Valuation Viewpoint

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SEVERANCE DAMAGES: PROJECTED VERSUS ACTUAL

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WITH: BRADLEY J. GUNN, GUEST CONTRIBUTOR

One of the most difficult assignments an appraiser can undertake is to value the damage to a property owner in relation to a partial taking of the property. This generally occurs when the government exercises its right to acquire property through eminent domain. The expansion of roadways accounts for the majority of partial takings. In partial takings, as in cases when the entire property is condemned, the condemning authority owes the property owner the fair market value of the property taken. In addition, the owner is to receive the value of any damage to the remaining property, commonly called severance.

The difficulty in determining the appropriate amount of compensation for the severance damage due to the property owner is two-fold. First, it is very difficult to envision all the factors that will impact the property in the "after" condition. Second, and even more difficult, is that once the factors which will affect the remaining property in the after condition are identified, finding evidence and support in the market place in order to justify the damages calculated can be very difficult.

The scope of this article is not a general analysis of partial takings, rather it is a specific case study of the former Win Stephens Buick property in St. Louis Park, MN. In 1989, the Minnesota Department of Transportation (Mn/DOT), condemned part of the Win Stephens property for use in expanding Highway 100 as part of the Interstate 394 expansion project.

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MARKET TRENDS AND INDICATORS

Office Buildings	→	0%
Retail Centers	↑	3%
Industrial Buildings	→	0%
Apartments	→	0%
New Housing Starts	↓	4.9%
Productivity	↑	4.0%
Composite PE	→	20
Consumer Confidence Index	↑	104

In This Issue ...

MARKET TRENDS AND INDICATORS

ECONOMIC INDICATOR

	1998	1999	2000	2001	2002	2003	2004
New Housing Starts—Yearly Totals	330,500	347,300	317,500	330,400	349,600	374, 100	355,900

*Midwest Region re-defined in 2002

P/E RATIOS IN SELECT INDUSTRIES

Industry (Year end)	1985	1990	1995	2000	2002	2003	2004
Automotive	6	N/M	12	9	16	21	11
Banking	9	14	12	19	13	14	14
Retailing—General*	16	23	22	13	24	22	22
Food & Staples*	14	22	18	24	18	27	25
Fuel-Oil & Gas*	11	15	40	16	26	12	12
Health Care Equipment & Services*	18	22	22	45	22	24	25
Manufacturing—Capital Goods*	20	16	16	20	20	24	21
Service Industries—Commercial*	22	21	18	32	21	24	21
Telecommunications	11	15	21	26	24	21	32
Transportation	18.3	28	21	18	NM	56	NM
Utilities*	11	15	17	17	22	19	19
Pharmaceuticals & Biotechnology*	—	—	—	—	24	35	24
Composite	15	17	19	26	29	23	20

*Reporting categories changed in 3rd Qtr 2002 to more accurately identify and report industry activity. NM=not measurable

ECONOMIC INDICATORS

Indicator (5 yr. avg.)	1985	1990	1995	2000	2002	2003	2004
Inflation	5.0%	4.0%	3.1%	3.4%	1.6%	2.3%	2.7%
Productivity	1.7%	0.6%	1.5%	2.9%	4.7%	8.6%	4.0%
GDP	4.0%	1.8%	2.7%	3.8%	2.4%	3.1%	4.4%
Consumer Confidence	84.9	104.2	99.2	128.6	64	91.7	104

RATES OF RETURN AND RISK HIERARCHY

Investment	Current
30 Year Treasury	4.7%
Aaa Bond	5.3%
Bbb Bond	5.5%
Commercial Mortgage	5.5–6.75%
Institutional Real Estate	8–9%
Non-Institutional Real Estate	9–11%

Investment	Current
Speculative Real Estate	11–15%
S & P Equity (Ibbotson)	11.9%
Land Development	12–17%
Equipment Finance Rates	14%
NYSE/OTC Equity (Ibbotson)	15.9%
NYSE Smallest Cap. Equity (Ibbotson)	17.9%

Sources: National Real Estate Index (2005), Appraisal Institute; F.W. Dodge Division, Business Week, Value Line, U.S. Chamber of Commerce, Standard & Poors, Investment Dealers Digest, U.S. Government Census.

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SHENEHON ONLINE

BY SCOT A. TORKELSON

Now that the 'tech bubble' can be seen in the rearview mirror, there is one innovation of the internet that will likely always be with us: universal, free, and immediate access to global information. Millions of interested individuals now contribute to collective web building endeavors. Their efforts are variously called open source, freeware, or net communities, but the curious fact is that all of the information is *free*. There is no charge to contribute information and no charge to use the system.

It is precisely this aspect of open source endeavors that allows them to thrive even as internet scheme after internet scheme has crashed and burned under the weight of mounting costs and scant revenues. When you work for free, you have no overhead and no need of revenues—aside from donations in some cases. Some of these open source systems have truly become global in reach and have the potential to unseat even Microsoft from its lofty perch (Linux). Some are considered illegal in certain countries (Grokster file sharing). Some have found ways to harness the open source spirit to create a successful business model (Ebay). Some, like Wikipedia, fall into all of these categories.

