



BST | 

John R. Johnson
Managing Partner

Presented for :

Turnaround Management Association

March 16, 2011

www.BSTco.com



Business Valuation in Tumultuous Times



About the Speaker

John R. Johnson CPA/ABV/CFF CBA DABFA is the Managing Partner of **BST Valuation & Litigation Advisors, LLC**, with offices in New York City and Albany, NY. He specializes in many financial aspects of litigation, with emphasis on the valuation of closely held businesses and professional practices, as well as forensic accounting services and economic damage analysis. Mr. Johnson is a frequent author and lecturer for many organizations, including the NYS Bar Association, American Bar Association, Law Journal Seminar Press, Practising Law Institute, American Society of Appraisers, NYS Society of Certified Public Accountants and has lectured at many past Judicial Training Programs for The Office of Court Administration and the NYS Judicial Institute. Mr. Johnson is a member of the editorial board of the *New York Family Law Monthly*, published by the *New York Law Journal* and serves as a Special Liaison to the Executive Committee of the Family Law Section of the New York State Bar Association. He has participated in over 1,500 litigation matters as a financial expert. He has served as a NYS Supreme Court appointed forensic and financial expert in approximately 500 matters throughout New York State and has provided expert testimony in support of his findings on over 100 occasions. He was appointed by the Chief Judge of the State of NY to serve on the “Miller Commission” to examine the process of matrimonial litigation in NYS and make recommendations for reform.

BST Valuation & Litigation Advisors, LLC

26 Computer Drive West
Albany, NY

(800) 724-6700 * www.BSTco.com

28 West 44th Street
New York City





Reasons for Valuation

Financial Reporting
Business Succession
Acquisitions
Estate & Gift Planning
ESOP's
Goodwill Impairment
Fresh Start Accounting
Compensatory Stock/Option grants
Litigation
 Dissenting Shareholder Actions
 High Net Worth Matrimonial Actions



A History Lesson

- A look back
 - 2/27/2007 Freddie Mac announces that it will buy no risky subprime mortgages
 - 4/2/2007 New Century Financial Corp (subprime mortgage lender) files for Chapter 11
 - 6/1/2007 S & P downgrades 100 bond issues backed by second-lien subprime mortgages
 - 6/7/2007 Bear Stearns suspends redemptions on it's "High Grade Structured Credit Strategies Enhanced Leverage Fund"
 - 6/28/2007 Fed maintains federal funds rate @ 5.25%
 - 7/24/2007 Countrywide warns of "difficult conditions"
 - 7/31/2007 Bear Stearns liquidates 2 hedge funds of mortgage backed securities



A History Lesson

- A look back
 - 8/17/2007 Fed states “downside risks to growth have increased appreciably”
 - 9/18/2007 Fed reduces primary credit rate Fed funds rates 50 bps to 5.25% and 4.75%
 - 10/2007 and 12/2007 Fed lowers rates twice by 25 bps
 - 10/9/2007 Dow Industrials hit all time high of 14,165 (bear market begins)
 - 01/11/2008 B of A buys Countrywide for \$4 billion
 - 01/30/2008 Fed reduces rates by another 50 bps
 - 03/17/08 JP Morgan Chase offers to buy Bear Stearns for \$10/share (quoted market price before announcement \$2/share)
 - 03/18/08 Fed reduces rates 75 bps
 - 6/05/2008 S & P downgrades bond insurers AMBAC & MBIA to AA



A History Lesson

- A look back
 - 09/15/2008 Lehman Bros. files for Chapter 11
 - 09/15/2008 B of A announces intent to purchase Merrill Lynch for \$50 billion
 - 09/16/2008 Fed lends \$85 billion to AIG
 - 09/15/2008 Dow Industrials close 10,917 (14,165 11 months earlier)
 - 09/16/2008 Reserve Primary Money Fund (money market fund) “breaks the buck”
 - 10/14/2008 Treasury Dept announces TARP
 - 03/09/2009 Dow hits 6,547 S & P hits 676
 - Bull Market Begins



What did all of that mean for the valuation community at that time?

Complete Chaos!



