SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NASSAU

SERGIO MAGARIK, Individually and derivatively on behalf of KRAUS USA, INC.,
Petitioner,

-against-

KRAUS USA, INC., MICHAEL RUKHLIN and RUSSELL LEVI,
Respondents.

Index No. 606128/2015

RESPONDENTS' POST-TRIAL MEMORANDUM OF LAW

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INTRODUCTION & RELEVANT HISTORY

1. Respondent Kraus USA, Inc. (hereinafter "Kraus") is a New York corporation, headquartered in Port Washington, New York. At the commencement of this Proceeding, Kraus employed approximately 50 people, mostly in Nassau County. It also had a warehouse in Syosset. Kraus also had outsourced/contracted affiliates in India, and China. Kraus imports and sells primarily to the wholesale market kitchen and bathroom sinks, faucets, and accessories. Kraus does this both on-line and through commercial distribution channels, including directly to builders, with some consumer-facing sales through The Home Depot, Amazon and Lowe's. Russell Levi ("Levi") is its President and co-founder, with an ownership interest of 51%; Michael Rukhlin ("Rukhlin") is its Secretary and co-founder, and has a 25% interest in Kraus. Petitioner, Sergio Magarik ("Magarik") had 24%.

2. Magarik was an independent contractor/salesman for Kraus in 2007 and 2008. In his Petition, Magarik falsely claimed that he was a shareholder as of 2007, when Kraus was formed, notwithstanding that he never received a K-1, but only received a 1099 as an independent salesperson. Magarik first became a 20% shareholder in Kraus, as of January 1 2009. His shares increased to 24% as of January 1, 2010, which he maintained as of the commencement of this Proceeding, on September 21, 2015. Magarik sought Judicial Dissolution of Kraus pursuant to BCL § 1104-a, and the Petition contained five other causes of action (the "Fault Claims") with approximately 100 separate allegations, all of which were predicated upon a witch's brew of fraud, misconduct and malfeasance allegations against the two individual Respondents [see, Court Exhibit ("Ct. Ex.") 1] and where he falsely claimed there was an oral shareholder agreement with him as of 2007. On May 2, 2016, the individual Respondents exercised their right of election to buy Magarik's 24% interest pursuant to BCL 1118(c) at fair

value [Ct. Ex. 3]. After an approximately 2.5 year battle involving numerous discovery disputes and other issues, and several motions, almost exclusively involving Magarik's five non-valuation Fault Claims Petitioner withdrew—at the deadline for Respondents' time to file their motion for summary judgment on the Petitioner's five Fault Claims—each and every one of his five non-valuation Fault Claims with prejudice, by Stipulation dated July 26, 2018. The Statutory Valuation Date is September 20, 2015.

3. Significantly, this Proceeding was side-tracked almost exclusively by Magarik's needless litigation of his claim to have had an oral shareholder agreement since 2007 and his five Fault Claims for most of the time from and after the Respondents' election (May 2, 2016). Briefly, Respondents were forced to move for a Protective Order and related relief from the Petitioner's onerous discovery demands (Dkt. 142). Petitioner cross-moved to compel compliance with those demands (Dkt.152). By Decision and Order dated November 23, 2016 (Dkt. 187) Peter J. Mastaglio, Esq. was appointed as Referee, to supervise discovery and referred all discovery disputes to him, to hear, report and rule upon. The Special Referee issued a First Report dated December 28, 2016, and a Second Report dated January 26, 2017, the latter of which simply modified the compliance deadline set forth in the First Report (Dkts. 190, 191). The parties' respective discovery motions were each granted in part and denied in part. It is uncontested that Respondents served the Petitioner with approximately two hundred thousand (200,000) pages of mostly financial documents, largely in electronic format, in response to Petitioner's discovery demands. [Trial Transcript ("Tr."). at 157, 158] Additional discovery issues arose when, *inter alia*, Magarik's counsel did not allow their valuation expert, Randall M. Paulikens, of Friedman LLP ("Paulikens"), to answer certain questions posed at his deposition on August 29, 2017, which resulted in further delays and intervention by the Special Referee,

causing him to issue, after written briefings by both sides, a Third Report (Dkt.234), on December 17, 2017, in which he directed that Petitioner produce Paulikens for further deposition, which finally occurred on February 27, 2018. In fact, the Court's Certification Order, dated January 19, 2018 (Dkt. 235), made express reference to the outstanding discovery from the Petitioner, and the possible need to extend the deadline for dispositive motions as a result thereof. In fact, such extension became necessary and was granted on June 6, 2018 (Dkt. 242), with a new filing deadline set by the Court of July 20, 2018. With non-efiled permission of the Court, the new filing deadline was then extended a few days, in order for the parties to agree on a return date with an agreed-upon briefing schedule, which would provide Magarik with sufficient time to respond to Respondents' intended motion for summary judgment on each of the 5 Magarik's Fault Claims (see, Dkt. 244). On the eve of the filing deadline, Petitioner withdrew all of those Fault Claims, with prejudice, leaving only the matter of valuation to be determined by the Court (Dkt.246). Almost three (3) years and hundreds of thousands of dollars were simply wasted on legal fees, expert fees and production costs on those five Fault Claims. While the Stipulation to withdraw the Fault Claims admittedly provided that no inference should be drawn against either party with respect to the withdrawal itself, as will be more fully discussed below, at trial, it became evident that Magarik's pleading and thereafter dogged pursuit of the Fault Claims, was all a sham, designed and propagated in an ongoing, bad faith and malicious "strategy" to hurt and damage the Respondents and the business of Kraus as much as possible, for as long as possible; the end of the line being the summary judgment deadline, by which time, the Fault Claims would have been indefensible.[1]

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[1] As will be noted below, by the time of the summary judgment deadline, this Court had already issued two separate Decisions in which it found that at least some of Magarik's unsupported claims were contrary to the evidence presented.

THE LEGAL STANDARD

4. The legal standard and general principals of valuation in a proceeding such as the one at bar, were clearly articulated by Justice Driscoll in *Ferolito v. Arizona Beverages USA LLC,* 2014 WL 5834862 (Nassau Cty. Sup. Ct. Oct. 14, 2014):

> BCL § 1118 provides that the respondent in a dissolution proceeding filed under BCL § 1104-a may purchase the shares of the petitioner seeking dissolution "at their fair value." The statute neither defines "fair value" nor provides criteria for the determination of "fair value." The case law does, however, offer such guidance: "[I]n fixing fair value, courts should determine the minority shareholder's proportionate interest in the going concern value of the corporation as a whole, that is, what a willing purchaser, in an arm's length transaction, would offer for the corporation as an operating business." *Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161, 168 (1995), citing *Matter of Pace Photographers, Ltd.*, 71 N.Y.2d 737, 748 (1988), quoting *Matter of Blake v. Blake Agency*, 107 A.D.2d 139, 146, 486 N.Y.S.2d 341 (2d Dept.), *lv. denied,* 65 N.Y.2d 609, 494 N.Y.S.2d 1028, 484 N.E.2d 671 (1985). The value to be ascertained is "that of an interest in a going concern rather than a share of a business in the throes of liquidation." *In the Matter of the Dissolution of Seagroatt Floral Company, Inc.*, 78 N.Y.2d 439, 445 (1991). Fair market value is a "question of fact [and thus] depend[s] upon the circumstances of each case; there is no single formula for mechanical application." *Id.*
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> As *Seagroatt* recognized, "valuing a closely held corporation is not an exact science," and thus "courts in such proceedings confront a variety of evidence and methods aimed at determining the price of minority interests in closely held corporations - legal entities that by their nature contradict the concept of a 'market' value." *Id.* The Court thus has discretion to determine a valuation that "rests primarily on the credibility of the expert witnesses and their valuation techniques." *Adelstein v. Finest Food Distributing Co*, 2011 N.Y. Misc. LEXIS 5956 at *20. A court determining fair value may look to "market value, investment value and net asset value," *Blake*, 107 A.D.2d at 146. Nevertheless, "all three elements do not have to influence the result in every valuation proceeding. It suffices if they are all considered." *Matter of Endicott Johnson Corp. v. Bade*, 37 N.Y.2d 585, 588 (1975). Because closely held corporations "by their nature contradict the concept of a market value," *Seagroatt*, 78 N.Y.2d at 445, market value may be of "little or no significance" *Blake, 107* A.D.2d at 146. Rather, investment value is often the "appropriate

> valuation methodology." Such a methodology may incorporate a discount for the company's lack of marketability ("DLOM"), which recognizes that a potential investor would pay less for shares in a close corporation because they could not readily be liquidated for cash. *Friedman* [citation, supra], *Blake*, 107 A.D.2d at 149(DLOM is appropriate because "the shares of a closely held corporation cannot be readily sold on a public market").
>
> The Court may consider the company's past performance as well as future events that are "known or susceptible of proof" as of the valuation date. *Murphy v. U.S. Dredging Corp.*, 74 A.D.3d 815 (2d Dept. 2010), quoting *Matter of Miller Bros. Indus, v. Lazy Riv. Co.*, 272 A.D.2d 166, 168 (1st Dept. 2000) (internal quotation marks omitted). But the Court must not speculate about the company's future performance. *See Matter of Cohen*, 168 Misc. 2d 91 (Sup. Ct. N.Y. Co. 1995); *aff'd*, 240 A.D.2d 225 (1st Dept. 1997).

Ferolito, 2014 WL 5834862 at *7–8.

THE EXPERT VALUATIONS

5. Under §1118(b), shares are to be valued as of the day prior to the date on which such petition was filed. Court have strictly construed the statutory date. *Matter of Vetco, Inc.* 260 A.D.2d 642 (2d Dept. 1999). In this case, Petitioner's expert valued the Company one full calendar quarter year after the valuation date.