Wikipedia is a phenomenon among the freeware endeavors and a potential resource for the business valuation community. It is the essence of open source, written in eight languages and available via the internet, free of charge, around the world—no membership required. Wikipedia is the largest collective assemblage of knowledge in the world. It is, at its simplest, nothing more than an online encyclopedia, but its breadth and scope make it so much more. Today, the Wikipedia site (www.wikipedia.com) has 500,000 articles. Including all language versions, it has well over 1.5 million entries. These articles have been written, assembled, corrected, and revised by over 20,000 contributors. Some of these resources are truly amazing. Among those of special interest to members of the appraisal community are:

- **Counties and Cities in the United States**
  Derek Ramsey, one of Wikipedia's most active contributors, created "rambot," a Java program that creates and maintains current articles on American counties and cities throughout the United States.

- **Detailed Discussions of Cities**
  The real strength of Wikipedia is in the area of detail for anything you might think of in a city. Type in, for example, Minneapolis, Minnesota. There are lengthy discussions of the Hiawatha Light Rail Line, the Minneapolis-St. Paul International Airport, and area neighborhoods, to name a few.

- **Industry Information**
  Wikipedia's industry offerings are hit and miss at this point. The interest of contributors is decidedly more esoteric: focusing on photography and astronomy. Industry professionals are becoming more involved, however. Their contributions in the areas of finance, business management, and the business sectors will continue to improve this site's usefulness.

In addition to "taking" from the Wikipedia offerings, anyone with access to the site (which is everyone) can also "give" to the site. One can submit information at anytime, in any area of expertise, and the finished product will be posted in a matter of seconds for the entire world to see. Are you willing to tackle lack of marketability discounts? Wikipedia already has one of the simplest and best discussions of present value that I have ever seen. VV

EXECUTIVE COMPENSATION
TOO MUCH OF A GOOD THING?

BY CLAYTON J. SHULTZ

Introduction

The issue of excess executive compensation is one that is frequently encountered in business valuation. It is often the case, in privately held concerns, that the shareholders (those who own the company) and the executives (those individuals charged with managing the company) are one and the same. In the event that these two parties are related, there is an inherent conflict of interest with respect to executive compensation; the shareholders of the company set the salaries of the executives.

In a regular "C" corporation, these two groups of individuals are paid by the company's operations using two separate methods. Corporate executives are compensated, directly, using a blend of salary, perquisites and bonuses, whereas shareholders are compensated by dividends and, indirectly, through stock appreciation. A major difference between these two methods of payment is that executive compensation is paid before any corporate taxes are paid, which has the effect of reducing the corporation's taxable income. Dividends, on the other hand, are paid after the first level of corporate tax has already been paid and do not reduce the corporation's taxable income. Furthermore, dividends are subject to yet another layer of taxation at the shareholder level. Accordingly, there is a tax advantage to distributing the company's earnings in the form of executive compensation rather than through dividends because the executive compensation would be subject only to that individual's personal tax rate. This is a sound strategy as long as the amount of compensation paid to the executive or executives is judged to be reasonable by the IRS.

> "*Executive compensation data is expressed in dollar amounts and is sub-divided into base salary and additional sources of compensation such as bonuses and perquisites.*"

In determining reasonable compensation, the question that must be answered by the valuation professional is this: "What would an unrelated third-party pay in the form of compensation to a person of comparable skill and experience having the same duties and responsibilities?" In effect, the shareholder and executive must be put at arm's length from each other.

> "*In effect, the shareholder and executive must be put at arm's length from each other.*"

Factors Considered by the Courts

The five major factors considered by the Courts were initially set forth in *Elliotts v. Commissioner* and have been relied upon in subsequent Tax Court rulings. They include the following:

1. **Role in the Company** – The employee's position or positions in the company, responsibilities, and the number of hours worked;
2. **External Comparison** – The comparison of the employee's compensation with that paid to comparable employees in comparable concerns;
3. **Character and Condition of Company** – The financial and operational size of the company, financial position and performance, sophistication of operations, and other company-specific factors;

4. **Conflict of Interest** – The relationship between shareholder and employee;
5. **Internal Consistency** – The company policies with regard to compensation of all employees.

Outside Sources

There are several outside sources of executive compensation data available that vary in sophistication and vigor of analysis. While the list of resources below is not exhaustive, these data sources are a good starting point for the analyst in determining the reasonableness of compensation. We encourage the reader to research each of these resources, to fully understand how data is collected for each resource and learn how to appropriately apply it to the situation at hand.

- *Economic Research Institute (ERI)* – ERI offers an interactive database for executive compensation, allowing subscribers to search for compensation data sorted by industry (using SIC codes), annual revenues, time, and geographic area. Executive compensation data is expressed in dollar amounts and is sub-divided into base salary and additional sources of compensation such as bonuses and perquisites. Data is further detailed by managerial position within the organization and is statistically displayed as the 10th and 90th percentiles as well as the median. Additionally, the ERI data can be queried to create a maximum reasonable compensation amount.
- *Risk Management Association (RMA)* – Formerly known as “Robert Morris Associates,” this organization publishes the *Annual Statement Studies*, which is a publication of industry benchmark ratios. One of the areas studied in this regard is executive compensation, which is expressed as a percentage of total revenues. The companies studied by RMA are typically sorted by sales volume, and statistical data for executive compensation is limited to the median, the 25th and 75th percentiles. The RMA data pertains to all executives in the company and is not detailed for specific executive positions.
- *National Institute of Business Management (NIBM)* – Prior to its discontinuation in 2001, the *Executive Compensation Survey* published by NIBM contained executive compensation data on a wide variety of industries. The data used was collected from companies with annual revenues of less than $25 million in most cases. The maximum, minimum, median, 25th percentile, and 75th percentile data are presented along with the breakdown of base salary and other compensation. The NIBM data includes compensation information for the President/CEO position as well as several other key executive positions within the organization such as Vice President of Sales or Vice President of Operations. Although the usefulness of this resource is diminished to some degree, as its data is somewhat older, it still can be used as a proxy in determining reasonableness of compensation today.
- *SEC Filings* – If the company the analyst is studying is large enough, comparisons to executives in publicly-held companies may also be appropriate. These companies are required to report the compensation levels of their top executives. Depending on the comparability of the companies, this information may provide some useful insight in determining reasonable compensation for the subject company.

