BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
PEAK TRAVEL GROUP,) OTA NOs. 220610675
) 220610676
APPELLANT.)
)
_________________________________)

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, November 14, 2024

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 11:02 a.m. and concluding at 4:03 p.m. on
Thursday, November 14, 2024, reported by
Ernalyn M. Alonzo, Hearing Reporter, in and
for the State of California.

APPEARANCES:

Panel Lead:	ALJ SARA A. HOSEY
Panel Members:	ALJ AMANDA VASSIGH ALJ EDDY Y. H. LAM
For the Appellant:	STEVE MATHER DAVID MANN BOB SWEENEY JAMIE SIEMAN
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD CAROLYN KUDUK BRADLEY KRAGEL

I N D E X

E X H I B I T S

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(Department's Exhibits A-L were received into evidence at page 7.)

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1 California; Thursday, November 14, 2024
2 11:02 a.m.
3
4 JUDGE HOSEY: We are now on the record in the
5 Appeal of Peak Travel Group and R. and L. Peak, OTA Case
6 Numbers 220610675, and 220610676. Today is November 14th,
7 2024, and it is 11:02 a.m. This hearing is being held
8 virtually via Zoom with the consent of the parties.
9 I am Judge Sara Hosey, and with me today are
10 Judge Amanda Vassigh and Judge Eddy Lam.
11 Can I please have the parties state their names
12 for the record, starting with Appellants.
13 MR. MATHER: Steve Mather appearing for Appellant
14 Peak Travel Group.
15 JUDGE HOSEY: And for the Franchise Tax Board.
16 MS. KUDUK: Carolyn Kuduk for the Franchise Tax
17 Board.
18 MR. KRAGEL: Bradley Kragel for the Franchise Tax
19 Board.
20 JUDGE HOSEY: Okay. Thank you.
21 The issues to be decided in this appeal are:
22 Whether Appellants have shown respondent Franchise Tax
23 Board erred in assessing additional tax based on the
24 built-in gains from the sale of Peak Travel Group; and
25 whether Appellants have shown whether FTB has failed to

1 adjust the gain from the installment sale of Peak Travel
2 Group's assets.
3 Does that sounds accurate, Mr. Mather?
4 MR. MATHER: Yes. And I would like to note, I
5 think Mr. Mann's -- was muted when he was trying to enter
6 his appearance.
7 MR. MANN: Yes. I apologize. David Mann is also
8 appearing for Peak Travel Group.
9 JUDGE HOSEY: Thank you, Mr. Mann. I appreciate
10 it.
11 Mrs. Kuduk, do those issues sound appropriate?
12 MS. KUDUK: So whether Appellants have
13 established that Respondent erred in assessing additional
14 tax based on built-in gain, and then whether Appellants
15 have established that Respondent failed to properly tax
16 the gain?
17 JUDGE HOSEY: Yes.
18 MS. KUDUK: Yeah. That sound about right.
19 JUDGE HOSEY: Okay. Great. Thank you.
20 All right. As to our exhibits today, for
21 Appellant, we have premarked Exhibits 1 through 15.
22 Is that accurate, Mr. Mather?
23 MR. MATHER: Yes.
24 JUDGE HOSEY: And any objections from the
25 Franchise Tax Board, Mrs. Kuduk?

1 MS. KUDUK: No.

2 JUDGE HOSEY: Okay. And then for the Franchise

3 Tax Board we have premarked Exhibits A through L.

4 Is that right, Mrs. Kuduk?

5 MS. KUDUK: Yes, A through L. Thank you.

6 JUDGE HOSEY: Okay. And were there any

7 objections from the Appellants, Mr. Mather?

8 MR. MATHER: No.

9 JUDGE HOSEY: All right. Having no objections,

10 Exhibits 1 through 15 and A through L are now admitted as

11 evidence into the record.

12 (Appellant's Exhibits 1-15 were received

13 into evidence by the Administrative Law Judge.)

14 (Department's Exhibits A-L were received into

15 evidence by the Administrative Law Judge.)

16 JUDGE HOSEY: Moving to our witness testimony

17 today, Mr. Mather, can I have you call your first witness.

18 MR. MATHER: Are we having opening statements

19 first?

20 JUDGE HOSEY: Oh, yeah. We are having opening

21 statements. Thank you. I was just ready to go. I'm so

22 excited.

23 Mr. Mather, are you ready for your opening

24 statement?

25 MR. MATHER: Yes, I am.

1 JUDGE HOSEY: All right. Please proceed.
2
3 OPENING STATEMENT
4 MR. MATHER: The overriding question I think we
5 have today is what -- what really are we doing here?
6 There are two issues in the case, and I'll address them
7 separately, with the first one being the installment gain
8 issue.
9 On that issue, the parties agree that the value
10 of the contingent payment to be received in 2015 or 2016,
11 after the year of the sale, is actually taxable in 2014.
12 So the parties agree on law, essentially. The parties
13 also agree, apparently, based on the statements made at
14 the prehearing conference, that the Appeal of Amarr case
15 controls, and that the actual contingent payment is a
16 reasonable and acceptable proof of the value of the
17 contingent payment that's includable in 2014. The parties
18 also agree that the contingent payment that was actually
19 made in our case was $3,537,500, which was set forth in an
20 agreement that appears in Exhibit 14, and it was paid as
21 shown in a wire transfer in Exhibit 15. So as best I can
22 tell, every single issue in this case is agreed between
23 the parties, and I'm not sure why we're still contesting
24 this.
25 Secondly, on the built-in gain issue, the parties

1 also agree on the law in this issue that there's an amount
2 that is taxable in 2018 that has built-in gain based on
3 Peak's value on November 1, 2009. The FTB based their
4 determination that the value was $9 million on
5 November 1, 2009, based entirely on a third-party
6 appraisal by a company called Arxis. From what we can
7 tell, both Arxis and this so-called appraisal -- appraiser
8 are still active, but they are not appearing as witnesses
9 in the hearing today. So they're not going to be here to
10 try to defend that valuation.
11 Our position with respect to that is that FTB is
12 essentially abandoned the determination, since they're not
13 offering anything other than a gross -- grossly hearsay
14 statement in the form of -- of the appraisal report
15 without having a witness available to determine if that
16 appraisal is worth anything at all. And we, obviously,
17 think that it is worth nothing at all. So since the FTB
18 has abandoned their determination in this appraisal, which
19 was the sole basis of their determination, there cannot
20 possibly be any presumption of correctness associated with
21 that determination.
22 If they wanted to defend -- if FTB wanted to
23 defend their determination, they needed to have somebody
24 here to do that. So since the determination was based
25 entirely on this appraisal, and since the appraiser is not

1 here to even help us understand what the appraisal was
2 about, there can't -- cannot be a presumption of
3 correctness. And the burden of proof in this case really
4 doesn't matter at all.
5 And, finally, even though the FTB is not
6 presenting a case here today, we -- we are presenting a
7 case. We have three witnesses that are all testifying,
8 more or less in unison, that the $710,000 valuation in the
9 Marshall & Stevens appraisal report is based on industry
10 standard methods consistently applied and provide
11 consistent conclusions that support that $710,000
12 valuation. So we're not sure, since the FTB is offering
13 nothing today, we're not sure what's left on this issue
14 either.
15 That includes our opening remarks.
16 JUDGE HOSEY: Thank you, Mr. Mather.
17 Is the Franchise Tax Board ready for their
18 opening, Ms. Kuduk? Please begin when ready. Thank you.
19 I think you're muted.
20 MS. KUDUK: Yes, I just unmuted.
21 JUDGE HOSEY: Okay.
22 MS. KUDUK: First, my name is Ms. Kuduk. So
23 thank you.
24 ///
25 ///

1 OPENING STATEMENT

2 MS. KUDUK: And I want to begin by saying I
3 assure you I am presenting a case here today. And I'd
4 like to begin by saying the two transactions are relevant
5 to this appeal.

6 First, on November 1st, 2009, Peak Travel Group,
7 which I'm going to call "PTG," converted from a C
8 corporation to an S corporation. And on
9 November 1st, 2014, Direct Travel bought PTG for
10 $25.3 million. The sale closed in 2014, but the sales
11 agreement specified that one payment was to be made in
12 2016 of up to $8 million, contingent on gross income.

13 There are two issues in this appeal, as we went
14 through: Whether Appellants have established that
15 Respondent erred in assessing additional taxes based on
16 built-in gain calculated from a fair market value of
17 $9 million attributable to PTG as of November 1st, 2009,
18 the date of its S corp election; and whether Appellants
19 have established that Respondent failed to properly tax
20 the gain from the distribution of PTG's contingent payment
21 obligation per California Revenue & Taxation Code section
22 24672 and the Appeal of Amarr.

23 Respondent does not concede that we have lost the
24 burden of proof. This is Appellant's burden of proof to
25 prove these two issues. At issue is the correct amount of

1 gain to be taxed in 2014. The gain is calculated by
2 subtracting Appellant's basis from PTG's fair market value
3 on November 1st, 2009, used to calculate built-in gain,
4 and the fair market value of the contingent payment
5 obligation as of November 1st, 2014, the date PTG's assets
6 were distributed to its shareholders. This is not the
7 same as the amount that was received in 2016.
8 Appellants provided a report from Joselyn, Tepper
9 & Associates, which I'm going to call "Joselyn," which
10 estimated PTG's selling price at $1.95 million in an asset
11 sale, and $745,000 in a stock sale. Appellants provided a
12 separate report from Marshall & Stevens, which I'm going
13 to call "Marshall," which gave PTG a fair market value of
14 $710,000 as of November 1st, 2009. Respondent hired a
15 valuation expert, Arxis, which assessed PTG's fair market
16 value at $9 million as of November 1st, 2009. Respondent
17 found the $9 million valuation to be more reliable and
18 assessed proposed taxes based on that evaluation.
19 Respondent didn't rely on the reports produced by
20 Appellants for the reason stated in the Arxis report,
21 pages 4 and 5.
22 First, Respondent found that Joselyn's $745,000
23 estimated selling price to be unreliable because Joselyn
24 reported that 99 percent -- that 99.9 percent of travel
25 company sales are asset sales. So 99.9 percent of the

1 time, PTG would sell for $1.95 million. Further, Arxis
2 noted that no valuation date was provided. The Joselyn
3 report did not say that it was a conclusion of value based
4 on the fair market standard. And Joselyn's expertise in
5 the travel industry is not -- and is not a valuation firm.
6 Respondent found that Marshall's valuation to be
7 unreliable because Arxis determined that the financial
8 data of the valuation used was artificially low.
9 Marshall's valuation used an income and marketing approach
10 applying a multiple to net income. However, PTG's net
11 income from 2005 to 2009 never exceeded $49,000. Even
12 though revenue grew from $61 million in 2005 to
13 $122 million in 2008 and $95 million in 2009. During that
14 time, EBITDA stayed constant at 3 percent of revenues.
15 Arxis noted that the valuation did not normalize net
16 income to adjust for nonoperating income and expenses,
17 nonrecurring income and expenses, related party
18 transactions, and owner/officer compensation. As a
19 result, Arxis found the valuation was artificially low.
20 Respondent found that Arxis' valuation to be more
21 credible because Arxis used a market approach, which
22 encompass the sale of multiple travel-related agencies,
23 and also considered PTG's 2007 asset purchase of Journeys
24 by Ambassador, which I'm going to call "Ambassador." The
25 valuation incorporated business tangible assets and good

1 will, and was inline with a $25.3 million that Direct
2 Travel paid for PTG in 2014. Further, Section 7.4(i) of
3 the sales agreement obligated Direct Travel to pay any tax
4 liability associated with the built-in gain or the
5 Section 338(h)(10) election.
6 The Marshall valuation, which is more than
7 $7 million less than the Arxis valuation, was prepared for
8 John Coffman, who is the chief financial officer of Direct
9 Travel, and who authorized the report. Appellants provide
10 no fair market value for the contingent payment obligation
11 at the time of its distribution in 2014, and asked to be
12 taxed on the $3.5 million received in 2016. Appellants
13 have the burden to show what the fair market value of the
14 contingent payment obligation was on November 1st, 2014.
15 Absent any proof, Respondent maintains that the fair
16 market value is the $8 million maximum sale price stated
17 on the sales agreement. The amount received in 2016 is
18 not the same as the fair market value at the time of
19 distribution and can't be substituted for it.
20 Today I will discuss the facts of this appeal,
21 the law, and why the Arxis valuation is the better
22 estimate of PTG's fair market value on November 1st, 2009,
23 and why the $8 million stated on the sales agreement is
24 the fair market value of the contingent payment obligation
25 when Appellants have not met their burden to prove

1 otherwise.
2 Thank you.
3 JUDGE HOSEY: Thank you. And I apologize for my
4 mistake.
5 Please correct me if I mispronounce the name or a
6 title honorific or pronoun. I really appreciate it.
7 Okay. That concludes our opening statements.
8 Mr. Mather, are you prepared for your first
9 witness?
10 MR. MATHER: Yes. We call Bob Sweeney as the
11 first witness.
12 JUDGE HOSEY: Thank you.
13 Mr. Sweeney, are you prepared to swear in before
14 your testimony? Can you hear us? Can you please unmute
15 your microphone, Mr. Sweeney?
16 MR. SWEENEY: Here we go.
17 JUDGE HOSEY: There we go. Thank you. Okay.
18 Can I please have you raise your right hand. Thank you.
19
20 R. SWEENEY,
21 produced as a witness, and having been first duly sworn by
22 the Administrative Law Judge, was examined, and testified
23 as follows:
24
25 JUDGE HOSEY: Thank you.

1 Mr. Mather, you may please begin.

2

3 DIRECT EXAMINATION

4 BY MR. MATHER:

5 Q Mr. Sweeney, could you state your full name and

6 your business address?

7 A Sure. My name is Bob Sweeney, and the business

8 address is 3141 Simpson Park Road in Gainesville, Georgia.

9 Q Welcome. What is your educational background?

10 A In 1976, graduate of Long Island Lutheran, and I

11 went to four years of college and was a few credits short

12 of graduating.

13 Q And can you briefly describe your employment

14 history?

15 A Sure. I worked nine years as a retail stock

16 broker for Lehman Brothers and Oppenheimer & Company. And

17 then in 1991 I started my present company Innovative

18 Travel Acquisitions, and we are consultants. We advise

19 sellers of travel companies. We are not real estate

20 brokers. We don't advise them on anything to do with real

21 estate as far as leases or purchases of real property. We

22 simply consult with sellers that are looking to exit the

23 travel industry.

24 Q So you've been in this consulting business since,

25 I believe you said, 1991?

1 A Yes, sir.

2 Q And so you continue to be to until today?

3 A Yes.

4 Q So about how many travel business sales are there

5 in a typical year?

6 A About 7 percent of the overall population turn

7 over in a typical year. So --

8 Q And what's the population?

9 A From retail travel agencies, probably 10,000

10 would be the roundest number, so 700 a year.

11 Q Okay. And how many transactions have you

12 participated in?

13 A Well, we've sold 680 travel companies now over

14 the last 35 years.

15 Q Is there any particular size of company that you

16 represent?

17 A No. We're really not bound by size. Actually,

18 mostly small to midsize companies is what we wind up

19 doing. Occasionally, we'll get something large but, for

20 the most part, midsize companies.

21 Q Which party do you typically represent in the

22 transaction?

23 A The seller.

24 Q Is that always the seller?

25 A Ninety-nine percent of the time.

1 Q So what's your process for deciding when you're
2 going to represent a seller in a proposed transaction?
3 A We send them a mutual nondisclosure agreement so
4 that we can exchange information freely, and we request
5 them to send us the last few years of income statements.
6 And we have a little travel agency analysis form we ask
7 them to fill out. We ask them to enclose a check for
8 $500, along with that information. And for that, they're
9 going to get our opinion of value. And then if we are on
10 the same page as far as what our synopses is on what the
11 opinion of value represents and the amount is good, then
12 we move forward.
13 If they say, oh, I'd never sell for that, et
14 cetera, then they've got themselves a professional report
15 and that's it, and we're finished. We don't take them on.
16 Q You say a professional report. What -- what kind
17 of things do you look at to determine the value for this
18 purpose?
19 A Mostly comparables but, you know, the driving
20 force is always the earnings, you know, the EBITDA number.
21 That's historically always been the number that's used on
22 any business that has profits. There are break-even
23 agencies where there formula can't be applied, obviously.
24 Q So and how -- what do you use? You know, how do
25 you use the EBITDA to determine a value?

1 A Sure. I think the range is anywhere from
2 two-and-a-half to about six -- maybe six-and-a-half times
3 earnings in the transactions that we get involved with.
4 And that multiple expands as the level of profits goes
5 higher. So somebody making a million dollars a year in
6 EBITDA is going to be at the high end of that range, five,
7 five-and-a-half times earnings in normal market
8 conditions, than someone who is making $150,000 a year.
9 They're gonna maybe get two-and-a-half times earnings.
10 They're gonna -- you know, maybe you get up to three times
11 earnings if you get to where you're making $400,000 a
12 year, something like that. And then the multiple just
13 expands upward that way.
14 Q So do you propose a value range to the -- to the
15 client? Is that how it happens?
16 A Yes. Absolutely.
17 Q And -- and that value range is based on the
18 EBITDA multiple?
19 A That's the biggest driving force. There are a
20 few other factors, but they're not -- they're not driving
21 it. I'd say 97 percent of it goes into that.
22 Q And what -- what about balance sheet items? Do
23 those factor in your valuation?
24 A Sure. I mean, if there's a lot of debt in the
25 corporation, then that puts up some red flags. And yeah,

1 a debt free business is more attractive to the buyer than
2 a business that's got high debt.
3 Q And so in your process do you figure out what the
4 EBITDA multiple should be and then adjust for balance
5 sheet, or does the balance sheet impact what the EBITDA
6 multiple is?
7 A No. The balance sheet really doesn't become
8 involved on the -- on the cash flow of the business, you
9 know, on the -- I think what the buyers are trying to
10 figure out is what are the nonrecurring expenses, you
11 know, what is going to disappear. And, you know, items
12 like that.
13 Q Okay. So the EBITDA multiple is -- is
14 independent or like a first step, and then the balance
15 sheet might adjust the overall price that you're seeking?
16 A Sure. Or the terms, maybe.
17 Q Are balance sheet items typically a major factor
18 in travel agencies?
19 A I haven't seen them be, no.
20 Q And why is that?
21 A You know, there's no hard assets, and I think
22 that, you know, the buyers are looking at the cash flow of
23 the business. You know, most of them are asset sales.
24 You know, but I would say there's -- you know, there's
25 more than 1 percent stock sale. I'd say there's probably

1 15 percent of the transactions are stock sales.
2 Q Now, would you -- does the revenue of the
3 business impact your valuation very much?
4 A No.
5 Q Why is that?
6 A Because some people, you know, are good with
7 expenses and other people aren't. And it's going to be,
8 you know, a good margin that's built into the business.
9 So, you know, they can be a company doing $150 million in
10 total sales, and they are a break-even operation. You
11 know, then there's somebody who is doing $3 million in
12 sales, and they're making really good money. So it's not
13 really relevant.
14 Q And so when -- when you're referring to sales,
15 what kind of -- what number are you referring to,
16 typically?
17 A The total sales volume of the operation. And I
18 think what many people from outside the industry, when
19 they go to evaluate a travel company, they don't realize
20 that it sounds like it's a really big company if they're
21 doing $150 million a year in sales, but they might keep
22 $15 million of that if it's good mix of business. You
23 know, corporate agencies might keep 7 or 8 percent of
24 that. And I think the numbers get thrown around
25 haphazardly. And what's revenue? And what's sales? And

1 what's volume? And the key number is the earnings.
2 That's the bottom line number is the one that's -- that's
3 what the buyers want to look at.
4 Q And why do the buyers care about the earnings so
5 much?
6 A They can see into the future to see if there's a
7 historical trend of what, you know, what it is they're
8 going to be picking up on the cash flow side of the
9 business. And there's usually some synergy, so that's why
10 they did do the transactions.
11 Q And are a lot of -- a lot of the purchases, in
12 your experience, are they debt financed?
13 A Yeah, there's -- there's definitely some debt
14 financing. Yeah. And there's -- there's some owner
15 financing also.
16 Q Does -- does the bank care about what the
17 earnings are, or do they care about the revenue? What
18 does the bank care about in a transaction?
19 A Earnings. And that's what drives it, you know.
20 How long is it going to take to pay it back, and will they
21 be able to service the loan? You know, that's what the
22 bank looks at. But they don't care about the size on the
23 top. They care about, you know, how much is left in the
24 bottom. So that's been my experience. And, you know,
25 these travel companies they're tough to get loans on

1 because there's no hard assets.
2 It's not like selling a trucking business or
3 manufacturing company. You can't go kick the tires and
4 say this is worth it. It's all good will. It's the
5 relationship between the agents and the clients. That's
6 what for sale, and you can't put a fork into that. And,
7 you know, it's not the easiest thing in the world to
8 finance.
9 Q Now, so you -- going back to your process, you
10 have -- you've given an estimate or a range of values to
11 the client, and they've signed up. How do you find a
12 buyer? What do you do to find a buyer for this client?
13 A Well, when I first started out. That's what I
14 did for a first couple years out. I went out, and I met
15 the -- the key people in the major financial markets that
16 were big participants in the consolidation game and, you
17 know, update that. But that's what I did for two years.
18 Just went out and met everybody I could on the buy side.
19 Q And so what -- what factors go into you finding
20 the right buyer for your seller?
21 A Well, you know, there's things like global
22 distribution systems, they have to match up; and mix of
23 business have to match up and, you know, the culture of
24 the company. And it's -- we somewhat operate like a
25 dating service. If somebody wants a corporate agency in