6. To determine the "fair value" of Magarik's 24% share in Kraus, Petitioner, through counsel, retained Paulikens, who arrived at $7,011,000.00 as the fair value of Magarik's interest, without taking any discount for lack of marketability ("DLOM"). The Respondents, through counsel, retained Paul G. Marquez, of BizValue, Ltd. ("Marquez"), who arrived at $1,100,000.00 for the fair value of the Magarik's interest, after applying a 25% DLOM.

7. A court's responsibility is to "ensure that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand." *Nease v. Ford Motor Co.,* 848 F.3d 219, 229 (4th Cir. 2017). With respect to reliability, a court must ensure that the proffered expert

opinion is based on scientific, technical, or other specialized knowledge and not on belief or speculation. *Id.*

8. In *In Re Cysive, Inc. Shareholders Litigation,* No. 20341 (Del. Chan. August 15, 2003), The Delaware Court of Chancery, where many fair value cases are heard, considered the weight given to "management projections". The Court rejected the shareholders' claim, and affirmed the appraiser's decision to apply zero value to the company-produced software in that case, finding that while management had projected substantial revenues from the sale of the software in issue, those projections were totally unreliable because the revenue was never realized.[2]

9. In *In re Global Technovations, Inc.,* 210 WL 2671706 (Bankr. E.D. Mich.), the court rejected the defense expert's Discounted Cash Flow Analysis ("DCF"), finding, among other things, that the company "had demonstrated a historical inability to create accurate projections…" The expert's DCF analysis was held to be "unreasonable and unreliable".

10. In *Gray v. Cytokine PharmaSciences, Inc.,* 2002 Del. Ch., LEXIS 48, the trial court rejected both parties' expert valuations, having reasoned that both valuations were litigation-driven. There, respondent's expert had produced a DCF analysis and a comparable companies analysis in his valuation. The Court concluded that his entire valuation was unreliable for several reasons. Among them, in preparing his DCF, the expert made his own projections. The court also found the expert's market approach to be unreliable, because the comparable companies the expert used were much larger than the company he valued, both in

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[2] Similarly, in the matter at bar, Kraus' CFO testified [Tr. 989, 990] that he included sales and income from the planned launch of new products into his rolling forecast which he had prepared and given to BHI, the bank, but that as of the Valuation Date, the new family of products to have been launched were only "in the very early stages and hadn't developed yet".

terms of revenue and market capitalization. In addition, only one of the 10 "comparable" companies used by the expert was in the same business as that of the company being valued.[3]

11. In *Schooltz v. Schooltz*, 27 Va. App. 264, 498 S.E.2d 437, 1998, Va. App. LEXIS 255, the Court rejected the expert's opinion on the value of the businesses, "because the expert's projections were overly speculative and by implication, unreliable."

12. Even management projections performed by inexperienced personnel should also be rejected. In PetSmart, Inc., 2017 WL 2303599, at page 86 (Del Ch 2017), the Court stated:

> I take guidance from other instances where this court has examined the reliability of projections used for the purposes of appraisal. Specifically, this court has deemed projections unreliable where the company's use of such projections was unprecedented, where the projections were created in anticipation of litigation, where the projections were created for the purpose of obtaining benefits outside the company's ordinary course of business, where the projections were inconsistent with a corporation's recent performance, or where the company had a poor history of meeting its projections. (footnotes omitted)

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[3] At trial, Marquez testified that Paulikens "didn't apply the market approach properly... what he's applying is the guideline public company method...using guideline public companies. Not private, public." He simply collected numbers from Capital IQ and other databases, which is a multiple. He uses a gross number of sales only, without really vetting or understanding what goes into that multiple. His analysis was limited to comparing whether those companies are similar to Kraus, but did not look at whether Kraus is similar to those companies, which they are not. The companies used by Paulikens are 100 times larger than Kraus in revenue, 177 times greater in earnings. "[h]e ignored the more important enterprise value multiples which are EBITDA, EBIT, discretionary earnings, book value. And he does it in summary fashion, without any analysis. He just calculates an average. To properly perform guideline public company analysis, you have to, not only understand the multiples themselves, but you really have to look at the distribution of the multiples." [Apr. 4, 2019 Tr. at 45-47]

Paulikens himself acknowledged that "one of the flaws with all the market methods he used is that they are not ever completely comparable. For example, when asked about Roy Ceramics, one of the companies he used as a comparable, Paulikens stated that he stated it is a public company, had revenue in excess of $10B as of the Valuation Date, with more than 30,000 employees, has been in existence for decades and owns a substantial number of other brands worldwide. When asked whether Roy Ceramics' revenues came from products other than of the type of products sold by Kraus, Paulikens answered "Yes". When asked if he knew what percentage of sales and income was derived from sale of sinks and/or faucets he stated "That's one of the inherent weaknesses in any of the methods". [Tr. at 193-196] When asked if he knew what percentage of his comparable companies derived their income from the sale of sinks and faucets, he did not know. [Tr. at 199-207] Two of his "comparable" companies, QVC and Home Shopping Network ("HSN"), are also multi-billion publically traded companies, and not in the same industry as Kraus. They sell products worldwide through their television stations and programs. [Tr. at 211-213]

As support, the Court cited *In re Nine Sys. Corp. S'holders Litig.*, 2014 WL 4383127, at pages 41 and 42 (Del. Ch. Sept. 4, 2014) (citing *Kahn v. Household Acq. Corp.*, 591 A.2d 166, 175 (Del. 1991))).

In PetSmart, the Court rejected the use of management's projections since the Company (a) did not regularly create five year projections but rather put together annual budgets (b) senior management was new on the job and never prepared long-term projections. See PetSmart at pages 87-90.

THE COMPARABLE APPROACH

13. The first step in doing a comparable approach valuation is to identify comparable companies. The target comparable companies should be in the same business and should derive their revenue from the sale of the same or similar products. They should function in the same market place; be similar in size, sales and margins. To perform a reliable comparable-companies analysis, the companies selected must be comparable to the company being valued. The equity sales transactions must actually be "comparable" to the hypothetical transaction at issue.

14. Kraus' business is limited to the sale of sinks, faucets, and accessories.

15. In the case at bar, the companies selected by Petitioner's expert as "comparables" differ so drastically from Kraus that they are simply unreliable. The differences between the companies used by Paulikens as "comparables," and Kraus are so significant, that his utilization of those companies made his comparable analysis unreliable.

16. As of the valuation date, Kraus was only in existence for 8 years. It had 50 employees and its net sales were less than $34M annually. (Ex. #3 in evidence Table Ex 2-1). Paulikens admitted that there was no way to measure what if any amount of sales and income was generated by these companies from the sale of sinks and faucets. Almost each of those

"comparable" companies were well established conglomerates, public companies with a long history, some, more than 100 years old. Some of the companies chosen as his "comparables" were not even in the business of selling sinks or faucets. For example, QVC and HSN sell a multitude of different products (watches, clothing, electronics to name a few) worldwide via a television platform [Tr. at 199-213]. They are nothing at all like Kraus. Almost all of Kraus' sales and income is generated domestically, while the "comparable" companies are international world-famous companies whose billions of dollars in sales and income are derived worldwide, in markets that Kraus has never been in or dealt with. They are simply not comparable.

17. When the differences between the companies identified as comparables is so large, the use of the comparable company method is meaningless for valuation purposes. See, *Neal v. Alabama By–Products Corp.*, Del.Ch., C.A. No. 8282, 1990 WL 109243, (Chandler, V.C.) (Aug. 1, 1990), slip op. at 21, aff'd, Del.Supr., 588 A.2d 255 (1991); *Citron v. E.I. DuPont de Nemours & Co.*, Del.Ch., 584 A.2d 490, 510 (1990). In this case, the differences between Kraus and the so called comparable companies as to product mix, revenues, profit margins, earnings, growth rates, asset size and geographic markets, all combine to make any comparison with Kraus totally meaningless. See, *In re Radiology Associates, Inc. Litigation*, Court of Chancery of Delaware, New Castle County, November 1, 1991, 611 A.2d 48517 Del. J. Corp. L. 1257. *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015).

18. Paulikens also uses only one (1) multiple, the Market Value of Invested Capital ("MVIC") to Sale Revenue. Since we know earnings multiples "won't work" for his analysis as Kraus had necessarily volatile earnings, it begs the question of "how about using the MVIC to Gross Profit or the MVIC to Book Value?"

19. Unlike the Paulikens Report, Marquez actually corroborated his income approach with the Direct Market Data Method, a market approach, and correctly applied regression analysis to justify his reliance on the method and for his overall conclusion. In addition, Marquez surveyed broker rules of thumb to gauge the reasonableness of his conclusion(s).

20. In a guideline company analysis, one must typically compare size, historical financial statements, historical operating and financial ratios, and growth rates for the subject and the guideline companies chosen. Paulikens analysis is bereft of any such analysis. In contrast, Marquez's position was that any use of any comparable approach without a comprehensive financial vetting of the companies selected should not be used. Without such an analysis, any basis for multiples selection by an expert would not be valid or reliable, if not properly adjusted for differences in risk size and growth in economic fundamentals.[4]

21. Most important, Paulikens failed to correlate the selection of his market multiple based on revenues to the comparable companies' profit margins—as they are the most important factor in its selection. As companies' profit margins increase, they naturally command higher revenue multiples. However, an inverse relationship exists between profit margins cash flow multipliers such as EBIT or EBITDA.