“*Depending on the comparability of the companies, this information may provide some useful insight in determining reasonable compensation for the subject company.*”

- *Salary Surveys* – Various government, non-profit, and trade organizations compile salary surveys that the analyst may choose to rely on for information.

Independent Investor Test

Another method used for determining reasonable executive compensation is the Independent Investor Test. This test and its corresponding methodology have been relied upon in numerous court decisions. The first step in this analysis is the determination of a required rate of return on the shareholders' equity. In developing this rate of return, the analyst should carefully consider all the factors that increase or decrease risk in the industry in which the subject company operates, as well as company-specific factors such as financial leverage, earnings history, and customer concentration among others.

The next step is the building up of the subject company's equity position. It's important for the equity amount selected to be an economic level of equity, which may differ from the company's historic book value. This can be calculated by using the equity value for the company determined through the income, market or asset approach to value. Another approach to estimating the economic value of the equity position, which is simple but effective, is to add an estimated portion of goodwill to the historic amount of stockholders' equity. However, this can be highly subjective.

> *"The analyst's conclusion of reasonable executive compensation will be the strongest and most reliable when: numerous data sources have been used, and the question of executive compensation has been approached from as many angles as possible."*

Once an economic level of equity has been determined, the independent investor test rebuilds the subject company's income statement using very specific guidelines. The income statement should be similar to the company's historic income statement with the exception of the executive compensation line item, which is omitted from the expenses. This is done because executive compensation is the variable for which the Independent Investor Test will solve. Once the income statement has been rebuilt without executive compensation, the result is a level of net income after tax that excludes executive compensation.

The final step is the computation of allowable compensation. The net income after tax without executive compensation is compared to the required return to investors. The difference is then divided by: 1 minus the applicable corporate tax rate. The end result is the reasonable pre-tax compensation estimate. Following, the reader will find not only the formula for determining executive compensation, but also an example of how the Independent Investor Test is applied.

FORMULA FOR DETERMINING EXECUTIVE COMPENSATION

Economic Equity Amount x Reasonable After-tax Return on Equity	=	Required Return to Investors
Net Income After-tax without Executive Compensation – Required Return to Investors	=	Reasonable After-tax Compensation Estimate
Reasonable After-tax Compensation Estimate ÷ (1 – tax rate)	=	Reasonable Pre-tax Compensation Estimate

INDEPENDENT INVESTOR TEST FOR ABC COMPANY

Estimated Tax Rate	35%
	Year 1
Historic Total Stockholders' Equity	$200,000
Unbooked Goodwill (Est.)	50,000
Economic Total Stockholders' Equity	250,000
Reasonable After-tax Return on Equity	18.0%
Required Return to Investors	45,000
Net Income After Tax per Book w/o Officers' Compensation:	
Net Sales	1,000,000
Cost of Goods Sold	(600,000)
Gross Profit	400,000
Officers' Compensation	0
Selling Expenses	125,000
General Expenses	125,000
Other Expenses	0
Total Expenses	250,000
Net Income Before Tax w/o Officers' Compensation	150,000
Tax	(52,500)
Net Income After Tax w/o Officers' Compensation	97,500
Computation of Reasonable Compensation:	
Net Income After Tax w/o Officers' Compensation	97,500
Required Return to Investors	(45,000)
Reasonable After Tax Compensation Estimate	52,500
Divided by (1 – tax rate)	65%
Reasonable Pre Tax Compensation Estimate	80,769
Rounded To	80,000

Conclusion

This article has discussed two major methodologies for determining reasonable executive compensation for regular "C" corporations whose shareholder and executive roles are filled by the same person or persons. The first of these methodologies is the use of external data sources for comparison. The second is the Independent Investor Test. The analyst's conclusion of reasonable executive compensation will be the strongest and most reliable when: numerous data sources have been used, and the question of executive compensation has been approached from as many angles as possible. VV