1 Chicago, then we go and find them a corporate agency in
2 Chicago.
3 Q So, I mean, is it your experience that the buyer
4 cares about the EBITDA also?
5 A Oh, God, I mean, yeah. That's it. I mean,
6 that's what they're looking at. That's the number.
7 Q So is it fair to say that you're trying to give a
8 parameter to the seller because you know what the buyer is
9 looking at?
10 A Correct. Yes. I mean, if I think we can get the
11 person four times earnings because they're making, you
12 know, whatever it is, $800,000 a year. I'm going to tell
13 them I think that's what we can get. We may market it 5
14 or 10 percent higher than it. We ask a little so that we
15 can have wiggle in our knees and be negotiable and -- but
16 absolutely. Yeah. I tell them where -- if we can wind up
17 at this number, you should be happy with that. And if
18 they agree that they would smile at that level, then we
19 take them on.
20 Q So when you're doing your initial estimate for
21 the client, it's -- is it a -- is it a pretty narrow range
22 that you expect the transaction to close in?
23 A Yeah. Yes. It's fairly tight. Sure.
24 Q So when you say two-and-a-half times EBITDA to
25 six-times EBITDA, that's not a single client. That's just

1 the range of all the transactions that you've seen?
2 A Of all. I mean, I've seen where it got frothy
3 back there a little bit in 2015 and '16. People were
4 paying six-and-a-half times, but that was brief and, you
5 know, it went away real quickly. Typically, I think
6 two-and-a-half. And in today's world, you know,
7 five-and-a-half might be more the high-end of the range.
8 Q But for a particular client, you're saying, well,
9 maybe we can get four, but we might be able to get 4.2.
10 Is -- is that kind of that type of range, not maybe we can
11 get 2, or maybe we can get 6?
12 A Oh, no. No. No. So something tight.
13 Q Yeah. Now, if you could turn to Exhibit 12,
14 which is your letter dated, May 11, 2023. Have you got
15 it?
16 A Okay. Yup.
17 Q All right. I'd like to go through a few comments
18 in this letter. So -- and -- and I think this is maybe
19 repeating a little bit, but only -- so you say that, "We
20 only accept clients that understand they will be valued by
21 one metric, EBITDA."
22 So what exactly does that mean?
23 A That means we're not going to take on a listing
24 of somebody who is telling me about the potential of the
25 company, or what they've got planned for next year. It

1 gets them to understand that it's going to be a report
2 card based upon the last three years of earnings, with the
3 heaviest weighting being towards the most recent
4 12 months. They have to understand that going in. And
5 then we --
6 Q So why do they have to understand that?
7 A Because we don't want to waste our time with
8 someone who thinks their business is worth, you know, ten
9 times what it's worth. You know, we -- we can't afford to
10 do that.
11 Q And is that because the buyers are just
12 going to -- I mean, you know what the buyers are going to
13 limit the price to?
14 A Yeah. I mean, we save people time and heartache.
15 That's -- that's what we do here for sellers.
16 Q So how do you determine what the EBITDA is for a
17 particular seller?
18 A Take the earnings before interest and taxes and
19 look at the depreciation, the amortization, and there it
20 is. It's, you know, it's right -- it's undisputable. It
21 is what it is.
22 Q And that's -- so that's the information they
23 provide in the initial package that you mentioned?
24 A Yes.
25 Q And is that information usually communicated to

1 the buyer then?

2 A Sure. Yeah. The buyer gets to see all the

3 information that they share with us, you know, once they

4 sign the confidentiality agreement.

5 Q Now, you also say it. I think you mentioned

6 before the range we see is 2.5 times EBITDA to six times

7 EBITDA. And again, that's the range in all the

8 transactions in your experience; right?

9 A Right.

10 Q So it's not the range in an individual

11 transaction?

12 A No. No. No.

13 Q And can you explain again, which -- what causes

14 it to be lower or higher in that reaping?

15 A Well, I mean, they may have just signed a

16 long-term GDS contract, taken a bunch of cash. That would

17 lower it. That's one thing that pops to mind. Maybe just

18 signed a long-term location lease that they don't need;

19 that would lower it. I mean, there's things like that

20 that could lower it. But for the most part --

21 Q Can you --

22 A -- doesn't move the dial very much.

23 Q You said a bigger agency might have -- be higher

24 in the range. Why would that be?

25 A Well, it's -- it's just the way it is. I mean,

1 as I said in the beginning, the multiple expands as the
2 level of profit goes higher. So there -- again, the guy
3 making $150, he's going to get two-and-a-half times.
4 Again, the guy making $300, maybe he gets three times, and
5 then it goes to three-and-a-half. If he's making, you
6 know, $400 maybe he gets four times -- maybe get four
7 times. When you get up to the half-a-million, six,
8 four-and-a-half times, $750. So it's a sliding scale that
9 expands like an accordion as that level of profits goes
10 higher.
11 Q And is there a reason for that?
12 A I just think more solid earnings. But, you know,
13 it's a -- there's more infrastructure that would come with
14 that typically.
15 Q Now, in our case, John Coffman submitted a
16 declaration that EBITDA multiples were typically between
17 three to nine times. How often have you seen anything
18 close to nine times?
19 A I don't swim in those ponds at the very top. So
20 six-and-a-half is the highest that I've seen personally.
21 Q And one of the transactions that was mentioned
22 before was an Ambassador transaction where there was an
23 EBITDA multiple of 2.7. That was a sale in 2007 for a
24 business that was exclusively in the leisure travel
25 market. Does that seem like a reasonable multiple for

1 that type of business in 2007?

2 A You know, I was not involved in that transaction.

3 So it sounds --

4 Q Sure.

5 A It sound -- you know, it doesn't sound crazy.

6 Q It would be at the lower end of the range. Does

7 that seem appropriate for a leisure travel agency?

8 A When was it? What year?

9 Q 2007?

10 A Well, we all know what happened after that, 2008.

11 I mean leisure business goes away, you know, really

12 quickly. They don't have to travel. So if somebody had

13 their crystal ball out and knew that we had a major

14 banking crisis coming behind it, that multiple probably

15 was probably a little more than what I would pay myself.

16 Q And is leisure travel versus corporate travel, is

17 there a difference on the multiple, typically, if that's

18 the primary business of the agency?

19 A No. The leisure agency just -- they don't get as

20 big as the -- as the corporate agencies do.

21 Q Now, another transaction was the sale of Peak in

22 2014, and that had a 5.9 times EBITDA price or entity

23 valuation based on -- with EBITDA of over $2.5 million.

24 Does that seem like a reasonable range for that?

25 A Absolutely. Absolutely. Yeah.

1 Q So nothing out of the ordinary on that?
2 A No.
3 Q Now, the valuation report that was submitted in
4 the case for Marshall & Stevens used a five times EBITDA
5 for the same Peak Travel agency in 2009 when it had an
6 EBITDA of $287,000. How does that -- does that strike you
7 any particular way?
8 A Yeah. Not -- not much reality baked in there.
9 No.
10 Q But what do you -- is it low? Is it high?
11 A You don't pay five times earnings for something
12 that makes less than 300. It's just -- I've not seen
13 that.
14 Q So that's -- that's an EBITDA. The 5.0 would be
15 on the high side of what you would expect?
16 A Very high. Yeah.
17 Q And was there anything about 2009 that would
18 cause the EBITDA to change?
19 A I forget how long it took us to get out of that
20 mess, but the travel business goes up and down real quick.
21 I know that. That's for sure. So I don't think there's
22 any dramatic event that would change that. But, you know,
23 paying 5.9 times earnings for a business making that kind
24 of money, that's right inline. That's about what you
25 would expect.

1 Q That's 5.9 for when it grew to two-and-a-half
2 million dollar; right?
3 A Yes.
4 Q Okay. Now, you may have heard that there is an
5 appraisal report authored by Arxis that is relied upon by
6 the Franchise Tax Board in this case. And they have, on
7 the same $287,000 of EBITDA in 2009, they determine the
8 value -- an enterprise value of $11.4 million, which is an
9 EBITDA multiple of almost 40. What do you think of that?
10 A Green land. I don't know what they were looking
11 at, but that's probably the most absurd thing I've ever
12 heard.
13 Q So is that consistent with any transaction that
14 you've ever seen in your career?
15 A Never. Not even close.
16 Q So if the seller had come to you and said I want
17 $11.4 million for my company with an EBITDA of $287,000,
18 what would you have done?
19 A I'd say your EBITDA needs to be $2 million-plus
20 to get that number. So come back to me then.
21 Q So for $287,000 EBITDA in 2009, how far off base
22 do you think $11.4 million is the value?
23 A Like ten times too much. I mean --
24 Q So that would be ten times more than any
25 transaction you've ever seen in your career; correct?

1 A That level, yeah. I mean, you know, pay somebody
2 three times earning for that that's -- yeah. It's about
3 right. They want more, but that's what they wind up
4 getting.
5 Q Right. So three -- a multiple of 3 would be
6 closer than a multiple of 40?
7 A Yeah. So maybe they're 13 times off, you know.
8 MR. MATHER: All right. I have no further
9 questions.
10 JUDGE HOSEY: Thank you. Thank you, Mr. Sweeney.
11 I'm going to see if the Franchise Tax Board has any
12 questions for you.
13 Ms. Kuduk, do you have questions for Mr. Sweeney?
14 MS. KUDUK: Can I ask for a quick break so I can
15 confirm with my cocounsel?
16 JUDGE HOSEY: Just like a few minutes?
17 MS. KUDUK: Yeah.
18 JUDGE HOSEY: Okay. Let's get back at 11:47.
19 MS. KUDUK: Okay. Thank you.
20 JUDGE HOSEY: You can turn off your cameras and
21 mute your microphones, please.
22 We are off the record.
23 (There is a pause in the proceedings.)
24 JUDGE HOSEY: We are back on the record.
25 Mr. Sweeney has just finished his testimony.

1 Does the Franchise Tax Board have any questions
2 for Mr. Sweeney?
3 MS. KUDUK: Yes, we do.
4 JUDGE HOSEY: Please begin.
5
6 CROSS-EXAMINATION
7 BY MS. KUDUK:
8 Q Okay. The first question is, have you ever had
9 any transactions with Direct Travel?
10 A Yes.
11 Q Okay. How many transactions?
12 A Oh, I don't know. Probably 15, maybe.
13 Q Okay. Okay. And have you done any prior
14 business with John Coffman?
15 A Yes.
16 Q Okay. And again, a rough estimate of the amount
17 of deals or --
18 A The same, about 15. About 15 it will be about.
19 Q Okay. And have you read the Arxis report?
20 A I glanced at it until I saw the 39 times EBITDA
21 number, and then I kind of lost interest.
22 Q I see. And did you read the Marshall report?
23 A I glanced at it, yes. I'm doing this because I
24 saw something that said 39 times earnings. I had to say
25 that's -- someone needs to be called out on that. That's

1 why I'm here. I'm just here to point out that absurdity.
2 Q I see. And this is a yes or no question. In
3 your experience can EBITDA be compressed?
4 A Yes.
5 MS. KUDUK: Okay. Okay. Those are the only
6 questions that I have. Thank you.
7 JUDGE HOSEY: Okay. Thank you.
8 I'm going to check with my panel really quick,
9 Mr. Sweeney, if there are any questions.
10 Starting with Judge Vassigh, do you have any
11 questions?
12 JUDGE VASSIGH: I do not have any questions for
13 Mr. Sweeney. Thank you.
14 JUDGE HOSEY: And, Judge Lam, are there any
15 questions for Mr. Sweeney?
16 JUDGE LAM: I'm going to hold my question. Thank
17 you.
18 JUDGE HOSEY: Oh, I think we're going to allow
19 him to leave once his testimony is complete. But if you
20 have any questions for Mr. Mather, then we can hold those
21 until the end, if you'd like.
22 JUDGE LAM: Yeah. No. It's okay. I don't have
23 any questions for Mr. Sweeney.
24 JUDGE HOSEY: Okay. Thank you.
25 JUDGE LAM: Thank you.

1 JUDGE HOSEY: I don't have any other questions
2 either. So, Mr. Sweeney, if you would like to leave, you
3 are welcome to.
4 MR. SWEENEY: Okay. Thank you. I appreciate it.
5 JUDGE HOSEY: Thank you for your time and effort
6 today. We really appreciate it.
7 MR. SWEENEY: Thank you. I appreciate it.
8 JUDGE HOSEY: Okay. Mr. Mather, would you like
9 to call your next witness?
10 MR. MATHER: Yes. We call John Coffman.
11 JUDGE HOSEY: Okay. Mr. Coffman, can you hear
12 us? I think you're muted.
13 MR. COFFMAN: Yes, ma'am.
14 JUDGE HOSEY: Hello. Welcome.
15 MR. COFFMAN: Thank you.
16 JUDGE HOSEY: We're going to swear you in before
17 your testimony. Can you please raise your right hand.
18
19 J. COFFMAN,
20 produced as a witness, and having been first duly sworn by
21 the Administrative Law Judge, was examined, and testified
22 as follows:
23
24 JUDGE HOSEY: Thank you.
25 Mr. Mather you may begin.

1 DIRECT EXAMINATION

2 BY MR. MATHER:

3 Q Mr. Coffman, could you state your full name and

4 business address?

5 A Yeah. It's John Coffman, 7430 East Caley Road,

6 Suite 320 E, Centennial, Colorado 80111.

7 Q I note you have a handsome collection of model

8 planes up behind you there.

9 A I have been in the travel industry for quite a

10 while.

11 Q So what's your educational background?

12 A I got a Bachelor of Science in Business

13 Administration from University of Tennessee.

14 Q And could you briefly describe your employment

15 history?

16 A After university, I was with Pricewaterhouse for

17 approximately 13 years. I was in the audit division and

18 part of their mergers and acquisition consulting division.

19 After I left Pricewaterhouse, I joined a company called

20 Direct -- or called Navigant, which was another corporate

21 travel management company. We grew through several

22 acquisitions. And, eventually, it was sold to another

23 travel company called Carlson Wagonlit Travel. And then I

24 stayed with them as their global mergers and acquisition

25 person. And then from there, I left and joined Direct

1 Travel as the CFO.

2 Q What does Direct Travel do?

3 A We do corporate travel management, but we also

4 have a high-end leisure division as well as a meeting and

5 event division. But the bulk of our business is corporate

6 travel management.

7 Q And do you have any certifications?

8 A I am a licensed CPA, Certified Public Accountant,

9 which requires me to take continuing education on an

10 annual basis.

11 Q And how often is your continuing education

12 focused on valuation or financial analysis?

13 A So as mentioned, we have to take 40 hours every

14 year, and so I've been doing that for the last 40 years.

15 Because I spent so much time doing mergers and acquisition

16 throughout my career, I've done over 150 that I

17 orchestrated. And then as I mentioned when I was with

18 Pricewaterhouse, I was involved in quite a few on behalf

19 of their clients. And so I -- I try to take as many of

20 those classes in the mergers and acquisition, but I don't

21 have a, you know, a track record all the way back for

22 those past 40 years; but it's quite a few.

23 Q So over 100 hours of classes?

24 A Oh, definitely over 100 in mergers, yes.

25 Q So why is the financial analysis or valuation,

1 why is that important in merger and acquisition?
2 A Well, so I think -- I think something that
3 everybody should keep in mind, fair market is what a
4 willing seller and a willing buyer are willing to pay for
5 a business. And so you have to come up with that
6 valuation so that you can find a willing buyer and a
7 willing seller to make sure you -- you can properly
8 execute on a transaction.
9 Q So is that when you were in accounting? Was that
10 you were involved in those types of determinations as
11 well?
12 A Yes. Usually, on that aspect when I was with
13 Pricewaterhouse, we had clients who would do most of the
14 negotiations. We would then perform the due diligence and
15 work around the financial accuracy to tell them whether
16 that valuation they had proposed or agreed upon was still
17 a valid multiple of EBITDA for them to make the
18 transaction.
19 Q So why was EBITDA so important?
20 A Well, EBITDA, in most aspects of a business,
21 represents free cash flow. And any time you're doing an
22 acquisition, you have to do a rate of return. It's no
23 different than if you're investing in, you know, stocks or
24 anything else. You want a rate of return. And so
25 everybody, to justify to their shareholders and to their

1 board, needs to have a reasonable rate of return, which is
2 based upon free cash flow to the valuation.
3 Q Now, so about how many years have you worked in
4 the travel industry then?
5 A Approximately 27.
6 Q And did you apply those EBITDA-based methods in
7 the travel industry as well?
8 A Definitely. We -- in the first company,
9 Navigant, we grew through about 80 or 90 acquisitions.
10 Then when TWT acquired them, as I mentioned, I was doing
11 global mergers and acquisitions as Direct Travel. We've
12 done a little over 50 of those transactions, and every
13 single one was based upon that EBITDA and free cash flow.
14 Q So what was your role in the transactions,
15 generally?
16 A I've been pretty much a team of one to where I
17 negotiated the purchase price. And I had a couple of
18 employees working with me when we do the due diligence.
19 I'd supervise it. I'd often have to hire, whether it's --
20 you know, depending upon the size, get a quality of
21 earnings from one of the big six accounting firms, and I'd
22 manage that process as well as work with the legal
23 advisers on the actual agreement to purchase the stock
24 purchase agreement. And then I would make the
25 presentation to the board and to any shareholders to

1 justify the acquisition.
2 Q So you said a quality of earnings. What's that?
3 A With any deal over a certain size, you want to
4 make sure that the EBITDA that you're basing that
5 valuation on is accurate. And so we often engage -- and
6 I'm doing one right now for a very large acquisition,
7 somewhere in the range of $340 million. You engage a
8 third-party accounting firm to go in and verify that
9 quality of earnings that they had represented, so that the
10 board and the shareholders feel comfortable with the
11 multiple against that EBITDA.
12 Q So how often do you have that quality of earnings
13 report in these transactions? Is it most of the time
14 or --
15 A No, because most of my acquisitions have been in
16 the small to medium size. Again, it's typically when it's
17 over a certain dollar value. We had our loan covenants
18 with a couple of times where we had our lenders that
19 required anything over a $20 million purchase price, to
20 have that quality of earnings. And then we've had our
21 board put some thresholds over my career on certain sizes.
22 But it's only the really large ones that you do that for.
23 Q And you mentioned the board. Describe the
24 process for the transaction getting approved?
25 A Well, as you can suspect, you know, the board has

1 various liabilities in managing a company. And so we have
2 to go in and present the -- the presentation on the return
3 on investment on the assets that were -- or the stock
4 we're buying. We actually, in our deals in the 150 I've
5 done, every single one was a stock deal, not an asset
6 deal.
7 And so we did -- we have to go in and verify, you
8 know, the reasons we're buying it, the areas that -- you
9 know, why we want to expand in that area or that part of
10 the country or into that jurisdiction, as well as the risk
11 associated with any acquisition. What's the, you know,
12 potential downside as well as potential upside with cost
13 avoidance and/or cost savings.
14 Q So did the board care what the multiple of EBITDA
15 was in a particular transaction?
16 A Very much so. Because again, they have to have
17 that return on the investment. They have to justify that
18 they're going to recoup their money that they're outlaying
19 within a reasonable time frame. And, as well as, we
20 have -- every -- every company I've worked for had some
21 fairly -- had some debt associated with it. And every
22 debt deal has a covenant that you must have a multiple of
23 your own EBITDA to your debt. It's called a leverage
24 ratio. And so if you pay too much for a business and
25 cannot pay down the debt associated with it quick enough,

1 then you will be out of compliance, and the banks can take
2 over your company. So it's a very important aspect for
3 every board member.
4 Q Now, going back to the transactions themselves,
5 what -- did EBITDA factor into the actual negotiation
6 discussions ever?
7 A Yeah. They -- I mean, I'd always start off my
8 discussion -- if I was buying your agency, Steve, I would
9 sit there and say I'm willing to pay you four times, five
10 times your EBITDA. And they're always presenting to us
11 what that EBITDA is. And then we go in and test it and do
12 due diligence. They may come back and say I -- I need
13 something higher, and we might meet in the middle during
14 the negotiation as with any negotiation. But, typically,
15 the ranges are pretty close when you're having that
16 discussion. It's not like you're -- I say, I'm going to
17 pay you 4 times, and they say, well, I want 15 times.
18 We're never going to get to a reasonable amount because it
19 would never, A, be approve by the board and, B, meet my
20 loan covenants that I have outstanding.
21 Q So in most of the transaction, you've been on the
22 buying side?
23 A I was on the buying side for all of them since I
24 left Pricewaterhouse. When I was with Pricewaterhouse, I
25 was on both sides.