Other Risk Factors That Valuators Were and Are Dealing With

Geopolitical risks

- Sovereign Debt Crisis

- Mid East unrest and instability

Event Risks

- Natural Disasters

- Terrorist Threats

Legislation/Regulation Risk

- Tax policy

- Deficit Reduction

- Other



Value is a forward looking process. After all, from an investor's prospective, value is the present value of future economic benefits discounted at a rate that reflects the risk and required return sufficient to entice investment given investment alternatives.



History can only be used when it is a **reliable** predictor of future performance

But what if history is a poor indicator ?

And worse yet, what if there's no clarity as to the future?



Are public markets a good indicator of value?

Are markets truly “efficient”?

What if the markets are dysfunctional?



Financial Reporting “Mark to Market” or “Mark to Model” FAS # 157

Big Controversy during the economic crisis. Did “mark to market” contribute or even cause the crash?

How can you “mark to market” a security where there is no market? What’s was the result?



FAS # 157 in a Nutshell

What is “Fair Value”

“Fair value is the price that would be received to sell an asset or paid to transfer a liability in an **orderly** transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.”



Hierarchy of Fair Value Inputs

“This Statement emphasizes that fair value is a market-based measurement, not an entity-specific measurement.”



Hierarchy of Fair Value Inputs

Observable

Level 1

Active markets—Identical assets

Level 2

Significant other observable inputs

Unobservable

Level 3

Reporting Entity's Own Assumptions (Mark to Model) but should incorporate relevant Level 2 inputs.



FAS # 157

So, did we have an out during the crisis?

“The notion of unobservable inputs is intended to allow for situations in which there is little, if any, market activity for the asset or liability at the measurement date.”



FAS 157-4

Title: Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly

Date Posted: April 9, 2009



FAS # 157-4

“In the Board’s view, a significant decrease in the volume and level of activity for the asset or liability is an indication that transactions or quoted prices may not be determinative of fair value because in such market conditions there may be increased instances of transactions that are not orderly. In those circumstances, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with Statement 157.



BUT.....

“Statement 157 does not prescribe a methodology for making significant adjustments to transactions or quoted prices when estimating fair value.”



Results.....

Huge write downs on assets in frozen markets where the underlying assets may have been performing to some degree

Compromised balance sheets

Failed capital reserve requirements

Near collapse of the financial markets



Financial Reporting Goodwill Impairment

Need to value acquisitions each period to determine if there has been an impairment of the purchased goodwill. Need for adequate internal segment reporting.



Financial Reporting Fresh Start Accounting

Need for Valuation of all assets (tangible and intangible) when “Fresh Start Accounting” is implemented pursuant to a plan of reorganization in bankruptcy



Business Succession & Estate & Gift Planning

Look to gift or bequeath to next generation
Look to “Sell” where no succession possible
Look to pass ownership through use of
ESOPS
Compensatory Stock/Option Plans
Management leveraged buy-outs



Acquisitions

Good prices for acquisitions

External financing options

- Tighter banking standards

- Needs for Seller financing and ‘earn-outs’

- More equity---less leverage

- PE and VC firms—high selectivity

Need for heightened levels of due diligence



What Must Business Owners Do?

Need for living, breathing business plans with well thought out forecasts and underlying assumptions

Must be based on probable outcomes, not overly optimistic or pessimistic ones

Assumptions must be constantly reviewed and modified where necessary

Outcomes must be tied to contingency plans that can be quickly and efficiently implemented by management



Methodology

Most appropriate methodology to use in turbulent times is discounted future cash flow since historic results will not constitute a sound basis for future expectation



Multiple Assumption Scenarios

Where one set of expectations can't be decided upon and multiple outcomes are possible, more sophisticated techniques can be used

Decision Tree Analysis

Monte Carlo Analysis

Use of Real Option Theory



Thank You For Your Attention!!

Please visit our website

www.BSTco.com

And click on the following path
for your personal copy of the PowerPoint presentation:

Valuation, Forensic & Litigation Services (Services menu on left)

Business Valuation (1st selection in drop down menu)

Resources section (hyperlinks on right)