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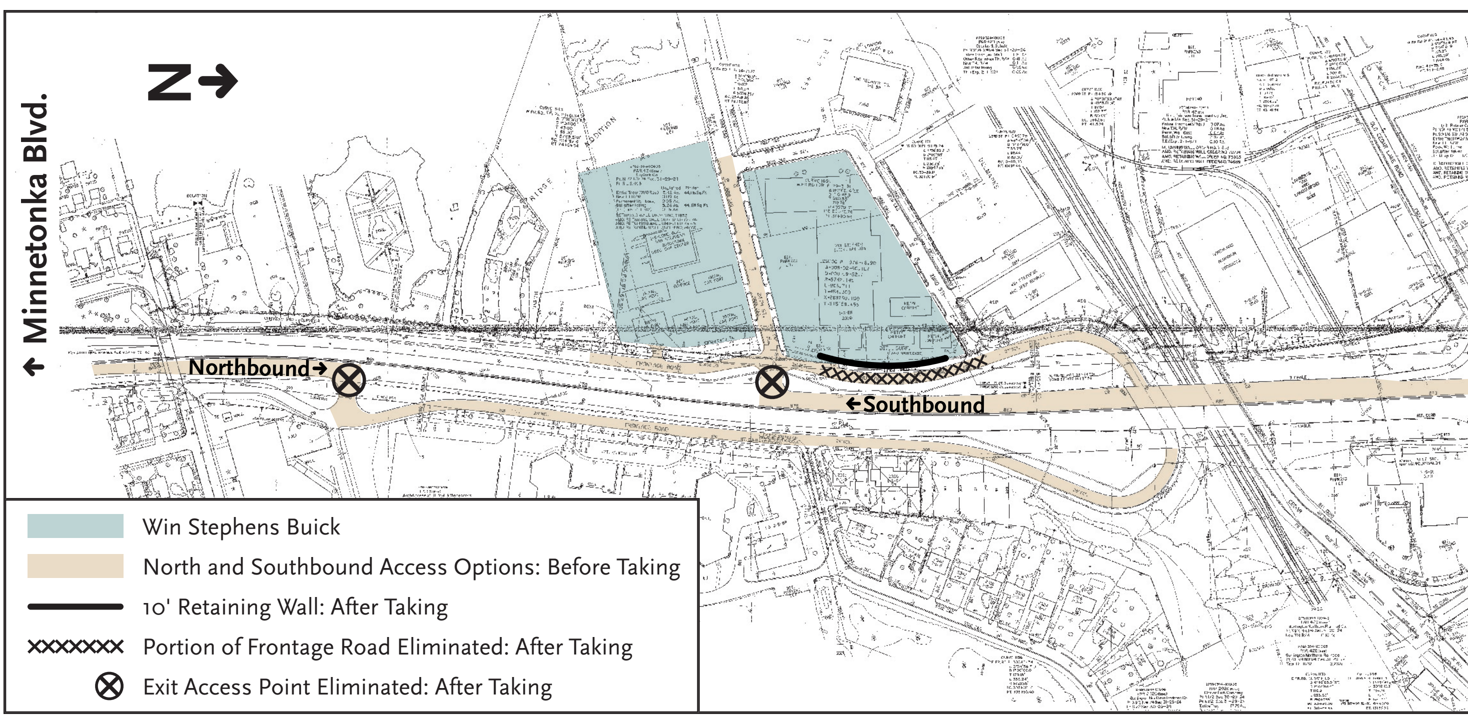
Shenehon Company was retained, on behalf of Win Stephens, for the purpose of preparing a before and after appraisal of the property as well as an estimate of damages. The following article will track this property from the time of the taking to the present and will examine how this taking has affected the property over the last 15 years.

History of the Win Stephens Buick Car Dealership

W.R. Stephens, Sr. founded the W.R. Stephens Company in 1930 after working in automotive sales and management for 28 years. The original W.R. Stephens Company sold Buick automobiles to a five-state area from its downtown Minneapolis location off Hennepin Avenue and Harmon Place. In 1958, W.R. Stephens became Chairman of the Board and Win Stephens, Jr. became the new president. In 1963, after 33 years in its downtown location, W.R. Stephens Company began operating in St. Louis Park, on the property that is the subject of this article. From 1963 until the time of the taking, Win Stephens Buick was a successful automobile dealership at the subject location. Several departments operated at this location including: sales and leasing of new and used automobiles; the service and repair of primarily Buick model automobile drive trains, bodies, and frames; and the sale of primarily Buick wholesale and retail automobile parts.

> *"Before the taking, Win Stephens Buick operated at near capacity for its location while keeping the quality of service very high."*

Before the taking, Win Stephens Buick operated at near capacity for its location while keeping the quality of service very high. Using the CSI (Customer Satisfaction Index), the primary measure of quality among GM dealers, Win Stephens Buick often scored higher than 90%. In the Twin Cities, at that time, the average among the 440 GM dealerships was 87%–88%. After the taking, the dealership saw sales volume drop and in 1993 the dealership was sold.



The Taking: August 23, 1989

The property is located on the southwest quadrant of the Highway 100/Interstate 394 interchange and the taking was a result of the 394 Corridor expansion project. In this case, the condemnation proceeding included three primary types of taking. The first taking was a permanent fee simple acquisition of 6,098 square feet. The second taking was a temporary construction easement of 503 square feet extending along the eastern border of the subject site from August 23, 1989 through December 31, 1993. The final taking included the loss of visibility of the main building from Highway 100 South, the resulting lack of organized layout of the subject site for automobile sales and more difficult access due to the loss of the pre-existing direct turnoff for traffic from Highway 100 southbound.