1 Q And you heard Bob Sweeney testify before; is that
2 right?
3 A I did. Yes, I listened to it.
4 Q Yeah. And so he said that he -- I -- I believe
5 he said that he discussed the EBITDA multiple with his
6 potential clients as well, and so -- and that they had to
7 provide the financial information to -- to him. So is
8 that -- would that be how you would typically get the --
9 the financial statements and the EBITDA calculations from
10 the buyer's agent, if you will or sell -- I mean, seller's
11 representative?
12 A Yeah. So, yeah. I mean, there's several -- or
13 there's a handful of brokers out there. Bob is the
14 largest or has been in the business the longest, but I
15 deal with quite a few other individuals. Where they're
16 helpful, the brokers, the representatives, is that
17 sometimes the owners may not be as sophisticated in
18 performing a transaction. So they're good at helping
19 educate those owners in those transactions. In other
20 situations, I deal directly with the owner. They're
21 pretty sophisticated. They've come from a financial
22 background, and so they're able to understand EBITDA and
23 multiples without any kind of representative.
24 Q So when there isn't a broker involved, like Bob,
25 the discussion still focuses on EBITDA multiples?

1 A It does. But, I mean, there -- it's a pretty
2 well-known in this industry because again, you're -- Bob
3 mentioned that you're not buying hard assets. All you're
4 buying are a cash flow. It's a cash business and a cash
5 flow. And so everybody who buys businesses in any
6 industry that's a cash flow business uses EBITDA for that.
7 And so these people understand it. There -- there's trade
8 publications out there in this industry that have talked
9 about EBITDA and multiples. It's just a widely-known
10 factor of how this industry had bought and sold businesses
11 and valued businesses. Because again, the fair market
12 value is what a willing buyer and seller are willing to
13 exchange.
14 Q And how does revenue factor into these
15 negotiations or discussions?
16 A It -- it really doesn't. Because again, there
17 are -- there are travel companies that have a lot of
18 international travel, and so they have higher commissions,
19 higher fees. There are companies that have -- that focus
20 more on leisure. The meeting and event companies have a
21 lower fee and lower things. It all then translates, based
22 upon their expenses, it comes down into EBITDA. So if you
23 have two companies that are performing similarly, it will
24 flow down into the EBITDA. So your best measurement is
25 always EBITDA.

1 And Bob mentioned they could have high rent.
2 They could have, you know, low supplier deals. They could
3 have -- if -- if it's an agency in a small town, they're
4 not going to have very good supplier deals because
5 there's -- it's a competitive market. If it's an agency
6 in New York, they're going to have competitive. And so
7 everything just happens to flow to EBITDA.
8 Q And what about balance sheet items, assets, or
9 liabilities? How do you take those into account, if at
10 all?
11 A Yeah. The only time you really take -- and I can
12 tell you in all my deals assets are minimal because again,
13 everything is on credit card. So there aren't huge
14 receivables. Sixty to 70 percent of your expenses are
15 your salaries for employees, your agents, and your
16 managers, and stuff like that. So there's not payables
17 associated with stuff. The other biggest expense is rent.
18 So again, you know, that's not a payable. You pay it at
19 the start of every month. So there's very little in
20 assets, very little in liabilities, and the only liability
21 that factors in is if they have debt.
22 And when you look at -- I believe both the
23 Marshall and the Joselyn, they mention that back in that
24 2008 valuation there was debt. Now, I want to correct the
25 other attorney because she mentioned that asset purchased

1 that Joselyn talked about is $1.5 million. The reason
2 there's a difference between an asset purchase of $1.5 and
3 a stock purchase of $745,000 is because in the stock
4 purchase the buyer would inherit that debt. In an asset
5 purchase, the seller has to pay off that debt.
6 So those two valuations are identical. The owner
7 is only going to get $745,000 because he has to pay off
8 the debt of $800,000 or so. So it's not -- that's the
9 only time that you have to factor in a liability is debt
10 because you have to pay that off, and that adjusts what
11 the owner would eventually take home. Whether they pay it
12 off, or you pay it off as part of the purchase price, it
13 reduces the price overall.
14 Q So as long as we're on this topic, why don't we
15 jump forward to Direct's purchase of Peak in 2014. Now,
16 Peak had some debt. Was that -- is that what you recall?
17 A I don't recall debt that he had. I -- I know the
18 eventual price we paid was the $15 million, and that was
19 for -- it was lightly under six times his EBITDA.
20 Q But the seller didn't get a check for $15 million
21 did he? Or do you recall?
22 A No. If he had debt on the books, he would not
23 have taken home $15 million. You're exactly right, sir.
24 Q So -- and how would the debt have been handled,
25 typically, by you in that transaction?

1 A Well, because we have a debt agreement -- we
2 already had a debt agreement, we were prohibited from
3 inheriting debt in our stock deals. And so we would pay
4 off that debt and reduce the amount that the owner took
5 home. And so if the -- let's hypothetically say there was
6 $2 million of debt, we would have written a check to
7 Robert Peak for $13 million and written a check to his
8 bank for the $2 million to pay off the debt. We have to
9 get it off our books because of the debt agreement that we
10 have in our possession.
11 Q So could you turn to Exhibit 11, which is your
12 declaration that you submitted in this case?
13 A Yes, sir.
14 Q Now, in -- let's see. In paragraph 11 --
15 A Yes, sir.
16 Q You -- you indicate that Peak's EBITDA on
17 November 1, 2009, was $287,000. How did you determine
18 that amount?
19 A It was through a review of their financial
20 statements. Obviously, I was not -- I had not -- we did
21 not own them at that time. So I took their income
22 statement from both their tax returns, as well as just
23 their normal financial statements that the company
24 produces.
25 Q And -- but in the context of the ultimate

1 purchase, if you recall, of Peak by Direct, would you have
2 received similar information from Peak?
3 A Yeah. Basically, identical information. It was
4 still their internal financial statements. We reviewed
5 tax returns as well as some other documents, but the
6 number one item is their internal financial statements.
7 Yes, sir.
8 Q Do you recall if Peak had audited financial
9 statements?
10 A I do not. They did not have audited.
11 Q Was that typical for this industry?
12 A Yeah. This industry, very few have audited
13 unless -- very few that I have ever acquired had audited.
14 Q And so you typically accepted or attempted
15 through due diligence to verify the information that the
16 seller provided; is that right?
17 A Yes, sir.
18 Q Okay. Now, if you could turn to look at
19 page 9 -- or paragraph 9 -- I'm sorry -- of the same
20 Exhibit 11. There's reference to the Journeys by
21 Ambassador transaction, and you indicate that there was a
22 multiple of 2.7 for that transaction, which again was not
23 Direct. Direct was not involved in that transaction;
24 correct?
25 A That is correct, sir.

1 Q So that was a Peak transaction before Direct --
2 long before Direct purchased Peak?
3 A Yes.
4 Q And you didn't work for Peak before you worked
5 for Direct; correct?
6 A No, I did not.
7 Q Okay. So 2.7 -- what would be the factors that
8 would cause 2.7 to make sense for that transaction?
9 A Yeah. So there's -- there's three things. If I
10 was doing the transaction, why I would come up with a
11 lower number such as 2.7, A, it's a very small agency.
12 Two, it's up the Northwest. It's not in a major city. So
13 it's not in a bunch of competitive markets. And again,
14 you get a lot better supplier deals and able to leverage
15 the suppliers in competitive markets. And then the
16 biggest factor, Journeys of by Ambassador was a leisure
17 agency.
18 In leisure business, the agent controls the
19 customer. And think of yourself, every one of you, if
20 you've ever used an agent to book your leisure travel, if
21 that leisure person -- or think of your barber or hair
22 stylist, if they move to another location, you follow them
23 to the other location. So if I purchase that agency,
24 there's a chance, there's a risk that they're going to
25 leave after a year, two years or whatever. And therefore,

1 again, you got to get your return on investment, weigh the
2 risk and value how long you're going to get that cash
3 flow. And that's where you come in with a lower multiple
4 because there's a higher risk that you will not retain
5 that business long term.
6 Q So I guess -- I mean, is it fair to say that when
7 we're talking about the multiple, it's not just a number.
8 It's about how quickly the buyers are going to get their
9 money back?
10 A Oh, 100 percent how I quickly the buyer is going
11 to get their money back because that's how you calculate
12 return on investment. That's how you make happy
13 shareholders and everything else. You have to be able to
14 generate that. Because for the first -- for that period
15 of time, you're paying off that acquisition price. And
16 then after that, that's free cash to your shareholders.
17 So the quicker you can get your money back and pay off
18 that purchase, the quicker your shareholders start reaping
19 the benefit of that acquisition.
20 Q So the smaller the multiple, the quicker you get
21 your money back?
22 A Definitely. Yes.
23 Q And you mention the size that it was small. Does
24 that factor into how the multiplier -- or the multiple
25 usually ends up?

1 A Definitely. Because they're less sophisticated,
2 so they -- they have less automation, less technology, and
3 smaller ones are usually set in their ways. And so as a
4 larger company you come in and start changing things
5 around, you can alienate them. And so again, you're going
6 to run that. There's a higher risk that you won't be able
7 to recoup your money. So you have to go to a lower
8 multiple in those situations. The larger the agency, the
9 more sophisticated, the more used to them doing things,
10 the way you do things, and therefore, you can pay a little
11 bit more for those -- those companies.
12 Q Now, we -- we saw that or talked earlier about
13 the -- and I think you mentioned that your multiple on the
14 ultimate Peak purchase was closer to 6, and the
15 Marshall & Stevens report in 2009 uses 5, so I think 5 to
16 5.9. Is there a reason there would be that difference?
17 A Yeah. In 2009 it was a smaller agency, and
18 therefore, I would have used -- if I was buying it, I
19 would have used a lower multiple. It's still a strategic.
20 It's in the San Jose area and -- so, you know, where the
21 Silicon Valley. So, you know, you can't go too low
22 because it's a strategic area and near San Francisco where
23 it's a very competitive airport and stuff like that. So
24 it might be a tad -- 5 might be a tad higher than what I
25 would have started with. But I can see where 5 is a very

1 reasonable for -- and the differential between the 5.9 and
2 the 5 results in a -- a -- why it would go down to that 5
3 just because of the size.
4 Q And in fact, the EBITDA in 2009 I think was -- or
5 the EBITDA in 2014 was almost 10 times what it was in
6 2009; isn't that right?
7 A That is. And if you want a -- if you want a fun
8 fact, Steve, so you take that $15 million we paid for Peak
9 and the EBITDA was 10 times, reduce that 15 by a factor of
10 10, you get to around 1.5, which is what both Joselyn and
11 Jamie's valuation for the company back in 2009 came in at
12 before deducting debt. And so we paid very similar. It's
13 just that the EBITDA was 10 times higher.
14 Q Now, in your -- again, in your declaration,
15 Exhibit 8 -- Exhibit 11, you refer in paragraph 7 to a
16 range of EBITDA of 3 to 9 times?
17 A Yes, sir.
18 Q And you heard Bob Sweeney say that he basically
19 never seen more than six-and-a-half. How often have you
20 seen more than six-and-a-half?
21 A Not very often. And again, typically, those are
22 only your bigger agencies. Obviously, the one I'm talking
23 about for $340 million is -- it's at 8 times. Direct
24 Travel and Navigant sold numerous times to private equity
25 investors. Which as anybody would know, private equity

1 are some of the most astute financial advisor -- or
2 financial investors out there. And during those times,
3 Direct Travel and Navigant never sold above 9 times. And
4 I have acquired one agency at 9 times, but it's -- it's a
5 rare circumstance.
6 And, typically, it's only when you have an
7 investment banker, such as a Goldman Sachs, such
8 Jefferies, Morgan Stanley who are representing the buyer
9 and the seller, and they -- the price does get driven a
10 little bit higher because of those investment bankers and
11 the work they put forth and the cost you're going to
12 incur. But again, as many times as my company has been
13 sold, which is probably six times, and as many large
14 acquisition as I've done, never above nine. And it's only
15 a handful if they've even exceeded that six,
16 six-and-a-half times that Bob mentions.
17 Q So for somebody like Peak, would -- you know, an
18 agency like that, would that ever -- would you ever expect
19 them to be much above six?
20 A No. Not at -- not at that price range. We -- we
21 just sold, and we had $70 million EBITDA, $70 million to
22 that $278,000 or to that, you know, 2.5 of Peak, and our
23 multiple was eight times. And it was negotiated as a
24 multiple of EBITDA. They didn't ask about revenue. They
25 didn't ask about anything else. It was 100 percent we're

1 going to pay you eight times your EBITDA.
2 Q So you saw Bob Sweeney's testimony, which was
3 kind of from the seller's side. Was there anything that
4 you heard in his testimony that seemed different than what
5 you saw from the buyer's side in these types of
6 transactions?
7 A No. He -- he talked -- I mean, he -- and again,
8 it's somewhat of an industry knowledge. He preps his
9 sellers for what buyers are going to be looking for. And
10 again, you've got to have a willing buyer and a willing
11 seller at a price they're willing to exchange. And so
12 he's prepping them for what he knows companies, such
13 myself, CTM, Amex, I mean, there's a lot of them that are
14 out there looking for acquisitions, but we all do it the
15 same way. And many times I'm competing with another one
16 of those for that acquisition, and we're both talking the
17 same language to the seller. So he's -- his testimony
18 sounded very reasonable because he's getting the seller
19 comfortable with our language that we're going to be
20 talking.
21 Q So when you're competing with another potential
22 buyer, it doesn't cause your EBITDA to go from 4 to 8?
23 A It can't because again, I've got loan covenants.
24 If I purchase something at too high of a multiple, I bust
25 my loan covenants and the bank takes the company over.

1 You -- you just can't go to crazy multiples. And -- and
2 we know the -- I've lost. I -- I've told you that I've
3 purchased 150. I've lost 200 deals. But you have to have
4 rigger and -- and know what you can accept for your risk,
5 and for what your board is willing to accept, and what
6 your lenders are willing to accept.
7 Q So do you think that the other kind of major
8 players, do they have similar loan restrictions and
9 financial issues that cause them to evaluate the
10 transaction similarly?
11 A Yes. Very much so. I -- I can -- you, know,
12 obviously, at various conferences I've bumped into my
13 peers. But, yeah, everybody's -- everybody does things
14 the same way in this industry. Otherwise, they -- they'd
15 win all the deals, but right now they don't.
16 Q Right. They'd win all the deals and then go out
17 of business; right?
18 A That is right.
19 Q So could you turn now to Exhibit C, which is the
20 Arxis valuation report?
21 A Yes, sir.
22 Q Now, the value that they came up with in this
23 report was a net of $9 million after an enterprise value
24 of $11.4 million, based on the 287 of EBITDA.
25 A Yes, sir.

1 Q Does that seem reasonable?
2 A Well, I think Bob used the word absurd. I'd use
3 something even worse than that. Again, I -- I would ask
4 anybody who is on this call, would you be willing to pay
5 $9 million for something that produces $287,000 in free
6 cash flow? I don't know of an investor, a banker, a
7 private equity that would pay that for a travel management
8 company which has marginal year-over-year growth. It's
9 just not something that you can, A, you could never
10 finance that; and B, you can never recoup your investment,
11 ROI, in a reasonable time frame.
12 Q So what would -- I haven't done the math, but
13 what would the -- what would -- how many years would it
14 take to get your money back in that? I guess if it was
15 $300,000, then it's 30 years?
16 A 30 years. Yes, sir.
17 Q So that's -- that's not reasonable?
18 A I don't think -- I don't think anybody could find
19 an acquisition in the history of acquisitions that have a
20 30-year return on your money. I -- I've never heard of
21 one in anything that I've talked about.
22 Q So the Arxis report primarily used revenue as a
23 basis for determining the market value. Is that -- is
24 revenue -- I think you kind of alluded to it before. Is
25 that -- is that a good indicator of what the value of an

1 agency is?

2 A As I've mentioned, I've never heard of anyone in

3 this industry that has used revenue. There are other

4 industries like the retail that has a revenue. But this

5 industry has never used revenue. And here's an

6 interesting fact, Steve. The revenue they used was total

7 air sales. That's not our revenue. The air sales gets

8 paid to the airline. All we get -- so if I sold you a

9 $10,000 ticket, I get $25 for the transaction fee. That

10 $25 is my revenue, not the $10,000 that you pay to United

11 or American or Delta. And so Arxis, for some reason, used

12 the price of the airline tickets.

13 Now, another fun fact. Our revenue is typically

14 about9 percent of what that airline price is in the end.

15 And again, if you reduce that valuation of $9 million by a

16 factor of 10, you come back to the same valuation. If

17 they had used the right revenue, they would have come to

18 our valuation that the other two people -- that the other

19 two valuation firms used. Because again, the revenue, in

20 theory, should flow down if you're using the right

21 revenue.

22 Q So just I'm clear on that. So then when

23 you're -- in your example of a $10,000 or $1,000 ticket,

24 does the agency even ever receive the money?

25 A No. No. It's a credit card. The customer uses

1 their credit card, and the merchant of record is American
2 Airlines, United Airlines, whomever. It is not the
3 agency. They then remit to us, on a separate charge, our
4 $25 transaction fee that we record as revenue.
5 Q But it seems that in at least some of the
6 financial information that we've seen, it -- the gross
7 booking revenue or the air -- what do you call it? -- air
8 something?
9 A Air sales.
10 Q Air sales. It gets reported by the agency. Why
11 is that?
12 A So this is going to take you back a long time,
13 but the global -- and Bob referenced it -- global
14 distribution system. And that's what our agents use to
15 book the tickets, the hotel, the rental car, all the
16 aspects of your travel is going through the global
17 distribution system, which feeds information to our
18 accounting system. The global distribution systems were
19 all invented by the airlines. They used to be part of the
20 airlines. And so Travelport, which is one, used part of
21 United. Saver used to be -- is one. It used to be part
22 of American Airlines. Amadeus was one of another -- of a
23 European airline, Air France KLM, I believe.
24 And so they designed it to where it did feed into
25 our accounting system because it used to be part of their

1 systems. It feeds that air sales in. But that's not our
2 revenue, and the money never gets transmitted to us. It
3 only gets transmitted to the airlines.
4 Q Okay. Now, you mentioned, which is I think is
5 Exhibit G, the Joselyn report or valuation.
6 A Yeah.
7 Q How is it that -- that you came into possession
8 of this? Do you know the circumstance that this was done?
9 A I do not. When we made the acquisition of Peak,
10 and we had the information -- let's see here. Let me just
11 pull it up real quick -- and we had the -- or we got the
12 information and were filing the Section 338(h)(10)
13 election, and we knew we had to factor in the timing of
14 the conversion from the C corp to the S corp, we -- I
15 think Tyler Peak said, "Here, I've got a valuation of near
16 the time I did it because I was looking at it." But
17 that's hearsay on what I recall he told me how he engaged
18 Joselyn.
19 Again, I was not part of Peak at that time that
20 he did it. And so we determined we needed another
21 valuation so that we had two of them, and that's when we
22 engaged with Jamie from Marshall & Stevens.
23 Q So the term that Joselyn uses -- did you know who
24 Joselyn was?
25 A Joselyn is an industry consultant, and he has

1 also represented companies similar to Bob but that's not
2 his -- his more full time job is help -- is a consultant
3 to travel management companies to help them improve their
4 financial results.
5 Q Now, he refers to -- he doesn't talk about EBITDA
6 in this letter. He talks about -- now, what's the
7 name? -- free -- what is it?
8 A Free cash flow.
9 Q Yeah. Free cash flow. So is that the same thing
10 as EBITDA, or is that something different?
11 A For these agencies, it is. I mean, your free
12 cash flow will be negatively impacted by your interest
13 payments. But as when we're looking at it, we're getting
14 rid of a debt and therefore, it turns it into EBITDA. But
15 in normal situations, we view EBITDA and free cash flow as
16 one and the same.
17 Q So he used a 2.5 multiplier here on the free cash
18 flow. So that would -- that would correspond to 2.5 times
19 EBITDA or -- pretty much?
20 A More or less, yes.
21 Q All right. Now, I'd like to turn just briefly to
22 Exhibit 14. This -- this relates to the other issue in
23 our case, which is the contingent payment that was due to
24 Peak in the transaction where Direct bought it in 2014.
25 So can you explain what Exhibit 14 is and how it relates

1 to that contingent payment?

2 A I failed to print that one off. I'm extremely

3 sorry.

4 Q Okay. It's entitled "Agreement and Authorization

5 For earn-out payment."

6 A Oh, yeah. Okay. So -- and this is again, this

7 was misspoken by -- by the other attorney. When we

8 negotiated with Peak, we always purchase an agency based

9 upon their EBITDA, as I've stated. When Peak was selling,

10 he came -- he told us that he wanted a higher purchase

11 price. I said we can't. We base it upon your EBITDA. He

12 said, "I just sold a bunch of new accounts that are going

13 to make a lot of additional EBITDA. So I think what I'll

14 do is I'll just wait six to nine to a year. And then when

15 I sell it, it'll be worth more."

16 Well we were very eager to expand into the west

17 region and in particular, San Francisco, San Jose area

18 because of the Silicon Valley and the growth of the

19 customers there. We had a huge presence in the east, a

20 huge presence in the Midwest, and we had a three-person

21 office in San Jose.

22 So I said, "I need to buy you now."

23 And he said, "I -- I need credit for these --

24 this new business."