22. It is simply absurd for Paulikens to compare Kraus to Tesla, Inc. as a "disruptor" in its industry. Kraus' execution of its marketing and sales plan(s) cannot realistically be likened to a multi-billion dollar behemoth with a dissimilar cost and capital structure that spans worldwide international markets, economies, and industries. Furthermore, without Kraus' ownership of its intellectual property, it would be impossible to command the (revenue) market multiple that Paulikens assigns to the company, especially within an industry

[4] All else being equal, if the subject company is more risky, expects lower growth, or has a lower return on sales, it will merit lower multiples.

with highly matured commodity products with growth tied to the extremely volatile down-stream construction industry—where there is high-risk and low return on investment.

23. As shown in Marquez's side-by-side analysis (Rebuttal Report, Tr. Ex.5, at p. 9), the public company conformed multiple to be used properly, must be adjusted to a private company level. Not only does the valuation literature support it, there are recent empirical studies that show a dramatic adjustment is necessary.[5] Marquez presents the derivation of the private company discount[6] (to the public guideline company analysis) that at a minimum should have been calculated and applied by Paulikens in order for Paulikens to utilize this method.[7] Using the price to earnings (P/E) ratio is the preferred multiple to adjust as it is the purported result of all market forces and (theoretically perfect) market information as implied in the value of the stock(s) by its investors.[8]

24. In the table on page 9 of Marquez's Rebuttal Report, he presents the Paulikens market approach as corrected.[9] Moreover, the Paulikens analysis is also defective in the following manner:

- Paulikens used comparable company data as of May 2017, not as of the third quarter 2015, or the Valuation Date.
- In the screen shots that Paulikens presented (pages 4 and 5 of Tab E to the Paulikens Report), the actual median of each comparable set is 1.10x. Either Paulikens ignores this data or cherry-picked the selections in his comp set of bathroom fixture companies and online furniture retailers. Both screen shots also show the low range of TEV/Total Revenues to be 0.2x and 0.3x, respectively. Moreover, a sample size of 5 and 4 observations, respectively, is not statistically robust to be reliable.[10] There must be a minimum of 7 samples,

[5] See Appendix A of Marquez' Rebuttal Report [Tr. Ex. 5]
[6] Referred to as the fundamental discount in the valuation literature (sic).
[7] With Kraus normalized earnings significantly less than $1.0 million, the Company's equity value would not exceed $5.0 million using the GPCM; see Tables 1 and 2 on page 10 of the Marquez Rebuttal Report.
[8] The use of public (or private) company MVIC ratios is more complex—the most significant reason being the differing capital structures of the guideline companies selected.
[9] See Exhibits 1 and 2 of the Rebuttal Report. [Tr. Ex. 5]
[10] Statistical Confidence, pp. 47-55. *Business Appraisal Practice* (Spring 2003)

but 10 would be preferable for a minimum sample size, which Paulikens did not use.[11]

- Paulikens includes a multiple for Construction Supplies companies he gleaned from Dr. Aswath Damodoran's database (online at http://pages.stern.nyu.edu/~adamodar/). However, though there may be some overlap in the products, it is not Kraus' industry and therefore should be excluded. See Exhibit "3" in Marquez's Rebuttal. Marquez points out that the surveyed companies within that dataset finds 51 domestic companies (surveyed by Damodoran) primarily providing equipment and machinery used in industrial and commercial construction supplies. Kraus' market is however the consumer (i.e., residential) market for sinks and faucets. Finally, Paulikens uses a 2016 data set (multiple of 1.78x using **2016** calendar year data) rather than using the dataset and as of the Valuation Date. The 2015 multiple is significantly lower at 1.51x and further has not been adjusted for Kraus' low profitability, nor was any adjustment made by Paulikens for size, liquidity, growth, leverage, quality, management and ease of raising capital.

- Paulikens includes a multiple for Furniture/Home Furnishings companies gleaned (of 1.36x) from the Damodoran database. These 30 domestic companies are primarily wholesalers and retailers of home furnishings—only a small relative overlap to Kraus' industry. Again, the 2015 multiple is lower at 1.28x and has not been adjusted for Kraus' profitability.

- Paulikens failed to list a source for the "Branded Businesses Multiplier for Durable Goods." One must verify the reference to a multiple for use in any analysis.[12]

- Paulikens selects a market multiple, MVIC to revenues, to apply to Kraus, based on average multiple of 1.39 adjusted 10% across the board for size. Paulikens does not base his 10% adjustment on any quantitative or qualitative analysis "but for" his experience. The comparable companies he uses are each different from each other and each should have been separately adjusted appropriately. Taking a 10% "shave" across the board is inappropriate and supportable. He also points to Kraus' fleeting brand value and its alleged research & development lab[13] to justify using a high revenue multiple based on the selection of comparables with household names. These unadjusted multiples simply do not apply to Kraus. Kraus is not a "brand", and Paulikens was unqualified to determine that it was a brand. In fact, he admitted that he had no formal education in branding of products or in marketing, no experience

[11] Although the Paulikens Report screen shots in the Tab E Market Approach show a sample size of 9 and 10 companies, he actually only used 5. [Tr. Ex. 2]

[12] Actually, Marquez found the data in Table 2 of a whitepaper, *Valuing Branded Businesses*, in the Journal of Marketing (American Marketing Association). However, the whitepaper is from November 2009 presenting data from 2000 to 2006, more than 10 years earlier from the date of the Paulikens Report.

[13] As shown infra, Kraus had no significant research and development as of the Valuation Date.

on when a product becomes a brand that people recognize, and that prior to having been engaged in this case, he had never heard of Kraus, but had heard of Kohler, American Standard and Moen. [Tr., at 150, 151] He testified he looked at the internet in 2016, post the Valuation Date, and saw Kraus' products. He decided it was a brand. Magarik testified that he considered Kraus as a brand in 2007, even before any Kraus product was ever launched for the first time, although he used the word brand in assisting in putting together Kraus brochures and advertising beginning in 2007. [Tr. Magarik at 541 through 543]

- Paulikens uses the full year 2015 revenues of $36.3 million to apply his average multiple instead of the trailing 12-month revenue of $33.3 million (thru 9/30/2015). The 2015 4th quarter result was not known or knowable and was not susceptible to proof as of September 20, 2015, the Valuation Date. It was therefore improper for Paulikens to use any data or figures post September 30, 2015. The difference multiplied by Paulikens inappropriate multiple caused an overstatement alone of some $4 Million Dollars and skews his entire analysis.

25. The valuation literature supports the widespread use of adjusting a public guideline company multiple to a private level, known as the Private Company Discount (PCD) or the Fundamental Discount. The most recent study (from 2010) surveys companies by industry and applies regression analyses to support the findings.[14]

26. In contrast, Marquez testified that the use of the guideline public company method (hereinafter, "GPCM") is reliable, if applied correctly by the appraiser. See Exhibits 3-1 and 3-2 of Marquez's Rebuttal Report [Ex. 5]. Paulikens however did not calculate a median, harmonic mean, nor present a standard deviation or coefficient of variation to his data selection to analyze the data selected.[15] Marquez however shows a side-by-side, Paulikens' Market Approach, his analysis, as corrected, and then the Kraus metrics applied in the same manner.[16]

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[14] See Appendix B of Marquez's Rebuttal Report; summarized there in Table 3 on page 12. [Tr. Ex. 5]
[15] Had he performed or presented this analysis, his conclusion(s) would be markedly different.
[16] See Table 4 on page 13 of the Rebuttal Report. [Tr. Ex. 5]

27. As can readily be seen, the GPCM is a much more complex analysis than the simple "averages analysis" employed by Paulikens in the Paulikens report. Also, the use of the GPCM is time-consuming and all the data points must be vetted and confirmed, and the financial information for each and every comparable company selected for use by the expert must be adjusted to comport with the subject company's business.

DISCOUNTED CASH FLOW

28. Paulikens also used the Discounted Cash Flow ("DCF") analysis to value Magarik's 24% interest in Kraus. This method projects future income and reduces it to present value. *Orange and Rockland Utilities v. Town of Haverstraw*, 12 Misc. 3d 1194(A), (Sup. Ct., Rockland Cty. 2006). Paulikens relied on what he called "management projections" and heavily relied on what he thought was BHI's reliance on those "management projections". However, when asked if he had any personal knowledge as to the weight, if any BHI gave to those projections, Paulikens stated "No." He did not know. (Tr. Paulikens Direct at 321 lines 15-25). In fact, the projections given to BHI were only a rolling forecast for no more than one (1) year, which changed continuously. Dan Lusby testified that he continuously changed the numbers as they became available. Mr. Lusby was not experienced in putting together a "management projection." Kraus never had long term projection. Lusby testified that management never ever met any of its forecasts. This information was available to Paulikens. It was error for Mr. Paulikens to rely on Kraus' rolling forecast, call it a management projection, and then create his own litigation-driven speculative projection for Kraus. Courts have recognized limitations in use of DCF analysis, particularly when the assumptions are unreliable. A DCF analysis works best (and, arguably, only) when a company has accurate projections of future cash flows...." *Adelphia, supra*, at *18. When "the factual underpinnings of the DCF computation become

unreliable ... the propriety of any use of DCF (and the weight DCF conclusions should be given) becomes debatable at best." Id. at *18, 2014 Bankr.LEXIS 2011 at *57–58. *In re JCC Holding Co., Inc. S'holders Litig.*, 843 A.2d 713, 721 (Del.Ch.2003). The court noted that there were no "reliable recent long-term projections from which [the financial advisor] could perform a DCF valuation analysis." *Id.* A DCF analysis is problematic where management's projections are inaccurate or unreliable. See, e.g., *Adelphia*, 2014 WL 2057791, at *10–11, 2014 Bankr.LEXIS 2011, at *33; See also, *In re DBSD N. Am., Inc.*, 419 B.R. 179, 197 (S.D.N.Y.2009).