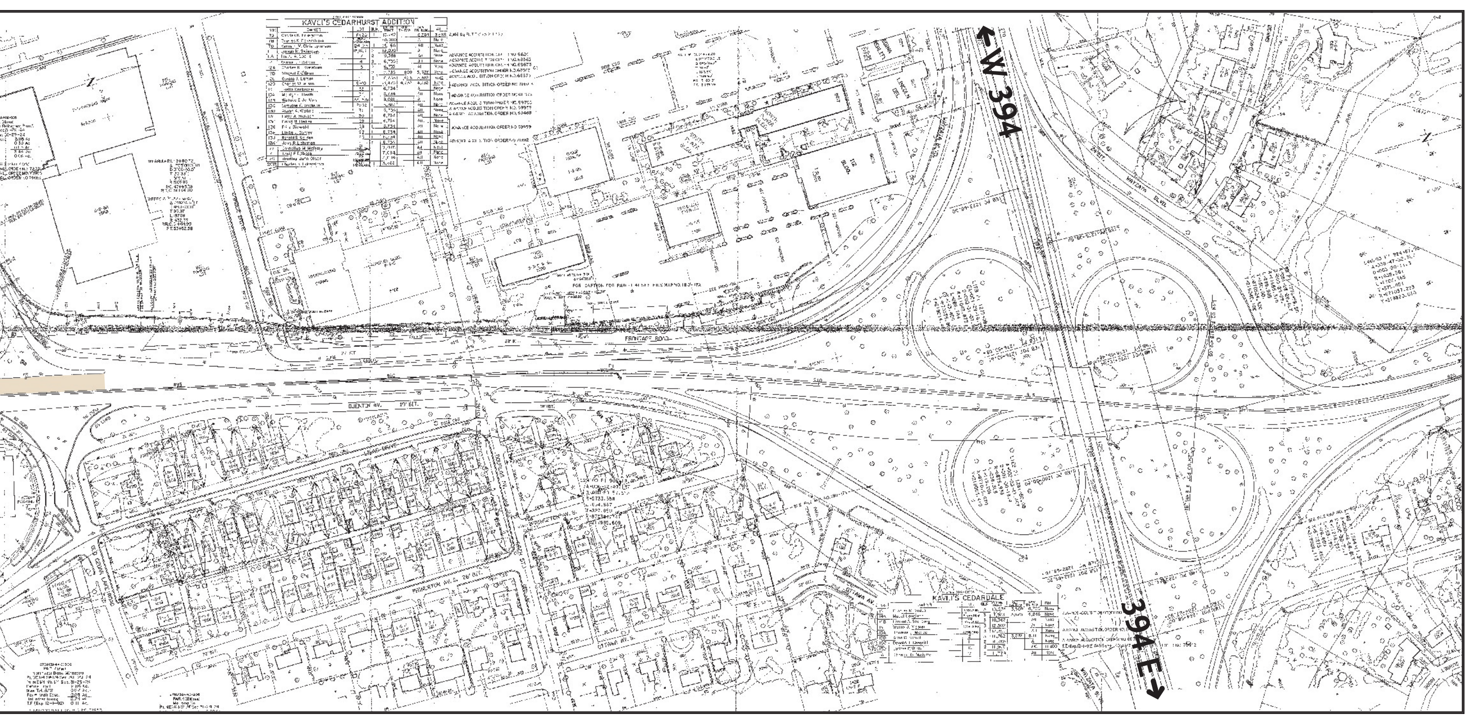
Before the taking, the property was 309,122 square feet in size. After the taking, Win Stephens Buick was left with 303,024 square feet subject to a 6,534 square foot temporary easement. Although only a small percentage of the land was taken, there were more severe consequences to the property than just a loss of land. The three primary effects that provided the basis for damages were: loss of visibility of the main building, loss of a functional layout and design, and loss of reasonably convenient access.

> *“Although only a small percentage of the land was taken, there were more severe consequences to the property than just a loss of land.”*

Effects of the Taking:

Loss of Visibility

Prior to the expansion of the highway, the subject property had many locational characteristics sought after by car dealerships, such as high traffic counts and excellent visibility. The elevation of the subject was approximately 10 feet below that of Highway 100, with clear sight lines from the highway. As part of the expansion project, Highway 100

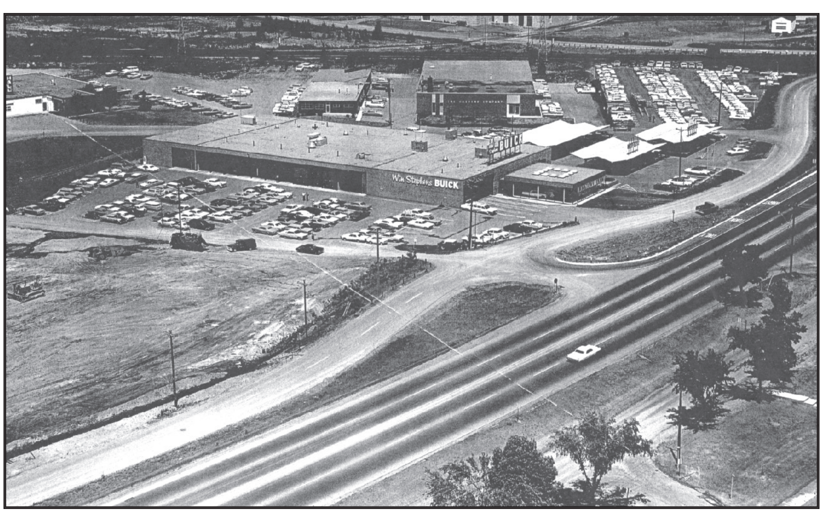


was elevated roughly five feet and a retaining wall was constructed. This 10 to 12 foot wall was constructed a mere 25 feet from the main showroom building. Because of increased road elevation and the construction of a retaining wall, the main showroom lost nearly all of its visibility from Highway 100. Car dealerships rely on high visibility from busy roads; this taking severely affected the use of this site as a successful car dealership.

"When there is ambiguity about the function of a given site, the typical customer tends to drive by."

