in two product formats which provide Discounted Cash Flow analysis valuation and stock screening on US public companies in the

Hemscott database. LCRT President Rawley Thomas is an MBVG Affiliate. The LCRT platform is also being used in conjunction with the Abbott Index, created by MBVG Principal Ashok Abbott, and Business ValueXpress software, created by MBVG Principal Mike Adhikari. Dr. Abbott, a professor from the University of West Virginia and Adhikari have worked closely with Thomas in developing a proprietary system for MBVG for valuing portfolios, such as hedge funds, for compliance reporting. Choniski, who heads sales and marketing of these products for MBVG, has said the portfolio valuation system is expected to be released within the next month. The equity valuation platform is immediately available.



Thomas

Choniski said that without delving into the details and proof, the underlying model produces

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SEC & PCAOB CHANGES MAY REDUCE SOX COSTS

In December the U.S. Securities & Exchange Commission (SEC) and the Public Accounting Oversight Board (PCAOB) both issued proposals and guidance which are expected to simplify management's assessment and testing of the internal controls over financial reporting, reducing the time and expense which has come to be associated with the compliance and reporting of section 404 of the Sarbanes Oxley Act of 2002 (SOX). SOX has been criticized by large and small businesses since SOX was passed.

On December 13, 2006, the SEC issued new proposals and guidance which would distinguish company obligations from the obligations of the company's external auditors. On December 19, 2006, PCAOB proposed a new standard on reports on internal control over financial reporting under SOX Section 404 The proposed Standard would replace the Board's existing internal control standard, Auditing Standard No. 2, by a completely new Auditing Standard No. 5, and would

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SOX

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affect annual reports of calendar year companies for 2007.

Comments on the PCAOB proposals are due by February 26, 2007. The comment period for the SEC's proposed interpretive guidance and rule amendments is 60 days from its publication in the Federal Register.

Minnesota Business Valuation Group President Randall Schostag said that the changes which are expected to be adopted should make reporting much easier for most companies while preserving the integrity of financial reporting and responsibility.



Schostag

The proposed new standard on internal controls is a principles-based standard designed to direct the auditor to focus on the most important matters, increasing the likelihood that material weaknesses will be found before they cause material misstatement of the financial statements.

Stephen Shulman, CPA/ABV, CVA of Anchin Block & Anchin, New York, New York, is an MBVG Affiliate. At ABA he heads up the Business Risk Services Group



Shulman

which among other services helps publicly held companies comply with the provisions of section 404 of SOX. In response to the announced changes, Shulman said, "We anticipate that the changes will be very beneficial to small and intermediate sized business. ABA has been helping clients comply with SOX since it was enacted and is gearing up to apply the SEC guidance in order to insure it will reduce the costs of compliance and reporting. We are currently gearing up to handle the additional work for non accelerated filers who must now comply and re-engineer the prior approaches taken by accelerated filers."

ABA is a regional certified public accounting firm with over 300 in staff headquartered in New York City. Shulman is accredited in business valuation (ABV) by the AICPA and a Certified Valuation Analyst certified by the National Association of Certified Valuation Analysts. Stephen has been working with the Minnesota Business Valuation Group for about two years. Most of the joint work to date has focused on goodwill impairment analyses, purchase price allocation, and the determination of employee and other stock option values when issued as other compensation. MBVG anticipates that now SOX assignments will be directed to ABA.

The changes by the SEC and PCAOB have arisen from criticism that the current rules to comply with Section 404 result in what are considered unnecessary effort and costs by companies and their audi-

tors. Historically, management's approach to assessing internal controls has been driven by the documentation and testing requirements applicable to external auditors under Auditing Standard No. 2. This approach has contributed to the excessive burdens placed on companies in their efforts to comply with Section 404, according to the critics.