29. Paulikens used the 2016 forecast (an increase in net sales of 41.2% over 2015 actual results!)[17] and then utilized his very own, not management's, 5% annual growth rate (thereafter) and the same expense ratios that were utilized in the 2016 forecast without subjecting it to any analysis.[18] When projections are presented by Kraus, in order for the analyst to use it or rely upon it, an analysis of every line item is usually performed to gauge the reasonableness of the Company's assumptions. No such analysis was presented in Paulikens' Report. Paulikens acknowledged that he did not inquire, vet, or seek to clarify, or confirm any of the projected data in the YEP analyses. He just blindly used them to inflate his valuation. The Kraus YEP Analyses were overly optimistic forecasts, similar to previous versions, in which the forecasts were never met, as testified by Lusby. The forecast versus actual difference (lower) vary from 20% for revenues to over 90% in net operating income.[19] Moreover, as of the Valuation Date, Paulikens knew or should have known, that Kraus was already way behind in its 2015 budget for the first nine months. As pointed out by Marquez, Kraus was 98% below its (overly optimistic)

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[17] The actual annual growth from 2014 to 2015 in net sales was 26.7%; from 2013 to 2014, the growth was -3.4%.
[18] It seems incredulous that Paulikens drops his growth rate from an incredible 41.2% in the first year of his projection to only 5.0% for the remaining years. It is more reasonable to decrease the growth rate on a graduated basis by say 10% or 20% but not decrease a top-line growth rate by a factor of over eight times (i.e, an 800%+ drop in growth).
[19] See updated **Appendix C** in the Rebuttal Report that now includes a full-year comparison for 2015.

operating income target of $5.457M, having earned a mere $90,946 for the first nine months of 2015. (Apr. 4, 2019 Tr.29:18–21).

30. Paulikens contends that BHI must have viewed Kraus favorably in order to close the loan and presumed that BHI relied upon Kraus' projections.[20] (Nov. 15, 2018 Tr., 178:3–17). Paulikens admitted he had no personal knowledge if BHI relied on Kraus' 2015 and 2016 projections. (Paulikens Direct Tr. at 177:23–25, 178:1–2, 321:15–25). Marquez, however, testified that Kraus was limited in accessing its asset-based loan (ABL) based upon its actual borrowing base and other operating and financial statement conditions in the loan.[21] Marquez pointed out that as of September 30, 2015, Kraus' book value (or tangible net worth = TNW) was less than $750,000 wherein Kraus was required to have a TNW of $1.5 million in order to increase the ABL from $7.0 million to $10 million which would allow Kraus to meet any working capital shortfall. The maximum amount that Kraus was able to borrow under the BHI loan terms was barely $6M, i.e., only $1M dollars more than the funds which they had available prior to the BHI refinance.[22]

31. The working capital shortfall of $2,929,000.00 as of December 31, 2015 identified in Paulikens' Report, Tab C [Ct. Ex. 2], Marquez explained that it meant that without access to that additional working capital line, the company cannot grow its sales any faster than it had previously, which was at a rate of 25%, and therefore could not have met the 41% growth projected in the 2016 forecast [Tr. Ex. 41], and the 2016 forecast would therefore have to be

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[20] Page 12, first and second bullet points of the Friedman Report.

[21] Kraus had to maintain a Tangible Net Worth (i.e., book value of equity) level of $1.5 million in order to increase the maximum revolving amount from $7.0 million to $10 million. The covenants in the loan agreement with BHI also include a maximum leverage ratio of 10.5x through 9/30/215 and 6.5x through 12/31/2015; and a maximum annual capital expenditure of $500,000.

[22] See, 11/15/18 Tr., at p.183, where Paulikens testified that Kraus' $5M in then existing loan debt was paid off at the BHI closing.

reduced to at least 25%.[23] Kraus was running out of cash and at the end of 2015, Paulikens noted that Kraus only had $17,471 of cash. They could not borrow more money to meet the shortfall, because they had already borrowed the maximum allowed based upon the borrowing base ratios contained in the loan documents. [Apr. 4, 2019 Tr. at 40-42]

32. As Marquez pointed out, in an article on his website, which Magarik's counsel used in an attempt to impeach Marquez's testimony and opinion on his use of a single-period capitalization method (aka single period discounted cash flow) instead of a DCF, "A buyer is buying the future, not the past. Projected earnings, therefore, is my answer to which earnings figures to use. The obvious problem with this is that it is difficult to estimate. But it's still the right figure to use. It makes most sense to buyers as long as the projection looks realistic." (Apr. 4, 2019, Tr. 84:4–10). Marquez continued to clarify his analysis of (Kraus) Management's forecast: "Caveat, if management's projections are not reliable, then the forecast can't be reliable and using projected earnings is speculative." (May 16, 2019 Tr., 936:9–11).

33. Unlike Paulikens, Marquez, did not rely on "managements projections", having deemed them unreliable, for the reasons set forth above. Though Marquez did not ultimately rely upon a (multi-period) DCF model, he nevertheless prepared a DCF (see, Tr. Ex.3, at Ex. 16), simply to illustrate that it could be used but, only with realistic assumptions. He could not utilize the Company's projections as they were based on unreasonable assumptions and thus he utilized a single-period discounted cash flow (i.e., capitalization of cash flow or income) with an optimistic weighting of the Company's prior income results.[24] Marquez, unlike Paulikens, knew

[23] Simply put, without working capital cash, the Company would not be able to purchase more product to sell. Without a constant inflow of inventory, the Company would not be able to sell more product than it has on hand and therefore, there would be no more growth in sales as sales would remain at the same level.
[24] Marquez weighted the historical earnings optimistically as he afforded the greatest weight on the years with the highest earnings in descending order wherein the lowest earnings year had the least weight.

that Kraus had never met a single one of their projections for sales or income, i.e., they were historically unreliable.[25] As of December 31, 2015, Paulikens confirms Kraus as having an actual shortfall of $2.92M. See Paulikens' Report, Tab – C (Balance Sheets). Most importantly, without the anticipated working capital, Kraus could NOT have grown its sales any faster than its current compound annual growth rate of 25% and not its incredible 41.2% growth projection for 2016 and thus, Paulikens' DCF analysis is fatally flawed.

34. The DCF model itself (Tab E of the Paulikens' Report) includes only the Kraus 2015 actual and 2016 budget and then Paulikens generated his own completely speculative, hypothetical forecast for 2017 through 2020, "based upon the information presented". The 18.7% operating expense ratio implied in the 2016 forecast yields a projected 2016 operating expense of $9.596M, yet the actual 2015 results already had a $10.044M operating expense level or 27.7% of 2015 net sales. This assumption grossly reduces the forecasted expenses and therefore again artificially inflates his value of Kraus.

35. Of note, Paulikens calculated the equity cost of capital as 21.97% (22% rounded). Marquez' report presented a very conservative 17.5% cost of equity capital.[26] Moreover, Paulikens' growth rate is 3.0% and Marquez surveyed 4.0% for the industry.[27] This implies that Paulikens believes Kraus is a risky company, if not a riskier company than the industry cohort. If this were the case, then how does Paulikens project Kraus with having the lower risk profile attendant to the public companies he compares them to in his comparable approach? In other words, how can Kraus command a public company (market) multiple if Kraus is so much risker?

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[25] See, *In re Global Technovations, Inc.*, supra, where the court the court rejected the defense expert's DCF, finding, among other things, that the company "had demonstrated a historical inability to create accurate projections…"
[26] Used to discount the future net income (to equity) in his report.
[27] Paulikens' resulting capitalization rate, used in his terminal value, was 19.0% (22.0% less a 3.0% long-term growth rate); Marquez's capitalization rate was only 13.5% (17.5% equity cost of capital less 4.0% near-term growth). In simple application, a lower capitalization rate results in a higher (net present) value.

36. Marquez presented a more realistic DCF model but did not rely upon it in his final analysis and conclusion. The growth and operating metrics Marquez employed were based on more reasonable assumptions that comport to Kraus' actual operating activity. Ultimately, Kraus' financial metrics were so volatile that Marquez did not want to generate a speculative projection and therefore rejected the method.

37. "Inputs in a discounted cash flow ("DCF") are predictions which are necessarily speculative in nature. The quality of these predictions is therefore central to the reliability of the underlying methodology." (quoting Harris v. Rapid Am. Corp., 1990 WL 146488, *6 (Del. Chanc. Oct. 2, 1990)).

38. While accepted by a Court, prospective methodologies, such as discounted cash flow, rest on a certain amount of speculation and opinion. See *In re Delaware Racing Ass'n,* Del.Supr., 213 A.2d 203, 212 (1965); *Cottrell v. Pawcatuck Co.,* Del.Supr., 128 A.2d 225, 231-232 (1956), cert. denied, 355 U.S. 12 (1957). If nothing else, such a fact should put the Court on notice. A discounted cash flow analysis, is only as good as the inputs to the model. *Neal v. Alabama By-Products Corporation*, Del.Ch., C.A. No. 8282, Chandler, V.C., slip op. at 22 (Aug. 1, 1990) (citing S. Pratt, Valuing A Business: The Analysis and Appraisal of Closely Held Companies (2d ed. 1989) at p. 84). It is therefore vital that the quality of these predictions be absolutely reliable.

39. To assess whether expert testimony meets the requisite standards a court should undertake "a rigorous examination of the facts on which the expert relies, the method by which the expert draws an opinion from those facts, and how the expert applies the facts and methods to the case at hand." *Amorgianos*, 303 F.3d at 267. It has been held that "[T]he quality of the projection as to the future benefits over some period and the residual or terminal value is central

to the reliability of the underlying methodology of the discount cash flow method." Harris v. **1265 Rapid–American Corp., Del.Ch., C.A. No. 6462, 1990 WL 146488, Chandler, V.C. (Oct. 2, 1990) at 14. An inability to reconcile a comparable companies analysis and a DCF analysis has been determined to be an indicator of unreliability. *Lippe v. Bairnco*, 99 Fed.Appx. 274, 279 (2d Cir.2004); *To–Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., Inc.*, 953 F.Supp. 987, 996–997 (N.D.Ill.1997) aff'd 152 F.3d 658 (7th Cir.1998) .