Loss of a Functional Layout and Design

Additionally, the taking created a loss of functional layout for Win Stephens Buick. Functional layout and design refer to the effectiveness with which the buildings and various improvements are arranged on a given site. This is essential for commercial developments such as restaurants, retail stores, automobile dealerships, and the like, because potential customers must be able to quickly identify what product the commercial real estate is selling. When there is ambiguity about the function of a given site, the typical customer tends to drive by. Successful businesses rely on the use of distinctive advertising clues to clearly communicate their products.



Before the Taking: shows clear sight lines and excellent access from Highway 100

With regard to automobile dealerships, functional layout and design include the placement of a showroom in front of the improvements, facing the main roadway with an unobstructed view; available land facing the roadway to display new and used cars; good/fair access to the site; and a generally logical layout so that customers can quickly determine where to enter the site and where to go for sales and/or service.

Before the Mn/DOT taking, Win Stephens Buick's functional layout and design were very successful. The main building showroom faced Highway 100 South with unobstructed visibility from the passing traffic. The site had land available for display of both new and used cars. It had good/fair access and a generally logical layout for customers. After the Mn/DOT taking, Win Stephens Buick suffered a loss of visibility of the main building showroom great enough to create an unacceptable level of ambiguity with regard to the subject site's business. A front showroom is one trait common to all automobile dealerships. An automobile dealership that, in effect, has no visible front showroom building cannot be identified readily by potential customers as an automobile dealership. The presence of many cars provided some clue as to the use of the property as did the smaller used car building. At the time, however, potential customers may have interpreted these clues as indicative of a parking facility or, perhaps, a used car (lower quality) dealership.

Loss of Reasonably Convenient Access

Another problem created by the expansion of the roadway was that it became difficult to access this site from the highway. Prior to the taking, traffic traveling south on Highway 100 had excellent access to Win Stephens Buick simply by turning right onto 24th

Street West, which bisected the subject property. Northbound traffic could enter the site by taking the frontage road exit at 26th Street, continuing north, crossing under Highway 100, and looping south to the 24th Street West entrance. Before the taking, access was excellent for southbound traffic and fair for northbound traffic.

Access to the site after the taking was more limited. Southbound traffic exited Highway 100 considerably south of the subject site onto Minnetonka Boulevard to northbound Highway 100 to the east frontage road, and then north to the subject. The other option for southbound traffic was to access the collector distributor *before* Interstate 394. Northbound traffic exited Highway 100 just north of Parkwood Road and proceeded north under Highway 100 and south to the subject. It was our conclusion that access was inconvenient, primarily due to the loss of the direct turn off of Highway 100 onto 24th Street West for southbound traffic. This made the site much less appealing to the walk-in customer and turned the dealership into more of a destination site for people who had already decided that they wanted to buy from this car dealer.

“*...there has been compelling market evidence since then to suggest that the actual damages were far greater than the State anticipated.*”

In Shenehon Company’s 1991 appraisal, using August 23, 1989 as the date of value, we concluded a before the taking value of $3,400,000. After considering the damages listed above, we concluded an after the taking value of $1,700,000.

Before Value	$3,400,000
After Value	$1,700,000
Difference	$1,700,000
Plus Temporary Easement Damages	$ 11,600
Damages Resulting From Taking	$1,711,600

The State’s appraisal valued the subject before the taking at $3,000,000 and at $2,800,000 after the taking, claiming effective damage to the property of $200,000. Many of the damages identified in Shenehon’s appraisal were unusual for takings of this type and were not commonly compensable (or generally accepted by the state) in cases of eminent domain at the time of our report. The significant disparity in damage estimates between the two appraisals stems, in large part, from the uniqueness of this taking. At the end of the trial, the Minnesota Department of Transportation compensated Win Stephens $644,000 plus interest for a total amount of $730,000.

Even though the settlement fell between the damage estimates of the two sides, and it may have seemed reasonable at the time, there has been compelling market evidence since then to suggest that the actual damages were far greater than the State anticipated.

November 16, 1993 (Date of Sale)

The first indication that Win Stephens Buick was damaged in excess of the compensation awarded was when another Twin Cities car dealer purchased the property for $1,500,000 in late 1993. This amount was $200,000 lower than the Shenehon 1989 after-the-taking value estimate of $1,700,000. All of the major automobile dealers in the area (the potential market for this property), had a chance to bid for the purchase of the Win Stephens property. This was an

After the Taking: a retaining wall blocks view of the car dealership from Highway 100 open market transaction, and it was considered an "arm's-length" transaction by most real estate experts.

2000–Present

Over the last several years, this site has undergone some dramatic changes because the property has functioned poorly since the new owners purchased it in 1993. Many of these modifications are being done in an effort to, once again, make the site functional as an automobile dealership. The original main showroom building of nearly 54,000 square feet was demolished to make way for a new one. The new structure houses the showroom as well as the parts and repair facilities. It is slightly smaller, at approximately 51,000 square feet, and is comprised of two stories. With the construction of a second story showroom, the site has regained some of the visibility that was lost in the taking. Another remedy to the visibility problem is a new sign, higher in elevation than the retaining walls along Highway 100, identifying the business.

> "*It is important for a property owner, whose land is the subject of a taking, to be cognizant that there are many ways in which a property can be damaged.*"

The replacement building is now set back even further from the retaining wall on Highway 100 than the former Win Stephens showroom was. The increased visibility of the building, its new layout, and its smaller size help to partially restore functional layout and design to the site.