25 And so I said, "Okay. Your current business is

1 worth $15 million, just under six EBITDA. What I'll do is
2 pay you a similar multiple on the growth of your EBITDA
3 over the next year. If you grow nothing, you get your $15
4 million, and that's it."
5 So the value of that earn-out payment at the date
6 of the transaction was zero because there's no guarantee
7 of growth. He ended up growing as he anticipated because
8 he had those new customers. He didn't know how much those
9 new customers would travel or, you know, how profitable
10 those new customers would be. He just knew they would get
11 somewhere. And then we paid him. At the end of the next
12 year we paid him that similar multiple for that earn-out,
13 which was about $3.5 million.
14 And so that earn-out related to merely the growth
15 in the business over the year I earned it as a mechanism
16 to permit me to buy it today, instead of waiting a year
17 and potentially somebody else coming in and buying it and
18 I losing that acquisition, which we found to be very
19 critical to our business strategy. So it still was a -- a
20 little over -- just under a six multiple. It was just
21 paying it on the forward EBITDA.
22 Q So a couple of things about that. First off,
23 there was a cap of $8 million, I believe. Is that what
24 you recall?
25 A There was. We put that on there just to say

1 there's absolutely -- you know, no matter how successful
2 all that new business is, I can't -- my lenders at this
3 time, I can't go any higher than an eight. But it was
4 just a hypothetical cap. We had no expectation. Had no
5 expectation that that new business would ever be able to
6 reach that number. And again, it had to grow. It -- it's
7 purely what that business grew by and then me paying it.
8 It's incremental. It wasn't like I was taking part of the
9 original purchase price and holding it back. It wasn't a
10 hold back. It was an earn up.
11 Q And it would have had -- I guess if we're talking
12 a similar multiple, how big would the agency have had to
13 grow the EBITDA in a year to cause it to be $8 million?
14 Would it have to be 50 percent more? Is that kind of the
15 math on that or --
16 A So yeah. Yeah. Because it was an 8 -- it was a
17 $15 million original price, so you're exactly right. They
18 would have had to grow by another -- the original was
19 about 2.5. So yeah, they would have had to grow by
20 approximately $1.4 million of EBITDA in one year, which is
21 just impossible to happen.
22 Q So the $8 million isn't really any kind of
23 indication of the value of that earn-out was when the
24 transaction closed?
25 A No. And, in fact, again, I say that the value of

1 that earn-out was zero, because let's -- let's hypo -- and
2 I -- I had one other deal that had a similar arrangement
3 that happened right before COVID. Guess what? They got
4 zero because the business did not grow during COVID. And
5 so it -- the value of it is only if those customers
6 transact, and be if those customers are profitable. So it
7 has no value until those customers transact and they are
8 profitable and contribute to my cash flow in that
9 subsequent year. But I -- I had one that got zero in
10 COVID.
11 Q So you call it an earn-out but, I mean, are
12 some -- is that term used in another context in some
13 deals, or is this -- is this a popular -- is this the
14 typical where it's based on an increase in the future, not
15 just a percentage of future revenue, whether it's up or
16 down?
17 A And now, so very rarely. Again, it's a handful
18 of deals that I use the true term earn-out, and it's based
19 upon the future growth of that business. And it's usually
20 because the owner -- it's a way for me to incentivize that
21 owner to sell today as opposed to waiting a longer period
22 and selling down the road and, again, potentially losing
23 out on that acquisition because one of my competitors
24 comes in and buys it without me knowing. So it's just a
25 tool.

1 Now, most of our deals do not have an earn-out.
2 We only pay based upon your actual EBITDA as of the date
3 of acquisition. That -- that is 99 percent of our deals.
4 There's just a handful that I have to -- that are very,
5 very strategic to where our board and where our management
6 wants to go that we have to have an earn-out. But again,
7 you're only paying on that EBITDA.
8 Q So it's not really -- it's not really a situation
9 where you're giving him 50 percent upfront and then you
10 pay -- you make payments so long as the business doesn't
11 go down. I mean, that could be called an earn-out too, I
12 suppose; right?
13 A It could. Yeah. I think you're right. And I
14 think what -- if you -- when you look at the transcripts,
15 I use the word earn up when I describe where you can
16 actually get more than the original purchase price. What
17 you describe where you get a certain percentage of the
18 purchase price, I would agree. That's what you could also
19 call an earn-out. And that's just helping you get to that
20 end purchase. You negotiate a price. You say I'm going
21 to pay you $5 million for your business. I'll pay you
22 two-and-a-half today, and I'll pay you another 500 or
23 whatever over the next period of years as long as your
24 business stays flat or better.
25 Q Okay. So the amount in this Exhibit 14, the

1 exact amount $3,537,500. And then in Exhibit 15 we have a
2 wire transfer for that same exact amount on the next day.
3 So was that everything that was paid under that contingent
4 arrangement?
5 A Yes. Yeah. We had only the one earn up, one
6 year earn up for Peak. And we made the one payment
7 once -- once we all agreed to the amount.
8 Q So what was that process then? How did you
9 determine what the amount was?
10 A So we took his earnings, one year later his
11 earnings, and compared it to the $2.5 million EBITDA that
12 was when we acquired it and then applied the multiple to
13 it to get to what that payment would be.
14 Q Okay. So that one year then was when Direct
15 owned Peak?
16 A Yes. Yeah.
17 Q Okay. And was there anything beyond the year?
18 There was no agreement?
19 A No. Nope. We would never do that long term,
20 Steve, because you -- you have to -- you have to integrate
21 the business. And so we want them to start using our
22 benefit plans for their employees. We want them to start
23 using our insurance for the business. We want them to
24 start using our phone system. And once you start doing
25 that, you can impact the EBITDA. We want them to have

1 better computers, better this. And so we're trying to
2 turn the business into a more efficient, more effective
3 machine. And, therefore, you can't rely on that EBITDA.
4 So when you have this earn up situation, you got
5 to kind of do a hands off so that the owner doesn't
6 question that you harmed his ability to earn on -- on the
7 earn up. So you got to keep it short term in nature to
8 permit the ability for you to execute on your overall
9 acquisition strategy.
10 Q So, I mean, you obviously interacted with Tyler
11 Peak on a lot of the Peak Travel Group financial
12 reporting. Did you ever find that to be inaccurate or to
13 see that he was playing with the numbers at all?
14 A No. No. He had -- they had good books. And the
15 larger you get -- and was -- he's considered a large
16 agency. Anytime you get into, you know, a double-digit
17 million acquisition, they're going to have a fairly
18 sophisticated accounting department that is helping them
19 out.
20 Q Okay. Maybe just one last question, if you still
21 have the Marshall & Stevens report there handy.
22 A Yes, sir.
23 Q Could you turn to Exhibit 3, which is on page 38
24 of 49 in that report?
25 A Yes, sir.

1 Q So there -- I mean, this represents five years of
2 financial reporting for Peak Travel Group. Is there
3 anything that you would see in that -- in those numbers
4 that would give you any cause to believe that they weren't
5 reliable?
6 A I -- no. I mean, you -- you started to have a
7 downturn in 2009, which reflected in economy and some of
8 the stuff that went on around the world during that time.
9 So no, it -- to me, it looks like it flows pretty
10 reasonably, and each category flows. You know, as your
11 revenue drops in 2009, your SGNA has to drop in 2009. You
12 have to adjust your business. And you'll find in our
13 industry -- and this is where I notice the other
14 attorney -- I mean, in our industry about 80 percent or
15 more of our cost are variable.
16 And what that means is we can take them up or
17 downs as the economy goes up or down, or as our volume
18 goes up and down. And therefore, as your business
19 increases, you take -- you got to take your cost up. I
20 mean, if your business increases, you've got to add more
21 travel agents. You can't service more business without
22 adding more travel agents. And as I mentioned, salaries
23 are about 70 percent of your cost. So that cost is going
24 to go up in a similar fashion.
25 And as your volume goes down because of whether

1 it's a recession, and economic -- something going on
2 around the world, then you have to take your cost down.
3 And that's why your EBITDA flows at a fairly consistent
4 percentage because your expenses are variable and flow up
5 and down with your revenue. So everything that I see in
6 here just from a cursory review looks very reasonable.
7 Q So if you see the gross profit line --
8 A Yeah.
9 Q -- and that's -- every year it's 9.5, 9.3, 9.4,
10 10.2. So is that what you were talking about before as
11 being the real revenue of the business?
12 A Yes. That is -- that's the money that Tyler
13 Peak -- well, before your expenses. But that's the money
14 that hit his bank account, and then he paid out his
15 expenses, which then result in your EBITDA. But that --
16 that's the only amount of money that flows into the
17 actual -- actual bank accounts.
18 Q And that 9.5 or 9.3, that looks like a pretty
19 typical sort of number?
20 A Yeah. Based upon my knowledge of their business,
21 yeah. But again, this was all before we took it over.
22 Q Right. Right. But -- and you said -- did you
23 say that was about what year Direct -- Direct -- that's
24 about your percentage of the air sales, I think you called
25 it?

1 A Yes. Our revenue -- our revenue has trended
2 around 9.5 as a percentage of air sales. Yes, sir.
3 Q So there's nothing in 9.5 in 2009 that looks
4 fishy to you?
5 A No.
6 Q Or in any of the other numbers in 2009 that are
7 on this Exhibit 3?
8 A No. Nothing. And again, the expenses flow in a
9 similar fashion. So I -- they look reasonable too. So,
10 yeah.
11 MR. MATHER: I have no further questions.
12 JUDGE HOSEY: Okay. Thank you, Mr. Mather.
13 And thank you, Mr. Coffman. I'm going to see if
14 the Franchise Tax Board has any questions for you.
15 Ms. Kuduk, do you have any questions for
16 Mr. Coffman?
17 MS. KUDUK: I do, but I think that we need -- is
18 it possible for us to take our lunch break now? I'm going
19 to need a break whether -- so is that possible?
20 JUDGE HOSEY: Let check with --
21 MS. KUDUK: Because it's 1:00 o'clock, right?
22 JUDGE HOSEY: -- Mr. Mather. I don't know if
23 Mr. Coffman needs to leave.
24 What are your plans, Mr. Mather?
25 MR. MATHER: I'm not sure what Mr. Coffman's

1 schedule is. I'd just as soon take a five-minute break
2 and finish up with him, and then take our lunch.
3 JUDGE HOSEY: Okay.
4 MS. KUDUK: I'm happy to take a 5 minute -- well,
5 maybe a 10-minute break because I have to run to the
6 ladies' room.
7 JUDGE HOSEY: Sure. We can take 10 minutes and
8 then return at 11 -- or no, sorry -- 1:03. And then we
9 can finish Mr. Coffman's testimony and questions, and then
10 we can take a longer break for lunch.
11 MS. KUDUK: Okay.
12 JUDGE HOSEY: Okay. We are going to be taking a
13 30 -- or sorry -- 10-minute recess.
14 And we are off the record.
15 (There is a pause in the proceedings.)
16 JUDGE HOSEY: We are back on the record.
17 We are turning to the Franchise Tax Board to see
18 if they have any questions for our witness Mr. Coffman.
19 MS. KUDUK: No. We have no questions. Thank
20 you.
21 JUDGE HOSEY: Okay. I'm going to turn to my
22 panel to see if they have questions for you, Mr. Coffman.
23 Thank you for your time.
24 MR. COFFMAN: Yes, ma'am.
25 JUDGE HOSEY: Thank you.

1 I'm going to start with Judge Vassigh.
2 JUDGE VASSIGH: Hi, Mr. Coffman. In FTB's reply
3 brief, they say that Appellants are putting forth a
4 completely new asset valuation method referring to EBITDA.
5 Can you tell us a little bit about how long EBITDA has
6 been used for this purpose in this industry?
7 MR. COFFMAN: Yes. So I -- I've been in this
8 industry for 27 years. And I even worked for Navigant,
9 which was my first business in this industry, for a
10 year-and-a-half prior to me coming over to Navigant. And
11 I was helping them with acquisitions. And in that
12 year-and-a-half before I came over, we did 11 deals, and
13 every one of those used EBITDA. So as long as -- for the
14 last 28 or 29 years that I've done all these acquisitions,
15 EBITDA was the only factor in those acquisitions. So I
16 don't know how much longer before that, because I wasn't
17 in the industry.
18 JUDGE VASSIGH: Thank you, Mr. Coffman. I don't
19 have any other questions.
20 JUDGE HOSEY: Thank you, Judge Vassigh.
21 I'll turn to Judge Lam. Do you have any
22 questions for Mr. Coffman?
23 JUDGE LAM: Yes, I do. So I want to start off
24 with that I know the Arxis appraisal stated that the
25 Marshall & Stevens' appraisal was unreliable for several

1 reasons. I'm interested in the reason that they gave, is
2 that the Marshall & Stevens' appraisal used historical
3 financial statements without any effort to normalize
4 reported net income to adjust for nonoperating income
5 expenses? Do you have any insights into that, or any
6 reply to that?
7 MR. COFFMAN: So just as my experience, these
8 businesses, especially, at an agency that has $287,000 of
9 EBITDA, does not have any nonoperating expenses. Again,
10 when you look at any of those financial statements -- and
11 trust me as I say, I've lost 200 deals and closed 150 --
12 you have salary expense; a huge part of it. Then you have
13 rent. And then you have some technologies that are
14 required in this industry such as a GDS, such as your
15 phone, such as your insurance, things like that. They
16 really -- I haven't seen nonoperating expenses in deals
17 that I've looked at. So the fact that they didn't give an
18 example or couldn't quote an amount, that's what sort of
19 surprised me when I was looking at their valuation.
20 JUDGE LAM: Thank you. And what about in their
21 report? It said that -- let's see -- that there was an
22 aggressive adjustment for understating debt by $951,000.
23 MR. COFFMAN: You said that they asserted that
24 the debt was understated by $951,000?
25 JUDGE LAM: Right.

1 MR. COFFMAN: Now, again, what I believe -- and
2 you can ask the Marshall & Stevens guy as the next
3 witness. But what he did was he reduced -- as I think you
4 heard early on in my statement, when you buy a company
5 that does have debt, the amount that the owner is going to
6 get is less by the amount of the debt. So you have to
7 repay the debt from the purchase price. So if you come up
8 with a purchase price of 1.5 million, but they've got the
9 $951,000 of debt, then the actual price to the seller is
10 only going to be that $710,000 because you have to always
11 factor in the repayment of the debt. So that's a fairly
12 normal process. And again, when I saw that, I think the
13 Steven -- Marshall & Stevens did it correctly by reducing
14 for the debt.
15 JUDGE LAM: Thank you. I have no further
16 question.
17 JUDGE HOSEY: Okay. Thank you, Judge Lam.
18 I think that concludes our testimony from you,
19 Mr. Coffman. We really appreciate your time, effort, and
20 energy in this case.
21 MR. COFFMAN: Yes, ma'am. Thank you all very
22 much for taking the time to listen.
23 JUDGE HOSEY: You're free to leave --
24 MR. COFFMAN: Thank you.
25 JUDGE HOSEY: -- if you would like. Yes. Thank

1 you.

2 Okay. Let us take our longer break. I'm

3 guessing -- Mr. Mather, I'm guessing you wouldn't want to

4 start your next witness at this point, would you?

5 MR. MATHER: No. I'd prefer -- you know, I think

6 we had scheduled a half hour for lunch. Maybe we'd come

7 back at 1:45 or so.

8 JUDGE HOSEY: Yes. That's the plan, is a half

9 hour for lunch.

10 Does that work for the Franchise Tax Board,

11 Ms. Kuduk?

12 MS. KUDUK: Yes. We're fine. Thank you.

13 JUDGE HOSEY: Okay. Then we will take a

14 30-minute recess and return at 1:45. Please leave your

15 Zoom where it's at. Just mute your microphones and turn

16 off your cameras, and we will reconvene at 1:45.

17 Thank you everyone.

18 (There is a pause in the proceedings.)

19 JUDGE HOSEY: We are back on the record.

20 And we are turning to Appellant for the third and

21 last witness.

22 Do you want to call him, Mr. Mather?

23 MR. MATHER: Mather.

24 Hard for you Sacramento people.

25 JUDGE HOSEY: Mather. I'm sorry.

1 MR. MATHER: Just teasing.

2 JUDGE HOSEY: No. I apologize.

3 MR. MATHER: I know it's hard for you Sacramento

4 people.

5 JUDGE HOSEY: It is. It is just what comes to

6 mind.

7 MR. MATHER: Yes. The Appellants call Jamie

8 Sieman.

9 JUDGE HOSEY: Thank you.

10 Mr. Sieman, can you hear us?

11 MR. SIEMAN: Yes.

12 JUDGE HOSEY: Okay. We're going to swear you in

13 before your testimony. Can you please raise your right

14 hand.

15

16 J. SIEMAN,

17 produced as a witness, and having been first duly sworn by

18 the Administrative Law Judge, was examined, and testified

19 as follows:

20

21 JUDGE HOSEY: Thank you.

22 Mr. Mather, you can please begin.

23 MR. MATHER: Thank you.

24 ///

25 ///

1 DIRECT EXAMINATION

2 BY MR. MATHER:

3 Q Mr. Sieman, could you state your full name and

4 your business address?

5 A Sure. It's James Sieman, but I go by Jamie.

6 Address is 201 North Franklin Street, Tampa, Florida,

7 33602.

8 Q What's your educational background?

9 A I have a Bachelor in Science and Finance from

10 Purdue University.

11 Q Could you briefly describe your professional

12 experience?

13 A Sure. Post graduation in the early 90s, I

14 graduated with a finance degree, like I said, and I went

15 into the banking industry for a few years. I found out

16 that wasn't very exciting. So in 1998, after looking for

17 a job, I applied for a position at Marshall & Stevens and

18 I was hired as an associate in their Chicago office then.

19 Q And what's an associate mean?

20 A An associate is just an entry-level position,

21 like a financial analyst. So we work with the more senior

22 people in assisting in the projects -- in the appraisal

23 projects; you know, building the models, helping with the

24 report writing, and working with a senior-level person

25 being trained by them.

1 Q So was that entirely doing -- working on
2 appraisals?
3 A Yes, 100 percent. At Marshall & Stevens, that's
4 all we do is appraisals.
5 Q Okay. And so what is your current position?
6 A Currently, I'm a managing director in principle,
7 and I work out of the Tampa office and run the Southeast
8 Financial Group.
9 Q And so you've been with the Marshals & Stevens
10 the entire time?
11 A Not the entire time. There was a brief stint
12 around 2006, 2007 that I left for another position to be a
13 director at a small accounting firm in Chicago. And after
14 about a year there, the gentleman who actually hired me at
15 Marshall & Stevens left Marshall & Stevens, and we both
16 started a valuation practice at Kroll in their Chicago
17 office. We were there up until the beginning of 2009, and
18 we both returned back to Marshall & Stevens at that point.
19 And I've been with them ever since.
20 Q So have you been, essentially, working on
21 appraisals or business valuations this whole time since
22 you started with Marshall & Stevens originally?
23 A Yes. Yes. In various -- and like I said, at the
24 beginning you start out as an associate, but you're --
25 you're in the mix of doing the appraisals, and you just

1 work your way up and -- to the, you know, manager,
2 director, and managing director level. But yeah, it's
3 been appraisals the whole time.
4 Q So what certifications do you have?
5 A I am an Accredited Senior Appraiser. So I have
6 my ASA through the ASA, which is the American Society of
7 Appraisers.
8 Q And what do they do?
9 A The American Society of Appraisers is our
10 society, our group, our association that -- it's a
11 multidiscipline association. So you have the business
12 valuation group, which is where I fall under. But they
13 are a multidiscipline firm. They also have tangible asset
14 groups, commercial real estate, gems and jewelry. But
15 they do most of the education and credentialing for the
16 appraisal industry. They've been -- they're the largest
17 and longest-standing appraisal association that there is.
18 Q And what did you need to do to get that
19 certification?
20 A To get the ASA?
21 Q Yes.
22 A It's a -- it's a long process because it requires
23 experience along with other factors. So it's about a
24 five-year process in total. So you start by doing course
25 work. You have to take within your discipline certain

1 courses. In my case, it was a four
2 business-valuation-related courses, which are about four
3 days long with a proctored exam at the end of it that you
4 need to pass. And that usually takes, because of them
5 being offered, maybe a couple of years to get through
6 those courses. And then you have to pass the USPAP exams,
7 which is the Uniform Standards of Principal Appraisal
8 Practices, and then you have to pass an ethics exam. So
9 once you go through all that and you have two years
10 experience in the industry, you get your accredited member
11 designation, an AM designation.
12 And then from there, once you reach five years
13 worth of, you know, full time appraisal experience, you
14 can then apply for your ASA, your Accredited Senior
15 Appraiser. And in order to do that, what they do is, they
16 do a peer review of some reports that you've prepared. So
17 those have to go through a kind of local -- the local
18 chapter peer review where they review your reports, and
19 then they do an interview. They do -- they check your,
20 kind of, professional references on top of that. And then
21 once they approve your reports and you've hit that five
22 years of experience, you can then get your ASA.
23 Q Okay. So I'm a little confused. So ASA is the
24 organization, and it's also the designation?
25 A And it's the designation. So the designation is

1 Accredited Senior Appraiser. The organization is American
2 Society of Appraisers. They're both ASA.
3 Q Oh, okay. And how long have you been an ASA?
4 A I've been an ASA since about 2003, 2004. So
5 approximately 20 years.
6 Q And there's nothing more senior than senior, I
7 guess?
8 A Yeah. I mean, they do have fellows in the -- in
9 the organization also, but those are more kind of
10 distinguished-type titles. They're nothing that you can
11 actually work towards but from an educational standpoint.
12 Q So when you say that you're doing financial
13 analysis and valuation, is it always for a third-party
14 client, or is there other things that you work on as well?
15 A Ninety-nine percent of the time it's projects
16 that I'm working for with -- for other individuals,
17 whether they're doing some tax plannings, estate planning.
18 We also do a lot of work in financial reporting with
19 valuations. I do a little bit of work with our sister
20 company, which is called MS Capital. They are our
21 investment banking arm. They do a lot of representing of
22 sellers in their businesses, and we get a lot of those
23 from wealth managers that we kind of deal with. And for
24 them, I provide them some support in doing what we call
25 calculations of value for their clients. It's not a lot.