40. Where an expert's opinion used that is not "based on sufficient facts or data" and is also not "the product of reliable principles and methods properly applied," the result should be rejected. *Lippe, supra*; *In re Rezulin Prods. Liab. Litig.*, 369 F.Supp.2d 398, 425 (S.D.N.Y.2005).

41. An expert opinion is unreliable and not based on sufficient facts and data when the expert "made no attempt to reconcile his view [ ] with a number of real world events". *Point Prod. A.G. v. Sony Music Entertainment, Inc.*, No. 93 Civ. 4001, 2004 WL 345551, at *10 (S.D.N.Y. Feb.23, 2004). Where a comparable approach and a DCF analysis do not yield similar results, they should be rejected. *Lippe, supra*; see Chapter 9. A court should exclude expert valuation testimony if the expert bases his analysis on an inappropriate set of cash flow projections. *Frymire–Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 186–87 (7th Cir.1993).

42. Company projections made for litigation purposes and litigation driven are not reliable and should be rejected. *See, In re Family Dollar Stores, Inc. Stockholder Lit.*, 2014 WL 7246436, at 22. They are not made in the ordinary course of business. In the case at bar, Kraus CFO Daniel Lusby, CPA, testified [May 15, 2019 Tr. at 948–951] that he was hired by Kraus as Controller in October, 2013 and was elevated to CFO in April, 2014. The BHI refinance occurred in July 2015. Prior to becoming CFO, Lusby had nothing to do with Kraus projections,

and knew nothing about Kraus' business model and operations. He testified that he does not have any professional training, or degrees for making projections for any company, and that as Controller, when he was retained by Kraus in October, 2013, he did not need to know the operating aspect of Kraus. He testified that he created his first financial model and rolling one (1) year forecast in mid-February, 2014, and presented it to ownership, including Magarik. He updated his projections monthly, thereafter, based upon sales information provided by the Levi, Rukhlin and Magarik, as that information was available. He testified that none of the monthly Kraus forecasts were <u>ever</u> met in calendar year 2014, nor were any of the 2015 monthly forecasts ever met, through the Valuation Date [May 15, 2019Tr. at p.951]. This fact was known to Magarik, as he was one of the 3 Directors of Kraus throughout that time, and Magarik was given a copy of all financial documents and reports. On cross-examination, Lusby was asked if after the BHI loan closing, Kraus continued to rely on the "projections" given to BHI as part of Kraus' loan application process (Tr. Ex.HH) in the ordinary course of its business. Lusby replied "as standard practice, every month I update the actuals into history and I update the future projections based on updated knowledge. So those projections change all the time. It's called a rolling forecast". [May 15, 2019 Tr. at 951, 974] Lusby explained that "rolling projections…means that as I identify anything that has an impact to the numbers, I will make a change". [*id.* at p. 985] It was stipulated, and Lusby testified that he/Kraus gave four (4) different "projections" to BHI from June 1 to June 19. [*id.,* at p. 989; all 4 projections are in evidence, at Tr. Ex. 41, 68-70]. Kraus never had a stable long term projection. At best, it had a rolling forecast for a 1 or 2 year period. Since Paulikens had all of the 2014 and 2015 Kraus forecasts throughout the Valuation Dates, he knew that Kraus never met a single "projection" and his reliance on the 2016 Kraus forecast was not reliable for him to create his own litigation driven projection for his DCF model. He also never spoke to management nor did he ever visit the Company.

43. Paulikens identifies three valuation methods but eventually defaults to a discounted cash flow method. He specifically ignores the Company's historic earnings, which show volatility, literally ignoring the fact that 2011, 2012 and 2014 years generated operating earnings only $1.0 million in each year. The Kraus forecast were limited to 2015 and 2016. Beyond that point, Paulikens simply created his own litigation-driven projection, with the company earning pre-tax income of $5.75M in 2016, as his starting point, despite the fact that he had the 2015 actual results, which only showed approximately $596,000 of the pre-tax income. *i.e.*, less than 50% of the $1.124M which management had projected for 2015. Thus, his projection of pre-tax income is almost ten (10) times higher and his after-tax income projection is more than three (3) times higher than the adjusted 2015 after-tax projection. In no prior year has Kraus ever earned more than $1.1 million in pre-tax net income and it simply defies logic that Kraus can have such high earnings when it has such a current high working capital (investment) requirement.

44. Lusby testified that Kraus hopefully planned to use money from the BHI loan to launch new products, and that he included sales and income from the launch of new products into his forecast/projections, which he prepared and gave to the bank. However, as of the Valuation Date, all of the new proposed family of products to have been launched were only "in the very early stages and hadn't developed yet".[28] [May 15, 2019Tr. 989, 990, 1004] In fact, in

[28] In fact, Levi testified that due to delays in quality, the products started to come arrive in the U.S. in "I think…October, August, September". [5/15/19 TR. at 1026] Paulikens did not consider the extreme risk factors associated with the planned launch – and the success or failure -- of new products, e.g., timely production and delivery from China, increased competition in the marketplace, quality control concerns associated with new products, and consumer acceptance of same. He made no adjustment for those risks, even though Magarik is deemed to have had actual knowledge of the actualized risk, i.e., the delayed launch, as of the Valuation Date.

case of action of the Petitioner, Magarik accuses Respondent in fraud for not using any money from BHI for new products, a fact known to Paulikens. [See Petition 5th cause of action]

45. Rukhlin also testified that the anticipated sales and income from the proposed new products which were to be launched with money from the BHI loan were a big part of the 2015–2016 Kraus projections given to BHI. [May 15, 2019 TR. at 1002]. As to how the projections were made, Rukhlin testified that "…we were in the room and when we were giving the numbers to Mr. Lusby. The way we did it, the best we knew how, is where we took the products, how many products we have currently, how many products we were going to add, which product lines on which channel..." (*id.,* at 1003).

46. Levi also testified that the projections given to BHI took into account the anticipated sales from the new products. "It was a rosy projection", but as of the Valuation Date, the anticipated sales had not taken place [May 15, 2019 TR. at 1027–28] Further, as of the Valuation date, Kraus had competition from other companies selling the same type of products sold by Kraus. In fact, Levi testified "It was a cutthroat environment…it was either survive or die. It was very difficult. It was the most difficult year I have, worst", as by that time, all of the other companies sold their sink and faucet products in the same way as Kraus did. [*id.,* at 1029–30]

47. As stated, Paulikens did nothing to vet the 2014 or 2015 "projections" nor did he do anything to find out who prepared those forecasts nor if that person or persons who prepared the forecasts were qualified to do so. *See* The 12 Warning Signs of Unreliable Forecasts from Tarbell and Trugman, BVR Business Valuation Update, Volume 16 No. 11 November 2010. As a result, the use of any so called 2016 projections made by Kraus were unreliable – and should have been known to have been unreliable by Paulikens -- and should not have been used in his

2017-2020 litigation-driven and created projections and should therefore be rejected. See, *Gray, supra.* As stated above, Paulikens made no attempt to vet the "detailed management forecasts" (YEP Analysis) for 2015 and 2016 from June 8, 2015 that was presented to BHI (Bank) as part of the closing documents for its loan in July 2015. Nor did Paulikens seek to ascertain what, if any, experience Lusby (the person at Kraus who prepared those projections) had at formulating such projections. Nor did he seek to verify whether Kraus had ever met any of its prior projections. And though he had the 2015 actual results, he apparently did not consider or compare it to the 2015 forecast.[29] In contrast, Marquez vetted the YEP Analysis with Kraus' CFO, Daniel Lusby, and used them as a guide to normalize earnings and project future operations (in his own DCF—see Exhibit 16 of Fair Value Report).[30]

PETITIONER'S CREDIBILITY AND COMMUNICATIONS WITH HIS EXPERT

48. On the one hand, Paulikens testified that it was essential for him to understand the totality of Kraus' business. To understand "what's the English" (Tr. at 52). Yet, Paulikens did not speak with or interview Dan Lusby or management, nor did he perform a site visit to Kraus. In fact, he had no idea as to the size of Kraus' facility, its equipment and/or the existence of the Research and Development lab/department, a significant factor in his faulty determination that Kraus was "unique and innovative" relative to its competitors as of the Valuation Date of September 20, 2015.

49. Marquez, on the other hand, correctly ascribes value to Kraus as a Marketeer, predominantly a wholesaler of kitchen faucets and sinks.[31] Kraus sells its kitchen faucets and sinks and accessories to distributors and retailers primarily in the United States. The Company markets its own products under the Kraus tradename—virtually and functionally a private label.

[29] See page 16, 3rd paragraph of the Paulikens Report.
[30] See, Apr. 4, 2019 Tr., at p. 32, 33.
[31] Marketer or promoter of (primarily) commodity products and services.