The SEC proposals would eliminate the current requirement for the external auditors' report on internal control to include a specific opinion on whether management's assessment of internal control is fairly stated and would only require an opinion on whether a company's internal controls are effective. They would also only require identification of controls that relate to areas that are both material and pose a risk to reliable financial reporting. The PCAOB believes its new standard will result in audits that are more efficient, risk-based, and scaled to the size and complexity of each company.

The proposals also would provide interpretive guidance on how management should annually evaluate the effectiveness of internal control, using a "principles-based" approach, which would provide flexibility to exercise judgment and develop an assessment process tailored to a company's circumstances.

The proposed standard, according to advocates, eliminates audit requirements that are unnecessary to achieve the intended benefits.

STOCK PICKS

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superior explanation (tracking) of historical stock listings and more predictive capability than other models of this genre. “That means more realistic and useful valuations across industries, across market caps, across companies of varying operating rates of return and growth. Having a good handle on this fundamental valuation is key to the market price formation process and making superior stock selections,” Choniski said.

Research has demonstrated that as stock prices wind their way through changing expectations and sentiment, market prices generally migrate towards the stock’s intrinsic value, according to Thomas and Choniski.

Thomas has said that back-tests of paper portfolios show sizable and consistent shareholder returns above the aggregate universe of stocks considered. Choniski has said that three money managers are currently evaluating this new equity analysis platform for use alongside or instead of their current decision support systems.



Choniski

By translating analyst forecasts into stock values, according to Choniski, investors can quantify the importance of the performance inflexion point on expected value creation. This can be used in conjunction with

historical model tracking error or other factors in a comprehensive equity ratings system customized for any company and its customers. Thomas states it has a ratings system superior to ones utilizing more naïve accounting based ratios like P/E ratios, equity market to book ratios, or price momentum which are generally uncorrelated to prospective shareholder returns. Choniski believes that this rating system greatly enhances the value of trading platforms to investors.

The easy to use product called ValueFocus allows active traders to enter their own current year or next year performance expectations and screen for stock picks from the US equity universe, by sector or industries of interest. These traders can view the ability of ValuFocus and other traditional valuation models to track historical market prices. The traders can see the operating economic rate of return, rate of growth and performance versus the S&P 500 in chart form, and thus base portfolio selections on sophisticated analytics to go ‘long’ on the most under valued stocks and/or short on the most over valued stocks or apply options strategies to improve performance.

Choniski also noted that concern over the high trading commissions resulted in the discount brokerage business which subsequently developed into a concern over the fees paid to money managers. “This platform allows a handful of analysts to cover the entire portfolio, thus supporting a cost-

efficient business model for seeking and delivering risk-managed alpha,” Choniski said.

The LCRT platform means investment funds can provide: low-overhead, low-fees, including long only, long/short, large, mid, or small cap, industry focused, etc.; funds can mimic strategies of equity hedge funds; or value-tilted individual portfolios, separate managed accounts or specialized value weighted EFTs.

MBVG LAUNCHES STRATEGIC PLANNING AUDIT

MBVG Principal Michele Smith has announced release of a proprietary strategic review for business by the Minnesota Business Valuation Group in February 2007. “This strategic review consists of an audit of business operations, ascertaining whether existing business processes contribute to stated goals or detract from them,” Smith said.

The strategic audit has been in development for two years, according to Randall Schostag, MBVG president. “During my 30 plus years of doing business appraisal, the clearest indicator of businesses which fail to achieve targets has been failure to develop strategic plans tied to value creation,” Schostag said. “We realize that strategic planning is time consuming and expensive, discouraging business owners from developing a solid plan. MBVG’s goal has been to develop a cost-

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AUDIT

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effective process whereby a business can obtain an annual checkup to ascertain if there are major issues which should be considered.” Schostag said the strategic audit will be offered as an add-on to valuation and that valuation will be offered as an add-on to strategic planning. “Combining both is essential for successful planning,” Schostag added.