1 Like I said, it's probably 1 percent of my time that I
2 work with them. But I do work with the MS Capital Group
3 and helping them. Essentially, establishing due diligence
4 evaluation work around potential deals.
5 Q But that still essentially valuation work?
6 A The process is valuation work, but it's not an
7 opinion of value. We go through same methodologies as we
8 typically would for a standard business valuation but
9 there's some just agreed upon terms that they're not
10 considered opinions of value when we give them to the
11 client because they provide a range of value so that MS
12 Capital can then take it from there, work with their
13 client to develop, you know, are we going to do -- go
14 through the process of trying to sell the business or not.
15 So they're not full opinions of value, but you go through
16 pretty much the same methodologies to get to the -- the
17 range of value that we provide.
18 Q So I guess you heard Bob Sweeney's testimony
19 earlier?
20 A Yes.
21 Q Is that on a much larger scale, kind of a similar
22 sort of thing assisting the seller in determining a range
23 of value?
24 A Yeah. I would say that MS Capital portion of
25 the -- of the -- is pretty similar. I mean, you know,

1 we're -- we're looking at the financial information that
2 the potential client has. Now these people have not
3 engaged us to do valuations and provide opinions. It's
4 we're getting the financial information, building out
5 models, and doing kind of ranges. So look again, we'll
6 look at here's a company. Here's a company's EBITDA.
7 Here's a range of multiples based upon this method and
8 this method. And, you know, coming up with kind of a
9 value range for that that our MS Capital team can do --
10 take, and then say, you know, here's our estimate where we
11 can be at. Let's fine tune this. And sometimes they turn
12 into full valuations for other purposes. A lot of times
13 it's just for their due diligence work. And again, that's
14 not a huge portion of what I do.
15 Q Are you familiar with the valuations of the
16 travel business?
17 A I would say as a whole I'm a kind of generalist.
18 So I do work across many types of industries, all types of
19 industries, retail, manufacturing, biotech, information
20 tech, all that kind of stuff. But I have done travel
21 businesses before. But really, the methodologies and
22 approaches in valuating a business are pretty much the
23 same across the board.
24 Q So what are those methodologies. I mean, how do
25 you in general approach the business valuation?

1 A Yeah. When you're appraising anything and any
2 business, there's really three approaches you can look at;
3 the cost approach, the market approach, and the income
4 approach. Now, the cost approach is just that. You know,
5 what does it cost to recreate this asset. That's not very
6 applicable for a growing concern businesslike Peak
7 business or any kind of company that's, you know, a cash
8 flow generating business. So then we really rely on for
9 most operating businesses looking at the market approach,
10 and there's really two methods under that market approach.
11 You can look at guideline transactions, and that's the
12 actual sales of companies.
13 And then we can look at guideline public
14 companies, and those are publicly traded companies where
15 we pull down their financial information. And as of our
16 valuation date, what is that company selling for right
17 now? What is its stock price? And based upon that data,
18 we can again, calculate multiples from that information
19 that we can then apply to our -- our subject company.
20 And then the last approach is an income approach.
21 And really, there's a couple of methods under the income
22 approach you can use. If you've got a business that's
23 pretty stable, you know, not projecting any kind of
24 serious growth or something like that. You could do a
25 capitalization of earnings if their earnings are pretty

1 stable. Or most of the time we do some type of a
2 discounted cash flow analysis where we're looking at
3 future cash flows and then present valuing those cash
4 flows to today through some kind of rate of return.
5 Q So you've heard us talk about EBITDA all day long
6 so far. So how does EBITDA factor into those methods of
7 appraisal?
8 A The EBITDA really comes into a play from the kind
9 of the multiple standpoint. We look into guideline
10 transactions. You know, we do a search for guideline
11 transactions in the industry that we're looking for. You
12 know, a lot of transactions are private, so they don't
13 publish a lot of data relative to that. But there are
14 certain areas where you can get some -- some information
15 relative to what kind of multiples are being traded.
16 So we typically look at an EBITDA multiple
17 because it's, again, like it's kind of been stated. It's
18 representative of a company's cash flow. And that's
19 usually what an investor is concerned about is what is the
20 cash flow generating capacity of this business so that,
21 you know, they can kind of look at a valuation based upon
22 that. And same thing within the guideline public company
23 method. We use that information to develop those
24 multiples that then can apply to the proper metric. And
25 in most cases it's an EBITDA. Because, again, that's what

1 investors are concerned about.

2 Q So is the EBITDA used in the discounted cash flow

3 method, or is it a different number that's used?

4 A It -- it's a little bit different than a

5 discounted cash flow method. I mean, you're calculating

6 your cash flows up to an EBITDA standpoint. But then your

7 discounted cash flow method takes into account investments

8 in the company and working capital, investments in capital

9 expenditures to really come up with kind of the -- what's

10 that? -- free cash flow distributable to the shareholders.

11 And that free cash flow is then present valued to today to

12 come up with your -- your value indication.

13 Q Okay. Could you turn to Exhibit B, which is the

14 report you did for Peak?

15 A Sure. Got that.

16 Q So you are the person that prepared this

17 report -- or principally; correct?

18 A Yes.

19 Q And when was the report done?

20 A The report was issued in January 26, 2015. So

21 that would have been the report production date when we

22 issued it.

23 Q Okay. And -- but that was not the valuation

24 date?

25 A No. No. The valuation date was

1 November 1, 2009.

2 Q And what were you asked to do in this engagement?

3 A We were asked to value the total equity of Peak

4 Travel.

5 Q So that's the total equity. So what does that

6 mean?

7 A Yeah. That's -- that's the -- the total equity

8 is the fair market value of the equity. So what we do,

9 when we're doing our business valuations, we do them on a

10 debt-free, cash-free basis. So the value indications

11 you're coming up with EBITDA is really the value of the

12 total invested capital of the company. So you're

13 stripping out anything relative to how a company is

14 capitalized, things like that. So when we come up with

15 the value of the total capital, that's the debt plus the

16 equity.

17 So to get to the equity at that point, you make

18 any adjustments for cash and nonoperating assets, any

19 working adjustments, if required. Then you subtract the

20 debt. That's your final equity value. So EBITDA is going

21 to get you to the enterprise value, and then you subtract.

22 You make your adjustments and subtract that to get to the

23 equity value.

24 Q So the enterprise value is the fair market value

25 of the company ignoring debt -- its debt or its other -- I

1 see.

2 A Right. Exactly.

3 Q But then the equity value is what -- is the --

4 presumably the value you could sell it for?

5 A It's -- you can almost look it at as a proceeds

6 type value. We have the business value let's say at a

7 million dollars and say there's $100,000 of cash and

8 nonoperating assets. We're at a million-one, and there's

9 $500,000 of equity or of debt. You subtract the

10 million-one and the $500,000, and then you're left with

11 $600,000 of equity. So it's just like any other thing.

12 If you own a home and it's worth $500,000, and you have

13 $300,000 in debt; you have $200,000 worth of equity. So

14 if you sold your home, your proceeds would be that

15 $200,000 because you have to pay off the debt.

16 Q So in this Exhibit B, what was the final value

17 that you determined as the result of the analysis?

18 A Yeah. I came up with the total equity value of

19 $710,000.

20 Q And could you kind of take us through some of

21 these pages and exhibits and see how the principles you

22 described are evidence in the report.

23 A Sure.

24 Q Well, let's start with -- let's see. Well,

25 you -- I'm going to say it wrong. So why don't you just

1 explain it?

2 A Okay. I mean, really if you look at the report
3 in the final -- in the back half of the report there are
4 exhibits, Exhibit 1, Exhibit 2, Exhibit 3, Exhibit 4.
5 Exhibit 1 is a summary of the whole analysis. So
6 everything that's done from Exhibit 2 and on is summarized
7 in Exhibit 1. So what we do is we come up with the value
8 of the business enterprise, which is the debt plus the
9 equity through each of the methods. So we did under the
10 transaction method, the guideline company method, and the
11 income approach. And all three of those correlated pretty
12 well. Because when you're looking at multiple approaches,
13 you know, if you have any kind of outlier valuation
14 indication, you really need to double check some of the
15 assumptions that may be utilized in all the different
16 approaches so that, you know, in the end they kind of
17 reconcile relatively closely.

18 So in Exhibit 1 you can see we came up with the
19 value range between the three approaches. And then based
20 upon our weighting, we looked at each one of them equally.
21 We came up with an unadjusted enterprise value of
22 $1,470,000. So that's your debt plus your equity before
23 any kind of working capital, nonoperating assets, things
24 like that. So then all you do is, if there's any working
25 capital adjustment that gets taken -- in this case it was

1 $70,000 -- we add back the cash and the nonoperating
2 assets off the balance sheet -- that' $835,000. And then
3 you just subtract the debt to come up with the equity
4 value.
5 Q Okay. So is it -- so the $1,470,000 is the value
6 of the projected future income?
7 A In this case, the $1,430,000, under the income
8 approach, that's the value of the projected income. So
9 that's using the discounted cash flow analysis. The other
10 two methods, transaction and guideline company, are where
11 we're developing multiples and applying them to the
12 company's EBITDA to come up with a value indication.
13 Q Which is also an earnings based formula?
14 A Yes. Right. Because we're using EBITDA as the
15 basis of the process, right.
16 Q And so the ones lower down the page that are the
17 balance sheet items that would vary from company to
18 company, I guess?
19 A Correct. Correct. So we've taken cash out of
20 it. You just add the cash back since the whole analysis
21 is debt-free cash. And the other assets are considered
22 nonoperating; so when you're looking at the value of a
23 business, you know, if there's -- if you've got working
24 capital, fixed assets, and everything else, intangibles
25 and other. This analysis -- the first portion of the

1 analysis takes care of the working capital to the tangible
2 assets.
3 If there are any other assets that aren't
4 included in there, those are considered nonoperating
5 assets and added back. So there was a loan to a
6 stockholder that was added back directly. Because that's
7 really a nonoperating asset, just stripped out. And cash
8 surrender value of life insurance, again, another
9 nonoperating asset that's not in the working capital. So
10 we need to account for it, so we have to add it back.
11 Q And then similarly, the debt is subtracted out, I
12 guess?
13 A Right. Right.
14 Q Because they're conceivably could be a company
15 that has the same EBITDA and the same discounted future
16 cash flow that doesn't have none of these items?
17 A Right. Exactly.
18 Q Okay. So, all right. Then you have the three
19 approaches. Where does that come from? Where does the
20 $1,435,000 come from, for example?
21 A The $1,435,000 is under the guideline transaction
22 approach. So within that report, Exhibit 4 and Exhibit 5
23 are the guideline transaction approach.
24 Q Okay.
25 A So Exhibit 4 is transactions we found out of the

1 Capital IQ Company database. That's the database we
2 subscribed to at the time. And we were able to find two
3 transactions that actually published the financial metrics
4 that we could use, in this case EBITDA. Because, again, a
5 lot of times transaction don't publish all the
6 information. And in this case, we found two that traded
7 in an EBITDA multiple of four-and-a-half and 5.3. We
8 selected five as the final multiple tool applied to our
9 company.
10 Q Okay. And then Exhibit 5, what do you --
11 A Yeah. Exhibit 5 is when we apply that multiple.
12 So we look at the company's EBITDA, which their latest
13 fiscal year EBITDA, which is the most recent EBITDA, was
14 $287,000. We multiply that by five, and then we came up
15 with the value indication of $1,435,000 under that
16 approach.
17 Q So the $287,000, if you turn back to Exhibit 3,
18 where does that come from?
19 A This comes from the company's financial
20 statements. It's their 2009 EBITDA.
21 Q Okay. The adjusted EBITDA number, kind of the --
22 A Right. Yeah. It's the most recent EBITDA from
23 their 2009 financial statements.
24 Q So this is -- pardon me. Where did you get the
25 information on Exhibit 3?

1 A The company provided all the financial
2 information to us.
3 Q And so that's five years, I guess.
4 A Correct.
5 Q Is that -- do you take into account the earlier
6 years?
7 A Sometimes you do. It depends on the type of
8 company and the industry. I mean, mainly what we're
9 looking here is more, kind of, trends. You know, first of
10 all, the company has been profitable for five years. So
11 this is definitely a growing concern analysis. And from
12 an investment standpoint, they're generating positive
13 EBITDA. So that to us is going to be the best value
14 indication for most operating businesses like this. It's,
15 you know, what kind of cash flow are they're producing?
16 And in this case, you know, under a market approach we
17 look at the EBITDA for that.
18 Q And it looks like in almost all of these years
19 it's -- the EBITDA is 0.3 percent, 0.3 percent, 0.3
20 percent, .03 percent. So that's pretty consistent it
21 seems?
22 A Pretty consistent, yeah. Yeah. And it's kind of
23 like what John was talking to, you know. A lot of this
24 business, the expenses are variable. So you can adjust on
25 the fly, kind of, as, you know, revenues are increasing or

1 decreasing. You know, when you've got that high-level of
2 variability, you can adjust to maintain that same level
3 of, kind of, profitability; in this case, you know, the
4 kind of the 0.3 percent.
5 Q So -- so based on this five-year -- five-year
6 history, that $287,000 looks like a pretty solid number, I
7 guess. Is that fair?
8 A Yeah. I mean, when you look at the overall five
9 years, that $287,000 looks like a pretty standard number.
10 A pretty well-established -- you know, not necessarily
11 average but kind of where the company typically is from a
12 profit standpoint.
13 Q So you heard the testimony of Bob's
14 two-and-a-half to six range, generally speaking. Is that
15 kind of information anything that you factored into this
16 particular part of your analysis?
17 A I would say our analysis, it doesn't necessarily
18 just rely upon that. I mean, we do our own independent
19 analysis trying to find third-party transactions, like we
20 did in transaction data. There it indicated
21 four-and-a-half to 4.3 times. And we looked guideline
22 public companies. And in that case, I think our ultimate
23 selection was kind of in that five range also. So it does
24 fall within the range that Mr. Sweeney was talking about.
25 And for companies like this, you know, the kind of

1 established company like this, I think at that multiple
2 range makes sense.
3 Q So five, just in general, irrespective of the
4 travel business, would be kind of what you'd expect for a
5 mature business like this?
6 A For a business of this size, you'd probably be
7 looking at, again, range. From my experience, for typical
8 company, maybe a four to seven multiple. Again, you know,
9 we have some nuances in this travel industry that,
10 obviously, Mr. Sweeney and John talked to from real world
11 experience about their experience in the range of
12 multiples that are paid in this industry. I think our
13 data is kind of independent but still kind of supports
14 that we kind of fell within that range that they're
15 talking about.
16 Q Was these two transactions in Exhibit 4, was that
17 a reasonable number for you to draw on?
18 A I would say it is because they were reasonably
19 close in range. Again, finding transaction data
20 of published company -- or that companies publish so you
21 can compile full data is -- it's difficult. But the ones
22 that we could, you know, are kind of pointing in that
23 direction of that five -- four-and-a-half to 5.3. And in
24 this case, you know, the 5.3 was a much smaller company in
25 enterprise value, but we still kind of dialed back the --

1 the selected to a five. So it fit within the range of the
2 transactions and seemed, you know, reasonable.
3 Q Okay. And so the $1,435,000 we saw comes from
4 the mathematical formula on Exhibit 5?
5 A Yeah. So literally just applying the selected
6 multiple to the latest fiscal year of EBITDA.
7 Q So the next number then on Exhibit 1 is
8 $1,550,000 for the guideline company method.
9 A Yeah.
10 Q Where does that come from?
11 A The guideline company method starts on Exhibit 6,
12 but I mean, you really -- you get into the crux of the
13 analysis on Exhibit 10. And on Exhibit 10, so these are
14 the guideline companies we looked at within the industry.
15 Now, remember these are publicly traded companies. So
16 much larger, more diverse, maybe geographically deeper
17 management in most cases because they are public
18 companies. So these are the actual EBITDA multiples of
19 each of these companies as of our valuation date. So we
20 look at them. Based upon this, we select a kind of
21 baseline EBITDA multiple.
22 Q So the financial information for these companies
23 then is audited financial statements that are published?
24 A Correct. This is all public data that would be
25 in their 10-Ks, 10-Qs.

1 Q Okay. So then you came up with 9.0, I guess?
2 A Right.
3 Q What modifications do you make for that then?
4 A Well, when you're looking at -- again, when we're
5 looking at this data, these are much larger publicly
6 traded companies. So we need to adjust this multiple
7 to -- to make it more the size of a closely-held company,
8 and then the size of that closely-held company. So you
9 could see on Exhibit 11 we have the same EBITDA, $287,000,
10 that selected multiple of nine from the Exhibit 10 that we
11 started with. And then we make a, what we call a discount
12 for size, diversification in management of 40 percent.
13 And so the adjusted market multiple we're using out of the
14 guideline company method is that 5.4.
15 Q So where does that 40 percent come from?
16 A That 40 percent, the support for that comes
17 from -- if you go to the next exhibit, Exhibit 12. So
18 what this is, this is data out of Houlihan Lokey. And
19 what it does is it compares PE multiples of large
20 companies to small companies. So based upon that
21 differential, we call it a size discount, even though
22 there's probably more that kind of goes in. It was
23 basically adjusting the multiple from these large, large
24 publicly companies to a -- to what a smaller company would
25 sell for.

1 So if you look at the data here, small versus
2 large companies, we look at a ten-year period and $100
3 million or more in, let's say in 1998. They were trading
4 at PE multiples of 24.2 on average, the companies. The
5 $25 million or less, so that would be the small company
6 size, were trading at 12.6. So there's an implied
7 discount for size of 47.9 percent. We look at this over a
8 ten-year period, and then we apply, you know, our
9 adjustment to that multiple based upon, you know, what we
10 know about the company, the industry, and this data. So
11 this data supports, you know, those discounts anywhere
12 from, you know, 25 to 40 percent.
13 Q Okay. So that's the $1,550,000 number. And then
14 the other number on Exhibit 1 was $1,430,000. Where is
15 that? Where does that come from?
16 A So that's the other approach we use. That's the
17 income approach, and that's the discounted cash flow
18 analysis. That's presented in Exhibit 13. So what we're
19 doing here is management would provide us projections of
20 future cash flow, future revenue, future margins, and
21 looking at the projected cash flow for the next five years
22 into the future. And at that point, we cut it off and
23 pretty much say that they're going to grow at a long-term
24 growth rate from that period going forward. That's the
25 terminal period at the end.

1 So all this is doing here is, if you go kind of
2 two-thirds way down the line, your profit before income
3 taxes, that's your EBITDA line; so year one, $230,000.
4 Then you make adjustments for tax effecting that, make
5 adjustments for any capital expenditures. They may need
6 to buy new computers, things like that. So we're coming
7 up with a free cash flow in year one of $165,000. And
8 then that same methodology carries forward, and then we
9 present value all that back to today. Because, you know,
10 a dollar three years from now is not worth a dollar today.
11 So we present value that back at what we're considering
12 the investor's required rate of return.
13 Q So that is based more on projected future
14 earnings than historical earnings. Is that fair?
15 A Correct. Correct.
16 Q And you said the cost approach didn't apply, so
17 there was no other method that you applied in this --
18 A No. No. We applied the two approaches, and then
19 three methods in total; guideline transaction, guideline
20 public company, and income approach.
21 Q But they're all fundamentally based on earnings?
22 A Correct. Yes, because in the market approach we
23 use EBITDA, and the income approach is forecasted free
24 cash flow or EBITDA?
25 Q And why not revenue?

1 A Well, I mean, when you have an established
2 business with -- it's just based upon my experience,
3 EBITDA is the driving factor in most valuations. It is in
4 a lot of the valuations I do. I do a lot of work for --
5 in the mergers and acquisitions of private equity
6 companies where we do the financial reporting, where we
7 value all the assets after a deal is done. I see it a lot
8 of private equity valuation models of them pricing a deal
9 because they need to provide those to me once the deal is
10 done. And in those models, there's always some sort of
11 discounted cash-flow analysis. And there's always some
12 sort of metric of EBITDA; whether it's in the exit
13 multiple or, you know, here's the purchase price. Here's
14 the company's EBITDA. We're paying X times EBITDA for it.
15 So the revenues never come into play in -- in the
16 investor's decision like this. It's always going to be
17 the cash flow because that's how you get paid back. I
18 mean, your future cash flow is how you're going to service
19 your debt. Your future cash flow is, you know, what could
20 be distributed to shareholders at the end of the day.
21 It's not the revenues.
22 Q And you heard John Coffman say that, you know,
23 ultimately this is willing buyer, willing seller. So is
24 that fundamentally what you're trying to determine in any
25 valuation?