The Kraus tradename and mark are not owned by Kraus. They are owned and registered by ICG Licensing LLC.[Tr. Apr. 4, 2019 at 66; Tr. May 15, 2019 at 999) Magarik has no interest in that entity. As Rukhlin testified, Magarik was fully aware that the Kraus name and logo was owned by ICG in which he had no interest because they discussed it every time Kraus took out a loan and the lender required Rukhlin and Levi to sign guaranties and to sign on behalf of ICG. [Tr. May 15, 2019 at 999–1000]. Marquez testified that the tacit value in Kraus lies not in its "brand", but in its business plans with its Chinese manufacturers, marketing efforts, distribution relationships in the U.S., pricing, cooperative advertising, and incentives. [Apr. 4, 2019 Tr., p. 64]. Had Kraus had (real) brand value, it would also have pricing power (and excess earnings). [Apr. 4, 2019 Tr. at p. 55]

50. The date of valuation is September 20, 2015. Under the Fair Market Value standard, which Paulikens explicitly applies, it is interpreted to mean the facts that were "known" or "knowable" as of the valuation date.[32] The Court may consider the company's past performance as well as future events, but only if they are "known or susceptible of proof" as of the valuation date. *Murphy, supra, v. U.S. Dredging Corp.,* quoting *Matter of Miller Bros., supra*) (internal quotation marks omitted). However, the Court must not speculate about the company's future performance. *See, Matter of Cohen,* 168 Misc. 2d 91 (Sup. Ct. N.Y. Co. 1995); *aff'd*, 240 A.D.2d 225 (1st Dept. 1997). While Marquez uses the financial statement date of September 30, 2015 for administrative convenience, Paulikens used the annual 2015 financial statements ending December 31, 2015. Immediately, any company financial measure (or amount) used in the Paulikens Report is incorrect (and skew the valuation results) and is in direct violation of BCL § 1118, which mandates that fair value be determined as of *one day before the*

[32] In New York, the standard is what facts were known or "susceptible of proof as of the valuation date." *Murphy, supra.*

Petition was filed. Even if the December 31, 2015 Financial Statement was subsequently provided, Paulikens should have used the interim financial statements which were available to him through September 30, 2015, the end of the 3rd quarter of 2015.[33] The calendar year-end 2015 Kraus financial statement was not even have been used until March 10, 2016, the date that report was issued. Using data post the Valuation Date is improper. The results of the 2015 4th quarter financial statement should not have been used. This obviously creates a mismatch in the calculation and application of valuation multiples used by Paulikens, and his valuation should be rejected.

51. Paulikens explicitly states he is calculating "Fair Value" using the fair market value ("FMV") standard without any valuation discounts. This must be distinguished from the factors considered in New York cases: Net Asset Value, Investment Value, and Market Value. FMV is a U.S. Treasury concept embodied in Revenue Ruling 59-60 which Paulikens relied upon and which he cites several times. [Tr. Paulikens direct pgs. 52-55]. The definition of "fair market value" requires reasonable knowledge of the relevant facts, without any compulsion to buy or sell. However, fair value as contemplated in New York is a construct to equalize the value of a corporation to its shareholders, majority and minority alike. The Company may or may not be sold, but the standard strives to calculate the value that every shareholder would receive if their individual interests were cashed out or transferred to third parties.[34]

52. Paulikens mentions these incorrect metrics as of December 31, 2015 and calculates Kraus' economic income in Tab D of his Report (Ex. D), but makes no use of it. Any

[33] Magarik was a Director until 5/3/2016 so was provided with the 2015 Financial Statement and other interim reports, by Court Order.

[34] Marquez testified that had he utilized the standard of fair market value, his valuation of Kraus would have been significantly lower—as the standard requires knowledge of the relevant facts. [Transcript 4/03/19, pages 726-728] The relevant facts that Marquez alludes to are Petitioner's baseless waste and looting claims, Magarik's claim of keyperson marketability, their overly optimistic financial projections, Kraus' risk of default or bankruptcy, and cut-throat competition.

calculation using this quantum (or measure) of income would not yield the results he was trying to achieve. Even a 20x multiple of earnings (*i.e.*, the public company level) would yield a value for the equity of only $7.2 million—still far below the level of his two other methods. Marquez however projects a normalized, but optimistic, cash flow as of the 3rd Quarter of 2015—this is the correct measure of income—as it comports to the valuation date and what was "known or knowable" in terms of the Company's actual earning capacity as of the Valuation Date. Marquez projected a normalized current earnings (pre-tax net income) of $890,986, the same basis that Kraus' earnings are reported on its financial statements. Of note, the actual trailing 12-month income that Kraus earned was only $77,450.[35]

PAULIKENS' RECONCILIATION OF HIS TWO METHODS

53. Paulikens presents a $19 million value using a DCF approach and a $39 million, using value under his comparable approach: he weights them 50/50 or 1:1 several times within his report. This is simply incredible and totally unreliable. The weighting results in a $29 million value for Kraus, the "simple average"—but the dispersion is too great for him to explain other than the inference that he needed to achieve a desired result.[36] This is a major red-herring in valuation results, and should be rejected by the Court. The 2 approaches used should be close in value to one another. Experts use 2 approaches, as a check to insure that the valuation is correct. To add his $19 Million Dollar DCF value to the $38 Million Dollar comparable/market

[35] By the end of 2015, the full-year pre-tax income was only $595,826, having earned over $600,000 in the 4th Quarter. This amount is still *less* than what Marquez optimistically calculated for Kraus' prospective earnings capability based on its actual prior earnings.

[36] Mathematically, Paulikens presents two methods that vary 100% greater from one and 50% less than the other. This presentation is not only unsupportable, it makes the reader wonder if there are actually two separate companies being analyzed.

value approach value and then simply divide the $58 Million Dollars total by 2 to arrive at a $29 Million Dollar value for Magarik's 24% interest is simply absurd and must be rejected.[37]

54. Paulikens testified that Gary Trugman was a leading authority on how to value a business. (Tr. at 260). Paulikens also relied heavily on Revenue Ruling 59-60 (Tr.52–54). In Understanding Business Valuation: A Practical Guide To Valuing Small To Medium Sized Businesses, by Gary Trugman, Chapter 17, published by the American Institute of Certified Public Accountants, Inc, 5th Edition, 2017, Gary Trugman warns appraisers and states:

> Avoid a common error, which is to take a straight mathematical average of all methods. Most often, the result will be incorrect. In fact, Revenue Ruling 59-60 specifically tells us not to just average the numbers.

Yet, that is exactly what Paulikens did.

RESEARCH & DEVELOPMENT

55. Kraus did not have any equipment for research and development until it purchased a 3-D printer around February or March, 2015. No one at Kraus even knew how to operate the printer at the time it was purchased, and in fact, no one designed anything on the printer through the Valuation Date. [TR. at 1008, 1009] Levi testified that Kraus did not have any equipment for research and development until it purchased a 3-D printer in early 2015, and was not used to actually develop or research anything through the Valuation Date. [Tr. Levi May 15, 2019 at page 1031–32] Nor was any money used which may have been allocated to research and development as of the Valuation Date. [TR. at 1031–32].

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[37] It is widely know in the valuation literature that the market and income approach should be relatively confirm each others valuation. There are market inputs in the income approach and income inputs used in the market approach. For example, the income multiples derived from either public or private companies or transactions drive the market-derived cost of capital or discount rates that are inherently calculated from these market inputs. For the Price to Earnings (P/E) multiple, if the multiple is 10x, the inverse or capitalization rate is 10%. If the implied growth rate in earnings of the company is 4%, its cost of capital is 14%. As a rule of thumb, the market and income approaches should not vary by more than 20%.

56. On cross examination Mr. Magarik testified that he did not know if any money was used by Kraus as of September, 2015 for research and development. [TR. at 610 and 611] See Marguez's Rebuttal Report Appendix C that shows that in 2014 and 2015 no funds were used for research and development.

THE $30 MILLION DOLLAR VALUATION ON THE SHAREHOLDERS' PERSONAL FINANCIAL STATEMENTS

57. Magarik testified as to how the 3 shareholders arrived at a $30 Million Dollar valuation on the personal financial statements given to BHI (Exhibits 71-73). They sat in the office and discussed this together. Magarik stated that "we looked at the past, we looked at the current, the present, and forward with all of the new products that were coming out and we came to that valuation to determine that's how much the company is worth." [TR. at 520, 521, 577, 620] In arriving at the value of $30M, the first thing that Magarik personally looked at was gross sales, "was an educated guess". [TR. at 622, 623]

58. Rukhlin testified that he, Levi and Magarik "got in the room together…and we knew that it was an [asset based credit line], so that value didn't have a big effect. So we just talked about it, what we're going to put in the field and, you know, Serge said that we should put the sales number. So he convinced us that the sales number is the number to put in and that's what we did". The meeting lasted "about a minute". No documents were used or relied upon; it was just a conversation between ownership in the office. [TR. at 1007]

59. Rukhlin also testified that the Kraus tradename and logo are owned by ICG Licensing, LLC ("ICG"); Magarik has no interest in that entity. Magarik was aware of the ownership and we discussed it over time because whenever Kraus took out a loan, e.g., Chase, and then BHI, ICG was always a guarantor on the loan. When it would be time to sign the

guarantees, all three of us signed on behalf of Kraus, but only Levi and I signed on behalf of ICG (TR. at 999–1000)

60. As of the Valuation Date, none of the new products had launched, due to multiple issues, including quality control, "so the timelines didn't go as well as we thought they were going to go". (TR. at 1004)

61. Regarding "brand," Magarik testified that the word "brand" was injected into the marketing materials as early as 2006, and the word "brand" was used thereafter, in every advertisement for Kraus whether online or in print between 2007–2010. [TR. at 541–42]. Kraus was not formed until 2007, but in Magarik's opinion, it was already a brand prior to its formation. [TR. at 542].

DISCOUNT FOR LACK OF MARKETABILITY

62. A discount for lack of marketability ("DLOM") recognizes that a potential investor would pay less for shares in a close corporation because the interest sold/purchased cannot be readily liquidated for cash. *Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161, 165 (1995). *Blake*, 107 A.D.2d at 149.