Smith has more than 25 years of experience consulting Fortune 500 companies such as Verizon, GE, St. Paul Companies, Litel, and CitiBank. Her primary expertise is strategy, particularly alignment of organizational design, business processes, and performance management. She is joined with Fred Hansen, an MBVG Affiliate. He is a principal at Applied Strategic Technologies (AST), a company he co-founded in 1981. In Hansen’s 20 plus years as a business consultant, he has worked with a wide range business enterprises, from Fortune 500 companies, such as Cisco System, Verizon, American Express, and 3M, to small and mid-sized companies. Hansen has experience in telecommunications, manufacturing, healthcare, legal services, financial services, insurance, utilities, and electronics. He is presently pursuing his doctorate.

To illustrate Smith’s work, Schostag cited a project she

conducted in Kirkland, Washington in December. In that project Smith worked with LoGix Controls, an engineering firm specializing in elaborate control systems. The LoGix Controls’ chief executive defined the company problem as “poor customer service skills” on the part of the engineers who regularly interact with customers. These customers include nationally distributed grocery store chains, electrical utilities, and wineries.

“To address customer service skills,” Smith said, “the CEO was considering a firm offering a skill building workshop focused on active listening, dealing with conflict, effective presentation skills”, and other service-related skills. “We instead offered an alternative approach re-conceptualizing the problem as a systemic issue rather than a skill issue.”



Smith

Smith said skill training often fails because the organizational system defeats good practices and good skills.

“Trainees learn new skills but fall back into old habits once they return to their jobs because of system pressures,” she said.

System issues start with strat-

egy, according to Smith. In many cases, performance is an alignment issue. “It is hard for people to contribute to the organization when it is not clear where the organization is headed or what is important about their performance in serving customers,” Smith said. In the case of LoGix Controls Smith focused the engineers on one of the key dynamics of strategic effectiveness: the Cycle of Interaction with customers.

A Cycle of Interaction is a repeatable cycle of interactions with the customer, made up of critical touchpoints or “moments of truth”, the complete set of customer interactions. “Every firm has a Cycle of Interaction, from those with the most complex services to those with the most concrete products,” Smith states. “Even when you are driving a car, you are still interacting with the manufacturer by virtue of the experience you are having.” To operate effectively, each step in the Cycle must deliver the benefit that the customer is buying and deliver it efficiently from the perspective of the organization.

Smith worked with LoGix Controls’ management and the engineers to define this Cycle and to identify disconnects in current processes and systems. “Once this was accomplished, it became very clear, especially to the CEO, that while the engineers in the company were very technically sophisticated, they did not understand the business issues or the strategy of the company. This in turn hindered them from acting strategically with their customers in preparing proposals, installing systems, and training their customers to use these highly sophisticated systems,” Smith said.

Professional Business Appraisals

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BUSINESS VALUATION

Goodwill Impairment Analysis (141/142)

Businesses

Intellectual Property

Intangible Assets

Options

Strategic Planning

ESOP

Divorce

Shareholder Oppression / Dissenting Rights

Buy/Sell Agreements

Merger / Acquisitions

Fairness Opinions /Purchase Allocation

Planning

BUSINESS ASSET VALUATION

Experts or Consultants

Sale / Purchase

Insurance

Fair Rental Rates

Financing

Ad Valorem Taxes

Condemnation

Feasibility

Purchase Price Allocation

Property Records

Fiduciary Review

Sale / Leaseback Structuring

Business Planning

**WE ARE AVAILABLE FOR PRESENTATIONS FOR ESOP IMPLEMENTATION,
MERGER & ACQUISITION CONSIDERATIONS, EXPERT TESTIMONY PREPARATION,
GENERAL BUSINESS VALUATION, AND MANY OTHER TOPICS.**

OUR FORMAT IS POWER POINT - BASED.

**WE REQUEST THAT YOU SUPPLY THE SOUND SYSTEM AND APPROPRIATE DISPLAY
INSTRUMENT.**

WE WILL CONNECT OUR COMPUTER.

PLEASE ALLOW AT LEAST 30 DAYS FOR SCHEDULING.