1 A Yeah. We go by Revenue Ruling 5960 and the
2 definition of fair market value, and that being a willing
3 buyer, willing seller. Neither are under compulsion to
4 buy. So it's really kind of that middle ground area
5 valuation. So you always got somebody who wants a deal.
6 You always got somebody who wants, you know, to get paid
7 too much for their business. Ours is a willing buyer,
8 willing selling scenario where it's like we've matched up
9 the valuation to those that are selling and those that are
10 buying; this is a reasonable value. And that's the fair
11 market value.
12 Q Now, if you could turn to Exhibit G, which is the
13 Robert Joselyn valuation.
14 A It's here somewhere. Okay. Got it.
15 Q So this was done in 2008, so it's obviously
16 much -- it's a current valuation. But what method did
17 Joselyn use here, and how does that relate to the methods
18 you applied in your report?
19 A Yeah. The main methods used in here is a
20 multiple approach. So it would be a variation of the
21 market approach. Any time you use in multiples, that's
22 going to be a market approach based valuation. And kind
23 of the range of multiples that, you know, he described as
24 being relevant to the industry, and then his opinion as to
25 what multiple would be applicable specifically to Peak.

1 So -- but it's ultimately just a cash-flow multiple.
2 Q And he's -- he referred to it, and I couldn't
3 find the term this morning, and I'm missing it again.
4 It's something like before the -- before cash flow or --
5 or forward cash flow or --
6 A Yeah. I think it was the pretax cash flow.
7 Q Before tax cash flow, yeah.
8 A Before tax cash flow. So that's pretax cash
9 flow. So EBITDA is earnings before interest, taxes,
10 depreciation, and amortization. So that's EBITDA. So
11 pretax cash flow would essentially be the same thing.
12 Because EBITDA, the DA, depreciation and amortization of
13 EBITDA, those are noncash expenses. So you deduct them
14 for tax purposes, but they're actually noncash. That's
15 why those get added back. That's the DA part of EBITDA.
16 The T is the taxes, obviously, and the I is interest. So
17 earnings before interest, taxes, depreciation, and
18 amortization, that's what you have left to service your
19 debt, service your interest payments. Pay your taxes.
20 Invest in the company through capital expenditures or any
21 working capital need you may be. And then everything
22 after that is what's available to the shareholders.
23 Q Okay.
24 A So it's a measure of free cash flow.
25 Q So he -- he wasn't calling it EBITDA, but it's

1 something basically the same?
2 A If -- if cash flow would always kind of indicate
3 what you kind of have left over, which would include
4 depreciation and amortization because those are noncash.
5 So although it's not specified as EBITDA, that terminology
6 implies an EBITDA because it is a free cash flow.
7 Q So this is, obviously, a little less
8 comprehensive than yours, but do you think that this
9 provides a reasonable valuation of the company?
10 A When I reviewed it, yeah, I do believe it did. I
11 mean, obviously, they have some significant experience in
12 traveling agencies and kind of what they're selling for,
13 looking at the multiple selected. They didn't seem
14 completely out of line. There are some, you know, other
15 pieces of it where there's just a little bit of missing
16 data that it's -- I wouldn't be able to track, you know,
17 kind of, perfectly. But to me, ultimately, it's, you
18 know, what's the basis you're using; free cash flow and
19 what multiple are you applying to that. And, you know,
20 based upon the, kind of, the multiple they are applying
21 here, it didn't seem unreasonable.
22 Q So but I guess would one of the main differences,
23 at least with respect to the multiple, be that you did it
24 based on transactional information, and he seems to kind
25 of use it based on his volume of experience?

1 A Yeah. I would say that the main thing here is,
2 you know, it's a pretty short report. Obviously, the
3 multiple seems to be within the range. But our analysis
4 is just a completely independent third-party analysis
5 where we presented the data we had. And you can kind of
6 walk through it step-by-step and see how the data, where
7 we got and how it's applied, what it's applied to, and
8 then what the ultimate value is based upon that. It's a
9 little more comprehensive.
10 Q And to the extent you can tell it's -- he's kind
11 of coming with his multiple based on his experience in the
12 industry it seems?
13 A Right.
14 Q Yeah. So that's -- that's fundamentally
15 different than what you did?
16 A Yeah. Our analysis is, again, just kind of a
17 completely independent willing buyer, willing sender --
18 seller, third-party type of analysis. Where he's
19 providing an opinion kind of based on his experience. You
20 know, it even states here, you know, current experience is
21 travel and are actually selling for. So I think that's
22 more kind of what -- what this analysis is.
23 Q Right. Now, could you turn to Exhibit 11, which
24 is John Coffman's declaration?
25 A Yes. Got it.

1 Q And some of this was covered by John's testimony
2 also, which we saw, but he references being involved in
3 150 transactions. Does that seem like an adequate sample
4 size to get some sense of the what the industry
5 transactions are?
6 A I would say absolutely. I mean, in the world of
7 valuation, I would say if you've done 150 valuations of
8 one specific industry, you would be considered an industry
9 expert in that particular industry.
10 Q And in paragraph 7, John mentions a range of
11 EBITDA multiples of 3 to 9. And I think in his testimony
12 he said, "Well, rarely over 6." Does that comport with
13 what your findings were?
14 A It definitely does with the transaction data.
15 Like I said, we're at four-and-a-half and 5.3 were those
16 transaction. If you look at the guideline public company
17 method, you know, we selected a nine. That's a publicly
18 traded company multiple that we're selecting there. So
19 that's the high end of the range. And again, he's dealing
20 more with closely held companies, smaller companies. So
21 that nine seems to be an outlier from a closely held
22 company standpoint. From the public company data that,
23 you know, we're kind of presenting in our report, you
24 know, that's probably kind of the more the median average
25 in that -- in that subset.

1 Q Now, in paragraph 9 John refers to the Ambassador
2 transaction, which he computed to have an EBITDA multiple
3 of 2.7 and had explanations for why that might be lower
4 than normal.
5 A Right.
6 Q Did those explanations sound reasonable to you?
7 A Yeah. Because when we're looking at valuations
8 and, especially, even in the world of private equity,
9 they're going to want to pay for a higher multiple for
10 growth. What can we take this company and expand it to?
11 How can we expand it? You know, if something is suit --
12 very established business and just kind of continue on in
13 the same path that it's at right now with the same level
14 of growth, same level of profitability, there isn't that
15 upward expectation that you would want to pay a higher
16 multiple.
17 So it sounds like from his explanation, you know,
18 this business was in a niche business. There was an
19 opportunity for them from a synergistic standpoint to make
20 any improvements on top of that. So it's, you know, most
21 like it's just kind of a fold in of a typical add on
22 acquisition where, you know, we're -- we're gaining more
23 EBITDA out of this business, but we're not going to pay an
24 exorbitant multiple for that.
25 Q And I believe that in the Joselyn report they --

1 he used a 2.5 multiple, ultimately. So that's not far off
2 either?
3 A Right.
4 Q And now in part 10 or paragraph 10, John refers
5 to the Peak sale to Direct Travel, which was later --
6 several years later than your valuation, but I guess at
7 around the time maybe that you did it. Is that something
8 you should have taken into account in your report?
9 A I would say no. Because, you know, we're doing
10 an valuation as of a specific valuation date,
11 November 1, 2009. So in the world of valuations and
12 appraisals, the standard is what's known or knowable as of
13 that date. So if we know something is happening three
14 months later post our valuation date or did happen, if it
15 was kind of known or knowable as of that valuation date,
16 then yes, that can be considered.
17 You're talking about a transaction that happened
18 five years after the valuation date. The company is
19 completely changed in that amount of time. That is
20 something that would not be considered as of my valuation.
21 Q Now, that transaction, I think, had an EBITDA of
22 5.9.
23 A Right.
24 Q So still in the ballpark, I guess?
25 A Yeah. I mean, when you look at kind of our

1 ultimate EBITDA applied, it was probably in the five range
2 or so, so same thing. I mean, in that -- or that
3 five-year period, they grew the business. They grew the
4 EBITDA. They didn't necessarily grow the multiple very
5 much from a sales standpoint. So, again, not reasonable
6 to use that as a benchmark value in an appraisal five
7 years prior to that.
8 Q But the EBITDA was not quite ten times what it
9 was at your valuation date.
10 A Right.
11 Q Would you expect a multiple to be higher if the
12 EBITDA was that much higher?
13 A Not necessarily. I mean, it's just a higher
14 EBITDA at that point. You know, have the fundamentals of
15 the business change to where it would, you know, warrant
16 paying a higher multiple than in prior years? I mean,
17 they did pay a higher multiple. I mean, a one times
18 multiple is -- is a pretty good increase off of a five
19 multiple. They did pay a higher multiple in that, you
20 know, subsequent transaction. But, again, I wouldn't say
21 it would have any bearing on, you know, a valuation I'm
22 doing as of five years prior to that --
23 Q Right.
24 A -- with a completely different financial mix in
25 the -- in the profitability.

1 Q Right. But just in general, you mentioned before
2 when you were talking about the -- I can't remember what
3 it was called -- but the public companies. You know,
4 bigger public companies had a higher multiple. So it --
5 would that -- would that apply in this range also or
6 not -- not necessarily?
7 A No, not necessarily. Because again, those are
8 publicly traded companies. That's data coming right off,
9 you know, their stock price and their financial metrics.
10 You're still comparing them to a closely held company.
11 Even though that company's EBITDA grew ten times, it's
12 still not even close to the size of what -- you know, what
13 those public companies would be as far as profitability,
14 revenue, anything. So to me, there wouldn't be a big
15 adjustment in the multiple for that.
16 Q Would the income stream reflected in the EBITDA
17 be more reliable if it was bigger, or is that a conclusion
18 that's hard to make?
19 A It's -- it's hard to make. I mean, I will say
20 that the larger the company, you know, the more scrutiny
21 it goes through on its financials, especially if it's like
22 getting an audit or something like that. I know -- I
23 believe Peak Travel had, like, complied financial
24 statements by an accountant. So that's better than just
25 an internal QuickBooks statement printed off. So, you

1 know, there was a little bit of scrutiny done in the
2 compilation of the financial statements. But the larger
3 the company becomes, you know, more their just accounting
4 systems get more updated. There's a higher level of
5 scrutiny if you're going through an audit. But
6 ultimately, yeah, I don't -- at -- at that size, it still
7 isn't worth the kind of size I'm talking about where you'd
8 start to go through that heavier level of scrutiny.
9 Q Okay. Could you turn now to Exhibit 12, which is
10 Bob Sweeney's statement.
11 A Okay.
12 Q Now, do you know -- did you know Bob Sweeney
13 before this case?
14 A No.
15 Q So he has -- says his firm has been involved in
16 660 sales in the travel industry. Is that enough to make
17 him a credible authority?
18 A I would say absolutely yes. I mean, you've got
19 that much experience. You're involved in that actual
20 sales of companies. First of all, the level of data he
21 would have by being personally involved in that is beyond
22 anything that any valuation analysis would have. I mean,
23 he's got all that private data himself, since he executed
24 those transactions.
25 Q Right. And his EBITDA range is 2.5 to 6. So

1 that sounds reasonable also?
2 A Yeah. Like I said, still falling within the
3 range we used for Peak. It looks like it's falling within
4 the range that actual transactions were, you know, done
5 by -- with, you know, Journeys and Direct Travel. So it
6 doesn't seem unreasonable, that range.
7 Q And he -- he says that EBITDA is the absolute
8 driving force behind any reality-based valuation. Is that
9 also a reasonable statement?
10 A I mean, I would agree. Because again, investors
11 are concerned with cash flow. That's how you get your
12 return. It's in the end, we have revenues of X, but what
13 is my ultimate cash flow that I can use to continue to run
14 the business, to service my debt, and have something maybe
15 distributable to shareholders afterwards. And then if I
16 pay X, how long is it going to take to recoup that -- that
17 investment? So, you know, most private equity firms,
18 based upon my experience, they're going to want holding
19 periods anywhere from three to seven years with the
20 average kind of being around five years. So if you're
21 paying an EBITDA multiple of 10, 15, 20, there's no way to
22 recoup that investment within the, you know, standard
23 holding period that you're going to hold most of these
24 investments.
25 JUDGE HOSEY: Excuse me. Mr. Mather, we're

1 coming up on an hour here, just to give you a time frame.
2 MR. MATHER: Right. But I haven't used my two
3 hours before. So I've -- that's what I said upfront, that
4 they wouldn't all be equal. So the first one was closer
5 to a half hour. So if I could be granted some leeway.
6 JUDGE HOSEY: Are you still planning for an hour
7 for your closing arguments?
8 MR. MATHER: Less than 15 minutes.
9 JUDGE HOSEY: Okay. Then we can use a little of
10 that time.
11 MR. MATHER: Okay. Thank you.
12 BY MR. MATHER:
13 Q So now, I'd like you to turn to the Arxis report,
14 which is Exhibit C.
15 A Okay.
16 Q All right. If you could go to page 9, this is
17 the CV of Chris Hamilton who prepared this report. How
18 would you compare your qualifications to Mr. Hamilton's?
19 A Well, he has nice qualifications, but I would say
20 that, you know, he has a CVA, which is Certified Valuation
21 Analyst. But he's also a CPA and a CFE, Certified Fraud
22 Examiner. So, you know, as far as amount of time spent
23 between the different -- the three different kind of
24 practices, I would say that my -- my experience is 100
25 percent appraisal valuation related. I don't have a CPA.

1 I don't do any tax work, audit work, anything like that,
2 any forensic accounting work. It's 100 percent business
3 valuation where, you know, he obviously has other
4 designations and other areas where he spends his time, you
5 know, on projects.
6 Q So what's a CVA?
7 A That is a -- it's a designation through NACVA,
8 which is the National Association of Certified Valuation
9 Analysis, which I believe has fallen under the, AICPA,
10 which is the guidelines for CPAs. And so the CVA is a
11 designation that they give, through that organization,
12 primarily to CPAs. So you can be a CPA, Certified Public
13 Accountant, and say, all right, I want to do valuations
14 too. I'm going to get the CVA designation also through my
15 association.
16 So it's just a different association, and it's --
17 it's not as stringent, especially if you have a CVA -- CPA
18 to get. Because if you have a CPA, you're kind of almost
19 granted that through a much less robust process. I
20 believe it's like you have to submit one report that
21 you've completed within a 12-year period and take one,
22 like, five-hour exam, and you can get the CVA. Where, you
23 know, I do valuations. And then I have my ASA through
24 VASA, and that's, you know, like I said, a much more
25 rigorous process. And all my time is just spent doing

1 valuations.

2 Q So it's, as you understand it, like a

3 specialization designation for CPAs?

4 A Exactly.

5 Q Now, if you could turn to page 1. In the second

6 to the last full paragraph, it references tangible value

7 of $293,000 and intangible value of $8,707,000. What is

8 tangible and intangible value?

9 A Well, what he's referencing to here is, you know,

10 the value indication being $9 million. If you look the

11 stockholder's equity as of the valuation date, it was

12 $293,000. So where is the rest of the value in that

13 $9 million? All in the intangible value, he's saying. So

14 intangible value being good will, customer relationships,

15 things like that. So it's a really high kind of ratio of

16 intangible to tangible value. We know there's not a lot

17 of tangible value in these service companies like this.

18 But the intangible value there seems abnormally high

19 relative to -- not only that, but not only to the -- to

20 the earnings. Because intangible value, that's all

21 supported by excess earnings.

22 So when you're looking at intangible value, let's

23 say that covered customer relationships, which I value as

24 part of financial reporting. That's all done on the

25 excess earnings of the business. So if you don't have,

1 you know, all those earnings to support that value,
2 there's -- it just doesn't make sense. So really, even
3 though you're kind of breaking these two out, that
4 intangible value has to be supported by earnings.
5 Q And was there any evidence in the Arxis report
6 that it was supported by earnings; I mean, an actual
7 computation based on real earnings?
8 A No.
9 Q So what --
10 A There was no earnings approach.
11 Q Yeah. So what did Arxis use as their method?
12 A Arxis used the price to revenue multiple as their
13 only indication of value.
14 Q And where -- well, let's see. Let's turn to
15 page 36 of the report, the Arxis report, Exhibit C?
16 A All right.
17 Q So how does this explain how Arxis came up with
18 its value?
19 A So this is information out of deal stats which
20 tracks private transactions. So these are like brokers
21 who are selling businesses, like Mr. Sweeney, but they
22 actually give the data to this deal stats to kind of build
23 the database of private transactions. Now, again, it's
24 not all encompassing at all whatsoever. And a lot of the
25 data in these kinds of things are missing because you

1 could see certain factors are just not reported for it.
2 So what he's doing -- like, if we take, for
3 example, the very first one. He's taking, you know, the
4 net sales amount of $2 million and dividing that by a
5 market value of invested capital and comes up with a
6 invested capital of sales ratio of .04. So he's looking
7 at all those invested capital of sales ratios and
8 determines, okay, what am I going to apply in the case of
9 Eco? And in this case, he took 0.12 of revenue. But,
10 again, you're kind of mismatching, to me, the data because
11 he's applying it against the gross revenue of the company,
12 which we've been through, that they don't collect that
13 money at all.
14 They don't even see it flow through their bank
15 account. The actual revenue of the company is that net
16 amount, which is closer to that $9 to $10 million a year.
17 So if you take that same multiple, which is based off of
18 net sales and all these transactions, you'd end up with,
19 you know, a considerably lower value in the kind of
20 million -- if you apply the same 0.12 multiple, kind of in
21 that million -- million-two range for that valuation.
22 Q And would that then be adjusted for the assets
23 and liabilities?
24 A Yes, because this is a market value of invested
25 capital multiple. So once you -- the value you're

1 determining for that, that $11.4 million, is both the debt
2 and the equity. So then you'd have to subtract the debt
3 for that. It's just the application of this multiple to
4 the company's gross sales isn't appropriate.
5 Q Okay. So he basically applied the factor to the
6 wrong number?
7 A Right.
8 Q And I think you've just said, but I'll repeat it.
9 And if he had applied it to the right number then he's in
10 the ballpark of us?
11 A Yeah. If you take that 0.12 times, let's say $10
12 million, you're at a million-two at that point. So still
13 a little lower but --
14 Q One of the things that I see is that in the -- in
15 the kind of the highlighted line MVIC to net sales, it has
16 a range of 0.04 to 0.83.
17 A Right.
18 Q Is that a reliable indicator if it's got a range
19 of 20 times?
20 A In the valuations that I have performed, sales
21 and sales multiples are really not applicable to almost
22 all businesses. Because if you're going to apply a price
23 to revenue or a price to sales multiple or a revenue
24 multiple, there are certain valuation steps and theories
25 you kind of need to go through to see if that's even

1 applicable. Typically, what we do -- and this gets a
2 little bit kind of technical -- is we'll run a regression
3 analysis where we look at price to revenue multiples of
4 our transactions or guideline companies and compare them
5 to a profit margin, which is typically EBITDA.
6 You run that regression analysis. And if there's
7 a good correlation between the two, then maybe a revenue
8 multiple might be applicable. Ninety-nine percent of the
9 time there is no correlation, and it's just not an
10 applicable multiple. So that's why EBITDA is the driving
11 factor in almost all valuations because it's a reliable
12 multiple. There's no mixing of theories within it. It --
13 there's no correlation between other multiples like you
14 would with a price to revenue multiple.
15 So first of all, just the application of that
16 multiple isn't appropriate. And here, you have a wide
17 range of multiples. And, again, if you look at kind of
18 the size of the companies and everything else, there
19 doesn't seem to be any correlation. And you really can't
20 do that correlation because there's just not enough
21 profitability information in here to do that.
22 Q And was there any indication in the Arxis report
23 that they did any kind of that regression analysis to see
24 if it was a worthwhile factor?
25 A No. It just says they looked at these range of

1 multiples and selected the harmonic mean as being the
2 appropriate one to apply.
3 Q And what's the "harmonic mean?" Do you know what
4 that is? I've never heard of it before.
5 A To be quite honest, I'm not familiar what a
6 harmonic mean is. Typically, we're looking at -- you
7 know, in our analysis we're looking at high, low
8 multiples, average medians, and then 75th and 25th
9 percentiles. That's the range of multiples we'll
10 calculate, and we'll be able to determine something off of
11 that. The harmonic mean I'm not familiar with at all.
12 Q Maybe -- maybe it sung to him?
13 A It could be.
14 Q So he had also indicated that these were the only
15 12 transactions in the recent time frame. The latest of
16 which was a couple of years before the -- the one at
17 issue. We heard this morning that there's hundreds of
18 travel agency sales during the year. What would account
19 for the fact that he could only find 12, and none of them
20 were close in time?
21 A Right. Well, that's the limitation of these data
22 basis, and there are limitations for us too. But, you
23 know, especially with the deal stats because those are
24 private. Those are private transactions. You know,
25 obviously we just heard there's approximately 700 a year,