63. Paulikens refrains from applying a DLOM contending that he does not believe a DLOM is appropriate in this particular case because of the length of time this case has been pending. Marquez however applied a DLOM, not to the 24% interest but to the Company as a whole (an "entity-level" discount). This is the proper application of a DLOM in that it does not bias a minority interest holder (but accounts for the PCD on Kraus as a whole). Every shareholder would be subject to the same treatment.

64. *Ferolito v. Arizona Beverages USA,* 2014 WL 5834862, was a BCL 1118 case involving two 50 percent shareholders of the subject company's stock. A 25% discount for lack

of marketability was applied based on the company's lack of audited financial statements, the extensive litigation between the parties, uncertainties about the company's S-corporation status, and transfer restrictions in the Owners' Agreement. Similar facts are present in Kraus with the added uncertainties about the Company's financial condition, especially its liquidity and borrowing capacity.

65. Marquez presented the Court with applicable factors and analysis of his determination of a discount for lack of marketability for the subject company and Magarik's 24% interest. He found that the DLOM would be affected by the time value of money, transaction costs, key-person considerations, potential royalties, and other case specific risks. Marquez also considered a conventional DLOM based on rates of return affected by Kraus' own revenue size, market value, total assets, book value, and its operating margin compared to market data. Finally, Marquez applied a middle range of his estimate of the DLOM of 25% to his conclusion for the fair value of the Company before calculating the pro-rata 24% interest of $1.1 million.

66. In *Arizona*, the Petitioner had argued that no DLOM should be applied, while the Respondents' expert stated that a 35% DLOM was appropriate. Ultimately, Judge Driscoll determined that a 25% DLOM was appropriate in that case. As part of his analysis of the issue, Judge Driscoll found and noted that a DLOM "reflects that shares in privately held companies may be less marketable because those shares cannot be readily liquidated for cash" *citing, Blake, supra*, and that "nearly all courts in New York that have considered the question whether to apply a DLOM have answered in the affirmative".[38]

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[38]In *Hall v. King*, 675 N.Y.S.2d 810, 177 Misc.2d 126 (Sup. NY, 1998), the Petitioner argued for a 10% DLOM, while the Respondent sought a 25% DLOM, and the court found that a DLOM of 25% was proper in that case. In its analysis on the issue of the DLOM, the court noted that there is no blanket figure to be applied in all instances. And that our courts have utilized a number of different figures, based upon the evidence. See, e.g., *Matter of Blake, supra* (applying a 25% discount); *Matter of Whalen v. Whalen's Moving & Storage Co.*, 234 A.D.2d 552 (2d Dept.1996) (applying a 20% discount); *Lehman v. Piontkowski*, 203 A.D.2d 257, 609 N.Y.S.2d 339 (2d Dept.)

PREJUDGMENT INTEREST

67. BCL §1118(b) provides, in relevant portion that: "In determining the fair value of the petitioner's shares, the court, **in its discretion, may award** interest from the date the petition is filed to the date of payment for the petitioner's share **at an equitable rate** upon judicially determined fair value of his shares." [emphasis added] Accordingly, whether and at what rate prejudgment interest is to be awarded, is totally within the discretion of the Court, and is to be determined on a case-by-case basis. Further, interest should not be awarded, or any award of interest should be modified, upon a determination that the Petitioner has acted in bad faith. *See, Blake, supra.*

68. In *Adelstein v. Finest Food Distributing Co*, *supra* (also 2011 WL 6738941), the Court recognized that it "is not statutorily obligated to award pre-judgment interest, or any interest at all, to Petitioner" and that the Court "has the discretion to establish payment terms (*see*, *In the Matter of the Dissolution of Seagroatt Floral Company, Inc.*, 78 N.Y.2d 439, 445 (1991))". There, the Court denied the Petitioner's request for an award of prejudgment interest, at the rate of 9%, from the date the petition was filed, and instead, only awarded "interest, at the

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(applying a 25% discount), lv. to appeal dismissed 84 N.Y.2d 890, 621 N.Y.S.2d 505, 645 N.E.2d 1203 (1994). *See, also, Matter of Joy Wholesale Sundries, Inc.,* 125 A.D.2d 310 (2d Dept.1986) (failure to apply LOM discount—reversed); *Matter of Dissolution of Bambu Sales, Inc.,* 177 Misc.2d 459, 465–66 (Sup.Ct., Nassau Cty.1997, O'Brien, J.) (allowed 25% LOM on shares of corporation). In the *Matter of William R. Fleischer*, 107 A.D.2d 97 (2nd Dept. 1985) allowed a 25% DLOM and stated "Special Term did not err in reducing the value of petitioner's shares, as reported by the referee, by applying a discount of 25% for lack of marketability. In determining the "fair value" of the shares of a closely held corporation, discounts for the lack of marketability of such shares are appropriate and do not provide a windfall to the majority shareholders merely because the shares to be purchased by the majority pursuant to their election under Business Corporation Law § 1118 constitute a minority interest in the corporation (see, *Matter of Blake, supra*, at p.101).

statutory rate from the date of [sic] a copy of the judgment is entered hereon with notice of entry".[39]

69. In the matter at bar, no prejudgment interest should be awarded, as there can be no question that Magarik has committed myriad acts of bad faith, including, but not limited to, the knowing submission to the Court of materially false statements, and dilatory litigation tactics designed merely to cause the Respondents to needlessly incur hundreds of thousands of dollars in unnecessary discovery expenses and legal incident to defending the various meritless misconduct claims that were ultimately withdrawn with prejudice.

70. For instance, but in no way exhaustive, in his Verified Petition (Ct. Ex. 1, at ¶¶14-17), Magarik claimed that he, Levi, and Rukhlin entered into an "oral shareholders' agreement" in 2007, at the time of Kraus' founding, pursuant to which he was given a 24% ownership interest in Kraus, a place on the board of directors, and guaranteed continued employment by the company, and "full control over all sales and marketing" at the company. (*id.*, at ¶¶ 14–17, 92). The foregoing allegations are the seminal underpinnings for Magarik's breach of contract and related fault causes of action. At Trial, however, Magarik admitted that, in fact, he was a 1099 independent contractor of Kraus in 2007 and 2008, and first acquired a 20% share in Kraus in January, 2009 and another 4% in January, 2010 [Tr. Ex. 9; Tr. at 529-532, 591-595] In fact,

[39] As will be further described herein, while in the case at bar, it was Magarik's bad faith and dilatory tactics which delayed this proceeding, in *Adelstein,* the Court rejected "Petitioner's claim that the Court should award interest from the date of filing because of Respondents' "elaborate" motion to dismiss and an alleged failure to comply with discovery demands, is misplaced. Respondents motion was made in compliance with the CPLR and in no way was this motion frivolous or an abuse of process. Additionally, Petitioner's argument that Respondents failed to comply with discovery demands is misplaced since Petitioner filed a note of issue and certificate of readiness in this proceeding on or about September 21, 2010. Therefore, any discovery disputes after the filing of the Note of Issue, are beyond the dictates of the CPLR and would not impose an obligation upon Respondents. As such, the Court will not award discretionary pre-judgment interest from the date of filing of the Petition." Also, on similar reasoning, the Respondents should not be punished for the calendar length of the trial (first day was Nov. 14, 2018, last May 16, 2019), by having to pay prejudgment interest for that time.

Magarik expressly admitted that he did not become a shareholder of Kraus until 2009 [Tr. at 530].[40]

71. Magarik further alleged (Ct. Ex. 1, at ¶¶3, 84-88) that the Respondents were engaged in a campaign of systematic waste aimed at devaluing the company, and thus the value of his interest. Such allegations—as expanded in affidavits speaking of corporate doom and gloom by Magarik and his counsel—were the basis of Magarik's emergency application for the appointment of a temporary receiver, and injunctive relief, submitted with the Verified Petition.[41]

72. However, in complete contrast to those claims, Magarik's expert testified that Kraus' management projections reflected a 28% year-over-year growth in 2015 [Tr. at p. 225]. Magarik testified that as of the Valuation Date, he would compare Kraus to companies such as Moen, Delta and Kohler [TR. at 605, 606] Accordingly, there can be no question that Magarik's sworn-to allegations of wanton malfeasance, waste, and intentional (significant) diminution in value of the stock shares of Kraus, requiring the need for a temporary receiver, etc., and the related relief sought in the Petition, were nothing short of bold faced lies when they were made, and that Magarik unquestionably knew them to be such.

73. The Court denied the bond motion,[42] and in relevant part, found [emphasis added]:

> Moreover, Petitioner's assertion that "Respondents are suffering financial difficulty and may lack the wherewithal to consummate the buyout of Petitioner's shares" **is not only without evidentiary support but contradicted by Petitioner's own expert** who opines as to the financial

[40] The Court had already noted that these threshold allegations were at odds with the relevant documentary evidence (Decision and Order dated March 31, 2016, Dkt. 133), yet even at Trial, Magarik tried to dance around the issues before finally acknowledging the truth.

[41] Order to Show Cause, dated September 21, 2015, Dkt. 2-4.

[42] See, Decision and Order dated March 12, 2018 (Dkt. 237); this was the second time that the Court found Magarik's claims to be "without evidentiary support" and in fact, contradicted by actual evidence (see, Decision and Order dated April 5, 2016, Dkt. 133).

> wellbeing of Kraus. **As noted above, Petitioner's expert testified that Kraus is successful, profitable, its projections are increasing, etc., notwithstanding the allegations that Respondents have engaged in corporate misconduct**.