All of the customer and employee parking areas have been moved to the far west end of the site where there is little visibility. An employee parking ramp was constructed in the southwest corner of the property which has added parking density to the site, and ensures that the front lots are available for car display purposes. The current owners maximize the visibility of the new automobiles by designating the east side of the site for display parking.

Shenehon's damage estimate, as of August of 1989, was $1,711,600. Our conclusion was based on the amount of money that would have to be spent in order for the site to function as successfully as an automobile dealership after the taking as it did prior to the taking. Adjusted at 4% annually for inflation, the amount necessary to ameliorate these damages, in the year 2003, would be $2,963,937. In order to estimate what the new owners of the property have spent to restore the site, we used cost estimates from building permits filed with the city of St. Louis Park.

Shenehon determined, from these estimates, that the current owners have spent in excess of $4,000,000 in demolition, re-construction, and functional corrections to the site. It is evident from current pictures of the site that many of these changes were done in an effort to restore the visibility and functional layout as much as possible. The retaining wall along Highway 100 still blocks sight lines to some of the inventory display parking areas, and the accessibility issues that arose after the taking still exist.

Given that not all of the damages have been corrected and that the amount spent thus far has exceeded Shenehon Company's original damage estimates, it is clear that the damages to this site exceeded what anyone anticipated at the time of the taking. Furthermore, it shows that partial takings are very difficult to measure, depending on the property in question. It is important for a property owner, whose land is the subject of a taking, to be cognizant that there are many ways in which a property can be damaged. The owner should be justly compensated for all the damages that arise in the marketplace. VV

Brad Gunn, of Leonard Street and Deinard, is one of the leading attorneys in Minnesota practicing in the area of eminent domain.

MARKET TRANSACTION: BUSINESS VALUATION

WTC INDUSTRIES, INC.

1000 Apollo Road
Eagan, Minnesota 55121-2240

WTCO:OTC

Background

Prior to its purchase in May 2004, WTC Industries (WTC) engaged in the manufacture of water filtration systems and replacement filters serving the point-of-use potable water market. WTC's customer base consisted primarily of Original Equipment Manufacturers (OEMs). The company's products were marketed under the brand name "PentaPure."

In the years leading up to its sale, the company had grown significantly with respect to sales, posting a compound annual growth rate from 1999 to 2003 of over 50%, moving from \$5.1 million to \$28.3 million. For the twelve months ended April 2, 2004, the most recent date for which financial information had been filed with the Securities and Exchange Commission prior to the sale, WTC generated revenues of approximately \$34 million.

As revenues increased, profitability also improved, with the company's operating profit before taxes increasing from net losses in 1998 through 2000 to returns of 16.1% and 15.7% in 2002 and 2003, respectively. Increasing profitability resulted in an improvement of the company's equity position from a negative \$5.5 million in 1998 to a positive \$6.2 million in 2003.

The company's stock price enjoyed a considerable increase as well. In the first quarter of 2002, bid prices for the company's stock had a range of \$4.00 to \$8.71 per share. As the company's financial performance continued to improve, the bid prices also increased yielding a range of \$17.20 to \$29.50 per share in the first quarter of 2004.

The Transaction

The purchaser of WTC, a Meriden, Connecticut based firm called Cuno, Inc., is a manufacturer of filtration and purification systems for liquids and gases. In its most recently completed fiscal year prior to the purchase of WTC, which ended October 31, 2003, Cuno had revenues of \$288 million.

According to Cuno's 10-K filing for the year ended October 31, 2004, the company paid approximately \$115 million for WTC. At the time of the transaction, WTC had approximately 1.9 million shares outstanding, which would indicate a purchase price of about \$60.00 per share. This per share purchase price was essentially double the highest bid price in first quarter of 2004.

Using WTC's financial data for the 12 months ended April 2, 2004 and the \$115 million purchase price paid by Cuno, valuation multiples can be calculated. The salient multiples are presented below:

Price to Pretax Profit Multiple	**20.95**
Price to Equity Multiple	**14.60**
Price to Assets Multiple	**5.25**
Price to Revenues Multiple	**3.40**

Interpreting the Data

According to Cuno's 10-K filing, of the \$115 million purchase price, the company attributes \$73 million to goodwill and \$28 million to intangible assets. Furthermore, the valuation multiples resulting from the transaction are extremely high. These two factors point to the fact that Cuno's purchase of WTC was most likely a combination of synergy (the purchaser augmented an existing division) and financial motivation (WTC performed well in the years leading up to the acquisition). Cuno's 2004 annual report cites two primary reasons for the WTC acquisition. First, the purchase was intended to help solidify Cuno's position in the point-of-use water filtration industry at the OEM level. Second, Cuno believes, that through the purchase of WTC, it will be able to capitalize on an existing relationship between WTC and one of its major customers, thereby gaining a stronger position in the retail segment of the industry.

It is clear that Cuno purchased WTC, at least in part, for synergistic purposes. A financially motivated buyer would not have purchased the company for such large multiples. The company would not generate enough earnings to cover the purchase price for at least 21 years after the sale, which is too long for most financial buyers. This suggests that the price paid for WTC was not necessarily *fair market value*, the value borne out in the marketplace by a willing buyer and willing seller; but rather an *investment value* or *strategic value*, which is the value of the company to a particular individual (or organization) who benefits from economies of scale resulting from the acquisition. This point is further demonstrated by the fact that bid prices for the company's stock were between $17.20 to $29.50 per share only months prior to the purchase. In comparison, Cuno purchased the company for approximately $60.00 per share.