1 yet he can only find 12 of them over a decade period,
2 because all of those transactions aren't being funneled
3 and reported to this deal stats database.
4 It's brokers who have relationships with deal
5 stats who are doing these -- these transactions and
6 providing the information. I don't know if they get paid
7 for it, but they're providing the information. So there's
8 just a myriad. There's, you know, if you look at 700 and
9 you found 12 over a 10-year period, that means 98 percent
10 of them aren't even being reported through a database.
11 Q Now, one of the other things that the Arxis
12 report says is that they had incomplete information to do
13 some part of an analysis that they preferred to do. Does
14 that seem like a rational excuse?
15 A Well, I think it's, you know, the -- they did one
16 approach. And, again, when I'm doing a valuation, I want
17 to do as many approaches as possible because they sanity
18 check each other. They crosscheck each other. When you
19 look at transactions and guideline companies and an income
20 approach, when you kind of pull your analysis together,
21 they should make sense. Otherwise, if you have a
22 standalone approach, and you're selecting one, you have
23 absolutely nothing to sanity check that against. But in
24 this case, you know, his report does show, you know, our
25 exhibit that has five years of historic financial

1 statements, five years of historic EBITDA, you could have
2 just done a capitalization of income approach based off of
3 that, even if you didn't want to do a projected thing.
4 That's where you look at the company's historic
5 EBITDA. You come up with kind of what you think the
6 average EBITDA be. And they may even be the current
7 $287,000, but let's round it to $300,000. Then you come
8 up with a -- you build a required rate of return, and all
9 you do is you take that number, divide it by that required
10 rate of return; that's your capitalization of income. You
11 get a value indication based on that. That at least would
12 have provided a sanity check.
13 So if you've got a $300,000 EBITDA and let's say
14 a 10 percent capitalization rate, it's just like Shark
15 Tank. That turns into, you know, a $3 million value
16 indication; so not even that. And then you would compare
17 that to your transaction approach at $11.4 million and go,
18 wait. My earnings are not supporting this multiple
19 approach that I'm doing over here. What's going on?
20 Don't make sense. They don't correlate very well. So I
21 think the information was there through at least one
22 approach like that.
23 Q So the failure to do that -- I mean, did that, in
24 your view, prevent this from being a credible valuation?
25 A Yes. I believe so because it's just -- you --

1 you can't look at one thing on a standalone basis when
2 there's data out there. And there was data in here --
3 financial data that you could have done a secondary
4 approach, again, to crosscheck. Because he may have saw,
5 oh, well, this indication is coming up based upon a
6 capitalization earnings of $1.5 million, $2 million. Why
7 am I getting a $12 million indication out of my market
8 approach? You know, to me, on the market approach, is
9 because mixing apples and oranges and the basis that they
10 apply the multiple to.
11 Q So the value, as we said, is $11.4 million, an
12 enterprise value before adjustment. And the EBITDA was
13 $287,000. What's the -- what's the rate of return or the
14 pay back or the ROI or whatever you want to call it on
15 that?
16 A Yeah. I mean, you're looking at you know, at
17 multiple of about 39, 40 times EBITDA at that point. So
18 when you're looking at rates of return, you're looking at
19 kind of the inverse of that it. That's about a
20 two-and-a-half percent rate of return on your investment
21 per year.
22 Q And so, yeah, I guess --
23 A I was just saying because that, you know as an
24 investor, am I going to invest eleven-and-a-half million
25 dollars for at two-and-a-half percent rate of return based

1 upon this company's financial performance? Or can I just
2 take an alternative, throw it into a money market account
3 and earn 4 percent right now, or invest in the S&P 500,
4 which is a historically return of 10 percent? And that's
5 a diverse -- 500 company diverse portfolio of publicly
6 traded companies, much safer than in a closely-held
7 business like this. So a return like that is just --
8 it's -- no investor would accept that.
9 Q So how far off do you think that 11.4 is?
10 A Well, I think it's -- to me, it's the approach
11 that was done was applied against the wrong metric. So if
12 you look at kind of what's been, you know, talked about
13 here, you know, it's almost like a 10 to 1 adjustment if
14 you apply it to the correct metric. So you're talking 85
15 to 90 percent off, based upon just calculating the -- the
16 differential and revenue that that multiple was applied
17 to.
18 Q So ten times wrong?
19 A Right.
20 MR. MATHER: I don't have no further questions.
21 JUDGE HOSEY: Thank you, Mr. Mather.
22 And thank you, Mr. Sieman. I want to see if the
23 Franchise Tax Board has any questions for you.
24 MR. SIEMAN: Okay.
25 JUDGE HOSEY: Ms. Kuduk, do you have any

1 questions for Mr. Sieman?
2 MS. KUDUK: No. I have no questions. Thank you.
3 JUDGE HOSEY: Okay. Thank you.
4 I'm going to move to my panel and ask
5 Judge Vassigh, do you have any questions for Mr. Sieman?
6 JUDGE VASSIGH: I don't have any questions.
7 Thank you, Mr. Sieman.
8 MR. SIEMAN: Thank you.
9 JUDGE HOSEY: Thank you.
10 And I'm going to go to Judge Lam.
11 Do you have any questions for Mr. Sieman?
12 JUDGE LAM: No questions. Thank you.
13 JUDGE HOSEY: Okay. Thank you.
14 We really appreciate your time and attention in
15 this matter, Mr. Sieman. I know it's been a long day. We
16 really appreciate everything you've given to us today.
17 MR. SIEMAN: Thank you.
18 JUDGE HOSEY: Okay. Mr. Mather, would you like a
19 short recess before we to arguments, or are you ready to
20 move into your closing argument?
21 MR. MATHER: I'd prefer 5 or 10 minutes, if we
22 could have it.
23 JUDGE HOSEY: Yeah. Let's do five minutes. So
24 let's be back at 3:05.
25 (There is a pause in the proceedings.)

1 JUDGE HOSEY: We are back on the record.
2 And we are moving to Appellant's legal arguments.
3 Mr. Mather, are you ready to begin?
4 Oh, I can't hear you. Sorry. I think you're
5 muted.
6 MR. MATHER: Oh, okay. All right. I thought I
7 did that. I was doing something different.
8 JUDGE HOSEY: Anyways, thank you.
9 MR. MATHER: Okay. So just one thing, Jamie, if
10 you don't want to stay on for the rest, you don't have to.
11 You are excused, I believe.
12 Isn't that correct?
13 JUDGE HOSEY: Yes. You are excused, Mr. Sieman,
14 thank you so much for your time. You don't have to stay
15 if you'd like to leave.
16 MR. SIEMAN: Thank you. I appreciate it.
17 JUDGE HOSEY: Thank you.
18
19 PRESENTATION
20 MR. MATHER: Thank you.
21 So I started with my opening statement by
22 wondering why we're here, and I still wonder why we're
23 here. Again, I'll go through the issues. On the second
24 issue first, the installment gain, the party seem to agree
25 what the law is, and let's take a look at what the

1 evidence is. As we heard from Mr. Coffman, this was not
2 really an earn-out in the traditional sense. It was an
3 earn up. It was a possible future payment, certainly
4 contingent based on future events, not based on a payout,
5 you know, of -- based on the historical performance of the
6 business. It was based on something that was different.
7 So his statement was -- or his testimony was that
8 he thought the thing had no value. So if we're looking
9 for a valuation, according to Appeal of Amarr, the only
10 evidence we have in the record of any valuation is
11 Mr. Coffman's assessment that has zero value at all. If
12 you don't want to accept Mr. Coffman's statement of a zero
13 value, we also have the value of what was actually paid.
14 That's $3,537,500 that was based on the one-year period
15 that was applicable for the potential payment. So those
16 are the only two pieces of evidence that we have in the
17 record.
18 The other thing we have in the record is we have
19 this pie in the sky cap on what it could possibly be.
20 That's no kind of valuation that anybody believed in but
21 the Franchise Tax Board. In spite of the language in the
22 Appeal of Amarr, which says that if you don't have a great
23 valuation as of the date, then the actual payments are
24 good evidence of what the value is. In spite of that,
25 this case that the Franchise Tax Board supposedly has

1 adopted, as they said in the prehearing conference,
2 they're -- they're still sticking with $8 million, which
3 is just nonsense. It's gibberish. Maybe it's $3.5
4 million, maybe it's zero, it's not $8 million. There's
5 not even a colorable claim to $8 million.
6 Okay. So the second issue then, is the built-in
7 gain issue that we spent most of the testimony on. And
8 critically, again, what we have is that we have the entire
9 Franchise Tax Board determination based on the Arxis
10 report where the guy that authored the report wouldn't
11 even come here to defend it. So FTB couldn't get any --
12 couldn't get him here. Couldn't get anybody here. We
13 have been making these arguments since our reply brief
14 18 months ago and still nothing. So as I said before, I
15 think FTB has abandoned the determination by the failure
16 to put on any credible evidence whatsoever. Certainly,
17 not entitled to any presumption of correctness based on
18 this piece of paper that -- that nobody thinks has any
19 credibility whatsoever.
20 And why is that? Well, because as the evidence
21 showed, we have it that the author of the report is a CPA,
22 a forensic accountant with a part-time appraisal
23 designation. That's the author of the report. He used a
24 revenue basis formula when the entire industry uses
25 EBITDA. Not only the travel industry, but basically any

1 type of valuation of a business from an investment
2 standpoint is based on EBITDA. And why is that? Because
3 that determines how quickly you're going to get your money
4 back. Revenue determines nothing. It could have a
5 correlation.
6 In this case, he didn't prove a correlation. He
7 used the wrong amount for the revenue. He used the gross
8 bookings, the air sales, I think as Mr. Coffman referred
9 to it, not -- not the agency's actual gross revenue. And
10 that -- that alone reconciles the Arxis report with our
11 report. Because as everybody testified, the Arxis report
12 is off by at least a multiple of ten. And the difference
13 between the air sales and the gross revenue of the agency
14 is a multiple of ten. So if you eliminate that single
15 error, then you get to the point where Arxis and -- and
16 the four bits of appraisal information that we have are
17 basically within a very reasonable range.
18 So wrong number, wrong method. He used the MVIC
19 factor, which from his sample of 12 transactions over
20 ten-year period in which there were probably 7 -- 70,000
21 transactions -- if I got my math right. 700 a year for
22 ten years -- 7,000. Sorry. Seven-thousand transactions,
23 he finds 12 and comes up with an MVIC as his real
24 indicator of value that has a range from 0.04 to 0.83, a
25 range of 20 times. So not -- not an indicator that has

1 any high degree of correlation to the values from his own
2 sample. And he doesn't do any kind of analysis to say why
3 that is. He just picks a number and applies it to the
4 wrong revenue item.
5 He also, as was highlighted by -- certainly by
6 Jamie Sieman -- ignored -- absolutely ignored five years
7 of earnings history, reported and incorporated it in his
8 report. Reported in the Marshall's & Stevens in Exhibit 3
9 to their report. Five years of earning history he ignores
10 entirely and so therefore, has no check on his wild
11 conclusion of $11.4 million of enterprise value.
12 So -- and -- and finally as was made -- I think
13 the point was made by every one of the witnesses here.
14 Who pays $11 million for a business that earns $287,000?
15 Nobody. Nobody pays that. Nobody pays anything near
16 that. Nobody pays $1.4 million for that, much less $11.4
17 million. It's just an absurd piece of garbage that can't
18 support anything in this case. And we've been fighting
19 against this for years with the Franchise Tax Board
20 hanging on to, I guess the burden of proof. Which they
21 are absolutely cannot be entitled to in this case when
22 it's so clear that the entire basis of the determination
23 is just a complete fabrication.
24 So what is the evidence in the case? So -- well
25 we've got evidence from four witnesses, essentially,

1 counting Joselyn -- but if you don't count Joselyn,
2 because he's retired and is not here -- three live
3 witnesses that said EBITDA is what drives the valuation of
4 a service business, and specifically two extremely
5 qualified industry experts that says in the travel agency,
6 it's -- it's basically the foundation of the negotiation.
7 Now, Arxis didn't seem -- didn't see it worth to even test
8 their assumption with. But that's what the industry --
9 that's what the market is. It's like saying I'm -- I'm
10 appraising the market value without looking at the market,
11 but we -- we can look at the market.
12 We have Sweeney, we have Coffman, and we have
13 Sieman that all said EBITDA is the driving force. We have
14 EBITDA. We have in Exhibit 3 to the Marshall & Stevens
15 report. We have $287,121. There's no serious question
16 that that's the real EBITDA number. It was applied
17 basically by everyone, and it was very consistent with the
18 five-year trend for the business and the typical amount of
19 EBITDA based on the volume of real sales from this agency.
20 So we've got the EBITDA. Then we've got the
21 multiple witnesses basically testifying to an EBITDA
22 multiple of two-and-a-half to six times. Sweeney says
23 two-and-a-half, six -- to six times exactly. Coffman said
24 maybe in a very large -- a very, very large agency it
25 could go higher, maybe as high as 8 or 9. But almost all

1 of the transactions are six or less. And we have Sieman
2 who used five based on comparable sales, and 5.9 based on
3 an analysis of publicly held companies. So everybody --
4 everybody -- all the evidence, all the credible evidence
5 in this case is an EBITDA of six or less. And we've got
6 Arxis with an EBITDA of 40.
7 So also, the other adjustment is if you look at
8 the Marshall & Stevens report in Exhibit B, we spent some
9 time on page 36, the balance sheet items. The EBITDA
10 multiple determines the enterprise value. Balance sheet
11 items vary from company to company and need to be adjusted
12 out. That's what Marshall & Stevens does. So that's --
13 nobody is really contesting the adjustments for the
14 balance sheet item. So what we're left with is
15 Marshall & Stevens has a $710,000 valuation based on
16 industry standards, confirmed by experts in the industry,
17 experts in transactions in the industry. It has
18 impeccable professional qualification, not a part time
19 CPA. He's independent, analytical. Tested it three
20 different ways to determine that the conclusion was
21 appropriate and, as I said, backed up by Sweeney Coffman
22 and Joselyn. All three of those additional sources of
23 detailed industry expertise confirming the
24 Marshall & Stevens report.
25 So what we have from the Franchise Tax Board is

1 nothing. We have absolutely nothing credible other than,
2 well, maybe it was this. It could have been that. We
3 found this ridiculous Arxis appraisal to be the most --
4 the most appropriate means, quite clearly because it was
5 ten times anything realistic, and that supported a better
6 adjustment. But there's nothing -- the actual evidence,
7 you know, if Arxis had come in and explained these
8 seemingly glaring errors in the report, maybe we'd have
9 something. We're left with nothing on the side of the
10 Franchise Tax Board and nothing to sustain that
11 determination.
12 That concludes my remarks.
13 JUDGE HOSEY: Thank you, Mr. Mather.
14 I'm going to see if my panel have any questions
15 for you before we move forward.
16 Judge Vassigh, do you have any questions?
17 JUDGE VASSIGH: I don't have any questions at
18 this time. Thank you.
19 JUDGE HOSEY: And, Judge Lam, do you have any
20 questions?
21 JUDGE LAM: No questions at this time. Thank
22 you.
23 JUDGE HOSEY: Okay. Mr. Mather, you will a
24 period for a final statement after FTB's presentation,
25 just to forewarn you.

1 MR. MATHER: Thank you.

2 JUDGE HOSEY: Thank you.

3 Moving to the argument for the Franchise Tax

4 Board, Ms. Kuduk, are you ready to begin your

5 presentation?

6 MS. KUDUK: Yes.

7 JUDGE HOSEY: Thank you.

8

9 PRESENTATION

10 MS. KUDUK: Okay. I'm going to start with the

11 facts. In July 2007, PTG purchased Ambassador for $2.52

12 million, increasing PTG's yearly sales by $29 million. On

13 August 17th, Joselyn estimated PTG's selling price at

14 $1.9 million in an asset sale and $740,000 in a stock

15 sale. November 1st, PTG converted from a C corporation to

16 an S corporation. Five years later on November 1st, 2014,

17 Direct Travel bought PTG for $23. -- $25.3 million with

18 one contingent payment made in 2016. Per the sales

19 agreement, up to $8 million of the sales price was

20 designated as an earn-out based on gross income for a

21 period ending in 2006.

22 As part of the sale, Appellants made an internal

23 revenue code section 338(h)(10) election, which designated

24 the sale as an asset sale. Further, Section 7.4(i) of the

25 sales agreement obligated Direct Travel to pay any tax

1 liability associated with the Section 338(h)(10) election
2 and the built-in gain. No built-in gain was reported by
3 PTG nor Direct Travel.
4 In 2015, Marshall valued PTG's fair market value
5 at $710,000 as of November 1st, 2009. The Marshall's
6 valuation was prepared for John Coffman, who is the CFO of
7 Direct Travel. In 2019 Arxis valued PTG's fair market
8 value at $9 million as of November 1st, 2009.
9 Respondent's determination of a deficiency is presumed
10 correct. Appellants have the burden to prove that Arxis'
11 valuation, which Respondent used to prepare the proposed
12 tax assessment, is erroneous. Appellants haven't met that
13 burden. Both issues in this case depend on fair market
14 value.
15 As we heard previously, fair market value is
16 defined as the price at which property would change hands
17 between a willing buyer and a willing seller when the
18 former is not under compulsion to buy, and the latter is
19 not under any compulsion to sell. Both parties have
20 reasonable knowledge of the facts. Courts have determined
21 that fair market value is a question of fact. Fair market
22 value doesn't -- doesn't substitute for debt. It doesn't
23 subtract for debt. Fair market value is the value of --
24 that what it will be sold for in an open market. You
25 can't have two fair market value determinations based on

1 the structure of a deal, this one fair market valuation.
2 Using the factors of Revenue Ruling 3960, there
3 are three approaches to valuation, which we've heard
4 before. There's the income approach, which uses the
5 present value of the business's future income stream; the
6 net asset value approach, which aggregates the net value
7 of the assets of the business at a fixed point in time;
8 and the market approach, which compares the company to an
9 arms-length transaction involving sales of similar
10 corporations, or its own sales. Arxis relied on the
11 market approach using sales of comparable companies and
12 PTG's 2007 purchase of Ambassador.
13 Marshall used an income/market approach based on
14 net income. But Arxis noted that Marshall did not adjust
15 for net income for nonoperating income and expenses,
16 nonrecurring income and expenses, related party
17 transactions, and most importantly, owner officer
18 compensation. Also Arxis stated that Marshall did not
19 properly account for the acquisition of Ambassador or
20 intangible assets.
21 So the first issue in this Appeal is the built-in
22 gain. And the built-in gain is calculated by subtracting
23 the basis from PTG's fair market value on
24 November 1st, 2009, the date of its S corporate election.
25 For 2014, California law requires an S corporation to pay

1 C Corporation tax rates on any gain recognized within ten
2 years of the S corp election is taxable. Appellants did
3 not report any built-in gain, but now acknowledge that
4 their built-in gain is taxable. However, Appellants
5 dispute the correct amount of the built-in gain.
6 Section 7.4(i) of the sales agreement requires
7 Direct Travel to pay any tax liability associated with
8 built-in gain and associated with the 338(h)(10) election.
9 So at issue in this appeal is PTG's fair market value on
10 November 1st, 2009, and the correct amount of built-in
11 gain.
12 So as we've heard -- we've heard all afternoon,
13 Appellants present two reports. The first is the Joselyn
14 report, which is not a valuation of fair market value but
15 an estimated selling price of undetermined date. The
16 Joselyn estimates PTG's selling price at $1.95 million in
17 an asset sale. And here, PTG made a 338(h)(10) election
18 which treated the sale as if PTG sold the assets to Direct
19 Travel and then liquidated, distributing the proceeds to
20 PTG's shareholders. This was done so Direct Travel could
21 get corresponding depreciation.
22 At a minimum, this report gives PTG an estimated
23 selling price of $1.95 million, not $745,000, a price
24 discounted for a stock sale, which does not address the
25 facts of this appeal in which a 338(h)(10) election was

1 made. Further the Joselyn report was done in August 2008.
2 PTG bought Ambassador for $2.52 million a year earlier.
3 This report does not address the value of those assets,
4 nor this $29 million increase in PTG's sales.
5 The second report is the Marshall report. The
6 Marshall report provided a fair market value opinion of
7 $710,000 for PTG as of November 1st, 2009. Again,
8 according to Arxis, this valuation failed to normalize net
9 income for nonoperating income and expenses, nonrecurring
10 income and expenses, related party transactions, and owner
11 operated compensation. As Mr. Sweeney said, EBITDA can be
12 compressed presumably because the cash has been taken out
13 of the company for compensation. The accuracy of a
14 valuation depends on the validity of the assumptions used
15 in the calculations.
16 Here, Arxis stated that Marshall's assumptions
17 were faulty, as Marshall's valuations did not account for
18 profit taking, which compressed net sales. The valuation
19 did not consider the acquisition of Ambassador. And the
20 valuation did not properly account for intangible assets
21 or goodwill. Mr. Coffman said the cost deviate in a
22 company. But here, Arxis says the valuations did not
23 account for these deviations. Appellant's valuations were
24 also inconsistent with the net asset value approach.
25 In 2009, PTG's assets totaled $3.6 million.