74. In addition, as witness credibility is a key element in the Court's evaluation of the evidence presented in a valuation hearing, it is significant to note that that Petitioner's expert was complicit in the Petitioner's "say whatever is necessary or convenient, truth be damned" scheme. More specifically, Paulikens submitted an Affidavit in support of the Magarik's then cross-motion to compel discovery (Dkt. No. 226, at ¶¶8,9), in which he sought to justify Petitioner's demand for, essentially, every Kraus financial document since the year *before* it was formed, and stated [emphasis added]:

> In addition, **to determine the value of the Company as of September, 2015, <u>it is critical</u> for us to have information concerning Kraus China and the other <u>businesses that Petitioner alleges drained the Company of resources</u>**. To the extent that waste and fraud occurred, **the lost value must be factored into the appraisal. The value dispersed to Kraus China and other ventures is also <u>critical</u> to understanding the value of the Company** because of the alleged relationship between Kraus China and the Companies' suppliers....that could adversely affect the Company's value."

75. Yet, at trial, Paulikens testified that while he was aware of the Fault Claims, he did not consider them in his valuation, because: (a) by the time he had done his valuation, "I believe that aspect of the case was, I don't want to say dropped, but set aside", and (b) "the [alleged] mismanagement [if any} was historical. We were looking forward. So mismanagement from the way we did it was moot". [Tr. at 352, 353]

76. Further, when asked at trial, following his review of the approximately 200,000 pages of discovery documentation, which it was admitted that Kraus had provided [Tr. at 157,

158],[43] whether he found any evidence of "theft or anything like that," Paulikens testified "I didn't look for it and I didn't find any, no." [Tr. at 353].[44]

77. More, Paulikens' sworn testimony that he believed that the Fault Claims having been "set aside" by the time he performed his valuation is patently false. The final party depositions, *which he attended*, mostly devoted to the Fault Claims, took place on July 25, 2017 [Tr. at 295;Tr. Ex. 56, 57]. Paulikens' Initial Report of Value is dated August 7, 2017 [Tr. Ex. 2], and the Petitioner's Fault Claims were not withdrawn until nearly *one full year later*, by Stipulation dated July 26, 2018 [Dkt.246]. As is more fully demonstrated herein, the parties' discovery disputes, the majority of which were over the fault allegations, extended through at least late February, 2018 [see, Dkt. 242].

78. In light of the foregoing—including Paulikens' above-noted trial testimony that he did not even look for, nor find, any evidence to substantiate the "massive scope" of "Respondents' wrongdoing" [see, Ct. Ex. 1, ¶4]—and in light of the fact that, even if any of the alleged mismanagement actually existed, it was effectively rendered moot as a result of his having valued "future Kraus," there can be no question that Magarik's bad-faith conduct—including: (1) his Verified Petition's myriad false statements and claims; (2) his having thereafter engaged in dilatory and malicious discovery and litigation tactics that forced the Respondents to move for a Protective Order, to which Magarik responded with a cross-motion to compel discovery; (3) the resultant full day hearing before the Special Referee; and (4) the Respondents time, manpower and expenses in producing the responsive documentation, conducting depositions on the fault issues, etc., all supposedly needed to obtain documents and information

[43] and which Paulikens had, in his above-noted Affidavit, *twice* said was "critical" to being able to perform his valuation.

[44] Similarly, in pre-opening statement colloquy, the Court sought to clarify that it would not be hearing evidence with respect to Magarik's withdrawn mismanagement/Fault Claims. Magarik's counsel advised the Court that "our expert didn't value the company based on those allegations, He used different methodologies…" [Tr. at 5]

which Paulikens' testified was "critical" to his ability to value Kraus—was, in fact, all part of Magarik's bad-faith scheme to disrupt the Respondents' from being able to focus on their business, to cause as much stress and financial hardship as possible, (*e.g.*, costs and legal fees incident to the motion practice, hearing, production of the discovery responses, defending the bond application, etc.), and to delay as long as possible the valuation, which should have occurred immediately following the Respondents' exercise of their election rights on May 2, 2016 [Dkt. 138].

79. In short, had none of the ultimately dead-end Fault Claims been pursued following the Respondents' election in May, 2016, it is very possible that this matter would have been ready for trial as early as the fall of 2016, instead of the fall of 2018, when it actually commenced. In some cases, courts have denied interest. *E.g.*, *Matter of Schneiderman (Luv-A-Cup Coffee Service, Ltd.*), 204 AD2d 173 (1st Dept. 1994).

80. Interest rates in New York are awarded "at such rate as the court finds to be equitable." BCL § 623(h)(6). Accordingly, in the event that the Court should determine that prejudgment interest should be awarded, equity should prevent the Respondents from having to pay interest for the time spent defending themselves from the now-dead Fault Claims and chasing Magarik to permit his expert to be properly deposed. Significantly, the Court is not required to award the statutory rate of nine percent for prejudgment interest set forth in CPLR § 5004. *Murphy,* 74 A.D.3d 815 (2d Dept. 2010). Rather, prejudgment interest must be awarded at an "equitable" rate. *See* BCL §1118(b); *see also Whalen*, 234 A.D.2d 552.

81. More, it is long established that where prejudgment interest is awarded in a matter such as the one at bar, it "is not awarded as a penalty or to punish a party, it is a cost imposed for having the use of another party's money over a period of time. *Giaimo v. Vitale*, 101 A.D.3d

523, 956 N.Y.S.2d 41 (1st Dept. 2012), *citing*, *Manufacturer's & Traders Trust Co. v. Reliance Ins. Co.,* 8 N.Y.3d 583, 838 N.Y.S.2d 806, 870 N.E.2d 124 [2007]. Accordingly, while Respondents posit that no prejudgment interest should be awarded at all, ala *Adelstein, supra,* if the Court should elect to award prejudgment interest to Magarik, it should be at a rate not greater than the mean prime rate since the Valuation Date (which can be calculated and provided to the Court upon request). Such rate would compensate Magarik for Kraus' "use" of "his" money. In contrast, any higher interest rate would unquestionably penalize and punish the Respondents, which is contrary to the purpose of such an award.

RESPONDENTS SHOULD BE PERMITTED TO PAY OUT THE VALUATION PRICE

82. In *Matter of Gene Barry One Hour Photo Process, Inc. (Taines)*, 111 Misc2d 559, 444 NYS2d 540 (Sup. Ct. N.Y. Cty. 1981), the court held that it has discretion to fix payment terms in order to permit the corporation to continue as a viable business without undue disruption. In *Adelstein,* 2011 N.Y. Misc. LEXIS 5956, the Court declined to provide the payor-shareholder's requested five (5) year pay-out, due to the facts and circumstances in that case, specifically including the facts that the case was delayed by the respondents having switched attorneys, and had time in which they could have allocated funds for eventual payment. In the case at bar, however, while the proceeding was commenced in late 2015, Magarik's ongoing bad faith in pursuing his false claims robbed the Respondents of the ability to allocate funds for the eventual pay-out. As Marquez testified, as of the Valuation Date, Kraus was all but out of cash, as it only had approximately $18,000.00 available cash on hand [Apr. 4, 2019 Tr. at 9]. As such, during the pendency of this matter, the Respondents were busy doing everything possible to keep the company afloat, while simultaneously being forced to expend, literally, hundreds of thousands of dollars in legal costs and fees, including the production of the more than two-

hundred-thousand (200,000) documents in discovery. In addition, the wild disparity in the parties' valuations made it impossible to calculate the amount of funds which would be needed.

83. Projections, forecasts and wishful thinking aside, as the chart below reflects, the reality is very simple: as of September 30, 2015 (10 days after he Valuation Date), based on a trailing twelve month calculation (such that September 30, 2015 was, essentially, the end of the fiscal year), Kraus only had pre-tax income of ***$77,450.00***. Not millions of dollars, or even hundreds of thousands of dollars. [45] That $77,450.00 would then get distributed to the shareholders, *pro rata*, which would then be taxed. That is the simple reality.

Kraus USA, Inc. Income Statement TTM - September 30, 2015	(Trailing 12 month)
Gross Sales	$40,586,538
Returns and Allowances	($7,288,596)
Net Sales	$33,297,942
Cost of Goods Sold[46]	$24,176,758
Gross Profit	$9,121,184
Administrative Expenses[47]	$9,043,734
Pre-Tax Income	**$ 77,450**

84. As such, it is respectfully requested that, no matter what dollar amount the Court will determine the buy-out price to be, the Court should, as a matter of equity, take into consideration how long it would take Kraus to pay that buy-out price, based on the *actual* pre-tax earnings, as that is where the payment money would have to come from, without impeding, or

[45] The chart is reproduced from the Marquez Report (Tr. Ex. 3, p. 38, Exhibit 2-1).
[46] Includes cost of products, customs fees, container costs, trucking, transportation, etc.
[47] Salaries, rent, office expenses, marketing, advertising, warehouse equipment, etc.

crippling Kraus' ability to operate, grow, or to even survive. Indeed, the remaining two shareholders (Levi and Rukhlin), who together 76% of Kraus's remaining shares, cannot be expected to continue to put their blood, sweat and tears into the company, day after day, year after year, if the sole mission in Kraus' continued existence will be to satisfy Magarik's 24%. They have families to feed and to care for. There simply must be a balance between the two concerns, and that is why a multi-year payout is warranted, appropriate and necessary. The Respondents cannot be expected to keep Kraus' doors open for the sole purpose of being able to pay Magarik. Given Magarik's bad faith conduct, the Respondents request a pay-out of not less than three (3) years if the Court should adopt Marquez's valuation, and at least seven (7) years should the Court adopt any of Paulikens' valuation conclusions.

CONCLUSION

For all the foregoing reasons Petitioner's expert's valuation should be rejected and Respondents' expert's valuation of Magarik's 24% interest in Kraus of $1,100,000.00 should be adopted by the Court. Petitioner should not be awarded any interest since the delay in this proceeding was caused by the unnecessary litigation of 5 separate Fault Causes of action and Respondents should be permitted to pay the amount determined by the Court over a 5 year period.

Respectfully Submitted,

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