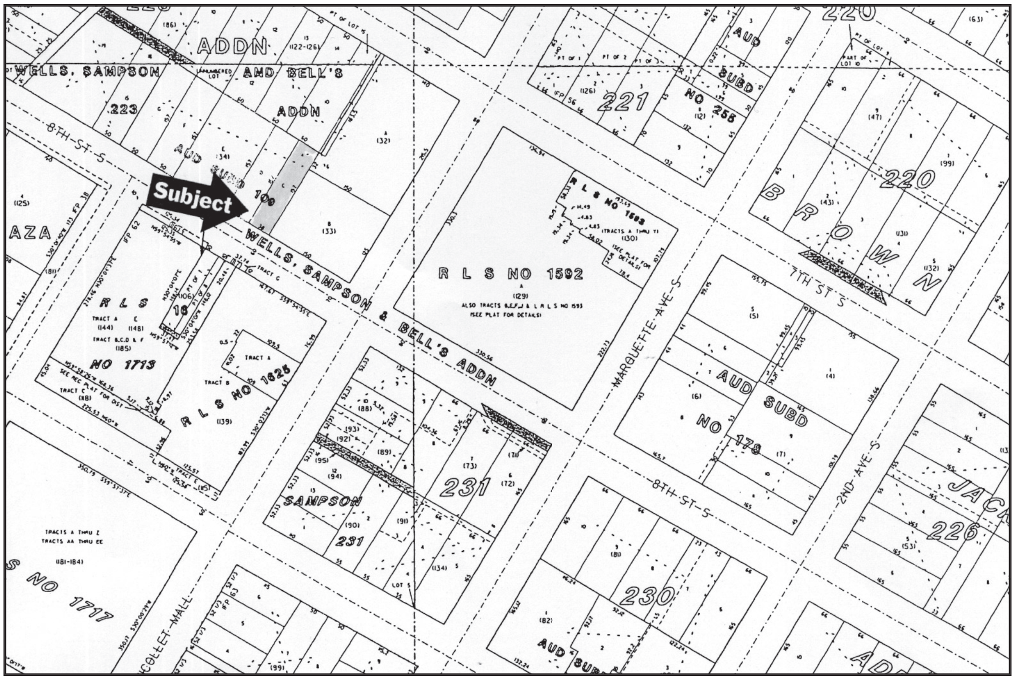
INCOME STATEMENT & EQUITY SUMMARY (IN THOUSANDS)

	1998	1999	2000	2001	2002	2003
Net Sales	$3,786	$5,142	$7,557	$18,982	$24,882	$28,304
Operating Profit Before Tax	($3,042)	($142)	($920)	$1,500	$4,002	$4,431
% Profit	−80.4%	−2.8%	−12.2%	7.9%	16.1%	15.7%
Total Assets	$882	$1,275	$3,661	$6,283	$13,658	$18,406
Total Liabilities	$6,400	$6,858	$9,231	$10,286	$10,414	$12,168
Total Equity	($5,518)	($5,583)	($5,570)	($4,003)	$3,244	$6,238

HISTORIC BID PRICES FOR COMPANY STOCK

	Low	Midpoint	High
2004			
January 1–March 31	$17.20	$23.35	$29.50
2003			
October 1–December 31	$9.30	$16.03	$22.75
July 1–September 30	$7.00	$9.38	$11.75
April 1–June 30	$9.00	$10.33	$11.65
January 1–March 31	$6.00	$9.50	$13.00
2002			
October 1–December 31	$4.00	$7.05	$10.10
July 1–September 30	$7.00	$10.75	$14.50
April 1–June 30	$8.71	$13.23	$17.75
January 1–March 31	$4.00	$6.36	$8.71

MARKET TRANSACTION: REAL ESTATE



Property:	Land under a portion of Marshall Field's Department Store
Address:	8th Street west of Nicollet Mall Minneapolis, MN
Buyer:	Eagle Ridge Partners
Seller:	Beebe Trust
Source:	Buyer, representative of the seller
Sale Date:	December 2004
Land Size:	5,966 square feet
Sale Price:	$2,834,500
Unit Price:	$475.11 per square foot
Zoning:	B-4, Downtown Business District
Utilities:	All available
Topography and Soil:	Level, assumed stable
Visibility and Access:	Good
Remarks:	Site is improved with the Marshall Field's Department Store. The subject land is nearing the end of a 100-year land lease expiring in December, 2009. At that time, the improvement (the store) on the site will revert to the land owner of record at the end of the lease. This is one of three parcels located on 8th Street not owned by May Company or its predecessors, otherwise May Company owns the entire block under both the store and its adjacent parking ramp. At the same time as this transaction, May Company purchased one of the other leased properties for $350 per square foot, however this lease was written in such a way that the improvements do not automatically revert to the land owner upon expiration in 2009.

SCOPE OF SERVICES

Shenehon Company is a Real Estate and Business Valuation firm, serving both the private and public sectors throughout the United States. Our unique combination of real estate and business valuation expertise allows us to provide a wide range of services and to offer innovative solutions to difficult valuation issues. Obtaining accurate and reliable industry information and expertise should play a key role in any decision-making process, and Shenehon Company is dedicated to equipping its clients with the tools necessary to make informed and knowledgeable decisions regarding their capital investments.

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- Bankruptcy proceedings
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- Special assessment appeals
- Special purpose real estate
- Tax abatement proceedings
- Tax increment financing
- Utility and communication easements

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