1 Long-term debt was $2.4 million. So using the net asset
2 approach, Arxis noted that PTG's values would be at least
3 $1.2 million. Using this valuation method, PTG would be
4 valued at least half-a-million dollars more than
5 Appellants allege, but inline with the $1.95 million
6 expected sale price stated in the Joselyn report.
7 The third valuation type is the market approach.
8 Arxis relied on the market approach using the sale of
9 comparable companies to PTG. Respondent found that Arxis
10 valuation of $9 million was the better valuation because
11 it relied on data from comparable transactions, 12 in all,
12 and emphasized the amount PTG paid for Ambassador in 2007.
13 Arxis also used market value of invested capital and MVIC,
14 which Respondent found more accurately valued PTG because
15 it included business intangible assets and goodwill.
16 Further, applying MVIC to the purchase of PTG in
17 2014 yields an MVIC to sales ratio of 15 percent. This is
18 comparable to the ratios used by Arxis in valuing PTG on
19 November 1st, 2009. In contrast, Marshall applied an
20 industry-based multiple to pretax cash flows. This method
21 discounts the value of PTG improperly, according to Arxis,
22 because it does not account for the increased expenses and
23 salaries as revenues increased.
24 Further, the Arxis valuation was more
25 representative of what PTG actually sold for in 2014, and

1 the value of the assets PTG bought in 2007. An
2 arms-length sale relatively close in time may be
3 indicative of fair market value of a closely held company.
4 Five years after the 2009 valuation, Direct Travel bought
5 PTG for $25.3 million, bolstering the credibility of an
6 Arxis valuation of $9 million as of November 1st, 2009.
7 Given these facts, it was Respondent's determination that
8 the valuation of $9 million was the more accurate
9 estimate.
10 The second issue in the appeal is the correct
11 amount of tax to be paid on the $8 million earn-out
12 payment. And I think I want to take this moment to
13 explain that I think Appellant's misunderstand what's
14 taxable in this second issue. They say that Coffman has
15 valued the earn-out payment at zero. They say they got
16 $3.5 million in 2016 but the actual -- the actual amount
17 that's taxable is a 2014 value. That's when the fair
18 market value of the contingent payment needs to be made.
19 And I understand that Appellants also say that
20 that is not inline with the precedential case of Appeal of
21 Amarr. However, that's incorrect because if you read
22 footnote 17 of the Appeal of Amarr, it specifically says
23 what's at issue in the Appeal of Amarr is not the fair
24 market value, but when the taxes should be paid, and the
25 valuation of the contingent payment was yet to be

1 determined. So in this appeal that is what is at issue.
2 What amount do we use for the fair market value of the
3 contingent payment?
4 So Respondent's position is this $8 million
5 maximum sales price listed in the sales agreement, and
6 that's the fair market value of the earn-out as of
7 November 1st, 2014. Appellants assert it's the
8 $3.5 million, then they assert it's zero. I'm not really
9 quite sure what their position is. Appellants elected to
10 treat the stock sale as an asset sale per
11 Section 338(h)(10). Appellants' election means that all
12 of PTG's assets were sold on November 1st, 2014, and the
13 proceeds were deemed sale of their assets were treated as
14 a distribution to the shareholders of PTG. The contingent
15 payment obligation is included in that distribution.
16 Therefore, the $3.5 million received in 2016 is also
17 irrelevant. Also, and an expert's opinion 2002 -- in 2024
18 is also irrelevant.
19 Appellants have the burden to show the fair
20 market value of the contingent payment obligation on
21 November 1st, 2014. They have not met that burden.
22 Again, Mr. Coffman's testimony on the mechanics of the
23 earn-out and how much it could be valued is irrelevant.
24 Appellants needed to have a fair market valuation of that
25 contingent sale obligation as of 2014 when they

1 distributed it to their shareholders. That's the
2 transaction that's being taxed.
3 The gain recognized on the deemed distribution is
4 a difference between the fair market value of the
5 contingent payment obligation and the basis in that
6 obligation on the date of the deemed sale. Payments
7 received after the close of the year in which a
8 disposition of assets occurs are taxed per Internal
9 Revenue Code Section 453(c) as installment payments.
10 California conforms to Section 453(c). Contingent
11 payments are taxed as installment payments.
12 I'm sorry. This is going to be long.
13 Treasury Regulation Section 1.338(h)(10)-1(d)(8)
14 8 states that in the case of an installment sale, the
15 corporation is treated as distributing the installment
16 obligation to the shareholders in exchange for their
17 recently sold stock. The gain recognized on the
18 distribution of the contingent payment obligation to the
19 shareholders is what's taxed in this appeal. Per
20 California Revenue & Taxation Code Section 24672, the
21 unrecognized income of installment obligations held by a
22 corporation must be recognized in the corporation's final
23 year, and that is subject to tax.
24 Because PTG filed its final tax return in 2014,
25 it must report the gain realized on the deemed sale of

1 assets in 2014. According to Amarr, the unreported income
2 is the difference between the fair market value of the
3 contingent payment obligation at the time of distribution
4 and the basis in the obligation. Again, as I said before,
5 the question in this appeal is whether the fair market
6 value of the contingent payment obligation is $8 million,
7 which is the maximum selling price stated on the sales
8 agreement. Absent any evidence from Appellants to the
9 contrary, such as a valuation report, Respondent can only
10 assume the maximum selling price is the fair market value.
11 Additionally, there's regulatory guidance that
12 the maximum selling price would be treated as the fair
13 market value for purposes of recovering basis when
14 applying the installation method -- I'm sorry -- and
15 installment method. And Appellants have stated on their
16 3805E form that the sale was valued at $23.5 million,
17 using the fair market value of $8 million for their
18 contingent payment obligation.
19 Valuation is an estimate. Courts tell us in an
20 actual arms-length sale in the normal course of business
21 within a reasonable time before or after the valuation
22 date is the best evidence of fair market value, because it
23 shows the actual value of the company. Here, five years
24 from the date of valuation, Direct Travel bought PTG for
25 $23.5 million. And one year earlier PTG bought Ambassador

1 for $2.52 million. Further, the fair market value of the
2 contingent payment is $8 million because Appellants have
3 provided no evidence to the contrary. They have not met
4 their burden of proof.
5 In conclusion, Appellants bear the burden of
6 proof to show that Respondent's deficiency and in turn,
7 its valuations, are in error. Appellants have not met
8 that burden. Respondent properly proposed a tax
9 adjustment to include built-in gain from the sale of PTG's
10 assets and from the distribution of the contingent payment
11 obligation. So Respondent's notice of assessment should
12 be upheld.
13 Thank you.
14 JUDGE HOSEY: Thank you. I'm going to check with
15 my panelist to see if there are any questions for you,
16 starting with Judge Vassigh.
17 JUDGE VASSIGH: I do have a question for
18 Ms. Kuduk. You indicated and talked about this, so I
19 would just like to ask you to clarify for us. Is it FTB's
20 position that the relevant law precludes reliance on
21 EBITDA as a valuation method?
22 MS. KUDUK: I'm so sorry. You're glitching in
23 and out. Can you say that again?
24 JUDGE VASSIGH: Okay. I just wanted to clarify.
25 Is it FTB's position that the relevant law precludes the

1 use of EBITDA as a valuation method in this case?
2 MS. KUDUK: When you say relevant law, what law
3 would that be?
4 JUDGE VASSIGH: You assessed the valuation
5 methods that FTB looked at. And, you know, I'm just
6 wondering if you're saying EBITDA cannot be considered a
7 reliable valuation method?
8 MS. KUDUK: Oh, because of Revenue Ruling 5960?
9 JUDGE VASSIGH: Hm-hm.
10 MS. KUDUK: Oh, I see what you're saying. I
11 would have to confer with my cocounsel. Is that a
12 problem?
13 JUDGE VASSIGH: Judge Hosey, can we give FTB a
14 few moments?
15 JUDGE HOSEY: Do you want five minutes?
16 MS. KUDUK: Yeah. He's not in the same room as I
17 am. So I'm going to have to call him. Sorry. Yeah.
18 JUDGE HOSEY: Okay. Let's take a quick
19 five-minute break, and then that will be -- what is it? --
20 3:45 we'll reconvene.
21 MS. KUDUK: Okay. Thank you.
22 JUDGE VASSIGH: Thank you, Judge Hosey.
23 JUDGE HOSEY: And so let's just turn off our
24 cameras and microphones. Yeah. We'll see you all in five
25 minutes.

1 (There is a pause in the proceedings.)
2 JUDGE HOSEY: We're back on the record.
3 We're returning to Respondent Franchise Tax
4 Board.
5 Ms. Kuduk, did you have a response?
6 Oh, Ms. Kuduk, are you there? Can you hear me?
7 MS. KUDUK: Yeah.
8 JUDGE HOSEY: Did you have a response?
9 MS. KUDUK: I'm going to hand you off to my
10 cocounsel.
11 JUDGE HOSEY: Oh, okay.
12 MR. KRAGEL: Judge, if I understand your question
13 correctly, the Franchise Tax Board does not take the
14 position that EBITDA cannot be used as a valuation
15 methodology. Okay. Our position is that, based on what
16 our expert told us about the other reports, we found it to
17 be unreliable in this instance.
18 JUDGE VASSIGH: Thank you for clarifying that.
19 MR. KRAGEL: You're welcome, Judge.
20 JUDGE VASSIGH: I do want to ask a follow-up
21 question because it sounds like from Appellant's experts
22 that EBITDA is the standard for a valuation in this
23 particular industry. So I want to know if the Arxis
24 valuator -- I saw his CV in the exhibits. Does he have
25 experience with this type of industry, maybe not travel

1 agencies specifically, but similar industries?

2 MR. KRAGEL: Can I take that one also Addie?

3 You know, we don't -- am I still going? Yeah.

4 We don't -- I can't tell you for certain because

5 our expert was no longer available to us when Ms. Kuduk

6 and I took over handling the case. Also, there's one

7 other of things that sort of -- in my -- what impressed me

8 by our own expert's report was the fact that he relied

9 upon 12 sales of travel companies in reaching his

10 conclusions. And while Appellant's counsel seems to think

11 that's a small number given the thousands of supposed

12 sales out there during this time period, we noted that

13 their own expert relied on only 2 sales. Interestingly

14 enough, one of the sales relied upon by Appellant's expert

15 is also one of the 12 sales that our own expert relied on.

16 So I think Appellant's counsel also said

17 something -- one or more of them said something to the

18 effect that the techniques or methodologies used can be

19 used across various types of industries. So I'm saying,

20 you know, whether or not our expert was steeped in

21 valuating travel agencies, he used similar methodologies,

22 or at least in the general sense of a market methodology

23 and used a much -- more numerous number of comparables.

24 So I guess that doesn't answer your question,

25 other than we can't really say because our expert isn't

1 available to us anymore.
2 Thank you, Judge.
3 JUDGE VASSIGH: Thank you, Mr. Kragel. I have no
4 further questions at this time.
5 JUDGE HOSEY: Thank you.
6 I'm going to move it to Judge Lam.
7 Do you have any questions for Respondent
8 Franchise Tax Board?
9 JUDGE LAM: No questions. Thank you.
10 JUDGE HOSEY: Okay. Thank you.
11 Let's move on to -- Appellant, would you like
12 time for a rebuttal or final statement, Mr. Mather?
13 MR. MATHER: No. I can go.
14 JUDGE HOSEY: Okay. Go ahead when ready.
15
16 CLOSING STATEMENT
17 MR. MATHER: So the FTB quoted a number of things
18 that are supposedly facts in the case, and those are --
19 there's a litany of incorrect assertions in that. The
20 first one was that the Ambassador transaction added
21 $29 million of sales. That is not a fact. It is an
22 assumed fact that came from the Arxis appraisal report on
23 page 7 of Exhibit C. So it's not a real number. It's an
24 assumed number based on multiple assumption. So not true.
25 The FTB repeatedly talks about the 20-something

1 million dollar sale. Not true. It's a $15 million sale
2 based on the current state of the company at an $8 million
3 earn-up. As we heard from Mr. Coffman, it could have
4 added valued or could have not have value. He believed it
5 not to have value. That's evidence in the record. He's
6 established with familiarity in this transaction as well
7 as familiarity with over 150 transactions, not counting
8 the 200 transactions that he did -- wasn't able to close.
9 But he understands how these processes work. So his
10 testimony is not nothing. It is -- what is nothing is
11 what the Franchise Tax Board has presented to us in this
12 case.
13 Another assertion that was repeated in different
14 context is that the fair market value of the business for
15 the purpose of our built-in gain computation doesn't -- I
16 think they said -- didn't include the asset -- reduction
17 for asset values. That's simply incorrect. It's the fair
18 market value of the business. It's not the gross value of
19 the assets that matters. And that is also in the Joselyn
20 report. The debt load of the company is what accounts
21 for, as Mr. Coffman said, the difference between the value
22 of the company and the value of the assets -- or the
23 estimated value of the enterprise based on an earnings
24 multiple.
25 The FTB repeated again the kind of ridiculous

1 assertion from the Arxis report that because there could
2 have been a few dollars here and there for nonoperating
3 assets or expenses for this and that or there other that
4 should be adjusted that we should disregard the -- the
5 sole method that's really reliable for valuing these and
6 come up with the -- the ridiculous assumptions applies by
7 the Arxis appraisal using the wrong method on the wrong
8 numbers. So these, as Mr. Coffman testified, businesses,
9 you know, travel agencies have almost no nonoperating
10 income and almost no nonoperating assets. They have to be
11 lean to survive because they're working on a very small
12 margin.
13 Again, you have that -- the Franchise Tax Board
14 says, oh, well, we didn't account for the net asset value
15 method of appraising a company. As was made clear by
16 everybody, that's not an appropriate valuation method for
17 a service business. It has no assets. So this is a
18 business that generates income. There was detailed
19 testimony how there's really no assets. There's rent,
20 there's -- 70 percent of the expense is payroll. So I
21 don't know how the net asset value of payroll would be
22 computed. It's clearly an irrelevant statistic. And even
23 suggesting it shows that the Franchise Tax Board doesn't
24 really understand the valuation issues on this issue yet.
25 Mr. Kragel indicated that there were only two

1 comparables in the Marshall & Stevens valuation method,
2 that is two comparables on one component of three methods
3 of valuation. There was also the public company method
4 which determined an EBITDA multiple based on public
5 companies. And of course, again, for the umpteenth time,
6 the Arxis guy used these 12 transactions that had partial
7 information. He used bits and pieces using a factor that
8 was -- had a wild range of results that had incomplete
9 information and based on the wrong sales number.
10 So with respect to the -- the installment gain
11 issue, I'm not sure that I followed that litany of
12 citations, but I think the rule is pretty simple. The
13 rule is that because of the 338(h)(10) election, we have
14 to include the value -- the value as FTB conceded -- the
15 value of the earn-up agreement as of the date of the
16 transaction. Mr. Coffman, again, testified it was zero.
17 And the Appeal of Amarr case clearly states and -- you
18 know, it's just ignoring what part of the holding in that
19 case is. It clearly states that in the absent -- if you
20 find Mr. Coffman's evidence to be not credible of the zero
21 value, then it's reasonable to look at what the payments
22 are, and the payments are 3.5.
23 The 8 is a meaningless number. They -- we get
24 hit with this $8 million, which was a cap, not a number,
25 not any kind of determination of what value was. It was a

1 cap, and it gets -- it keeps -- it comes back to us in two
2 ways. It comes back as somehow being evidence of value of
3 the earn-up agreement, which it's not. And it comes in as
4 an extra $8 million on the purchase price because the sale
5 was $15 million. The sale based on the historical -- the
6 status of the business at the time, the sale $15 million.
7 You only get into the 20s by adding in the $8 million,
8 which is not a number that was part of the sale. It was
9 just a -- it was a cap on the potential future payments
10 under that -- under the earn-up agreement.
11 So nothing -- nothing in the FTB's presentation
12 can change the result. They've offered no evidence. You
13 know, I appreciate the fact that they didn't bring in the
14 Arxis guy, as I mentioned before. He's still alive. He's
15 still in business. I don't know why he's not here, other
16 than he didn't want to try to defend this piece of garbage
17 that the FTB is saying is the basis of the determination
18 and the reason they should have the burden of proof, which
19 is absolutely nonsensical. If they don't want to bring in
20 the Arxis guy or somebody that's going to say the same
21 thing, and that's the sole basis of the determination,
22 they are not entitled to the presumption and the burden of
23 proof.
24 The burden of proof is not an absolute rule that
25 whatever number FTB gets some yahoo to come up with that

1 they could pull out of the air means that you have to
2 ignore everything else in the record in the case. You
3 have to ignore the experts, the travel experts, the people
4 involved in the transaction. And all these different
5 people, they count for nothing. But this guy who isn't
6 even here and has a report riddled which ridiculous
7 assertions, that's what sustains the burden of proof for
8 the Franchise Tax Board because everything else is useless
9 and that's just -- I mean, why don't we just make the rule
10 that whatever the FTB determines is the result. Because
11 that's essentially what they're asking us to do in this
12 case.
13 That concludes my remarks.
14 JUDGE HOSEY: Okay. Thank you. I'm going to see
15 if my panel has any other questions.
16 Judge Vassigh, any other questions for the
17 parties?
18 MS. KUDUK: Do I get to respond to that?
19 JUDGE HOSEY: I'm sorry.
20 MS. KUDUK: Do I get to respond to that or is
21 that --
22 JUDGE HOSEY: Would you like to?
23 MS. KUDUK: Oh, I think I would. Yes.
24 JUDGE HOSEY: We have about 20 minutes. I'll
25 give you five minutes if you would like to respond.

1 MR. MATHER: Well, she's not supposed to get a
2 response, but I would like to respond to her response.
3 JUDGE HOSEY: Well, you'd get a final response.
4 Yeah, you would get an opportunity to respond to her
5 response if you would like to.
6 MS. KUDUK: Okay.
7 JUDGE HOSEY: Ms. Kuduk, go ahead.
8
9 CLOSING STATEMENT
10 MS. KUDUK: Yeah, it might take me a little bit
11 of time to find them in the exhibits but I -- off the top
12 of my head, we did ask for a continuance to have our
13 expert here, and we were not granted that. So I don't
14 think it's fair that Appellants are making an argument
15 that our case is less credible because our expert wasn't
16 here. I mean, we can't control schedules. You now, we
17 can't -- so we did make the proper, you know, petition to
18 the Court to have him here.
19 Secondly, I'd like to read the part of Amarr
20 footnote 17 which does say -- so in Amarr, the OTA did
21 rule that the amount received was the fair market value,
22 but there was a reason for that. And the reason was that
23 this was a refund claim.
24 And in footnote 17, OTA said, "We note that the
25 maximum sales price may result in a conclusion that more

1 tax is due. Whereas, we are only deciding whether
2 Appellants are entitled to a refund based on FTB's
3 determination of the gain."
4 And FTB made that determination because it was a
5 refund claim. This is not a refund claim.
6 So what's at issue here is what is the fair
7 market value. And the fair market value, typically, would
8 be the value in 2014, not what's received years later.
9 My third thing I would like to say is that I know
10 the 3805E form is in the record in multiple places. If
11 you want me to find it I can, but I would just like to
12 point out that in the 2014 sale, $5.4 million of property
13 was actually sold. So PTG was not -- was an asset-based
14 company too. It held at least $5.4 million of real
15 property. So when Appellant was saying that this was not
16 a company that had actually hard assets, they actually
17 did.
18 And those are the only points that I would just
19 like to refute.
20 JUDGE HOSEY: Okay. Thank you.
21 And I'll go ahead and move it over to Mr. Mather,
22 if you'd like for an opportunity for a final response.
23
24 ADDITIONAL CLOSING STATEMENT
25 MR. MATHER: All right. With respect to the

1 unavailability of FTB's expert, if you recall, Your Honor,
2 they -- FTB said at the prehearing conference that they
3 didn't think that expert would ever be available. So and
4 apart from that, as we pointed out before in the objection
5 to the deferral request, that we've made these arguments
6 18 months ago and FTB -- if they don't have somebody here
7 now, I believe that they'll never come up with somebody.
8 And certainly, they're not going to come up with anybody
9 that comes up with a number like the Arxis report because
10 it's -- it's just unjustifiable.
11 The distinction on the Appeal of Amarr, I --
12 completely flew over my head. I don't know why if the
13 issue is the application of the statute it matters if it's
14 a refund case or a deficiency case. It's inconceivable to
15 me that that could be a distinction of any consequence. I
16 think you're trying to determine what the right result is.
17 And those are the only remarks I have.
18 JUDGE HOSEY: Okay. Thank you. I appreciate it.
19 I know we could probably go back and forth forever.
20 But I'm going to see if my panel has any final
21 questions for the parties, starting with Judge Vassigh.
22 JUDGE VASSIGH: I have no further questions for
23 the parties. Thank you.
24 JUDGE HOSEY: Thank you.
25 And Judge Lam?

1 JUDGE LAM: No questions. Thank you.
2 JUDGE HOSEY: Thank you.
3 All right. Are there any questions that I can
4 answer from the parties before we submit the case today?
5 MR. MATHER: Nothing from Appellant.
6 JUDGE HOSEY: Okay. We are ready to submit the
7 case. The evidence has been admitted into the record, and
8 we have the argument and your briefs, as well as the
9 testimony and oral arguments you presented today. We now
10 have a complete record from which to base the decision.
11 We are ready to submit the case and the record is now
12 closed.
13 This concludes this hearing for this appeal. The
14 panel will meet and decide the case, and the parties
15 should expect our written opinion no later than 100 days
16 from today.
17 I wish to thank both parties and all the
18 participants today for their time and effort in this
19 matter. And with that, we are off the record, and the
20 hearing is now adjourned.
21 Thank you, everyone.
22 (Proceedings adjourned at 4:03 p.m.)
23
24
25

HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 2nd day of January, 2025.

____

ERNALYN M. ALONZO
HEARING REPORTER